Republic of South Africa

In the High Court of South Africa
(Western Cape Tax Court, Cape Town)

Case No: **179**

In the matter between:

ABC Limited Applicant

And

The Commissioner for the

South African Revenue Service Respondent

Judgment delivered: 14 March 2011

LOUW J

[1] The relevant background facts to this VAT appeal are set out in the judgment in the income tax appeal ITC 11470 delivered simultaneously with this judgment.

[2] The respondent made a determination that the amount of R67m received by the appellant pursuant to the early termination of the exclusive distribution right which entitled the appellant to exclusively distribute JK whisky, YZ whisky and ST whisky (the defined products) in South Africa, Lesotho, Botswana and Swaziland (the designated territory) was subject to

VAT at the rate of 14 per cent. The appellant was assessed for VAT of R9 380 000, a penalty of R938 000 and interest of R7 804 274.09. The appellant's objection to the assessment was disallowed. The appellant appeals this decision and contends that the amount of R67m was not subject to VAT at all, or in the alternative, was leviable with VAT at the rate of zero per cent.

[3] The appellant is registered as a vendor for VAT purposes in terms of the Value-Added Tax Act, 89 of 1991 (the Act). Section 7(1) of the Act provides:

Imposition of Value-Added Tax

(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, known as Value-Added Tax;

(a) on the supply by any vendor of goods or services supplied by him … in the course of furtherance of any enterprise carried on by him; calculated at the rate of fourteen per cent on the value of the supply concerned …

[4] It is common cause that this case does not turn on the supply of goods. Consequently, the receipt of the amount of R67m will only be subject to VAT, if

1. a supply was made by the applicant
2. of services

3. in the furtherance of the appellant's enterprise.

[5] Section 37 of the Act provides that

> The burden of proof that any supply … is exempt from or not liable to any tax chargeable under this Act or is subject to tax at the rate of zero per cent … shall be upon the person claiming such exemption, non liability, rate of zero per cent …, and upon the hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong.

[6] The crucial terms are defined in section 1 of the Act. 'Enterprise' is widely defined to include

> Any enterprise or activity which is carried on regularly … and in the course or furtherance of which goods or services are supplied to any other person for a consideration …

The first proviso to the definition of 'enterprise' contains a deeming provision. It provides that

> anything done in connection with the commencement or termination of any such enterprise or activity shall be deemed to be done in the course or furtherance of that enterprise or activity.

Supply is defined to include

> all … forms of supply, whether voluntary, compulsory, or by operation of law, irrespective of where the supply is effected.

The term ‘services’ is very widely defined to include

> anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage …

[7] During the currency of the distribution right, the appellant carried on its enterprise as liquor wholesaler and exercised that right by buying in and selling the defined products in the designated territory. The appellant then voluntarily entered into the termination agreement, thereby terminating the distribution right.

[8] Mr. Emslie, who appeared with Mr. Sholto-Douglas on behalf of the respondent, submitted that by entering into the termination agreement, the appellant ‘surrendered a right’, the right in question being the exclusive right to distribute the defined products, 41 months before the right would otherwise have come to an end.

[9] Mr. Cilliers, who appeared with Mr. Louw on behalf of the appellant, submitted that, because the right would in any event have expired in January 2002 in fact no ‘surrender’ of a right occurred at all. The appellant merely agreed to the expiry date of the right being anticipated. This resulted at most, in a curtailment in the time the right would endure, he submitted.

[10] I do not agree with the latter contention. By agreeing to the early termination of the right, the appellant surrendered the remaining portion of the

right which would otherwise have endured for a further 41 months. Put differently, the appellant surrendered the right it otherwise had to exclusively distribute JK whisky for a further 41 months. The surrender of the right constituted 'services' as defined in section 1 of the Act and by concluding the termination agreement, the appellant voluntarily 'supplied' as defined in section 1 the services (being the surrender of the right).

[11] The 'value' on which VAT is to be calculated at the rate of 14 per cent is in terms of section 10(2):

> The amount of the consideration for such supply … less so much of such amount as represents tax

and section 1 provides that the term 'consideration'

> In relation to the supply of goods or services to any person, includes any payment made or to be made … whether in money or otherwise … in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person …

[12] The value of the services supplied was consequently the R67m.

[13] I turn to the third requirement, namely, whether the 'surrender' of the right occurred in the 'course or furtherance of any enterprise carried on' by the appellant.

[14] Mr. Cilliers submitted that the termination of the distribution right was the very antithesis of the course or furtherance of the appellant's enterprise since it made it impossible for the appellant to continue to sell its most profitable line of product.

[15] The appellant voluntarily concluded the termination agreement for what it considered to be good commercial reasons. In paragraph 4.5 of the appellant's statement of its grounds of appeal, it stated:

> 'It was commercially more sensible for the Appellant to have the distribution agreement terminated in 1998, upon payment of compensation for the termination of its rights, than to have the agreement run its full term and then not have it renewed. If it became apparent, in 1998, that the Appellant's rights to distribute JK and YZ whisky would not have been renewed in January 2002, this would have had a serious detrimental effect on the motivation of sales staff, leading to a reduction in income. Furthermore, the Appellant had to give itself time to attempt to limit the damage that would have been caused by the loss of its distribution rights by attempting to garner other business in the place of the lost products.'

[16] It is apparent from this passage that on the appellant's own case, the decision to surrender, in exchange for R67m, the right to distribute the defined products for a further 41 months in the designated territory, was integral to the furtherance of the enterprise carried on by the appellant as

contemplated in section 7(1) (a) of the Act. In the changed circumstances brought about by the merger of the two large liquor retailers in the UK, the appellant made a conscious business decision to agree, at a price, to an early termination of the right.

[17] My conclusion is therefore that the appellant supplied services on which VAT is chargeable. The next question is whether VAT is to be charged at the rate of 14 per cent, or at the rate of zero percent in terms of the provisions of section 11(2) (l) of the Act, which reads as follows:

> Section 12 (2) (l):
>
> (2) Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where:
>
> …
>
> (l) the services are supplied to a person who is not a resident of the Republic, not being services which are supplied directly
>
> (i) . . .
>
> (ii) in connection with movable property (excluding debt securities, equity securities or participatory securities) situated inside the Republic at the time the services are rendered, except . . .
>
> (iii) . . .
>
> and not being services which are the acceptance by any person of an obligation to refrain from carrying on any enterprise, to the

> extent that the carrying on of that enterprise would have occurred in the Republic.

[18] It is common cause that the services were supplied to F Co, a person not resident in the Republic and that the services were not the acceptance by the appellant of a restraint against the carrying on of an enterprise in the Republic. The issue is whether the services supplied by the appellant were supplied directly in connection with moveable property situated inside the Republic at the time the services were rendered.

[19] The respondent in its amended grounds of assessment contends that the services were indeed supplied directly in connection with movable property situated inside the Republic at the time the services were supplied. The movable property on which the respondent relies for this contention is not identified in the amended grounds of assessment.

[20] Clause 5.4 of the termination agreement provides that the new distributor appointed by F Co. was obliged to purchase all the appellant's stock of the defined products on the effective date of the agreement. Mr. X testified that the appellant sold all its remaining stock of the defined whisky on the effective date to the new distributor and that it levied and paid VAT on the sales. The position is therefore that, on the effective date of the termination of the distribution agreement and of the surrender of appellant's exclusive distribution right, there was no stock of the defined whisky products to which the appellant had any entitlement.

[21] In argument Mr. Emslie disavowed reliance on the appellant's stock of the defined products in the Republic at the time of the conclusion of the termination agreement. The services supplied by the appellant in the form of the surrender of the distribution right were not done directly in connection with moveable property (in the form of a stock of whisky) situated within the Republic at the time the services (in the form of the surrender of the right) were rendered. Mr. Emslie submitted that the moveable property in question was not a stock of whisky held by the appellant at the time of the conclusion of the termination agreement, but was the distribution right itself, which he contends was situated within the Republic because it was predominantly exercised by the appellant within the Republic.

[22] There are in my view two answers to this contention.

[23] First, I do not agree with the submission that the exclusive distribution right held by the appellant can constitute the moveable property as contemplated in section 11 (2)(l) of the Act. The services supplied by the appellant consisted of the surrender of the exclusive right. These services must be supplied *directly in connection with movable property situated inside the Republic* at the time the services are rendered. Logically there must be two separate entities: the services being supplied and the moveable property which stands in direct connection with the services being supplied. I fail so see how the right which is being surrendered, the surrender of which constitutes the supply of the services, and is thus a constituent part of the

services being supplied, can at the same time constitute the moveable property which is required by the provisions of section 11(2)(l) to be in direct connection with the very services being supplied.

[24] Secondly, the right to exclusively distribute the defined products derives from a contract, the distribution agreement. While such a contractual right may be classified as incorporeal moveable property, it is not clear at all that the right, as incorporeal moveable property, is situated in the Republic. Mr Emslie relies for his contention that this is the case on Spier Estate v Die Bergkelder Bpk and Another 1988 (1) SA 94 (C) at 98 GH and Pistorius: Pollack on Jurisdiction 2nd Ed p 105. In my view these authorities do not support the Mr Emslie's contention. In Spier Estate the question was whether the Cape Provincial Division had jurisdiction to entertain a counter application for the expungement or partial cancellation of a trade mark from the register of trade marks which was situated in Pretoria within the jurisdiction of the then Transvaal Provincial Division. The court held that the rights in question were evidenced by the appropriate entry in the register of trade marks permanently situated at a fixed place and could not be regarded as moveable. The right was not an *actio in personam* and the court which had jurisdiction was the *forum rei sitae* which is the court in whose area of jurisdiction the register is situated. The fact that the registrar could hear and determine proceedings before him at some place other than Pretoria did not derogate from this fact. The court added in a passage relied on by Mr Emslie that

> This is in conformity with the general principle that the *situs* of an intangible is to be found where the intangible can be effectively dealt with (cf Pollack *South African Law of Jurisdiction* at 122; cf also *Boyd*

v Commissioner of Inland Revenue 1951 (3) SA 525 (A) at 533; *Lamb v Commissioner for Inland Revenue* 1955 (1) SA 270 (A) at 279)

In Pistorius: Pollack on Jurisdiction 2nd Ed p 105, the other authority relied upon by Mr Emslie, the authors simply refer to the statement in Spier Estate for the same proposition. From the further discussion of the problems associated with jurisdiction at 105 and following, it is clear, however, that in the case of a right derived from a contract, the authors opine that the *situs* is the area where the debtor is an *incola.*

[25] In Spier Estate the court relied on two decisions. In Boyd v Commissioner for inland Revenue 1951(3) 533 (AD) the question was whether the whole of a dividend the taxpayer received from a company based in South Africa which company derived its income mainly from diamond mining operations in the then South West Africa but also from investments in South Africa, was taxable in South Africa. The issue was whether the amount received by way of dividends were received from 'any source within' South Africa. The court at 533D – 534G, held on two bases that the dividend was received from a source within South Africa and was therefore taxable as a whole:

1. The shares from which the dividend was derived was located in South Africa because the evidence of title to the shares was the register of shareholders which was in, or deemed to be in South Africa. The dividend was therefore derived from property in South Africa. Hence the source of the dividend was in South

Africa despite the fact that the company derived the major part of its income from operations outside of South Africa. The court quoted with approval the following statement in Gunn's Commonwealth Income Tax Law and Practice 549A.

> It is clear … that (a) the immediate source of a dividend is the shareholding and (b) a share is situated in the country where the shares are registered, i.e. where the share can be effectively dealt with.

2. A shareholder is not entitled to claim his share of the profits of a company unless a dividend is declared. Upon declaration of a dividend the amount due to the shareholder is a debt due by the company and the shareholders can sue the company for the dividend. The source of the dividend was thus a debt owed by the company, a person and debtor resident in South Africa.

[26] The second decision relied upon in Spier Estate is Lamb v Commissioner for Inland Revenue 1955 (1) SA 270 (AD) at 279 DG, concerned the converse position of a company which had its principal register of shareholders in London, and a branch register in Johannesburg where the taxpayer's shares were registered. In terms of the relevant English Act the shares registered in a branch register was deemed to be registered in its principal register, that is, in London. The source of the taxpayer's dividend was held not to be in South Africa, but in England and the dividend was consequently not liable to taxation in South Africa. The court endorsed, as a

general proposition, the statement made by Gunn, quoted in Boyd (above) that

> 'a share is situated in the country where the shares are registered, i.e. where the share can be effectively dealt with'

and pointed out that the main reason why the passage was quoted in Boyd was to refute the view that as a general proposition the source of a shareholder's dividend is the same as the source of a company's profits.

[27] In my view these decisions do not support Mr. Emslie's submission that the appellant's exclusive right to distribute Bell's whisky in the designated territory (South Africa, Botswana, Lesotho and Swaziland) was 'moveable property … situated inside the Republic' because the right was predominantly exercised by the appellant in South Africa.

[28] In MV Snow Delta: Serva Ship Ltd v Discount Tonnage Ltd 200(4) SA 746 (SCA) the court considered the question whether, for purposes of attachment to found jurisdiction in a matter between two peregrini, the rights of a charterer flowing from a time charter between SSL as charterer and Blue Star Line as disponent owner can be said to be property which was in Cape Town because the ship which was the subject matter of the charterparty was in Cape Town at the time. Harms, JA said the following, at 753 E-I:

> [9] . . . Some trite observations may be necessary to introduce a discussion of the subject. Rights in relation to the (contractual)

> performance (*obligatio)* of another have since time immemorial been classified as incorporeal. The obligation of the debtor is not property: it is the right (often referred to as the action) of the creditor. Obligations can therefore not be attached because they do not form part of the patrimony of the creditor, whereas rights can be attached and do form an asset in the estate of the creditor. Intangibles by their very nature cannot have a physical locality. They do not attach to the objects to which they relate. For purposes of, for instance, jurisdiction the law had to make an election based on practical considerations by deeming incorporeals to have a location. They are not located where the obligation has to be performed (*Voet* 1.8.30). *Voet* preferred the view that they are located at the domicile of the creditor (in this case SSL, not DTL), but proceeded to deal with the merits (which he recognised) of the opinion of Grotius (*Consultatien* part 3 No 151) which was that the *situs* of an incorporeal right is where the debtor (in this case Blue Star Line) resides.
>
> [10] Our Courts have adopted the view of *Grotius.* The first reported judgment is *Union government v Fishers's Executrix* 1921 TPD 328 (Wessels JP, De Waal J concurring). This judgment was approved and followed by this Court in *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property* 1923 AD 576. Innes CJ (at 581) pertinently held that the only attribute of locality that personal actions possess must relate to the locality where the debtor resides: it is only there that the incorporeal rights can be regarded as localised.

[29] On these authorities, the contractual right the appellant surrendered was not situated inside the Republic. The grantor of the right was F Co. and F Co. was the contractual debtor of the appellant. F Co, it is common cause, did not reside in the Republic.

[30] One final point remains. The respondent initially contended, as did the appellant, that the appellant concluded both the distribution agreement and the termination agreement with F Co. The respondent subsequently withdrew these allegations and in conformity with the stance taken by it in the income tax appeal, averred that it was ABC Group Ltd (Group) which concluded the two agreements with F Co. On the basis that Group concluded the two agreements, the respondent then contended that the R67m which was received by the appellant could only have been received by the appellant pursuant to a transaction between the appellant and Group. This postulated transaction between Group and the appellant constituted a supply of goods or services rendered to Group (not being a foreign resident), in the course of the furtherance of appellant's enterprise, being a supply which was subject to VAT in terms of section 7 (1)(a) of the Act.

[31] The question is whether the receipt of the R67m was received by appellant pursuant to a supply of goods or services as defined. The appellant could not, if Group was the party to the distribution and termination agreements be said to have supplied services in the form of the 'surrender of any right' being the exclusive distribution right, a right it did not have if it was not a party to the distribution agreement.

[32] It is therefore not necessary to decide the question whether it was Group and not appellant, who was a party to the two agreements.

[33] I consequently hold that the supply of services is subject to VAT at the rate of zero per cent in terms of the provisions of section 11(2)(1) of the Act.

[34] The following order is made:

1. The appeal is upheld;
2. The assessment, including the penalty and interest charge based on VAT at the rate of 14 per cent is set aside;
3. It is declared that the receipt of R67m by the appellant is subject to VAT at the rate of zero per cent in terms of the provisions of section 11(2)(l) of the VAT Act, 89 of 1991.

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W.J. Louw
JF Co.ge of the Western Cape Tax Court

I agree. _____

Assessor: Mr. B. Nduna

I agree. _____

Assessor: Mr. P. Ranchhod