



**IN THE HIGH COURT OF SOUTH AFRICA
WESTERN CAPE DIVISION, CAPE TOWN**

REPORTABLE

CASE NO: A20/18
(Tax Court Case No 13671)

In the matter between:

KANGRA GROUP (PTY) LTD

Appellant

And

COMMISSIONER FOR THE SOUTH AFRICAN

REVENUE SERVICE

Respondent

Coram: Gamble and Salie-Hlophe JJ, Thulare AJ.

Date of Hearing: 30 July 2018.

Date of Judgment: 27 August 2018

JUDGMENT DELIVERED ON MONDAY 27 AUGUST 2018

GAMBLE, J:

INTRODUCTION

[1] On 20 April 2017 the Tax Court dismissed an appeal by the appellant (hereinafter interchangeably referred to as “*the Group*” or “*the taxpayer*”) against a determination by the respondent (“*SARS*”) that the taxpayer was not entitled to claim a deduction of R90m in the 2007 tax year, a deduction which was alleged by the taxpayer to be an expense in the production of income. The taxpayer approaches this court on appeal in terms of s133 of the Tax Administration Act, 28 of 2011 (“*the TAA*”).

[2] The history of this matter goes back to the turn of the century. At that stage, Kangra Group (Pty) Ltd was a private company through which the late Mr. Graham Beck conducted his various commercial interests, each such interest in a separate operating division. As the evidence before the Tax Court reveals, Mr. Beck was a South African entrepreneur of note who had various business interests over the years in, *inter alia*, the wine industry¹ and retail stores², as well as horse racing and thoroughbred breeding³. But these, according to his former accountant and co-director in the Group, Mr. Alistair John Rogan (who testified on behalf of the taxpayer before the Tax Court) were essentially loss making ventures adjunct to Mr. Beck’s primary business interest which was the exploitation, beneficiation and sale of coal.

¹ Graham Beck Wines from the Madeba Estate near Robertson were served at the inauguration dinners of Presidents Nelson Mandela and Barak Obama.

² Stuttafords and Garlicks Department stores were once owned by the Group.

³ The Highlands Stud bred many winners in the racing industry

[3] Mr. Beck, who died in 2010 in his 81st year, was described in various obituaries placed before the Tax Court as a hard-working person of great entrepreneurial and philanthropic spirit, albeit that at times he was also dubbed “*a bit of a rough diamond*”. For instance, it was said that he was one who concluded deals through mutual trust and a handshake and was not averse to concluding informal agreements with clients with the material terms being recorded “*on the back of a cigarette box*”. In any event, over the years Mr. Beck’s company acquired mineral interests in collieries in KwaZulu Natal from whence it exported coal extensively through the port of Richards Bay. In 2006 his net worth was said to be in excess of R1.08bn.

[4] Mr. Rogan testified that round about 2000 he advised Mr. Beck of the pending introduction by the Government of a mining charter which was intended to promote Black economic advancement in the mining industry and suggested to him that it was time to acquire a Black empowerment partner in the coal business run by the Group. Mr. Beck was amenable to the suggestion and decided to approach the Shanduka Group. His decision in that regard was a strategic move given that the executive chairman of Shanduka at the time was Mr. Cyril Ramaphosa, who in February 2018 was sworn in as South Africa’s fifth President. According to Mr. Rogan, Mr. Beck approached Mr. Ramaphosa because of the latter’s long history of involvement with the National Union of Mineworkers.

[5] Mr. Rogan explained that in 2003 the coal business was hived off from the Group and Kangra Coal (Pty) Ltd (“Kangra Coal”) was established, with the necessary mining rights, contracts and the like being transferred to that entity. Mr.

Rogan said that Mr. Beck valued the coal business at R1bn and the transfer thereof to Kangra Coal was structured accordingly. Initially the Group continued to hold the shares in Kangra Coal and its management and personnel continued to run the coal mining business as before. As Mr. Rogan explained, there was really just “a *change of stationery*”. No money actually changed hands and the sale of the coal business was essentially an accounting exercise whereby a loan account was created in the books of the Group reflecting Kanga Coal’s indebtedness to it.

[6] As I understand it, as part of the restructuring of the coal division, a deal was concluded between the Group and Shanduka in terms whereof the latter acquired part of the shareholding in Kangra Coal for a purchase consideration of R250m and the assumption of its outstanding liabilities to the Group. The directors of Kangra Coal were then Messers Beck, Ramaphosa and Rogan, but Mr. Beck remained the driving force (or “*guiding mind*”) behind the coal business. Subsequently, Shanduka acquired effective control of Kangra Coal but that development is not relevant to these proceedings. Suffice it to say that all executive and management decisions relevant to this matter were made by Mr. Beck personally. Further, I should stress that the events relevant to this case occurred before Shanduka acquired control of Kangra Coal and Mr. Ramaphosa is not in any way implicated in this litigation.

THE AMCI DEAL

[7] Before the Tax Court the parties made common cause in relation to certain facts. It was agreed that on 12 December 2001 the taxpayer and AMCI Export Corporation (“*AMCI* ” – an American coal trader with its head office in Pennsylvania) concluded an agreement which was partly oral and partly written for the delivery of

540 000 metric tons of coal by the taxpayer to AMCI between January and December 2002. This was referred to by the taxpayer as "*the first agreement*" and it is common cause that both parties duly performed (at least in part) their obligations in terms thereof.

[8] It was further common cause that on 3 December 2002 the taxpayer and AMCI concluded a further partly oral, partly written agreement for the delivery by the Group of a further 750 000 metric tons of coal to AMCI. This was referred to by the parties as "*the second agreement*" and pursuant thereto the taxpayer was obliged to deliver that quantity of coal to AMCI during the period January to December 2003. The agreement in terms whereof Kangra Coal was established ("*the sale agreement*") was concluded on 25 March 2003 with Mr. Beck signing on behalf of both parties. The effective date of the sale agreement was 1 July 2003, a date which fell squarely within the currency of the second agreement.

[9] The papers before the Tax Court reveal that AMCI claimed that the Group did not deliver the full quantity of coal due under both the first and second agreements by the end of 2003 and it relied on a further oral agreement extending the duration of the agreements so that the balance of the order would be delivered in 2004 at the rate which applied to the second agreement – US\$27.50 per metric ton. That extension agreement was disputed.

[10] During the currency of the second agreement there was a significant escalation in the international price of coal. Mr. Rogan said that while the rate agreed upon under the first agreement was US\$ 24,50 per metric ton, in the market place it went up to around US\$ 40 per metric ton in 2003. Notwithstanding the increase in

price, and after the establishment of Kangra Coal, Mr. Beck accepted that that corporate entity was contractually bound, under the sale agreement, to supply coal to AMCI at US\$ 27,50/ton. The effect of the relevant terms of the sale agreement was that Kangra Coal was likely to be less profitable because the Group was locked into the deals with AMCI and Kangra Coal could not sell its coal on the open market at the prevailing higher price.

[11] It seems as if an attempt was made by Mr. Beck to persuade AMCI to accept the delivery of coal in 2004 at a higher price but the buyer stood its ground. Mr. Rogan testified that Mr. Beck thereafter elected not to abide by the terms of the second agreement thereby placing the Group in default of its obligations to AMCI. In the absence of direct evidence from Mr. Beck as to the reasons for this decision, Mr. Rogan was left to tender hearsay evidence and to resort to speculation. As he put it –

“Mr. Beck was running Kangra Coal – he was the boss, and he said don’t deliver to AMCI. He got tired of their complaints, about the quality of the coal. He identified other opportunities in the market and sold the coal for US\$40 to third parties instead of US\$25 per metric ton to AMCI.”

[12] It is reasonable to infer in the circumstances that Mr. Beck, an astute businessman with an eye for a bargain, looked at the numbers and decided to take his chances on the profits to be made by Kangra Coal selling coal on the open market at the higher price per ton while permitting the Group to default on its obligations to AMCI. In the result, during August 2004 the taxpayer refused to deliver the balance of the order to AMCI, thereby repudiating its contractual obligations.

[13] As will appear more fully hereunder, the concession before the Tax Court by Senior Counsel for the taxpayer (who was not the lead counsel on appeal) that the repudiation was occasioned by Kangra Coal⁴ is wrong in law and the taxpayer cannot be not bound thereby.⁵

THE ARBITRATION PROCEEDINGS

[14] As a consequence of the Group's failure to fulfill its obligations to AMCI, the latter commenced arbitration proceedings in Johannesburg in 2006 for contractual damages for the non-delivery of coal, claiming in excess of US\$15m from the Group. The claim was based, firstly, on the alleged short delivery of 72 950 metric tons of coal in 2004 under the first agreement, claiming damages of US\$3 354 717 and legal costs of US\$100 000 and €60 000. The second part of the claim in arbitration alleged a further short delivery in 2004 of 300 000 metric tons under the second agreement. The claim was for damages of US\$12 146 668 and costs amounting to £410 592.

[15] In formulating its statement of claim, AMCI averred that as a consequence of the Group failing to honour its contractual obligations, AMCI was in turn unable to honour its obligations to a third party to which it was contractually bound to on-sell the coal, a Portuguese company known as CarboPego. In the result, AMCI said that it had been exposed to claims for damages by CarboPego and the legal costs associated therewith in the High Court in England and sought to recover

⁴ See para 20.3 below

⁵ Government of the Republic of South Africa and others v Von Abo 2011 (5) SA 262 (SCA) at [18] - [19]

those amounts from the Group after such damages had been determined in the English court.

[16] The arbitration proceedings were opposed but were eventually settled on 5 September 2007 when Mr. Beck conceded the claims and agreed that the Group would pay AMCI the sum of R90m. A simple two page agreement was concluded between the two corporate principals - Mr. Beck on behalf of the Group and Mr. Ernie Thrasher on behalf of AMCI.

[17] While it was common cause that the exchange rate at the time was US\$1=SAR6,00, the precise basis for the quantification of the settlement was never established before the Tax Court given Mr. Beck's demise in the interim. It was assumed by Mr. Rogan that Mr. Beck had rounded off the claim brought by AMCI with reference to the prevailing dollar exchange rate and multiplied that with the aggregate of AMCI's claims in the sum of US\$15 501 386, the point being that Mr. Beck effectively conceded the entirety of AMCI's claim and settled it with a lump sum payment which was due and payable forthwith. It is common cause that such payment was duly made by the taxpayer to AMCI the following day, 6 September 2007.

THE TAXPAYER'S CLAIM FOR DEDUCTION

[18] When the taxpayer submitted its return for the 2007 tax year it sought to claim a deduction of R90m arising from the settlement with AMCI. Its stance was that that amount had been reasonably and *bona fide* incurred by the Group in the production of income and that the amount was wholly and exclusively laid out and expended for the purposes of the Group's trade. In 2012 SARS assessed the

taxpayer on the basis that the said amount of R90m was not deductible, hence the appeal by the taxpayer to the Tax Court. The nub of the case before the Tax Court therefore was whether the payment by the Group of the amount agreed upon in settlement of the arbitration proceedings was deductible as “*relevant expenditure*” in terms of s11(a) read with s23 of the Income Tax Act, 58 of 1962 (“*the Act*”).

[19] Prior to the commencement of the proceedings before the Tax Court the parties recorded certain common cause facts in terms of Rule 38(2)(a) of the rules promulgated in terms of s103 of the TAA. In addition to that which is set out above, it was common cause that Kangra Coal delivered coal to AMCI in terms of the second agreement and, further, that the taxpayer did not sell coal in the 2007 tax year. In consequence thereof the parties recorded the material disputed facts as follows:

“16. Whether Kangra Coal delivered coal to AMCI, in terms of the [second agreement], on behalf of the Appellant or on its own behalf.

17. Whether the Appellant’s obligation to deliver coal to AMCI in terms of the [second agreement] were (sic) transferred from the Appellant to Kangra Coal.

18. Whether Kangra Coal or the Appellant, on 5 August 2004, repudiated its further obligations to deliver coal to AMCI in terms of the [second agreement].

19. Whether AMCI did not consent to the cession of rights and delegation of obligations under the [second agreement] from the Appellant to Kangra Coal, as contemplated in clause 12.1 of the [first] agreement.

20. *Whether AMCI did not give prior written consent for the assignment of any rights or obligations in terms of the purchase order.*

21. *How the [sum of R90m] referred to in the settlement agreement between the Appellant and AMCI was calculated and compiled.”*

It is axiomatic that the taxpayer bore the onus of establishing the disputed issues.

[20] At the commencement of the trial the taxpayer made certain additional concessions to the effect that:

20.1 Kangra Coal delivered coal to AMCI in terms of the second agreement on its own behalf and not on behalf of the taxpayer.

20.2 The obligation to deliver coal to AMCI in terms of the second agreement was transferred from the Group to Kangra Coal⁶.

20.3 On 5 August 2004 Kangra Coal and not the taxpayer repudiated its further obligation to deliver coal to AMCI in terms of the second agreement.

THE RELEVANT “GENERAL DEDUCTION”

[21] S11(a) of the Act, which deals with deductions which may legitimately be made by a taxpayer in relation to its taxable income, is to the following effect.

“11. General deductions allowed in determination of taxable income

⁶ As will appear hereunder this was based solely on a term of the sale agreement.

For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived –

(a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature...”

[22] The point of departure is whether the taxpayer was carrying on a particular trade – an inference which must be made by the court from the facts - and an inference which ultimately is a matter of law.⁷ It is not in dispute in this matter that the Group carried on trade, both in the 2003 and 2007 fiscal years.

[23] That criterion having been established, and applying Sub-Nigel⁸, the court is then enjoined to apply the provisions of the Act to assess whether the claimed deduction is in fact deductible.

“(T)he court is not concerned with deductions which may be considered proper from an accountant’s point of view or from the point of view of a prudent trader, but merely with deductions which are permissible according to the language of the Act...”

Regard, therefore, must be had to the Act and the Act alone in order to ascertain whether the deductions sought to be made... are permissible.”

⁷ CIR v Stott 1928 AD 252 at 259.

⁸ Sub-Nigel Ltd v CIR 1948 (4) SA 580 (A) at 588.

[24] The approach to the question as to whether an expense has been incurred in the production of income, as contemplated in s11(a) of the Act, was articulated thus in PE Tramway⁹.

*“... (I)ncome is produced by the performance of a series of acts and attendant upon them are expenses. Such expenses are deductible expenses provided they are **so closely linked** to such acts as to be regarded as part of the cost of performing them.*

*A little reflection will show that two questions arise (a) whether the act to which the expenditure is attached is performed in the production of income and (b) whether the expenditure is linked to it **closely enough**.”* (Emphasis added)

[25] Accordingly, it has been said that there must a sufficiently distinct and direct relationship or link between the expenditure incurred and the actual earning of the income. However, that relationship or link may not always be self-evident. In Nemojim¹⁰, for instance, Corbett JA pointed out that:

“(I)t is correct... that in order to determine in a particular case whether monies outlaid by the taxpayer constitute expenditure incurred in the production of income important, sometimes overriding factors, are the purpose of the expenditure and what the expenditure actually affects.”

⁹ Port Elizabeth Electric Tramway Co v CIR 1936 CPD 241 at 245.

¹⁰ CIR v Nemojim (Pty) Ltd 1983 (4) SA 935 (A) at.....

The learned Judge of Appeal then referred to the earlier judgment of Schreiner JA in Genn¹¹ which is to the effect that

“In deciding how the expenditure should properly be regarded the Court clearly has to assess the closeness of the connection between the expenditure and the income-earning operations, having regard both to the purpose of the expenditure and to what it actually effects.”

[26] And, as the authors of Silke¹² explain, with reference to Nemojim

“These authorities clearly establish the point that, to rank as a deduction, the expenditure must not only have been incurred for the purpose of earning ‘income’ as defined but there must be a sufficiently distinct and direct relationship or link between the expenditure incurred and the actual earning of the income. As the ensuing paragraphs reveal, these restrictive tests result in the disallowance of a vast number of business expenses that are necessarily incurred in carrying on business but fail to satisfy a requirement that they be laid out for the purpose of earning the ‘income’.

[27] In the result it was incumbent on the taxpayer to establish before the Tax Court that the conclusion of the settlement agreement with AMCI was linked “*distinctly and directly*” with the actual earning of income by the Group before it could qualify as a deduction. To put it differently, it may be asked whether the taxpayer

¹¹ CIR v Genn & Co (Pty) Ltd 1955 (3) SA 293 (A) at 299G

¹² Silke on South African Income Tax Vol 2 para 7.8

proved that such income as was produced by repudiating the supply agreements with AMCI, was received by the Group (or accrued to it) as a consequence of such repudiation. To answer that question it is necessary to have regard to the interplay between the relevant contractual obligations at play in 2003 – 4.

THE TAXPAYER'S VARIOUS CONTRACTUAL OBLIGATIONS

[28] In considering the application of the relevant provisions of the Act, it is necessary to consider the contractual obligations imposed on the taxpayer. These were two-fold. Firstly there were the obligations arising from the first and second agreements in terms whereof the coal was to be delivered by the Group to AMCI. Secondly, there were the terms relating to the sale agreement.

[29] The first agreement was concluded between Messers Beck and Thrasher when the latter telephonically placed an order for the delivery of coal. That order was thereafter partially reduced to writing as appears from a purchase order dated 12 December 2001 transmitted by fax from AMCI to the Group the following day. The purchase order, which stipulates the quantity, quality, dates and price of the coal to be delivered, records that it was subject to the terms and conditions attached thereto, of which the following are relevant to this appeal.

“1. AGREEMENT: This purchase order represents the entire agreement between Buyer and Seller and is a binding contract upon the terms and conditions herein set forth. No change, modification or revision to this Purchase Order shall be binding upon Buyer unless made in writing and signed by one of Buyer’s authorised representatives. Waiver by the

Buyer of a breach by the Seller of any provision of this Contract shall not be deemed a waiver of that breach or any other breach of the same or of a different nature...

9. FAILURE TO PERFORM: *If Seller does not meet the specifications, terms and conditions of this Purchase Order, or in the event of failure of Seller otherwise to perform its obligations as herein provided, Buyer may suspend or cancel this Purchase Order, and shall be under no obligation to accept or pay for any coal not delivered or any services not completely rendered. Buyer may hold Seller responsible for all damages to buyer resulting from Seller's failure to perform under the terms and conditions of this Purchase Order...*

11. ASSIGNMENT: *Neither this Purchase Order nor any rights or obligations herein may be assigned by the Seller without Buyer's prior written consent. Buyer may, during the term of this agreement, assign the rights or obligations of this Purchase Order to a company which is associated with or a subsidiary of the buyer.*

12. TAXES: *Seller agrees to assume all liability under all laws that impose taxes or other exactions applicable to the sale of coal under this Purchase Order."*

[30] The conclusion of the second agreement evidently followed a similar *modus operandi*: a discussion between the two corporate principals followed by the submission of a written purchase order. It is common cause that the *pro forma* terms

and conditions attached to that order (to which I shall henceforth refer as “*the STC’s*”) were the same as the first.

[31] The interpretation of the various agreements (the settlement agreement, the purchase orders with their STC’s and the sale of the coal business) must be considered in accordance with the established principles enunciated in KPMG and the cases which follow it¹³. The purchase orders accordingly fall to be interpreted by giving the language used by the contractants its ordinary grammatical and syntactical meaning, the purpose being to achieve a sensible and businesslike result while always having regard to the contextual setting of the document. In Betterbridge the court usefully summarized the approach as “*a unitary endeavour requiring the consideration of text, context and purpose.*”

[32] Accordingly, it will be seen that clause 9 of the STC’s preserves AMCI’s common law right to hold the Group liable for any damages suffered by it as a consequence of the latter’s failure to perform in terms of the purchase order. Further, one finds that clause 11 of the STC’s precludes an assignment by the Group of its obligations under either the first or second agreement to any other party without the prior written consent of AMCI. All of these rights and obligations are subject to the sole memorial clause contained in clause 1 of the STC’s, which precludes reliance on, for instance, an oral variation of the STC’s.

¹³ KPMG Chartered Accountants (SA) v Securefin Ltd 2009 (4) SA 399 (SCA) at [39]. See also Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA) at [19], Dexgroup (Pty) Ltd v Trustco Group International (Pty) Ltd [2014] 1 All SA 375 (SCA) at [10] – [17] and Betterbridge (Pty) Ltd v Masilo and others NNO 2015 (2) SA 396 (GNP) at [8].

EXCURSUS - CESSION OF CONTRACTUAL OBLIGATIONS BY THE GROUP TO KANGRA COAL?

[33] It is perhaps convenient at this stage to deal with a procedural argument advanced by SARS. Notwithstanding the clear and express provisions of clause 11 of the STC's, SARS contended both in the Tax Court and on appeal that the taxpayer had actually ceded the right to claim any income tax deduction in respect of the settlement agreement to Kangra Coal. It based that argument on the express provisions of clause 12 of the sale agreement which clause traverses sale contracts¹⁴ (and policies of insurance) and records¹⁵ that the parties would use their best endeavours

“to procure that all other parties (‘third parties’) to the sale contracts... shall consent to the cession of rights and delegation of obligations thereunder from the seller to the purchaser with effect from the effective date.”

[34] Further, the Group and Kangra Coal expressly provided for the possibility that the consent of third parties to the transfer of rights and obligations under the first and second agreements might not be forthcoming by agreeing¹⁶ *inter se* that

¹⁴ Defined in the sale agreement with reference to an annexed list of contracts which included the first and second agreements, and which fell to be transferred by the Group to Kangra Coal as a consequence of the sale of the coal business contemplated in the sale agreement.

¹⁵ Clause 12.1

¹⁶ Clause 12.2

“..the seller and the purchaser agree that, with effect from the effective date, they will procure, as between them, that the rights and obligations under the sale contracts... shall be for the benefit and account of the purchaser.”

This provision entitled Kangra Coal to sell directly to AMCI under either the first or second agreement and to receive the benefits accruing from such sales and/or carry the costs thereof.

[35] Lastly, on this point, the parties agreed¹⁷ that

“all risk in and benefits to the sale contracts shall be deemed to have passed to the purchaser with effect from the effective date.”

[36] To the extent that SARS then seeks to argue that the obligations of the Group towards AMCI were effectively transferred to Kangra Coal by virtue of these terms, the absence of any prior written consent on the part of AMCI has the effect that any purported cession of the taxpayer's contractual obligations towards AMCI is null and void in the circumstances¹⁸. Nevertheless, SARS maintained its stance and asserted that the terms of the sale agreement between the Group and Kangra Coal effectively provided for the cession of all existing orders from the former to the latter and that there therefore must have been such a cession.

[37] Despite a call by SARS for the discovery of all documents recording such cessions, none emerged in the proceedings before the Tax Court. There is

¹⁷ Clause 12.3

¹⁸ Born Free Investments 364 (Pty) Ltd v FirstRand Bank Limited [2014] 2 All SA 127 (SCA) at [15]

therefore no evidential basis for SARS' bald assertion that the obligation to deliver the balance of the coal due under the second agreement must have been ceded by the taxpayer to Kangra Coal. On the contrary, the deeming provisions of clause 12.3 apply to the facts at hand. That, in my view, is the complete answer to SARS' argument regarding the purported cession. In the circumstances, absent any such cession, there was no privity of contract between the AMCI and Kangra Coal and it could only look to the Group for its contractual damages¹⁹.

[38] As a matter of fact, the parties conducted themselves accordingly. AMCI asserted its claim for contractual damages in arbitration against the taxpayer and there was no defence raised by the Group that the claimant had sued the wrong party. In the circumstances, I am driven to conclude that the Group was contractually bound to AMCI to deliver the quantity of coal agreed upon and, when Mr. Beck gave the instruction not to deliver further, the taxpayer (and not Kangra Coal) was the party which repudiated the first and second agreements. Further, such repudiation was fundamental to the settlement agreement concluded by Messers Beck and Thrasher on 9 September 2007: no other reasonable interpretation can be placed on the agreement in the circumstances.

[39] SARS referred further in argument to the opening address of lead counsel for the taxpayer before the Tax Court in which the following was stated with respect to the document filed under Rule 38(2)(a)–

¹⁹ Norman Kennedy v Norman Kennedy Ltd 1947 (1) SA 790 (C) at 802.

“It is accepted by Kangra [the taxpayer] that the delivery by Kangra Coal was made for its own benefit so there should be no issue in dispute any longer in respect of [disputed item] 16 (sic) we accept that the deliveries were made by Kangra Coal for its own benefit. What deliveries were made, invoiced for and money paid would have gone into the account of Kangra Coal.”

[40] The concession raises two point. Firstly, the fact that with effect from 1 July 2003 the Group no longer owned a coal division is neither here nor there: it could readily procure the coal it was obligated to supply to AMCI from any source. As it happened, at that stage Mr. Beck was still in effective control of Kangra Coal²⁰ and would have had no difficulty in seeing to it that the taxpayer met its obligations to AMCI. Secondly, the fact that Kangra Coal invoiced AMCI directly for the coal it supplied to it and received payment therefore directly from AMCI, does not negate or undermine the existence of the taxpayer’s on-going obligation *vis-à-vis* AMCI to deliver coal to it. Kangra Coal was obliged, in terms of clause 12.3 of the sale agreement, to assume the taxpayer’s obligations to AMCI and it was entitled, as an *adjectus solutionis causa*, to receive payment directly from AMCI.²¹

[41] Finally, it must be noted that under clause 12 of the STC’s the parties expressly agreed that the Group would be liable for any tax implications arising from, *inter alia*, the second agreement and pursuant thereto this obligation naturally fell at the door of the taxpayer.

²⁰ “*There was just a change of stationery*”

²¹ Norman Kennedy *ibid.*

WAS THE PAYMENT OF R90M LINKED TO THE EARNING OF INCOME?

[42] SARS pointed out that during cross-examination Mr. Rogan was referred to the Annual Financial Statements (*“the AFS”*) of both the Group and Kangra Coal for the period 1 July 2003 to 30 June 2004. These recorded that during that fiscal year the sale of coal was reflected as accruing to Kangra Coal and not the Group. Further, the AFS showed a marked decrease in the revenue of the taxpayer – of the order of R411,63m - while Kangra Coal’s revenue shot up by R381,02m. This state of affairs is consistent with the terms of clause 12.3 of the sale agreement.

[43] There can be no debate therefore that coal was delivered to AMCI by Kangra Coal and that it (and not the taxpayer) received payment for such deliveries. It is evident that Kangra Coal was the party which would thus have attracted the liability to pay income tax in respect of such revenue (if any such tax was payable), and it would have been the party entitled to make the relevant general deductions under s11(a) of the Act.

[44] As I have said, the sale agreement reflects that, *inter se*, it was agreed that Kangra Coal was liable to deliver to AMCI the coal which the taxpayer was contractually obligated to deliver. And so, when Mr. Beck gave the instruction that no further deliveries were to be made to AMCI in 2004, he effectively wore two hats – thereby knowingly causing the taxpayer to default on its obligations to AMCI and at the same time affording Kangra Coal the opportunity to sell its coal elsewhere at a better price and thereby increase its revenue.

[45] In this regard, it is self-evident that the refusal by Mr. Beck to deliver to AMCI meant that there was a significant tonnage of coal available to Kangra Coal for delivery to another interested buyer: a buyer that was prepared to pay US\$40/ton. But in order to afford Kangra Coal the opportunity to earn that increased income it was necessary to repudiate the agreements with AMCI. However, that repudiation came at a cost to the Group – it ultimately had to pay AMCI damages.

[46] According to the statement of claim in the arbitration, the mass of coal that was not delivered to AMCI in breach of the first and second agreements was of the order of 373 000 metric tons. The cost of this short delivery to AMCI (together with the attendant costs relating to the litigation in England) amounted to just more than US\$15m which it claimed as damages flowing from the breach. As stated above, applying the applicable exchange rate at the time this amounted to the equivalent of around R90m, which formed the basis for the settlement agreement.

[47] In that context, therefore, it seems to me that it can be said that the settlement agreement was the price that was paid for the opportunity to earn additional income from selling coal at US\$40 rather than US\$25/ton: a return of more than 60% over what would have been received had the coal been sold to AMCI. The question that follows is, once again, two-fold. Can the payment of contractual damages such as that incurred by the Group in settling the arbitration claim be termed expenditure in terms of s11(a) of the Act? And, if so, did such expenditure result in the taxpayer earning income?

WAS THE PAYMENT OF R90M EXPENDITURE UNDER S11(a)?

[48] It was submitted on behalf of the appellant before us that it appeared from the terms of the settlement agreement that the taxpayer had paid the globular figure of R90m in full and final settlement of its contractual obligations arising from the purchase orders placed with it by AMCI. With reliance on ITC 461²² this was said to constitute “*expenditure*” relating to the Group’s income generating activities in respect of the first and second agreements.

[49] The issue as to whether amounts paid in respect of damages and/or compensation constitute expenditure under the Act are dealt with in some detail by Silke in Vol 2 at Para 7.27, which passage includes a brief discussion of ITC 461. The approach is summarized by the authors thus at Vol 2, 7-61.

“For expenditure and losses paid by way of damages or compensation resulting from negligence during the course of earning income to be deductible there must be a very close connection between the trade or business carried on and the cause of the liability for damages or, as it has been put by the courts, the negligence must have constituted an ‘inevitable concomitant’ of the trade.”

[50] One of the leading Appellate Division cases on the point is Joffe²³. The matter involved an engineering company which supplied reinforced concrete. A workman was killed due to the negligence of the company in executing a contract and

²² (1940) 11 SATC 191

²³ Joffe & Co (Pty) Ltd v CIR 1946 AD 157 at 163

it was required to pay damages to the dependents of the deceased. The company's claim for a deduction of the amount so paid was disputed by the Revenue and rejected by the Appellate Division on the basis that the company's trading operation was to intended to provide reinforced concrete, and that negligent construction was not a necessary concomitant of that business. Watermeyer CJ dealt with the issue thus.

"There is nothing in the stated case to suggest that such negligence, and the consequent liability which such negligence entailed, were necessary concomitants of the trading operations of a reinforced concrete engineer; nor was it shown that the liability was incurred bona fide for the purpose of carrying on any trading operation. Consequently, according to the interpretation which I have suggested above, the payment of damages was not made for the purposes of trade."

[51] Applying that reasoning to the facts at hand one could ask the following question.

"Does the business of delivering coal to A in terms an agreed contract of sale with that party necessarily entail the concomitant (or simultaneous) duty (or right) to breach that contract in circumstances where it is more profitable to conclude a contract with B for the sale of the same merx?"

I have little doubt that the answer to that question is in the negative. Courts expect contractants to honour their obligations to each other and where they fail to do so the

law penalizes such conduct, for instance, by granting the innocent party the right to resile from the agreement or by awarding damages against the guilty party.

[52] In Joffe²⁴, it was argued on behalf of the taxpayer that

“(E)ven if the expenditure in question was not the necessary concomitant of the business of a reinforced concrete engineer, it was an expenditure necessarily arising out of the business methods employed by the appellant and, consequently, was a deductible expenditure.”

The Chief Justice gave this argument short shrift.

“This argument can be put in a slightly different form as follows: Appellant has chosen to conduct his business in a manner which necessarily leads to accidents in which third parties are injured and in respect of which appellant has to pay damages, consequently such damages are a deductible expenditure. It is possible that this argument can be refuted upon more grounds than one, but I shall only mention the following one: there is nothing in the stated case to show that the appellant’s method of conducting business necessarily leads to accidents, and it would be somewhat surprising if there were. Consequently the basis of... [the] argument disappears and it cannot be supported.”

[53] It may well be that an incident of trading in coal is the breaching of a contract of sale. For example, there may be a breakdown in the railway system

²⁴ At 165

resulting in the load not reaching the port on time and the supplier may have to face a damages claim from the buyer arising out of non-delivery. But that is a wholly different situation to one where the supplier wantonly breaches its obligations in order to secure a more lucrative contract elsewhere. As the authors of *Silke*²⁵ point out most of the cases discussed by them are fact-specific but it seems to me that the answer probably lies in the following *dictum* of Roper J in *ITC 815*²⁶.

“[N]egligence in itself affords no reason why a loss caused by it should be held to be non-deductible. And there is no reason in principle why it should make any difference whether the negligence is that of employees or of the taxpayer himself. Negligence is an element of inefficiency, and an inefficient taxpayer is taxed upon the income which he actually earns and not upon that which he would have earned had he been efficient. Whether or not a loss caused by negligence would be deductible, would depend upon the facts of the particular case and upon such matters as the nature and degree of the negligence and the character of the business.”

[54] If the law will not tolerate the consequences of commercial inefficiency for purposes of a deduction how can it be suggested that an intentionally unlawful act can qualify as such? This is precisely what the court held in *PE Tramway*²⁷.

²⁵ Vol 2 p7-64

²⁶ (1955) 20 SATC 487 at 488

²⁷ At 246

“If the act done is unlawful or negligent and the attendant expense is occasioned by unlawfulness or possibly the negligence of the act then probably it would not be deductible.”

[55] In the result I must conclude that payment of the sum of R90m by the taxpayer in settlement of the claim in arbitration does not constitute expenditure as contemplated under s11(a). But even if I am wrong on that score, I am of the view that the payment cannot be regarded as allowable expenditure under the Act because it was not incurred in the production of the taxpayer's income. I say so for the reasons that follow.

[56] As already stated, Mr. Beck's conscious decision not to deliver the full amount of coal due to AMCI resulted in that volume of the mineral being available for sale on the open market at the higher rate. But, that commercial opportunity only eventuated in 2004 when the contract with AMCI was repudiated. At that stage the Group was no longer involved in the coal business having disposed of it to Kangra Coal and the opportunity was therefore only capable of being exploited by Kangra Coal. This it did, as appears, *inter alia*, from the increase in turnover of that company in the 2003/4 fiscal year and the concomitant reduction in turnover on the part of the taxpayer.

[57] In the result, I am not persuaded that the taxpayer established that the relevant expenditure resulted in it earning any income, either in that tax year or subsequent thereto: all income from coal sales after 1 July 2003 accrued for the benefit of Kangra Coal. Furthermore, the fact that the taxpayer continued to earn income from other sources after the disposal of the coal division to Kangra Coal in

2003 does not in my view establish a sufficiently direct link between the expenditure claimed and the income earned by the Group.

[58] It is evident, furthermore, that any income associated with the alleged expenditure actually accrued to the benefit of Kangra Coal. That was the entity which reflected a substantial increase in turnover for the fiscal years in question and that entity has already rendered its tax returns and claimed all related expenditure for those years. Mr. Beck's decision to claim the deduction, not on behalf of Kangra Coal but the Group, seems rather to have been influenced by a number of other developments.

[59] Firstly, Mr. Beck no longer had effective control of Kangra Coal at the time the deduction was claimed – control of the entity then vested in Shanduka - and he was powerless to interfere in the corporate affairs of the latter and seek to claim the deduction through that entity.

[60] Secondly, the terms of the sale agreement provided that the Group was only liable for contingent liabilities which existed at the time of the sale, all other liabilities having been transferred to Kangra Coal. The claim (and subsequent settlement) in the arbitration proceedings was manifestly not a contingent liability at the time the coal business was sold as the repudiation of the AMCI deal had not yet even occurred, let alone been acted upon.²⁸

[61] Thirdly, as the Trial Court observed, Mr. Rogan testified that Mr. Beck was obviously reluctant to become embroiled in any dispute with Shanduka as that

²⁸ Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd 1993 (4) SA 110 (A) at 118G

might jeopardise the relationship with the purchaser of the coal division which had paid a substantial amount of money for the company. His decision to vest the claim in the Group was therefore a strategic one at the end of the day.

[62] In the result I agree with the conclusion arrived at by the Trial Court that the taxpayer did not discharge the onus of establishing that it was entitled to claim the general deduction contended for and the appeal against that finding must fail.

SECTION 89QUAT INTEREST

[63] Relying on the erstwhile provisions of s89quat(3) of the Act, SARS levied interest on the taxpayer's assessment accordingly. The Tax Court rejected the taxpayer's argument that it had contended that it was not liable for the deduction on "reasonable grounds" and confirmed the interest calculation. That finding by the Tax Court is a further ground of appeal before us.

[64] S89quat(3) of the Act, as it read at the relevant time, was to the following effect.

"(3) Where the Commissioner having regard to the circumstances of the case is satisfied that any amount has been included in the taxpayer's taxable income or any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, and the taxpayer has on reasonable grounds contended that such amount should not have been so included or that such deduction, allowance, disregarding or exclusion should have been allowed, the Commissioner may, subject to the provisions of section 103(6), direct that

interest shall not be paid by the taxpayer on so much of the said normal tax as is attributable to the inclusion of such amount or the disallowance of such deduction, allowance, disregarding or exclusion.”

[65] In his evidence before the Tax Court Mr. Rogan testified that, to his knowledge, the Group had taken legal advice from 2 independent practitioners in relation to the arguments advanced to the respondent in claiming the deduction. One such practitioner was identified as a Senior Counsel practicing at the Bar in Johannesburg who has particular expertise in tax law. However, those opinions were not placed before the Tax Court which criticized the taxpayer for failing to do so. I am not sure that production of the opinions would have made any difference in the circumstances as it could hardly have been the function of the Tax Court to assess the plausibility of the advice furnished in circumstances where it refused to uphold the appeal before it.

[66] In argument we asked the parties to address us on the correct interpretation of the phrase “*on reasonable grounds*” as it appears in s89quat(3) and they were granted an opportunity to file a post hearing note in that regard. In their respective additional submissions, the parties concurred that the test for such reasonableness was an objective one. In Attieh ²⁹ the Full Bench cited with approval the following passage from Juta’s Income Tax Vol 2 –

“The test as to whether the grounds are reasonable, is objective, in relation to the actions of the taxpayer. A mere subjective belief by the taxpayer that a

²⁹ Attieh v Commissioner for the South African Revenue Service [2016] ZAGPJHC 371 (11 August 2016) at [34]

deduction should be allowed, without taking advice on the matter, is unlikely to be reasonable. On the other hand, the reliance by the taxpayer on expert advice, even if this is wrong, will in most cases constitute reasonable grounds for the action taken.”

[67] In Foskor³⁰ the Supreme Court of Appeal upheld the taxpayer’s claim for the remittance of interest in circumstances where it had acted on legal advice for two decades, notwithstanding that a decision of the erstwhile Appellate Division delivered in the interim had found differently on the law point in issue in that matter. The point is that the court did not penalize the taxpayer for relying on advice which had subsequently been rendered wrong by virtue of the decision on appeal. Further, the Supreme Court of Appeal confirmed in Foskor that a court of appeal was at liberty to consider the question of interest afresh and to substitute the decision of SARS in an appropriate case.

[68] In Eveready³¹ the Supreme Court of Appeal commented as follows in regard to the reliance on professional opinions.

[25] Section 89(qua)(2) levies interest on unpaid tax in certain circumstances but the Commissioner may in his discretion waive that interest. On appeal from his decision it is for the Tax Court to exercise that discretion. The Tax Court found that Eveready had claimed the deduction in good faith on the basis of opinions that it had received from 2 professional advisers. We are

³⁰ CSARS v Foskor [2010] 3 All SA 594 (SCA) at [51]

³¹ Eveready (Pty) Ltd v The Commissioner for the South African Revenue Service [2012] ZASCA 36 (29 March 2012) at [25]

not sure that those opinions were quite as unequivocal as Eveready suggests but that is immaterial. It is open to us to interfere only if the Tax Court failed properly to exercise its discretion. We do not think that there are any grounds for finding that it did so and the cross-appeal must fail.”

[69] In my view, therefore, the authorities clearly establish that reliance on incorrect professional advice is not a bar to claiming a remittance of interest. What matters only is whether such advice was sought by the taxpayer. It follows that the failure on the part of the taxpayer in this case to produce the opinion from Senior Counsel before the Tax Court in order that that court could assess the cogency of the advice rendered to the client, was not fatal to its case. What is important is the fact that the taxpayer took such professional advice – something which was not disputed by SARS – and therefore behaved reasonably in the circumstances.

[70] In the result, I consider that the Tax Court failed to properly exercise its discretion in considering whether to grant a remission of the interest levied by SARS and that it is open to this court to interfere. I should add that in delivering the argument in reply on behalf of SARS, its legal representative very frankly and fairly submitted that the argument advanced by the taxpayer in this case had caused a considerable amount of debate within SARS’ legal team, thus demonstrating, once again, that the point was reasonably taken by the taxpayer.

[71] Consequently, the appeal against the refusal of the Tax Court to grant the taxpayer a remission in the payment of interest should succeed.

COSTS

[72] Costs will usually follow the result in an appeal, but where the result is not an unqualified success for one party then the costs will, generally, be awarded in favour of the party that has achieved substantial success in the matter. In this case, both parties have been successful. While we do not know what the extent of the remittance of s89quat interest translates to in monetary terms we can assume, given the amount of the capital involved and the duration of the period over which it was liable to be levied, that it is not an insignificant figure. That having been said, the bulk of the time devoted in argument, both in the heads and in court, was directed to the deduction issue. In the result, it seems to me to be fair to permit SARS to only recover 50% of its costs on appeal.

ORDER OF COURT

- A. The appeal against the levying by the respondent of interest in terms of s89Quat(3) of the Income Tax Act, 58 of 1962 (*“the Act”*) in this matter succeeds.
- B. It is directed that the interest so levied by the respondent in terms of s89Quat(3) of the Act should be remitted to the applicant.
- C. Save as aforesaid, the appeal is dismissed.
- D. The applicant is to pay 50% of the respondent's costs on appeal.

GAMBLE, J

I AGREE:

SALIE-HLOPHE, J

I AGREE:

THULARE, AJ