

https://dspace.org/

Capital allowances in terms of South African tax law

Coetzee, Hendrik Andries

2015-02-09
http://hdl.handle.net/10539/16942

Downloaded from a DSpace repository. https://dspace.org/

1.6 Building investment allowance

The special features of the building investment allowance which at present amounts to 20% [Section 13 (5); 13(6A)] of the cost of building or improvements thereto, are as follows:

- The building investment allowance is not available to mining or farming operations;
- The building or improvements thereto must be wholly or mainly used by the taxpayer for the purpose of carrying on therein in the course of his trade any process of manufacture [Section 13(5)(e)]. As from 1 July 1979, processes of a similar nature do not qualify.
- The allowance is also available to the taxpayer if the building or improvements thereto are let by him and was wholly or mainly used for the purpose of carrying on therein any process of manufacture. It is to be noted that no reference is made to a subtenant as is the case in section 13(1) which deals with the annual allowance. It is submitted that a lessor would qualify even where the buildings are occupied by a subtenant because section 13(5) uses the words "or if such building was let by him and was wholly or mainly used for the purpose of carrying on therein any process as aforesaid in the course of any trade (other than mining or farming)".
- The lessee of a building or improvements thereto carrying on therein in the course of his trade any process of manufacture, is entitled to the allowances subject to the following conditions:
  - The lessee must be entitled to occupation for at least ten years reckoned from the date of erection or commencement of improvements thereto [Proviso (i) to section 5].

. The receipts and accruals of the lessee must constitute income for the purpose of the Act [Proviso (iii) to section 5]. "Income" is defined in the Act and means the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax (Section 1).

. The allowance is available in the case of the erection of a building, during the year of assessment when the building was first used, and in the case of improvements to buildings, during the year of assessment when the improvements were completed [Section 13(6)].

. "Improvements" is defined and means "any extension, additions or improvements (other than repairs) to a building which is or are effected for the purpose of increasing or improving the industrial capacity of the building [Section 13(9)].

. Section 13(6) provides that the building investment allowance shall be made for the year of assessment during which -

"(a) in the case of erection of a building used by the taxpayer or the lessee the building was first so used;

"(b) in the case of any improvements to a building, the improvements were completed."

The words "so used" refers to the use as contemplated by section 5 i.e. a building solely or mainly used by the taxpayer or his tenant for the purposes of carrying on therein in the course of his trade any process of manufacture. By using the words "first so used" the investment allowance is linked to the first year during which the building is used for the purpose of carrying on a process of manufacture, and not merely to the year in which the building is first used.

It appears therefore that the investment allowance is available to a taxpayer in the year during which he first uses the building wholly or mainly for the purpose of manufacture, even though the building may have previously been used for another purpose.

The building investment allowance is not available in respect of any building brought into use or in respect of any improvements completed after 30 June 1986.

CHAPTER 2

INDUSTRIALISTS IN REGIONAL DEVELOPMENT AREAS

2.1 The large concentration of industrial activities in a few Metropolitan areas have been the concern of more than one country. In order to encourage a more equal spread of secondary industry in less developed areas, the South African Government has offered fiscal incentives to industrialists. Fiscal incentives can be highly successful in achieving an objective. For example the tax incentives offered in the sixties by the Irish Government in its economic expansion drive, have made Ireland an exceptionally attractive base for the location of industrial undertakings:

"During the ten-year period 1958-68 more than 250 new manufacturing plants having a capital investment of some £80 million were set up in Ireland by foreign enterprises. The bulk of these new undertakings were established by manufacturers coming from the United Kingdom (40%), Germany (20%), the United States (16%), the Netherlands (5%), Canada, France and South Africa.

In addition to the tax incentives (which are primarily of the tax holiday and the accelerated depreciation type) and the extremely favourable cash grants, Ireland offers subsidised interest loans, excellent commercial and general facilities and a surplus of good labour". (Barry Spitz, Doctor [(summa cum laude) of the University of Paris (Law), International Tax Planning, the South African Chartered Accountant, March, 1969, page 91)].

Sections 11 ter, 11 quat, 11 quin and 21 ter of the Act provide special incentive allowances for manufacturers and persons conducting operations of a similar nature to

manufacturing, in economic development areas. As regards the definition of "economic development" the Minister of Finance said during the third reading of the introduction of sections 11 ter, 11 quat and 11 quin that ".... if we were to define it we would make this Act very rigid indeed. This is a concession which we are granting from normal taxation and you cannot lay down a rigid definition which will require amendment almost yearly as circumstances alter. You may have an entirely new picture before you from year to year and it is impossible to have a definition of 'economic development area' which is likely to last for any length of time or which will allow the Ministers concerned sufficient elasticity to encourage, where necessary, the growth of the economy".

In discussing his discretionary powers under the Act as regards allowances in respect of economic development areas the Minister of Finance, during the same reading said: "I look at certain factors such as the number of people to be employed. After all, the idea is to bring the factory to the depressed area instead of bringing the depressed people to the factory; that is the whole idea so I must satisfy myself what the benefits are going to be and what the employment position is going to be".

The Minister then quoted an example: "If I am required to make a tax remission of R100 000 and employment is going to be created for only ten people, then naturally I must reject it. I have to look at all these things and I have to look at the extent of the relief, because the relief measures are not all applicable automatically in each case. It may be that in one case we give the incentive allowances; or we can give not the full allowance but a percentage of that allowance. In other cases we give the allowance on factory buildings. In a third case we can give it on the erection of houses for

employees; in another case we can, if we regard it as necessary, give it in respect of water and power so as to compensate these areas for the higher charges they have to pay for water and power. The whole idea is more or less to equate the position between these areas and the metropolitan areas" (Taxpayer October 1965 pages 193 and 194). The original concessions under sections 11 ter, 11 quat, 11 quin and 21 ter consisted of the following:

- A cash grant to cover removal costs of a factory and personnel, including dismantling plant, transport and re-installation.
- Loans for land, buildings, plant and working capital at rates which vary from nil to ruling bank rates.
- Loans to a maximum of R15 000 per dwelling unit in respect of key personnel redeemable over 20 years, at a rate of interest equal to 2,5% below the ruling Building Society rates.
- Railage rebates of up to 15% on the outward carriage of goods manufactured in an economic development area.
- Harbour dues rebates of 25% for goods manufactured in the Transkei/Ciskei region shipped through the East London harbour to another South African port.
- Price preference of up to 5% on State and Provincial tenders. This rate increases to 10% under certain circumstances.
- Income tax allowances:
  - An allowance of 10% of the cost of power and water, plus 10% of the cost of the transportation of raw materials or finished products (section 11 ter).
  - An allowance in respect of housing for employees in economic development areas of a maximum amount of 35% of the expenditure in the year of completion, plus 10% of the expenditure in each of the following 9 years (section 11 quin).

. Enhanced initial and investment allowances in respect of machinery or plant and buildings used in economic development areas, directly in a process of manufacture. [Enhanced initial allowances and the 2% annual allowance is, however, available when qualifying items are used in processes which in the Commissioner's opinion, is of a similar nature to a process of manufacture (sections 12 and 13)].

. A development allowance. This allowance is at the discretion of the Minister of Finance. A holding company, in the event of a wholly owned subsidiairy being unable to make full use of the allowance, may itself claim the allowance (section 21 ter).

Although not yet repealed the allowance under section 11 quat has in practice not yet been granted.

With effect from 1 April 1982 the incentives to taxpayers in economic development areas have changed. The emphasis from that date has shifted from tax relief to cash incentives. The change was brought about by the introduction of two key subsections to section 21 ter in 1982:

(1) "(3C) Where an industrialist has been granted a subsidy in lieu of any development allowance or any supplementary allowance previously authorised under this section in respect of any industrial undertaking or extension to an industrial undertaking, and such subsidy has become payable in respect of any period commencing during any year of assessment which ends or ended on or after 1 April 1982, the authorisation for the granting of the allowance in question shall, notwithstanding anything to the contrary in this section, be deemed not to apply in respect of the

said year of assessment and succeeding years of assessment of the industrialist".

(2) "5(b) Unless the Minister or the said officer, having regard to the circumstances of the case, otherwise directs, no allowance shall be authorised under this section in respect of -

i) any new industrial undertaking, if the application for the allowance is received after 31 March 1982; or

ii) any extension to an existing industrial undertaking, if the application for the allowance is received after 31 March 1984".

The change in approach to the incentives is generally explained in the following extract from the "Explanatory Memorandum on the Income Tax Bill, 1982":

2.2 Regional development incentives

"1 For some years the incentives granted to industrialists to establish new undertakings, or to expand existing undertakings, particularly in economic development areas, have taken a number of forms but consist broadly of the following:-

1) Cash grants provided mainly by the Department of Industries, Commerce and Tourism;

2) Subsidies in the form of, for example, reduced rail and labour tariffs;

3) Income tax incentives in the form of special allowances which reduce the undertaking's liability for tax.

Of these three forms of assistance the emphasis has largely been on the tax incentives and particularly the "tax holiday" provided for in section 21 ter of the principal Act.

2. The White Paper and the Information Document tabled in the House of Assembly on 31 March 1982 recommended, in so far as economic development areas are concerned, a change in emphasis in the direction of cash incentives rather than those in the form of tax reliefs. The new types of incentives came into force on 1 April. This Explanatory Memorandum is concerned only with the changes being made to the tax incentives and at this point it is necessary to make it clear that those changes do not affect the metropolitan areas in any way.

The term economic development area, as used in the principal Act, includes deconcentration points, industrial development points and other industrial points which are referred to in the Information Document.

3 Under the proposals existing undertakings in economic development areas may choose between the following:-

a) they may retain their existing incentives unchanged; or

b) they may elect to go over to the new system of incentives set out in the Information Document for the remainder of their concession period.

Unless the Minister otherwise directs, application for permission to make the change must be made not later than 31 March 1983.

New undertakings will have no such option open to them but will be obliged to accept the new forms of incentives.

Where an existing undertaking is expanded on or after 1 April 1982, but not later than 31 March 1984, the taxpayer will likewise be permitted to take either the incentives to which he is already entitled or the new types of incentives. The new incentives will, however apply to all expansions taking place as from 1 April 1984.

4 The new system which, as already indicated, lays emphasis on cash payments to industrialists .....

5 Because the new scheme will not apply outside economic development areas it follows that the existing industrial incentives in the principal Act must be retained for the benefit of industrialists in metropolitan areas".

The original concessions, which ranged from financial assistance to income tax allowances, were not very successful. A manual on "The Promotion of Industrial Development as an Element of a Co-ordinated Regional Development Strategy for South Africa" (issued by the Republics of South Africa, Transkei, Bophuthatswana, Venda and Ciskei) says the following on page 1:

"Efforts to achieve a more equal distribution of secondary industry have not met with particular success, and it has become clear that a new approach to promote development in the less developed areas is required. This object can only be achieved through a rationalisation of the development process, by way of close co-operation between all the States concerned. This entails inter alia, the elimination of duplicate structures, the harmonisation of development policies, and the mutual development and utilisation of basic infrastructures which, in turn, requires the formulation of development strategies for the different regions.

A coherent regional development strategy, aimed at the exploitation of the full development potential of each region, including the agricultural, mining, services and industrial sectors, requires close co-operation between the different States on a regional basis. The formulation of regional development policies is a continuing process, encompassing more than industrial development alone. The revision of the former industrial decentralisation measures was a first step in the formulation of an overall regional economic development strategy".

At a summit meeting on July 23, 1980, in Pretoria, the Republic of South Africa, Transkei, Bophuthatswana, Venda and Ciskei agreed to the following declaration:

"We, the Heads of Government of the Republics of South Africa, Bophuthatswana, Transkei and Venda (subsequently the Republic of Ciskei has also subscribed to this declaration), declare our belief that the private business sector can and must play a vital role in the economic development of our countries and in raising the standard of living of all our peoples. We therefore resolve to encourage private investment in our countries:

- by promoting peace and political stability;
- by subscribing to the rule of law which prevents the emergence or arbitrary government;
- by providing monetary stability;
- by restricting the public sector's direct role in the economy mainly to the provision of collective and strategic goods and services and the co-ordination of regional development;
- by providing, within the framework of each government's social and other non-economic policies, as much scope as possible to private business, enterprises to decide

what, how, where and for whom to produce;

- by ensuring the maximum mobility of labour, capital, technology and entrepreneurship which can be reconciled with our official social and other non-economic policies;
- by giving private business enterprises the assurance that they will not be nationalised and that their ability to make profits and to repatriate dividends will not be arbitrarily restricted;
- by minimising the use of direct controls of a socialistic nature;
- by generally providing a framework in which the forces of free enterprise and the market mechanism can make the maximum contribution to the economic welfare of all our people.

In making this declaration we are fully aware that, from an economic point of view, the framework within which private business enterprises operate in our countries has certain deficiencies which require urgent attention. To remove these deficiencies and to improve the general climate for private investment in our economies, we resolve to give priority attention to the following problems through the agencies of joint committees of representatives of our different countries:

- In certain sectors of our economy many prospective entrepreneurs lack the necessary managerial and technological qualifications.
- There exists a measure of uncertainty regarding the ownership of fixed property in certain areas and the free transfer of assets between enterprises.
- There is an over-concentration of economic activities in certain metropolitan areas, which makes it necessary to have a clearly defined policy on industrial decentralisation and rural development.

- The training of workers has not kept pace with the needs of industry in our respective countries, with the result that economic development is being retarded by a shortage of skilled labour. Certain regions have also been adversely affected by a movement of trained workers to other areas where the remuneration and other attractions are greater. The need to improve the training of workers and to improve the utilisation of manpower is therefore urgent.

- For important social and other non-economic reasons the mobility of labour within and between our countries is not as great as might be desirable from a purely economic point of view. The implications of this state of affairs need to be studied further.

- In certain areas of our countries private investment is hampered by insufficient infrastructural services, including physical services such as roads, railways, harbours, communication facilities, electricity, water and housing, and social services such as health and training facilities.

- In order to protect local firms from outside competition with a view to encouraging domestic economic development and the creation of employment opportunities, restrictions are sometimes placed on the free movement of goods and services over the borders of our respective countries. Although national or regional protective policies of this kind are often not without merit, they can cause serious disruption in the exporting countries if unilaterally applied.

> It is desirable therefore that the states concerned should deliberate together before imposing restrictions on the mobility of goods and services, and that full opportunity should be provided for negotiation and for consideration of the private investor's interests.

We trust that his joint declaration will serve its intended purpose of encouraging increased private sector participation in the development of our respective economies. We intend both jointly and separately to apply the principles set out in this declaration. Where necessary, we shall consult with one another and with the private sector, while we undertake to keep one another informed of our progress. All interested enterpreneurs are invited to discuss their problems, initiatives and plans with our Governments, with a view to removing possible obstacles in the way of increased private sector investment. We are convinced that the enormous development potential of Southern Africa can be fully realised only through close co-operation between the public and private sectors".

2.3 Development regions

The expression "economic development" has changed to that of "regional development" and for this purpose, the map of South Africa has been divided into eight regions:

A Western Cape Province.

B Northern Cape/Western Transvaal/Bophuthatswana.

C Orange Free State/Qwa Qwa/The District of Thaba 'Nchu of Bophuthatswana.

D Eastern Cape/ Ciskei/The southern part of Transkei.

E Natal/KwaZulu/The northern part of Transkei.

F Eastern Transvaal/KaNgwane/parts of Lebowa and Gazankulu.

G Northern Transvaal/Venda/parts of Lebowa and Gazankulu.

H Pretoria - Witwatersrand - Vaal Triangle/KwaNdebele/a part of Bophuthatswana.

Each of the above regions has been sub-divided into four types of industrial areas -

. metropolitan areas;
. deconcentration points;
. industrial development points; and
. other industrial points.

These industrial areas are defined in the manual on "The Promotion of Industrial Development as an Element of Co-ordinated Regional Development Strategy for Southern Africa (issued by the Republics of South Africa, Transkei, Bophuthatswana, Venda and Ciskei):

"Metropolitan areas are areas where the establishment of industries is most favourable for private enterprise because of the existing agglomeration advantages.

Deconcentration points are points adjacent or close to metropolitan areas towards which industrial growth could be channelled to lessen the presence of overconcentration in the metropolitan areas.

Industrial development points are where alternative agglomeration advantages can be created to counterbalance the existing metropoles and thus create employment opportunities in the region concerned.

Other industrial points are points where concessions have previously been granted, but which are not deconcentration points, industrial development points or ad hoc cases.

Ad hoc cases (not points) comprise all those cases outside the above-mentioned four categories which may, in exceptional circumstances and for particular reasons, be considered to merit certain incentives, ie ad hoc cases comprise all those cases where the specific project and not the area is the deciding factor for the granting of incentives in one form or another. Any such incentives will, however, be subject to a maxmimum, namely that of the nearest industrial point".

2.4 The incentives

The regional industrial development incentives which are available to taxpayers are in addition to any other concessions available to them under any other incentive scheme, for example such as export incentives.

2.5 Incentives in Metropolitan areas

As far as the metropolitan areas are concerned, only the Port Elizabeth/Uitenhage area warranted incentives as follows:

a) 20% rail rebate
b) Electricity subsidy
c) Training rebate in cash.

(See annexure A)

2.6 Who qualifies for incentives

Originally, the incentives were given to "industrial undertakings" as defined in section 21 ter of the Act:

"'Industrial undertaking' means any undertaking (other than a farming undertaking) in the course of which there is carried on a process of manufacture or a process which in the opinion of the Commissioner is of a similar nature".

The incentives in respect of regional development are available only to secondary industry. Operations which by their nature, cannot be regarded as farming, mining or service activities are regarded as secondary industry and would therefore qualify for the incentives. In the classification of industries the regional development authorities have a general guideline: The value added (administrative and marketing expenses, wages, salaries, depreciation interest etc and profit before tax) to products manufactured at regional development factories should constitute approximately 25 per cent of the ex factory price. Each case will, however, be considered on its individual circumstances.

An industrialist will not qualify for concessions if his operations could not reasonably be situated in any other area than an industrial point. A reason could be that raw materials exist at points and the industrialist could therefore not carry out his operations in, say a metropolitan area. An exception to the locality-bound rule may be made to capital intensive industries which, in the interests of developing well-balanced industrial complexes, are encouraged to re-locate to industrial points.

In order to qualify for the incentive industries must be established on zoned industrial properties at industrial points. Factories established in South Africa on land not so zoned will also qualify if authority for its establishment was obtained under the Physical Planning Act of 1967.

Industries already established at industrial points will qualify for the incentives only in respect of the expansion of their operations. The expansion must, however, result in the employment of additional capital and labour during the full financial year on which the application for the incentives is based.

The incentives may, in certain circumstances be extended to industries which render essential services directly connected to the manufacturing process at industrial development points. Each case will be considered on its individual circumstances.

2.7 Capital allowances

The enhanced initial and investment allowances on buildings, machinery or plant at regional development points will cease to be available to taxpayers with effect from 1 April 1982.

2.8 Rail rebate on outgoing goods

The rebate will be granted in respect of all official means of transport. This will include transport by the South African Transport Services, own transport or transport contracted by the taxpayer. The rebate will also apply to goods forwarded f.o.r sender's station.

2.9 Rebate on incoming goods

A rebate on incoming goods will only be granted in special circumstances such as the effect of the cost on the total cost of production.

2.10 Road transportation - own vehicles

In terms of an exemption under the South African Road Transportation Act, 1977, a decentralised industry is allowed to convey its own goods by means of one vehicle not exceeding gross vehicle mass of 18 000 kilograms, or one tractor, the gross vehicle mass of which does not exceed 18 100 kilograms. The carrying capacity of both these vehicles is approximately 14 000 kilograms. Both raw materials and finished products may be transported to or from the regional development point.

2.11 Rebate on private road transportation

The relevant rail rebates applicable at the various development points (see annexure A) will also apply to outward road transportation of finished goods in respect of -

- own vehicles;
- any other vehicles which are used under a valid transportation permit; and
- vehicles belonging to a private carrier and which are hired for this purpose.

2.12 Rebate on harbour services

All goods produced in the Port Elizabeth/Uitenhage area and shipped from East London to another South African port will be subject to a 50 per cent rebate on harbour dues.

2.13 Electricity subsidy

The cost of electricity of consumers supplied directly by Escom and the cost of electricity generated by the local

authorities themselves at industrial development points will be subsidised. The subsidy will ensure an end tariff to the consumer equal to the Escom tariff applicable in the area of the Eastern Tranvaal Undertaking. This rebate also applies to Port Elizabeth/Uitenhage/Despatch and Atlantis.

2.14 Subsidy on housing for key personnel

The maximum amount per housing unit which will be eligible for subsidies are:

- At Mandini (Zinkwazi, Ballitoville and Salt Rock are exceptional cases until sufficient residential sites are available at Mandini), Richards Bay and Empangeni - R59 000 per housing unit.
- All other points - R55 000.
- One housing unit out of ten at all points - R68 000.

The subsidies will be based on the ruling building societies interest rate provided that the interest rate after the subsidy has been applied is not lower than 6 per cent.

2.15 Training rebate in cash

Industrialists in regional development areas are allowed to deduct, in addition to the expenses actually incurred, a further allowance of 125 per cent of training costs relating to registered training schemes or centres. This incentive has been improved by paying the effective tax saving in respect of the 125 per cent training allowance as a non-taxable cash grant. The claim must, however, be substantiated by an audit certificate.

2.16 Special tender preferences

The percentage price preferences on tenders will apply in respect of purchases by all government departments, South African Transport Services, the Department of Posts and Telecommunications, provincial administrations and local authorities. The price preference will also apply in respect of similar bodies in Republics of Transkei, Bophuthatswana, Venda, Ciskei and self-governing States.

2.17 Labour incentive

This incentive is payable on a quarterly basis as a non-taxable cash grant in respect of seven financial years. The incentive is calculated as a percentage of the average number of employees per month employed during a financial year, times the average salary/wage per employee per month. All personnel employed at the manufacturing plant will qualify for the incentive.

2.18 Interest subsidy

This incentive which constitutes a percentage interest subsidy is payable on a quarterly basis as a taxable cash grant. It is paid to industrialists for a period of 10 years in respect of 100 per cent of their investment in land and buildings, and 50 per cent of their investment in other assets (other assets comprise manufacturing plant, machinery and equipment, office furniture, utensils, stocks and debtors, as well as leased items which appear in the financial statements) relating to projects, the capital investment in which does not exceed R7 million.

The interest subsidy will be calculated on a pre-determined market related rate (fixed at 16,3 per cent with effect from 1 July 1982) which will be reviewed on 1 January and 1 July of every year.

The subsidy is based on loans for the development of regional projects from financial institutions, development corporations or shareholders.

2.19 Rental subsidy

This incentive, which constitutes a percentage rental subsidy, is payable on a quarterly basis as a taxable cash grant. It is paid to industrialists for a period of 10 years in respect of 100 per cent investment in land and buildings, relating to projects the total investment in which does not exceed R7 million.

The rental subsidy will be calculated on a pre-determined market related rate (fixed at 16,3 per cent with effect from 1 July 1982) which will be reviewed on 1 January and 1 July of every year.

Lessees will qualify in respect of buildings erected by developers at regional development points. While the lessor charges the full rental the lessee would qualify for the subsidy to the extent shown in the above schedules and calculated on the market-related interest rate. For this purpose the lessee must, when claiming the rental subsidy, submit a certificate from the lessor reflecting the value of the land and buildings.

2.20 Relocation costs

Relocation costs, to a maximum amount of R500 000 will be re-imbursed where an industrialist moves his complete factory, or part thereof, as a going concern from -

- the Pretoria/Witwatersrand/Vereeniging areas to any regional development point;
- the Cape Peninsula to Atlantis, Darling and Vredenburg/Saldanha; and from
- countries outside the Republic to any regional development point in the Republics of South Africa, Transkei, Bophuthatswana, Venda and Ciskei.

An additional 20 per cent will be granted to compensate for unquantifiable costs.

Relocation of the following will qualify for the re-imbursement:

- Factory plant, machinery and equipment.

- Consumable stores, raw materials, unfinished and finished products.

- Vehicles

- Personnel

CHAPTER 3

HOTELKEEPERS

"Hotelkeeper" is defined in section 1 of the Act and means "any person carrying on the business of hotel keeper or boarding or lodging house keeper where meals and sleeping accommodation are supplied to others for money or its equivalent, if the gross receipts from that business during the year of assessment were in excess of two thousand rand, and includes any person carrying on such business the gross receipts from which during the year of assessment were not in excess of two thousand rand by reason of the fact that the building in which the business is carried on has been in the course of erection or extensively renovated or because of circumstances beyond such person's control, if the Commissioner is satisfied that during the immediately succeeding year of assessment or such further period as he may for good reason allow, the gross receipts from that business will be or could be expected to be in excess of two thousand rand per annum". It is to be noted that the definition uses the expression "gross receipts" and not "gross profit".

Both sleeping accommodation and meals must be provided by a taxpayer before he qualifies as a hotelkeeper. The Licences Act No 44 of 1962 provides in item 4 of the Second Schedule that a boarding- and lodging-housekeeper's licence "shall be required by every person who carries on the business of a hotel keeper or boarding or lodging housekeeper by supplying meals and lodgings to others for money or its equivalent or who carries on the business of letting residential flats or rooms". Where no meals are provided, a boarding- or lodging-housekeeper's licence may well have to be taken out.

The licence on its own therefore does not qualify a taxpayer as an hotel keeper for the purposes of the Act.

The Act does not stipulate the type of or the number of meals which must be supplied. It is submitted that the allowance in respect of hotel equipment may be claimed if meals are available on the premises e.g. from a restaurant which operates on a concession basis.

3.1 The nature of an hotel

"Hotel" is defined in the Hotels Act, 1965, as meaning "an accommodation establishment which is registered as an hotel under this Act".

"Accommodation establishment" is also defined in that Act and "means any premises in or upon which the business of supplying lodging and one or more meals per day for reward is conducted or is intended to be conducted, but does not include a home for the aged as defined in section 1 of the Aged Persons Act, 1967 (Act No 81 of 1967), or any establishment or premises in respect of which a notice issued under subsection (2) of this section is in force". In terms of subsection (2) of that section the Minister of Tourism may by notice in the Government Gazette declare any establishment for the purposes of the Hotels Act, to be deemed not to be an accommodation establishment.

"Lodging" under the Hotels Act "means bedroom accommodation and the services ordinarily associated therewith".

To summarise, a hotel can be said to be an establishment on the premises of which accommodation (including services ordinarily associated therewith) and one or more

meals per day are provided for reward. However, before an establishment can become an hotel, it must be registered under the Hotels Act (see definition of "hotel", supra). Section 14 of that Act list the persons who may apply for the registration of an establishment as an hotel as follows:

"(1) Any person who -

(a) conducts an accommodation establishment in respect of which an hotel liquor licence is held under the Liquor Act;

(b) is erecting or intends to erect or is making or intends to make additions or alterations to an accommodation establishment for which a conditional authority for an hotel liquor licence is held under the Liquor Act;

(c) conducts an accommodation establishment in respect of which an on-consumption licence, other than an hotel liquor licence or a club liquor licence, is held under the Liquor Act;

(d) is erecting or intends to erect or is making or intends to make additions or alterations to an accommodation establishment for which a conditional authority for an on-consumption licence, other than an hotel liquor licence or a club liquor licence, is held under the Liquor Act;

(e) conducts an accommodation establishment where liquor is not sold and where it is not intended to sell liquor;

(f) is erecting or intends to erect or is making or intends to make additions or alterations to an accommodation establishment where liquor is not sold and where it is not intended to sell liquor;

(g) conducts an accommodation establishment in respect of which written authority to sell liquor for consumption thereon is held under section 23(1)(a) or (b) of the Liquor Act;

may apply to the board for the registration of such establishment as an hotel".

Section 14 of the Hotels Act further provides for the registration of the establishment if, in the opinion of the Hotel Board, the establishment "complies with the requirements determined in terms of section 15(2) for any grade of hotel in any group for which provision is made in terms of this Act and in which such establishment is capable of being included". Regulations in regard to the determination of the grading and grouping of hotels were published by the Hotel Board in the Government Gazette of 1 August 1980. The requirements in terms of that notice are contained in three schedules -

- the requirements set out in the first schedule are the minimum requirements with which hotels shall comply at all times;
- the requirements set out in the second schedule are the minimum differential grading requirements with which hotels shall comply at all times in accordance with the grade determined by the board; and
- hotels shall be scored on a points system according to the factors set out in the third schedule and shall be graded in accordance with the number of points so allocated on the following scale:

Grade	Number of points allocated	Percentage in each factor
One star	400 - 550	40 - 55
Two star	551 - 650	55,1 - 65
Grade	Number of points allocated	Percentage in each factor
Three star	651 - 750	65,1 - 75
Four ..	751 - 900	75,1 - 90
Five star	901 - 1 000	90,1 - 100

may apply to the board for the registration of such establishment as an hotel".

Section 14 of the Hotels Act further provides for the registration of the establishment if, in the opinion of the Hotel Board, the establishment "complies with the requirements determined in terms of section 15(2) for any grade of hotel in any group for which provision is made in terms of this Act and in which such establishment is capable of being included". Regulations in regard to the determination of the grading and grouping of hotels were published by the Hotel Board in the Government Gazette of 1 August 1980. The requirements in terms of that notice are contained in three schedules -

- the requirements set out in the first schedule are the minimum requirements with which hotels shall comply at all times;
- the requirements set out in the second schedule are the minimum differential grading requirements with which hotels shall comply at all times in accordance with the grade determined by the board; and
- hotels shall be scored on a points system according to the factors set out in the third schedule and shall be graded in accordance with the number of points so allocated on the following scale:

Grade	Number of points allocated	Percentage in each factor
One star	400 - 550	40 - 55
Two star	551 - 650	55,1 - 65
Grade	Number of points allocated	Percentage in each factor
Three star	651 - 750	65,1 - 75
Four star	751 - 900	75,1 - 90
Five star	901 - 1 000	90,1 - 100

The regulations contain a proviso that -

"(i) if the total score is more than the minimum determined for a particular grade ...., the board may allow a shortfall of not more than 5 per cent in the percentage of any one factor or alternatively not more than an aggregate of five per cent in the percentages of more than one factor if it is of the opinion that such allowance will not detract from the general standard of the hotel concerned;

(ii) in the case of an hotel in respect of which a liquor licence in terms of the Liquor Act is not held such hotel shall be compensated for the non-availability of the following items:

Speciality bars: 41 points;

Variety of wines: 10 points;

on the formula of

$$\frac{\text{Actual total score} \times 51}{1\,000}$$

;"

(Note: The three schedules have been reproduced with the permission of the Government Printer and are attached as annexures B, C and D).

Section 23 of the Hotels Act provides that "no person shall conduct the business of an hotel unless the hotelier of the hotel in question is registered". That Act also defines "hotelier" in relation to an hotel, as meaning "the natural person charged with the management thereof". Paragraph 14 of the regulations published in the Government Gazette Notice of 1 August 1980 provides for the disqualification of hoteliers. Under that paragraph a natural person will be disqualified to act as a hotelier if he/she -

. is an unrehabilitated insolvent;

- was convicted, within five years prior to the date of application to be a hotelier, of an offence and sentenced to imprisonment for a period exceeding three months without the option of a fine; or
- was convicted and sentenced to a fine exceeding R50, within six months prior to the date of application to be a hotelier, of an offence under the Hotel Act or regulations, while being registered as an hotelier.

The Hotel Board may, if in its opinion special circumstances exist which make it desireable to do so, with the approval of the Minister of Tourism register as an hotel an accommodation establishment which does not comply with the requirements determined in terms of section 15 of the Hotels Act for any grade of hotel.

3.2 Hotel equipment - initial allowance

"Hotel equipment" is defined in the Act as meaning "machinery, implements, utensils or articles used in an hotel, but does not include vehicles or equipment for offices or for managers' or servants' rooms".

The special features of the initial allowance which presently is calculated at the rate of 15% on the cost of hotel equipment are:

- The hotel equipment must be new or unused [section 12A(2)];
- Hotel equipment will only qualify if brought into use by a taxpayer for the purposes of his trade as hotelkeeper [section 12A(2)(a)];
- Lessors of hotel equipment will qualify for the initial allowance if the equipment is brought into use by the lessee for the purposes of the lessee's trade as hotelkeeper [section 12A(2)(b)]. The initial allowance is not available to a lessor of

hotel equipment under a lease concluded on or after 2 October 1981, unless the period of the lease is at least five years, or in the case of hotel equipment which in the opinion of the Commissioner has a shorter life, such shorter period as the Commissioner may approve [section 12A(5)(a)]. Where the lessor disposes of his interest or portion of his interest or his right or portion of his right to receive rent under the lease within that period, the initial allowance granted in respect of the equipment, less any amount as the Commissioner may allow in respect of the expired portion of the lease, is added to income during the year of disposal [section 12A(5)(b)];

- The recoupment of the initial allowance is taxable [section 8(4)(a)];
- The cost of the hotel equipment for the purposes of determining the allowance shall be deemed to be the cost which, in the opinion of the Commissioner is the cash price of such equipment acquired under a transaction concluded at arm's length, plus the direct cost of installation.

3.3 Hotel equipment - investment allowance

The special features of the investment allowance are as follows:

- The hotel equipment must be new or unused [section 12A(3)];
- Hotel equipment will only qualify if brought into use by the taxpayer in any hotel in which the taxpayer carries on the trade of hotelkeeper [section 12A(3)(a)];
- The hotel equipment, in order to qualify, must be brought into use during the year in which such hotel is registered under the Hotels Act 1965;

- Lessors of hotel equipment will qualify for the investment allowance in respect of the cost of hotel equipment let by them if such equipment is used by the lessee in an hotel in which the lessee carries on the trade as hotelkeeper;
- The amount of the allowance is 10% of cost which in terms of section 12A(3A) is "deemed to be the cost which, in the opinion of the Commissioner, a person would, if he had acquired such hotel equipment under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such hotel equipment was in fact concluded, have incurred in respect of the direct cost of acquisition of such hotel equipment, including the direct cost of the installation or erection thereof". (See "cost of machinery or plant" C4.31 infra).
- The investment allowance is not available to a lessor of hotel equipment under a lease concluded on or after 2 October 1981 unless the period of the lease is at least five years, or in the case of hotel equipment which in the opinion of the Commissioner has a shorter life, such shorter period as the Commissioner may approve [section 12A(5)(a)]. Where a lessor disposes of his interest or portion of his interest or his right or portion of his right to receive rent under the lease within that period, the investment allowance granted in respect of the equipment, less any amount as the Commissioner may allow in respect of the expired portion of the lease, is added to income during the year of disposal [section 12A(5)(b)].

3.4 Hotel buildings

Hotel buildings and improvements thereto registered as an hotel under the Hotels Act 1965, will qualify for the following allowances (Section 13bis) -

- annual grading allowance ranging from 2% to 8% of cost depending on the grade of the hotel;
- annual allowance of 2% of cost; and
- investment allowance of 10% of cost.

The special features relating to these allowances are as follows:

- The aggregate of the annual allowance, and grading allowance must not exceed the cost of the buildings or improvements thereto [Section 13bis(5)].
- Hotel buildings or improvements thereto, to the extent to which an allowance has been granted in terms of section 11(g). (leasehold improvements, see Chapter 23), are specifically excluded for the purposes of the grading and annual allowances [Proviso to S13bis(1), S13bis(2)]. The aggregate of all allowances in respect of hotel buildings or improvements thereto amount to 110% of the cost.
- The buildings or improvements thereto must be used by the taxpayer or lessee for their purposes of carrying on therein their trades as hotelkeepers [Section 13bis(1)(d)(bb)]. The investment allowance will only be available to a lessee if he is entitled to occupation of such premises for at least ten years reckoned from the date of erection of the building or the commencement of the improvements [Proviso to S13bis(7)].
- Any untaxed recoupment in terms of section 8(4)(e) must be deducted from the cost of the buildings or improvements thereto, replacing those which have been damaged or destroyed, for the purposes of calculating the annual and grading allowances [Section 13bis(6)]. The recoupment of the investment allowance is not subject to tax.

- The investment allowance is available in respect of improvements to an hotel building, which was registered or will be registered within twelve months, as an hotel under the Hotels Act 1965 [Section 13bis(7B)].
- The allowances are calculated on cost. The word "cost" is not defined in the Act. The meaning is discussed in C4.17 infra.
- The annual grading allowance is an amount equal to a percentage of the cost of any building or improvements, calculated in accordance with the tables below: [These tables are in terms of the regulations under section 13 bis (4) of the Act].

TABLE 1

In respect of any year of assessment ended not later 29 February 1980	Rate of allowance (to be calculated on the relevant cost) in the case of - A 1-star	A 2-star	A 3-star	A 4-star	A 5-star
A. Where that year of assessment is the first year of assessment or any of the four years of assessment immediately succeeding the first year of assessment	2%	3%	5%	6%	8%
B. Where the year of assessment is a year of assessment following the five years of assessment referred to in A above	2%	3%	3%	3%	3%

TABLE 1

In respect of any year of assessment ended not later 29 February 1980	Rate of allowance (to be calculated on the relevant cost) in the case of - A 1-star	A 2-star	A 3-star	A 4-star	A 5-star
A. Where that year of assessment is the first year of assessment or any of the four years of assessment immediately succeeding the first year of assessment	2%	3%	5%	6%	8%
B. Where the year of assessment is a year of assessment following the five years of assessment referred to in A above	2%	3%	3%	3%	3%

TABLE 11

In respect of any year of assessment ended not later 28 February 1981	Rate of allowance (to be calculated on the relevant cost) in the case of - A 1-star	A 2-star	A 3-star	A 4-star	A 5-star
A. Where that year of assessment is the first year of assessment or any of the nine years of assessment immediately succeeding the first year of assessment	2%	3%	5%	6%	8%
B. Where the year of assessment is a year of assessment following the ten years of assessment referred to in A above	2%	3%	3%	3%	3%

It is to be noted that no additional incentives are available to hotel buildings situated in economic development areas.

CHAPTER 4

PROCESS OF MANUFACTURE

Although the Act provides relief in respect of capital expenditure under sections 12, 12A, 13 and 13 bis certain words and terms used in those sections were not in all instances defined. The result was that the courts had to interpret terms such as "process of manufacture". The following then is a review of the court decisions relating to the difficulties taxpayers had with the interpretation of the mentioned sections of the Act.

4.1 Meaning of "process of manufacture"

Whether a taxpayer's operations amount to a "process of manufacture" is a question of law [SIR v Hersamer (Pty) Ltd 1967(3) SA 177(AD), 29 SATC 53; SIR v Safranmark (Pty) Ltd 1982(1) SA 113(AD), 43 SATC 235]. The major difficulty experienced by taxpayers is the interpretation of the phrase "process of manufacture". The judicial interpretation of this phrase is as follows:-

> Quinet J in Minister of Finance v Bacher Aron & Co (Rhodesia) Ltd [1956(1) SA 63 (SR), 20 SATC 321]: "In my view, an article is manufactured only when the process of alteration results in the transformation of the articles into something substantially different from what it was". (C4.2 infra).
>
> Price J in Queen Slide Fasteners of SA (Pty) Ltd v Commissioner of Customs [1953(3) SA 195 (W), 19 SATC

73]: "The manufacture of a commodity usually connotes operations which involve a change of the character of the raw materials" (C4.3 infra).

Tredgold CJ in Kantor v Macintyre No & Another [1958(1) SA 45 (FC), 21 SATC 407]: "'Process' may certainly mean a single action, but, more ordinarily, it conveys the impression of a continuous series of actions or at least of a protracted single action, directed to some end. 'Manufacture' implies a change in the character of the article manufactured, the production of something that is essentially different". (C4.6 infra).

Jennet J in ITC 1006 (25 SATC 248 Confirmed in ITC 1061, 26 SATC 317): "---- a completed sirgle action or series of actions directed to produce something in a form suitable for use, essentially different from the material in its original form or state" (C4.7 infra).

JB Macualay QC in ITC 1101 (29 SATC 23), referring to definitions prior to this case, concluded that "emphasis is placed on the transformation resulting in something substantially or essentially different from the materials with which the process of manufacture commenced". (C4.10 infra).

Faure Williamson JA in SIR v Hersamer (Pty) Ltd [1967(3) SA 177 (AD), 29 SATC 53], agreeing with the previous definition held that "it must be recognised that the term 'essentially' obviously imports an element of degree into the determination of the sufficiency of the change that must be effected for a process to be one of manufacture". (C4.7 infra)

Beadle CJ in the Zimbabwean High Court case of COT v Processing Enterprises (Pvt) Ltd [1975(2) SA 213 (RAD), 37 SATC 109]: "(There) need be no change in the actual substance of the raw material before the process of dealing with it is regarded as a manufacturing process provided skill (C4.6 infra) has been applied in some way to that raw material and to such dealing, and its actual character, as opposed to its mere substance, is changed. Its physical substance may remain the same, but the process of handling may none the less be regarded as a manufacturing process if the raw material has been cleaned and broken up into its components".

4.2 Manufacture v alterations

In a Zimbabwean case [Minister of Finance (Southern Rhodesia) v Bacher Aron & Co (Rhodesia) Ltd, 1956(1) SA 63 (SR), 20 SATC 321] which related to customs duty the

taxpayer imported jackets and shorts from abroad. After some alterations in Zimbabwe, they were exported to South Africa. The court held that manufacture involves alterations but a process of alteration cannot for that reason be equated to a process of manufacture. Darling J in McNicol v Pinch (1906) 2KB 352 at 361, was quoted: "I think the essence of making or of manufacturing is that what is made shall be a different thing from that out of which it is made".

4.3 Manufacture v assembly

In another customs duty case [Queen Slide Fasteners of SA (Pty) Ltd v Commissioner of Customs 1953(3) SA 195 W, 19 SATC 73] a taxpayer imported lengths of 100 to 250 yards of zip fasteners. These lengths were without stops and slides, which operate to connect and disconnect the teeth of the fastener when moved up or down. The court had to decide whether the cutting of the endless chain into shorter lengths, the removing of a few teeth at each end and the fitting on of a slide and stops are, taken together, operations of manufacture or operations of assembly. The court used the example of a motor car, the various parts of which are manufactured from steel, and held at 78: "When, however, the separate parts that combined together in a certain way make a motor vehicle, each part being a finished article of its own kind, are imported and assembled into a car - the necessary operations to produce this result are not operations of manufacture, but of assembly and each of the separate parts is an integral part of the car". The court viewed the manufacture of a commodity to connote operations which involve a change of the character of the raw materials. Price J said at 78: "Linen cloth is manufactured from linen thread. Furniture is manufactured from timber.

Motor cars are manufactured from steel. There is, in all these cases, a very great change in character of the raw materials. They become something different from what they were". The process was held to be a process of assembly as a slight adjustment or alteration does not change the general character of the operation to manufacture.

In ITC 997 (25 SATC 177) a Zimbabwean taxpayer made cinematograph films or cartoons. Lengths of film was purchased and exposed by a camera. Thereafter the film was sent to laboratories for processing. The developed film was edited by the taxpayer and together with a sound track were again returned to the laboratories where a composite film was produced bearing both picture and sound. The taxpayer was held not to be a manufacturer because he "does not itself perform all the steps, and the fact that it performs some of the steps in a process which could be said to amount to manufacture does not make it a manufacturer". It is to be noted that the relevant question in that case was whether the taxpayer was a manufacturer. The court in fact found that the taxpayer performed some of the steps in a process of manufacture. This fact did not make him a manufacturer as is apparent from the above quotation.

4.4 Manufacture v preparation

A portion of the premises of a Zimbabwean taxpayer i- TA Ltd v COT [1960 (4) SA 917 (High Court of Southern Rhodesia), 24 SATC 47], was used for preparing tobacco for sale . In order to be able to classify the buildings as "industrial buildings" for the purpose of the Zimbabwean Act, the court had to decide whether this preparation process was a process of manufacture. The preparation process consisted of grading and bailing.

For the purposes of grading the tobacco was sorted so that each bale contained tobacco of the same grade. During the grading system steam was introduced into the grading shed to ensure that the tobacco had the correct mixture content. For the baling, presses were used. It was held at page 49 that although grading was essential, the preparation process was not one of manufacture: "Tobacco grading is, I think, more appropriately described as a farming operation than as an industrial operation. Its character is not in my view altered by the fact that in this instance it is an operation carried out by appellant on behalf of the farmer".

4.5 Manufacture v repair

The repair of an article cannot be considered a process of manufacture. In ITC 1246 (38 SATC 21) the taxpayer reconditioned fuel pumps and injectors for use in diesel engines, and contended that he was engaged in a process of manufacture. His argument was based on the fact that through the exercise of a high degree of skill and the use of machinery, non-functioning fuel pumps and injectors were converted into a functioning entity. The court held that "a person who picks to pieces a manufactured article and puts it together again does not make it. The test is whether or not the additional process has changed the article into something essentially different from what it was. It seems to me that basically the appellant's operation is one of repair". The latest practice of the Commissioner is to consider the reconditioning of injector pumps and turbochargers for diesel engines a process "similar to a process of manufacture".

4.6 Use of labour and machines with skill and experience

In R v Beneke & Another [1957(1) SA 594, 21 SATC 183], a case which concerned customs and excise duties it was held that pipe tobacco was manufactured only when the raw tobacco leaf has been subjected to all the normal processes requisite for converting the raw leaf into a tobacco ready for smoking. The cutting up of the tobacco was not considered to be the "manufacture" of pipe tobacco. The issue in Kantor v Macintyre No & Another [1958 (1) SA 45 (FC), 21 SATC 407] was whether, for the purpose of customs and excise duties, the tobacco sold by the applicant had been "subjected to any process of manufacture". The court considered the words "process" and "manufacture". As regards "process" the court did not arrive at a firm conclusion. Tredgold CJ said at 409: "'Process' may certainly mean a single action but, more ordinarily, it conveys the impression of a continuous series of actions or at least of a protracted single action, directed to some end". The court concluded that even if the expression "process" were construed as meaning any individual act in the course of manufacture, the cutting up of the tobacco by the applicant could not be described as "manufacture". This is the first instance where it was held that the "(skilful) cutting by hand or by a machine designed to facilitate the use of the material in a particular way, might, without abuse of language, be called 'manufacture'". In this case, however, the taxpayer merely chopped up the tobacco into rough, irregular shapes, suitable for packaging, and the process was not considered one of manufacture. The court in E S & A Robinson (Rhodesia) (Pvt) Ltd v Macintyre No [1962(2) SA 638, 24 SATC 767] classified the process of converting mill reels into counter reels as an elaborate process, involving expensive machinery, and a high degree of

technical skill in its operation. The taxpayer in the latter case, which also concerned customs and excise duties, imported kraft paper in the original mill reels and converted some of it into counter reels. The process was found to be one of manufacture.

4.7 Essentially different, suitable for use

A process of manufacture is a complete single or series of actions directed to producing something, in a form suitable for use, essentially different from the material in its original state or form. This test was applied by the court in ITC 1006 (25 SATC 248). In this case the taxpayer carried on the business of a scrap metal dealer. The heavy metal was cut to measurements for insertion into a furnace. The light metal was compressed into bundles of a required size. These two operations were necessary for the smelting process of the foundaries. The taxpayer claimed the initial and investment allowance. In considering the meaning of the words "process" and "manufacture" the court, with reference to various dictionary definitions, concluded that -

- "process" although it may mean a single action more ordinarily conveys the impression of a continuous series of actions directed to some end;
- "manufacture" implies the production of something essentially different from the material used; and
- that "a process of manufacture" means ordinarily "a completed single action or series of actions directed to produce something in a form suitable for use, something essentially different from the material in its original form or state".

The court held that the compression of the light metal into bundles was not in itself a process of manufacture in that in its bundled form the metal was still nothing more than scrap metal. It was further held that the compression of light metal into bundles was not a complete process but only a step in the process of manufacturing cast steel. The scrap metal had still to be subjected to a melting process whereby certain alloys were added. Relying on this decision, the Commissioner refused the capital allowances in a later case of SIR v Hersamer [1967(3) SA 177 (AD), 29 SATC 53]. This case also concerned a scrap metal dealer. The scrap had to be converted to various sizes and forms required by the foundaries. The light scrap was reduced to rectangular blocks and the heavy scrap was cut into various sizes. The court agreed that the article claimed to have resulted from a process of manufacture must be essentially different from the article as it existed before it had undergone such a process. However, the court held that the terms 'essentially' imports an element of degree into the determination of the sufficiency of the change that must be effected for the process to be one of manufacture. The view was expressed that there can be no fixed criteria as to when any such change can be said to have effected an essential difference, and that it is a matter to be decided on the particular facts of each case. On the evidence of the case the court found that the scrap in its uncompleted and shapeless form could not economically be used in the furnaces employed for the manufacture of steel. Faure Williamson JA was of the opinion that "(although) a briquette (or a block of light steel scrap) is physically the same material, unaltered metallurgically, as the steel scrap of which it is made, it has become essentially something different. It is now not a shapeless quantity of loose

steel scrap but a definite article, formed to certain desired specifications and compressed to great density, which has thereby acquired a utility and a commercial purpose which it did not previously possess." The process was held to be one of manufacture. It is submitted that in terms of the decision in the Hersamer case it may be concluded that for a process to be classified as a "process of manufacture" it is not essential for that process to produce a finished end product.

4.8 Process as one in a series

It is submitted that the decision in ITC 1006 (C4.7 infra) would have been different if the court had the benefit of the decision in COT v Processing Enterprises (Pvt) Ltd [1975(2) SA 213(RAD), 37 SATC 109] where it was held that every one of the essential processes in the course of converting the raw material into the finished product, can be termed a manufacturing process. This was an appeal of ITC 1228 (37 SATC 64) where the special court held that cotton ginning is a process of manufacture. The Appellate Division applied the facts of the case to the abovementioned principle. The stages of production were found to be as follows -

- the farmer grows the cotton and produces the seed cotton;
- the ginning of cotton and, that is, the division of seed cotton into its components of cotton seed and lint and cleansing of the lint;
- the spinning of that lint into yarn; and
- the final process of weaving the yarn into fabric.

The Appellate Division held:

> The earlier process of ginning and spinning may not have produced the end product but that did not mean that those processes may not have been regarded as manufacturing processes without doing violence to the meaning of the word "manufacture". A manufacturing process need not necessarily produce the end product provided it is an essential stage in the final production of that end product or an important stage in the final production of that end product. [Carfax Waste Paper Co Ltd v Minister of Labour, 1968 1 All ER 1041; Lord Advocate v Reliant Tool Co, 1968 1 All ER 162; SIR v Hersamer (Pty) Ltd, 1967 (3) SA 177 (AD), 29 SATC 53; and ITC 997, 25 SATC 177].
>
> Reference was made to an Australian case of Wangaratta Woollen Mills Ltd v Federal Commissioner of Taxation (Australian Tax Reports Vol 1 ATR 329). In that case the tops of raw wool were dyed so that coloured wool could be sold to people who wished to use it for weaving into various articles. The argument was that merely dying the wool was not a process of manufacture. In that case McTiernan J said at 337: "I do not think that to say that the dyed wool tops have been manufactured is to strain the language of the section.

> Manufacture connotes the simplist operations upon a raw material, and it matters not that the taxpayer conducts a further operation upon the product before it is sold".
>
> There need be no change in the actual substance of the raw material before the process of dealing with it is regarded as a manufacturing process, provided skill has been applied in some way to that raw material and to such dealing, and its actual character, as opposed to its mere substance, is changed.
>
> The process was held to be one of manufacture.

Beadle CJ concluded: "What has been done in this case is that the substance of the raw material has not been changed. It has been divided up into its different component parts and cleaned by the use of skill and sophisticated machinery. This handling of the raw material has introduced a sufficient change in the character of the original raw material to justify that handling being called a 'process of manufacture', becaue an essential change has taken place."

4.9 Different from that out of which it was made

In ITC 1052 (26 SATC 253) the taxpayer carried on the business of letting space for cold storage of perishable food stuffs in refrigerated rooms. The plant produced cold air and also ice which was sold. The taxpayer claimed the capital allowances contending that it was using a process of manufacture. The facts of the case were applied to the test "what is made shall be a different thing from that out of which it is made". The

production of cold air was found not to be a process of manufacture, whereas the production of ice was found to be such a process. The court held that the fact that cold air can be used for refrigeration, whereas warm air cannot, does not mean that cold air is essentially different from warm air. Van Winsen J used the following example to illustrate his view: "The fact that water at or near boiling point can be used to cook an egg, whereas cold water cannot, does not imply that the application of heat to water so as to raise its temperature is a manufacturing process". Referring to the ice making process the court found that apart from the product being new, it was suitable for use, and that it was substantially different from the raw material, namely, the water from which the process started.

In a Zimbabwean case [S v Clearwater Tea Manufacturers (Pvt) Ltd 1975 (3) SA 65(AD), 37 SATC 279] concerning licence duty, the court had to decide whether a taxpayer manufactured tea in its factory. Relying on the decision in the Processing Enterprises case (C4.8 *infra*) the court held that if a process has the effect of making an essential change in the character of the raw material used, then almost invariably what is done will be regarded as a process of manufacture. Tea leaves, it was held, changed essentially in two stages -

- the first change is brought about when a cellular structure of the leaves is destroyed so as to facilitate fermentation; and
- the second when fermentation takes place during a later stage of the processing.

The process was likened to the manufacturing process of the transformation of grapes into wine, by a process of fermentation, and was held to be a process of manufacture.

In a case [Gray No v Assistant Master & Another 1979(3) SA 427 (High court of Zimbabwe), 41 SATC 117] of a claim for duties on valuable diamonds allegedly smuggled into Zimbabwe, Beadle AJ held, at 123: "I think that the recutting of an old-fashioned cut diamond into a diamond of modern brilliant cut may be fairly regarded as a 'process of manufacture'".

4.10 Change in immovable property

The president of the special court in ITC 1101 (29 SATC 23) expressed a view that in the definitions of the term "process of manufacture" as well as the judicial interpretations thereof, "manufacture" is associated with an article resulting in the production of an article for use. He was not able, he said, to find an instance where the word has been applied to a productive activity resulting in an alteration or change in immovable property. In this case the taxpayer purchased heavy equipment and hired out the same for amongst others, road and dam construction. The taxpayer claimed the capital allowances contending that the machinery were used in a process of manufacture. Applying the facts of the case to the definitions of the term "process of manufacture" as expressed in the Bacher Aaron & Co and Kantor cases, the court held that it cannot properly be said that the ordinary metalled road constructed from raw materials of earth and stone is, in its complete state, essentially different from the raw materials which are its constituents. The court saw no fusing of the stone and earth in a manner which transforms their character into something essentially different. A similar conclusion was arrived at by the court in ITC 1247 (38 SATC 27). In this case the taxpayer who carried on the business of civil engineering and building contractors, was engaged in the

contruction of roads and other related activites. One of these activities was that of moulding concrete into shapes necessary for use in the contruction of curbs, drainage canals, manhole covers and saddles supporting underground pipes. The taxpayer claimed that the operations brought about a material change in the nature, shape and utility of pre-existing things; and, more specifically in relation to roads, that the operations constituted a process or series of processes, which produced from bare ground a product essentially different from what had pre-existed. The court had difficulty in accepting that the process whereby something is laid or constructed upon or affixed to or embedded in the earth is in itself from beginning to end a process of manufacture within the ordinary meaning of that phrase. The object so constructed from or affixed to the earth might or might not have come into existence as a result of a process of manufacture, but it did not appear to the court that the preparation of the earth to receive such object constituted a process of manufacture. The activity of moulding concrete into various shapes was however, held to be a process of manufacture. The court held that the several elements such as stone, gravel, sand and water retained their individual qualities, but upon completion of the process a different compound substance having a special quality as such was produced.

4.11 Volume of production

In the latest case [SIR v Safranmark (Pty) Ltd 1982(1) SA 113(AD), 43 SATC 235] on the subject the taxpayer held a franchise from Kentucky Fried Chickens to prepare and sell fried chicken in a specified manner. The taxpayer claimed the capital allowances and the sole issue before the court was whether the operation

amounted to a process of manufacture. The following aspects of the case assisted the court in its decision:

- Some of the plant and machinery were of a specialised nature.
- The use of the plant and machinery was standardised.
- Human effort and labour were used.
- The volume of production was based on anticipated demand.
- The volume of production was large.
- Applying the principles set out in SIR v Hersamer (C4.7 supra) and ITC 1247 (C4.10 supra), the court held -
  - the end product was different from the materials from which it was produced not only in nature but also in utility and value, in that the ingredients of egg-and-milk mixture and of the breading mix have ceased to exist and the inedible raw chicken has become an edible product;
  - that upon completion of the process a different compound substance having a special quality as such, viz edibility and special taste, has been produced and moreover produced in quantity for purposes of trade; and
  - that the operations therefore constituted a process of manufacture.

4.12 Process of manufacture - summary of judicial interpretation

In the course of considering the meaning of the expression "process of manufacture", our courts have suggested certain factors which may be taken into consideration. These factors include whether in the process of an article -

- physical labour or mechanical power has been applied;
- expensive machinery has been used;
- skill and experience have been used;
- the finished product is suicable for economical use;
- the raw material has become something different from what it was;
- the article has changed into something essentially different;
- the process produces a final end product;
- the process amounts to a slight change or alteration, in which event the process could merely be "assembly";
- the volume of production is large;
- the machinery used is standardised;
- the volume of production is large and based on anticipated demand; and whether
- the article is an immovable.

4.13 Commencement of the process

In accordance with judicial interpretation the term "process of manufacture" is associated with an activity or series of activities resulting in the production of

an article. The next important issue which the courts had to decide was where the process of manufacture commences. This inquiry seems to be similar to that which arises when a court has to decide whether an accused's actions amount to an attempt to commit an offence or whether they are only part of the preparation to commit the offence. Where does preparation end and perpetration begin? Such an inquiry has always been treated as a matter of law [R v Sharpe 1903 TS at 871 and 876, R v Nlhovo 1921 AD 485, R v Schoombie 1945 AD 541].

The leading case as to where the process commences is that of SIR v Cape Lime Co Ltd [1967(4) SA 226(AD), 29 SATC 131]. In this case the taxpayer carried on the business of reducing hydrated lime for agricultural and other purposes. The lime stone was removed by blasting sections of the rock from the face of a quarry. Much of the rock so moved was in portions of larger size and these portions were then reduced to fragments of manangeable size by further blasting on the floor of the quarry. The smaller fragments so produced were then transported from the quarry to the site of the crushing plant. For this purpose lorries were used and the court had to decide whether these lorries were used in a process of manufacture. The substantial issue which had to be decided was whether the process of manufacture commenced with the operations at the site or only with the later operations at the reduction plant. The court held on a majority decision that the blasting of rock on the floor of the quarry was the commencement of the series of operations which constituted the process of manufacture, and that the lorries had been used in that process. Wessels JA summed up as follows at 140: "The picture would no doubt have been clearer if the respondent were to have obtained its raw material

Author Coetzee H A
Name of thesis Capital allowances in terms of South African Tax law 1984

PUBLISHER:
University of the Witwatersrand, Johannesburg
©2013

LEGAL NOTICES:

Copyright Notice: All materials on the University of the Witwatersrand, Johannesburg Library website are protected by South African copyright law and may not be distributed, transmitted, displayed, or otherwise published in any format, without the prior written permission of the copyright owner.

Disclaimer and Terms of Use: Provided that you maintain all copyright and other notices contained therein, you may download material (one machine readable copy and one print copy per page) for your personal and/or educational non-commercial use only.

The University of the Witwatersrand, Johannesburg, is not responsible for any errors or omissions and excludes any and all liability for any errors in or omissions from the information on the Library website.