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THE APPLICATION OF SECTION 24C ALLOWANCES IN RESPECT OF FUTURE EXPENDITURE ON CONTRACTS

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A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in fulfilment of the requirements for the degree of Master of Commerce (Specialising in Taxation)

Johannesburg, 2022

ABSTRACT

Gross income definition as per the Income Tax Act No. 58 of 1962 (the Act) section 1(1) states that:

> '…the total amount, in cash or otherwise, received by or accrued to a resident during a year of assessment which is not of a capital nature'.

A discrepancy may exist when a taxpayer is taxed on the income on receipt or accrual. For a taxpayer in receipt of such income with the obligation of fulfilling the attendant contractual duties, the expense is only deductible when the requirements of section 11(a) read together with section 23(g) of the Act have been met. According to the general deduction formula, the expenses can be claimed when incurred. Future expenditures to be incurred will not be deductible under the general deduction requirements, however, a relief with reference to section 24C is available by deducting the expenditure to be incurred in subsequent years in the year income is received. Over the years, taxpayers have found themselves faced with SARS reviews and/or audits on the deduction under section 24C. This has resulted in various tax court cases with the latest appealed in the Constitutional Court. As new rulings regarding section 24C application appear quite frequently this research examines various tax court cases up to volume 84 of the South African Tax Cases. The research will analyse section 24C as per the Act and explore the requirements of Interpretation Note 78 entitled 'Allowance for future expenditure on contracts' – 2014 (IN 78) including the challenges faced by taxpayers in the application thereof.

Keywords

Income received in advance; Future expenditure; Contract; Actually incurred; Inextricably linked.

DECLARATION

I declare that this research report is my unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other University.



Asanda Sakhela

30 June 2022

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ABBREVIATIONS

BPR	The Binding Private Ruling
CC	the Constitutional Court of South Africa
Commissioner/ C:SARS	the Commissioner for the South African Revenue Service
Company	is any association, corporation, or a company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force in the Republic or any part thereof as defined by section 1 of the Act
Contract	it is a promise (in writing or otherwise) entered into with the intent of creating an obligation as per Law South Africa
GG	Government Gazette
IN 78	Interpretation Note 78 entitled 'Allowance for future expenditure on contracts' – 2014
ITC	Income Tax Case
SARS	South African Revenue Service
SATC	the South African Tax Cases
SCA	the Supreme Court of Appeal
the Act	Income Tax Act No. 58 of 1962
the Explanatory Memorandum	the Explanatory Memorandum on the Income Tax Bill, 1980

CHAPTER 1: INTRODUCTION

1.1 Background

Gross income is defined in section 1(1) of the Income Tax Act No. 58 of 1962 (the Act) as the amount, in cash or otherwise, received by or accrued to a resident during a year of assessment which is not of capital nature. There is a disparity in relation to when a taxpayer is taxed on the income and when a deduction is claimed on the expenses incurred to produce said income. There is, however, a relief with reference to section 24C by deducting the future expenditure in the year the income is received. Often, there are disputes by SARS on the application of section 24C that reduces the relief provided. For a taxpayer in receipt of an advance income with the obligation of fulfilling the attendant contractual duties, the expense is only deductible when the requirements of section 11(*a*) together with section 23(*g*) of the Act have been met. The future expenditure to be incurred will not be deductible under the general deduction requirements. Over the years taxpayers have found themselves faced with SARS reviews and/or audits with regard to section 24C claims. This has led to numerous cases with the latest appealed in the Constitutional Court. This research analyses various tax court cases up to volume 84 of the South African Tax Cases, as new rulings regarding section 24C application, appear quite frequently. The research will furthermore analyse section 24C and explore the requirements of Interpretation Note 78 entitled 'Allowance for future expenditure on contracts' – 2014 (IN 78) including the challenges faced by taxpayers in the application.

Section 24C of the Act was brought into being by section 18(1) of the Income Tax Act 104 of 1980. The intent was to provide tax relief to taxpayers once an income (*as defined*) has been received in advance during a year of assessment under a contract with the expenditure to be incurred in subsequent years. It may thus be said that section 24C permits a deduction of expenditure in year 1 which ordinarily would be deductible in year 2 or later (as per section 11(a)) (2021:1072). Clause 18 in the Explanatory Memorandum stated that the new section (*referring to section 24C*) caters for a situation which at times would arise in the construction or manufacturing industry where a large advance payment is made to a contractor before the commencement of the contract work (W.P. 8-'80 at 9). The receipt would typically be taxable as part of the taxpayer's gross income on receipt

or accrual, however, the expenditure in relation to that contract would only be deductible in subsequent years once it is incurred. Section 24C allowance has since been applied by companies in various industries where an income, in relation to a contract, has been received in advance. This notion was further explained by Galgut J in ITC 1697 (1999) 63 SATC 146 at 155:

> 'The s 24C allowance was introduced into the Income Tax Act for the benefit of building contractors, in particular, one who in a given contract is paid certain amounts in advance and where the builder's obligation to carry out certain work in terms of the contract will give rise to expenditure which will only be incurred in a later tax year. The fact that the allowance might have been intended for building contractors did not mean that it was not also available to others.'

This has confirmed the wider scope of section 24C applying to any transaction where an income is received in advance and the attendant expenditure is going to be allowed as a deduction in succeeding years of assessment.

1.2 Purpose of the research report

1.2.1 Research statement

With certain inconsistencies in the interpretation of section 24C by Tax Courts, IN 78 was introduced to make available guidance on the application of section 24C. As the interpretation note is merely a guide with no statutory powers, taxpayers are still experiencing difficulties applying section 24C. Therefore, this research analyses a sample of tax court cases pre and post the introduction of IN 78 related to the application of section 24C and compares the outcome to the guidelines under IN 78 to identify matters which were not specifically addressed by IN 78 as well as any new matters arising due to the implementation of IN 78 itself. The requirements under IN 78 cannot be enforced as they are merely guidance in the application of the law. There are abundant income tax matters on which the Act is silent, and which have not yet been resolved by the courts. To fill these gaps and to ensure the consistent treatment of cases alike, SARS has developed numerous departmental practices. Many of these practices are recorded in Interpretation Notes for the information of taxpayers and their advisers. These practices and Interpretation Notes do not have the force of law. The Commissioner does not always

assess taxpayers in accordance with these Interpretation Notes (See for example ITC 1675 (1998) 62 SATC 219 at 229).

1.2.2 Research questions

Numerous sub-questions will attempt to address the main research statement directly above.

1. Are there any matters that were not specifically addressed by IN 78?
2. Are there any matters that have arisen after the implementation of IN 78?
3. What recommendations on the inadequacies of section 24C can be explored?

1.2.3 Significance of the research report

This research identifies the causes of the inconsistencies in the application of section 24C and provides recommendations to reduce said inconsistencies. This research is practically relevant because the findings will be useful both from the view of the Commissioner and taxpayers. This research may be helpful to taxpayers in assessing whether they are eligible for a section 24C allowance or not. Tax professionals, when assisting clients with income tax analyses, may find some areas of the report useful in relation to the application of section 24C. The research report will be valuable to educators and scholars in general, as currently the available literature review is quite high-level and has not yet analysed whether IN 78 has helped clarify the requirements of section 24C. The importance of this research report will assist in providing some guidance on what areas of section 24C can be amended to lessen the burden in the application of the law. The research furthermore addresses a requirement for clarity with regard to the section 24C application, as evidenced by the limited case law and prior literature (see, for example, de Koker, AP. & Williams, RC. 2021).

1.2.4 Delimitations of the research

The scope and delimitation of the research report are within the realm of section 24C with a focus on how the legislation has been interpreted by the taxpayers in interaction with the Commissioner. The period under review is from 1980 when section 24C was introduced by the Income Tax Act Explanatory Memorandum up to the 2021 Constitutional Court review of section 24C cases. The case law under review includes a

sample of cases up to volume 84 of the South African Tax Cases. There are several similar provisions in other countries, but this research report only considers South African tax cases. The deductible amount as per section 24C is limited to expenditure that can be deducted in terms of section 11(a). The report does not give attention to how to calculate a deductible amount under section 24C.

1.2.5 Research methodology

The report is structured in a way that explores the challenges faced by taxpayers in the application of section 24C by going through the court cases published up to volume 84 of the South African Tax Cases. As such, the research follows a qualitative methodology. Section 24C has varying impacts on taxpayers depending on whether the Commissioner disallows the full deduction claimed or a portion thereof. In essence, a qualitative approach has been applied to the report with an analysis of section 24C shortcomings. The intention is to propose amendments which could offer a fair outcome to both SARS and the taxpayer. The research report places its reliance on the literature reviewed on the application of section 24C. Data has been collected from eight academic books, a scholar theses report, and a review of journal articles on the subject. The report, however, places substantial reliance on the court cases from the lower courts up to volume 84 of the Tax Courts, Supreme Court, and Constitutional Court cases.

1.2.6 Chapter Outline

1. Chapter 2 analyses the fundamental requirements, as stated in section 24C. The Act only defines 'future expenditure' under section 24C(1) with taxpayers relying on the Commissioner's interpretation of phrases such as 'income[1]', 'contract' and the timing issue between the receipt of an income and actually incurred expenditure as per the guidance provided by IN 78. Recently, there are court cases in the Supreme Court of Appeal including the Constitutional Court cases that have provided further guidance to the purpose of section 24C.
2. Chapter 3 of the research report reviews the legislative and judicial effects of section 24C examining the published Tax Court cases. The chapter takes a high-level evaluation of the two BPR provided by the Commissioner on the interpretation of

[1] This is a defined term in section 1 of the Act meaning the net of gross income and exempt income.

section 24C provisions. In addition to the review of lower court cases, an analysis of the Supreme Court of Appeal judgments and recently heard Constitutional Court proceedings on section 24C is undertaken.

3. Chapter 4 provides suggestions on the guidelines under IN 78, with the intention of expanding the requirements of IN 78 to facilitate the application burden to the taxpayer.
4. Chapter 5 summarises the findings of this research report and proposes parts of section 24C necessitating amendments and/or additional analysis.

CHAPTER 2: LITERATURE REVIEW

2.1 Overview

Chapter 2 analyses the fundamental requirements as stated in section 24C. The Act only defines 'future expenditure' under section 24C(1) with taxpayers relying on the Commissioner's interpretation of phrases such as 'income', 'contract' and the timing issue between the receipt of an income and actually incurred expenditure as per the guidance provided by IN 78. Of recent, there have been court cases in the Supreme Court of Appeal and the Constitutional Court that have provided further guidance to the application of section 24C. These cases are further analysed in Chapter 3, focusing on the court cases that are reviewing issues not addressed by IN 78.

The requirements of section 24C in subsections 2 and 3 in the Act can be paraphrased as follows:

1. Provided that the income of a taxpayer comprises an amount received by or accrued in connection to any contract and such amount will be used in whole or in part to fund future expenditure to be incurred by the taxpayer in the performance of the taxpayer's obligations under such contract, there shall be deducted in the calculation of the taxpayer's taxable income for such year such allowance (limited to the income received in advance) in respect of the future expenditure as relates to the said amount.
2. The amount of any allowance deducted under section 24C(2) in one year of assessment must be deemed to be an income received by or accrued in the subsequent year of assessment.

Section 24C allowance permits a taxpayer to deduct an allowance relating to future expenditure where an amount has been received in relation to a contract. In order for the taxpayer to claim the allowance in a year of assessment, the income should comprise an amount received or accrued in respect of any contract and the amount will be utilised to fund future expenditure to be spent. The Act defines 'future expenditure' under section 24C(1) as an amount of expenditure to be incurred after the end of a year of assessment in such manner that such amount will be allowed as a deduction from the taxpayer's

income in a following year of assessment; or in relation to acquisition of any asset of which any deduction will be permissible under the provisions of the Act.

With various taxpayers challenging the analysis of section 24C, as shown by the cases in the various tax courts and, more recently, in the Supreme Court of Appeal and the Constitutional Court, the Commissioner issued IN 78 to provide guidelines to the section. Part 2 of this Chapter reviews IN 78 guidance in relation to section 24C interpretation and application. The report furthermore touches on the Commissioner's discretion in allowing the deduction of section 24C as this was initially part of the requirements when the section was first introduced.

2.2 Interpretation Note 78 entitled Allowance for future expenditure on contracts ('IN 78')

2.2.1 Background as per IN 78

Interpretation Note 78 entitled *'Allowance for future expenditure on contracts'* ('IN 78') dated 29 July 2014 was issued with the purpose to make available guidance and clarification on the interpretation of section 24C when an income has been received in advance and the expenditure to be incurred in the future. Van Zyl (et al., 2015:12) stated that '…*Interpretation Notes are simply the interpretation of SARS in respect of the relevant provisions and do not have the force of law'*. Should a taxpayer disagree with the guidance in the Interpretation Note, they may contest the practice note. Despite the IN 78's extensive analysis of section 24C requirements necessary to claim a deduction regarding section 24C, there appears to remain a degree of ambiguity as to what arrangements in the contractual form will grant a deduction, especially in circumstances where many contracts are in place (Bouwer 2020:2).

The core of a taxpayer's business may be such that an amount is received that will be used to fund expenditure to be incurred in the future in performing deliverables in relation to a contract. An irregularity occurs when the income is received in a year and the expenditure is incurred in the following year of assessment. Without section 24C, the income would be taxable in full in the year it has accrued or received without any tax allowances for future expenditure (IN 78, 2014:2).

IN 78 further explains that the non-deductibility of these future expenditures is, as a result of most sections of the Act necessitating that the expenditure be 'actually incurred' prior to any deduction being available. These sections will include section 11(a) and section 23(e) which explicitly prohibits a deduction of an income added to any reserve fund or capitalised. Even though section 24C was formerly intended for taxpayers in building and manufacturing industries, it does not mean that the section cannot be applied to taxpayers entering into other categories of contracts. Provided that the guidelines and requirements of section 24C have been met, the section can be applied to taxpayers in various industries other than the building and manufacturing industry. A taxpayer is still required to assess whether section 24C applies or not on an annual basis using relevant detail. Using its discretionary powers, a resolution made by the Commissioner in relation to whether a taxpayer can claim section 24C or not is subject to an objection (with reference to section 104 of the Act) and an appeal (with reference to section 107 of the Act) in accordance with Chapter 9 of the Tax Administration Act, 2011 (IN 78, 2014:2). Under part 4 of IN 78, the Commissioner's guidance indicates that the allowance under section 24C can be permitted when all of the requirements have been met.

2.2.2 Income as per IN 78 interpretation

Subsection (2) of section 24C indicates that should the income of a taxpayer comprises the amount received by or accrued to the taxpayer (in any year of assessment) relating to any contract and the amount will be used in its entirety or in part to fund future expenditure to be incurred by the taxpayer in the performance of the obligations of the taxpayer under aforementioned contract, a deduction in the determination of the taxpayer's taxable income for such year an allowance (not exceeding the said amount) can be claimed in respect of so much of such future expenditure as relates to the indicated amount. Deduced from section 1(1) of the Act, the definition of an income is a remaining amount of the gross income of any taxpayer for any period of assessment subsequently deducting any amounts exempt from normal tax.

Part 4.1 of IN 78 the note indicates that the income referred to in section 24C(2) is the advance income that arises as soon as an income has been received upfront not when the amount has accrued to the taxpayer prior to being received. For the receipt to be considered as an advance income this initially gives the impression that rather the receipt

of an amount is prioritised. This is however further clarified by stating that the '*change in principle'* is to ease reference and to keep the note uncomplicated. As IN 78 is merely a guideline, the principles of the 'gross income' definition will always take precedence where the amount will be taxable on the earlier of receipt or accrual. A taxpayer must ensure they comply with the limitation of the deduction to only deduct up to what has been included in the income.

2.2.3 An amount received or accrued in relation to any contract

As per section, 24C an income accrued in advance to a taxpayer should be in relation to a contract in order to claim an allowance for future expenditure. As the definition of the word 'contract' is not defined in the Act, IN 78 applies the standard meaning of the word as per the Law of South Africa. As indicated under LAWSA volume 5(1) paragraph 370 defines contract as:

> *'…[a]n agreement entered into with the intent of creating an obligation…'*

IN 78 further specifies that the contract referred to under section 24C(2) must be valid. Using the definition as per LAWSA ((*LAWSA volume (1)* at paragraph 403):

> '…a valid contract is where the parties must have the necessary contractual capacity; the performance undertaken under the contract must be possible at the time of contracting; the contract itself, its performance and object must be lawful; and the constitutive formalities (if any) for the contract must have been complied with. Although there is no specific requirement that a contract must be constitutionally valid, public policy requires that the Constitutional and its values must be taken into account when considering whether a contract is lawful. Constitutional validity of a contract is therefore indirectly required'.

A taxpayer wishing to apply the provisions of section 24C must be able to demonstrate a presence of a valid contract, with an income received or accrued under the same contract, an accompanying obligation(s) and the future expenditure related to performing those obligations, to the approval of the Commissioner (IN 78, 2014:4).

2.2.4 The amount will be used to finance deductible future expenditure

Section 24C(1) of the Act defines future expenditure as an amount to be expended after the end of a year of assessment:

'…(a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or
(b) in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.'

The two subsections can be paraphrased as a deduction of future expenditure prior to fulfilling the requirements of the 'general-deduction-formula' in section 11(a) (read with section 23(g)). De Koker & Williams referred to the elements of the formula as an amount incurred must be an 'expenditure' or a 'loss' that has been actually incurred during the year of assessment in the production of the income not of a capital nature and if has been claimed as a deduction against income derived from trade either in part or in full, it must constitute moneys that were expended for the purposes of trade (2001:788).

The expenditure mentioned in section 24C(1) must then either be expenditure to be allowed as a deduction under the Act from the taxpayer's income in the succeeding year of assessment or expenditure in relation to the acquisition of an asset which will be incurred in a subsequent year of assessment of which any deduction will be allowed under the Act. The meaning of expenditure was determined in Labat Africa (2011:3) where the court had to decide on whether issuing shares as a payment for the acquisition of a trademark constituted expenditure that has been actually incurred or not, with reference to section 11(gA) of the Act.

Judge Harms in C:SARS v Labat Africa Ltd held that (and Lewis JA, Heher JA, Maya JA and Plasket AJA concurred):

> 'The term "expenditure" is not defined in the Act and since it is an ordinary English word and, unless the context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent. In the context of the Act, it would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended.'

Accordingly, the disbursement can be referred to as an action of spending money or the distribution of other assets of the taxpayer with an economic benefit. Meyerowitz

(2008:11-13) confirm this by stating that ‘expenditure’ might be in any form that has value in monetary terms and can include but is not limited to cash.

In Joffe & Co, in an appellate division the meaning of the word ‘expenditure’ was discussed where a taxpayer, a company that carried on an engineering business supplying reinforced concrete. An accident occurred where a concrete structure built by the company collapsed and killed an employee of a building contractor. The court concluded that the taxpayer was neglectful in its construction of the collapsed structure, and it was ordered to pay damages and costs. The taxpayer sought to deduct these damages and costs for income tax purposes. The question before the court was whether the expenditure could be allowed as a deduction under section 11(2)(a) of the Income Tax Act No 31 of 1941 at the time. The framework of section 11(2)(a) of the Income Tax Act No. 31 of 1941 was almost identical to the context of section 11(a) of the Act (van Zyl et al., 2014:139). The taxpayer had opposed that the compensation for damages including the legal cost were either expenditure or losses. Judge Watermeyer held that loss had several meanings and that its meaning in section 11(2)(a) was somewhat ambiguous and with reference to trading activities, loss is used to indicate an involuntary deprivation. The judge continued with an explanation of his line of reasoning that when a company bring harm to third parties and the damage is corrected, then the payment which is made in fulfilment of the damage may properly be called a loss, but when the payment has been made then it can properly be called an expenditure. Watermeyer CJ likened loss and expenditure and emphasized the voluntary nature of expenditure and the involuntary nature of losses. Section 24C, however, only refers to expenditure, not a loss. In enlightening section 24C, when a taxpayer takes part in a contract and agrees to spend money or to expend assets in delivering the obligations under the contract, this can be seen as an ‘expenditure’ deductible under section 24C (Calitz, 2015:31).

As section 24C indicates that the future expenditure will be incurred and the amount will be allowed as a deduction, it is crucial for the taxpayer to ensure the conditions of section 11(a) must be met in relation to the future expenditure and section 23(g) prior to applying the provisions of section 24C. To assess whether the future expenditure can be deducted under section 24C, the taxpayer should ensure that the amount is not of capital in nature. As further indicated in IN 78, taxpayers need to establish that an amount will be spent or

used in the future or show that there is a definite legal liability to outlay or disburse an amount (2014:4). The words 'will be incurred' indicate that there should be a high degree of probability that the expenditure will be expended by the taxpayer.

A taxpayer should be able to establish that, even though the expenditure is uncertain there is 'a high degree' of unavoidability that the expense will be incurred in a succeeding year. This requirement relates to section 11(a) requirements where an expenditure will be allowed as a deduction from an income when incurred in a subsequent year of assessment and capital allowances to be incurred in a following year of assessment on the purchase of an asset for which any deduction will be allowed. IN 78 further clarifies that the relevant assets consist of assets intended to be purchased in order to perform in relation to a specific contract resulting in the advance income being received.

A typical procurement of assets usually used in the taxpayer's trading operations will not be eligible for an allowance under section 24C. This type of expenditure relates to the expenditure which will be incurred in acquiring an asset and it in no way relates to the deduction of, for instance, a capital allowance on an asset which has been acquired and the expenditure has already been incurred. IN 78 indicates that in assessing whether a taxpayer will be permitted to claim a deduction under section 24C, deliberation must be given to the deductions allowable under section 11 and principally, section 11(a) which contains the provisions of the 'general deduction' requirements. Nonetheless, section 24C does not prescribe the section under the Act in which the deduction must be granted and is similarly not limited to section 11 provisions. The requirement to the taxpayer is that the future expenditure will be entitled to a deduction in the succeeding year of assessment.

2.2.5 Timing issue on receipt of an income and actually incurred expenditure

When a taxpayer receives an income in advance and the income relates to a contract in respect of which the expenditure is to be disbursed in the future, with the disparity between the taxation of the income and deduction of the expenditure, section 24C provides tax relief to taxpayers when such income has been received in advance in relation to a contract and the expenditure will only be incurred in the following year of assessment. Section 24C has since been applied by taxpayers in various industries where income has been received in advance in line with a contract for which a taxpayer can

claim an allowance on future expenditure to be incurred in a subsequent year of assessment.

The general deduction formula as contained in section 11(*a*) read with section 23(*g*) allows for a deduction when the expenditure has been actually incurred. The Act does not define the meaning of 'actually incurred', however, the courts have used several descriptive words for interpretation. In ITC 969 (1961) 24 SATC 777 at 786, judge Bliss indicated that for an expenditure to be actually incurred, it has to be a definite and absolute liability. As the future expenditure does not meet the definition of actually incurred, section 24C allows these expenditures to be deducted. After the introduction of section 24C, taxpayers are faced with numerous audits and reviews on the application of the law. There are yet more tax cases (Tax Court cases and only recently, Supreme Court cases and two Constitutional Court cases) that seek to clarify section 24C requirements.

As per section 24C(3), IN 78 further states that an allowance deducted in any year of assessment is deemed to be income in the succeeding year of assessment. Annually the taxpayer has to assess the application of section 24C using the guidance under PART V of IN 78. There are many income tax issues on which the Act is silent and have not yet been resolved by the courts. To fill these gaps and to ensure the consistent treatment of similar cases, SARS has evolved a large number of departmental practices. Many of these practices are recorded in Interpretation Notes for the information of taxpayers and their advisers. These practices and Interpretation Notes do not have the force of law – indeed the Commissioner does not always assess taxpayers to tax in accordance with these Interpretation Notes (de Koker 2021). In ITC 1675 (1998) 62 SATC 219 at 229, judge Wunsh indicated that:

> '…it cannot always safely be assumed that the Commissioner will consider himself bound by his own practice notes…especially if the practice constitutes a departure from the provisions of the Act.'

Even though various academic literature and case laws are available on how to interpret section 24C, this research focuses on the challenges faced by the taxpayer in the application of the law and analyses various tax court cases up to volume 84 of the South African Tax Cases, as new judgments on this issue are delivered time and again. The provisions of section 24C are compared to the guidelines under IN 78 to identify any

shortcomings. The research concludes with any possible remedies available to simplify the cumbersome section 24C provisions.

2.2.6 The future expenditure will be incurred

As the taxpayer will not have actually incurred the expenditure when section 24C allowance is claimed the taxpayer has to please the Commissioner that the expenditure will be incurred in a subsequent year of assessment. In reference to IN 78 (2014:4), taxpayers need to determine that an amount will be spent in subsequent years otherwise show that an absolute legal liability to spend the income exist. At the time of introduction of IN 78, the words 'will be incurred' specified that the Commissioner had to be content that there is a high degree of likelihood and unavoidability that the expenditure will be expended. A taxpayer consequently must be able to establish that, even though the expenditure is conditional at the end of the year of assessment in question, there is still a high degree of inevitability that the expense will be incurred in the following year (IN 78, 2014:4). Referring to ITC 1601 (1995) 58 SATC 172 at 179, judge Van Niekerk explained this situation as follows:

> 'Counsel for the Commissioner, in my view, correctly contended that the Commissioner will not be satisfied that future expenditure will be incurred where there is only a contingent liability. There must be a clear measure of certainty as to whether the expenditure in contention is quantified or quantifiable. The onus that the appellant bears here is to satisfy the Commissioner that the agreements relied upon will lead to deductible expenditure, in the following year. The appellant's contention that the use of the word 'will' relates only to time and not to the certainty of the expense, cannot in my view be correct. Since a deduction is sought, this must arise from an obligation and must be quantifiable. It was also, in my opinion, correctly submitted that s 24C was not enacted to provide a deductible reserve fund for possible 'comebacks', unforeseen contingencies or latent defects in the res vendita. This would be contrary to the provisions of s 23(e) of the Act …
>
> ….S24C is an exception to the general rule and as such the court, having regard always to its specific ambit is entitled to take a strict rather than a liberal view in its application to the facts in issue. The Commissioner, provided he too has full regard to the available facts, is entitled to adopt the same approach in exercising his discretion.'

As it is not feasible to stipulate exact conditions in which a taxpayer will be able to establish and prove the mandatory level of inevitability as the facts and circumstances of each instance can differ. The level of certainty required is unlikely to be met if the

fulfilment is not 'contractually obligatory' but is only 'potentially contractually obligatory' due to an act or an event apart from the taxpayer's client or customer taking action (IN 78, 2014:4). With reference to Income Tax in South Africa, authors, Clegg and Stretch stated that:

> '…[I]t is submitted that there must be in existence of an enforceable and uncontingent obligation to perform under a contract, which performance will lead to the incurral of expenditure'.

When section 24C was introduced, the Commissioner needed to be content that the income received would be utilized to finance future expenditure. This requirement was repealed by section 42 of the Taxation Laws Amendment Act 25 of 2015 by removing the Commissioner's discretion. The taxpayer, however, is still required with reference to section 102 of the Tax Administration Act, 2011 to satisfy the Commissioner on application of section 24C as is further shown in Chapter 3 where a detailed review of the court cases as a result of various audits issued by SARS occurs.

2.3 The Commissioner's discretion

The Commissioner at the time of the introduction of section 24C had the discretion to determine if the provisions of section 24C have been conformed to and furthermore to determine, in respect of future expenditure, the amount deductible. Therefore, the burden of proof responsibility was with the taxpayer[2]. With reference to section 102(1)(b) of the Tax Administration Act, a taxpayer ought to substantiate to the Commissioner the amount of the future expenditure is associated with the income in advance received or accrued under the pertinent contract. IN 78 indicates further that the taxpayer is not expected to deposit the funds received into an isolated account and to only expend the resources from that specific bank account to pay for the future expenditure. The assumption is that any funds will be available to the taxpayer to pay for future expenditure.

[2] The allowance is normally determined by taking account of the taxpayer's anticipated gross profit to be derived under the contract. Where a taxpayer receives amounts in advance of rendering services to clients it cannot be assumed that the allowance equates the amount received. The Commissioner will require the taxpayer to submit a calculation of how the allowance was arrived at and may call for copies of the contract to ensure that the taxpayer falls into the strict confines found in section 24C (Legwaila, T., 2019:234).

In various instances [ITC 1667 (1999) 61 SATC 439; ITC 1697 (1999) 63 SATC 146 and ITC 1527 (1991) 54 SATC 227], the courts had concluded that:

> '…the future expenditure must be incurred by the taxpayer in the performance of the taxpayer's obligations under the same contract as the contract under which the income was received by or accrued to the taxpayer'.

The Commissioner ought to be content that a high degree of probability exists, and that the expenditure will be expended by the taxpayer. Even though the expenditure is conditional at the end of any year of assessment, there is a high degree of assurance that the expense with certainty will be spent in the following assessment year. The Taxation Laws Amendment Act, 2015 and the Tax Administration Laws Amendment Act, 2015 removed the Commissioner's discretionary powers. The taxpayer, however, still has the burden of proof to the Commissioner that the provisions of section 24C are adhered to as per section 102(1) of the Tax Administration Act, 2011. Nevertheless, this has consequently put the application of section 24C under more scrutiny with more reviews being issued and more court cases of recent being heard at the higher courts than the tax courts. This bears the question of whether section 24C is achieving its main purpose of giving taxpayers tax relief?

2.4. Reversal of the preceding year's section 24C allowance

In the subsequent year of assessment, section 24C(3) states that the allowance deducted under section 24C in the prior year of assessment will be considered to be an income received in advance by or accrued to the taxpayer. Therefore, an allowance deducted by a taxpayer under section 24C in one year of assessment ought to be counted into the taxpayer's income in the subsequent year. In reversing the prior year's section 24C allowance this can be treated as a deemed income received in relation to the contract. An additional allowance may consequently be permitted in relation to the reversal in the succeeding year of assessment only if, provided after the end of that succeeding year of assessment, there is still future expenditure which is to be expended.

Consequently, in evaluating whether an income received or accrued in a specific year under review is intended to be used to fund future expenditure, the income will consist of actual amounts under the contract which are included as income including the reversal of

the previous year's section 24C allowance. The deemed income is considered under section 24C(3) and paragraph (n) of the definition of the 'gross income'. De Koker (2021:8.60) argued that a significant relaxation of the above principles was foreshadowed in the 'Explanatory Memorandum on the Income Tax Bill, 1980' to cater for the situation in which the expenditure in question is not incurred in 'the following year' but in a later year. The Explanatory Memorandum indicated that, in such event, in the succeeding year of assessment '*a new reserve will, if necessary, be calculated for that year*'. Giving effect to this proposal may create some difficulty since the operation of the allowance depends on the receipt or accrual in the year of assessment for which the allowance is claimed of an amount of income.

Assume that *a taxpayer derives an amount of income, say, R1m in year 1 to cover associated expenditure in years 2 and 3; in these later years he will derive no further payments in advance. How, then, may he claim a further allowance in year 2 to set off against the inclusion of the allowance granted in year 1?* The answer lies, perhaps, in the provision deeming the allowance of one year to be income derived in successive years referring to section 24C(3). If this deemed inclusion in the income may be construed as an amount received or accrued in respect of any contract the problem is resolved and a 'fresh' allowance may be claimed. The wording of this provision must be more precise if this is the procedure that is meant to be adopted and the comments in the 'Memorandum' appear to indicate that it was indeed so intended. If it were not so intended, the allowance would provide inadequate relief whenever a payment in advance is intended to cover expenditure (or allowances, for example, on machinery or plant) that would ordinarily be deductible over a longer period than the succeeding year. This more variable interpretation is already maintained by the definition of the term 'future expenditure' in section 24C(1), which states that the deduction of expenditure in 'a' (not 'the next') succeeding year and to 'any deduction' relating to the acquisition of 'any asset'.

CHAPTER 3: THE JUDICIAL EFFECTS OF SECTION 24C

3.1 Overview

Chapter 3 examines various judgments in which the requirements of section 24C and the guidance provided by IN 78 have not been covered. These requirements include an existence of a connection between an income and future expenditure under the same contract as listed under parts 4.1.1 and 4.2.1(b) of IN 78. This chapter outlines the context of the South African tax cases with a review up to volume 84 of the court cases. In addition, this chapter examines the Tax Court cases on the meaning of a 'contract that is inextricably linked to the income received in advance' and the consequential burden the Supreme Court of Appeal and the Constitutional Court judgments might have to the taxpayers.

Prior to the introduction of IN 78, the challenges in the application and interpretation of section 24C were evident in various cases in the Tax Courts. As these courts have no legislative and judicial powers to be binding, they merely indicated the convolution of section 24C and a prerequisite to review the Act. As indicated by Professor de Koker, it is worth noting that in City Deep Ltd (1924:306), the Appellate Division held that the Tax Court (or, as it was then called, the Special Court) is not a court of law at all. It appears that the Tax Court can accurately be described as merely 'a court of revision with powers to investigate the matter before it and hear evidence thereon'[3]. When the provision was initially introduced, the Commissioner had the discretionary powers to decide when a taxpayer can apply for a section 24C allowance. This discretion was removed by section 25 of the Taxation Laws Amendment Act, 2015.

[3] The Tax Court's jurisdiction and powers are laid down in the Act. It is entirely a creature of statute; hence (unlike the High Court) it has no inherent jurisdiction and can decide only those matters specifically entrusted to it. Indeed, it is not a court of law, being merely competent to decide issues between the parties; its decisions do not constitute precedents which bind the Commissioner in other cases. Nor is it a court of appeal in the ordinary sense.

3.2 A specific obligation under a contract

3.2.1 Big G Restaurants (Pty) Limited v C:SARS [2020] JOL 47786 (CC)

3.2.1.1 Background

The applicant was a franchisee Big G Restaurants (Pty) Limited ('Big G') operating numerous Spur and Panarottis eateries in respect of various franchise agreements with Spur Group (Pty) Ltd ('the Spur Group'). The clause of the franchise agreements included, inter alia indicated that:

1. Big G undertook that continuously its core business will be the running of the stated restaurants
2. Big G was obliged to give payment monthly to the franchisor as regards to each of the restaurants operated a franchise and service fee
3. Big G was moreover obliged to renovate the restaurants in a timely fashion as set on by the Spur Group

A responsibility was thrust upon Big G as per the franchise agreements to offer meals to its customers (this constituted the main business in relation to the agreement) and earn an income from the sale of the meals. The restaurant could not be operated by Big G and consequently earn an income, other than adhering to the franchise agreements.

Big G had deducted section 24C allowance for the 2011 to 2014 years of assessment in relation to revamping its restaurant premises as per requirements of the franchise agreements. The reasoning was that the income from customers had to be used to some extent to pay for the unavoidable imminent revamping expenditure to be incurred to honour its responsibilities under the franchise agreements. The Commissioner had rejected the deduction and imposed a further assessment for the years in question. Big G lodged an appeal in the tax court.

3.2.1.2 Income Tax Court appeal (ITC 1905 (2017) 80 SATC 223)

The case was initially heard at the Western Cape Tax Court presided by Cloete J. The issue decided on the appeal arose from Commissioner's rejection of section 24C

allowance with regard to expenditure to be incurred for refurbishing as per the franchise agreements. The essence of the contention was either or not:

> '…income received by Big G on sales of meals to its customers can be regarded as arising directly from or accruing in terms of the franchise agreements itself; and whether a high degree of certainty that Big G will incur future expenditure in order to refurbish or upgrade its restaurants in compliance with its obligation under the franchise agreements.

Big G contended that it had satisfied the necessities of section 24C in that its income had been earned in terms of the agreements under which it was obliged to incur the future expenditure. Big G had furthermore contended that there was nothing hypothetical about the obligation under the franchise agreement obliging it to refurbish the restaurant. The phrases 'subject to endorsement by the franchisor of exhaustive plans and requirements' were nothing further than giving the Spur Group complete control.

The Commissioner contended that as per the criterion of section 24C(2), it was a complete requirement that 'a contract' must occur from which the income is earned, and the obligation arose to incur future expenditure. The Commissioner further submitted that in the current situation, a franchise agreement existed that created an entitlement for the appellant to launch and operate the restaurants under the franchise agreement and the subsequent contract for the daily sales of meals to customers. It thus submitted that these were separate contracts which were lawfully autonomous and distinct from each other.

Judge Cloete held that:

1. The contract, not in any way must specify the precise expenditure that the taxpayer will incur. The taxpayer's obligations under the contract must be apparent or determinable and it is the expenditure that the taxpayer will incur in performing and meeting those obligations which are of relevance
2. Should Big G fail to sell meals to its patrons constituted a substantial breach of the agreement and the franchisor could cancel the contract
3. That the sales of meals to customers were therefore not part of the transaction, however, an element of responsibility essential to the same agreement of which the obligation to incur future expenditure was obligatory
4. With reference to ITC 1667, Blignault J noted that the rental and maintenance agreements constituted one single contract for the application of section 24C.

There was no requirement to have a single contract document to meet the requirements of section 24C

5. The court was not convinced that the phrases ‘subject to’ on the agreement lead to only a conditional obligation enforced in relation to incurring the future expenditure. A presence of an obligation that is unconditional cannot be reduced to conditional in which that obligation was to be accomplished.

The appeal was allowed on the basis that the fulfilment of the principal responsibility carried a high degree of probability and inevitability.

3.2.1.3 Supreme Court of Appeal review (C:SARS v Big G Restaurants (Pty) Ltd (2019 (3) SA 90 (SCA)) 81 SATC 185)

The Commissioner had appealed at the Supreme Court the decision of the tax court. The court was requested to determine if the income received by Big G from the eateries had accrued in connection with the franchise agreements; and if the expenditure to refurbish the restaurants in the future was in carrying out Big G’s obligations under the franchise agreements as intended by section 24C.

On review of the party’s contention, the Supreme Court concluded that:

1. Section 24C(2) requirements were that there must be an income received or accrued in relation to a contract, furthermore, the Commissioner must be content that the income will be applied entirely or in part to fund the future expenditure that a taxpayer will expend delivering the same contract obligations
2. Applying the precise meaning of in terms of, Big G had not received any income from the franchise agreement but earned its income from its patron’s sale contract
3. The franchise agreements and the patron contract were not inextricably linked
4. The reality that an agreement is essential to allow a taxpayer to generate an income, it does not imply that the taxpayer receives the income ‘in terms of’ that contract

With reference to the judgment in ITC 1667, the court had held that section 24C(2) requires Big G to incur the expenditure in the delivery of its contract requirements in

relation to the same contract as the contract under which the income was generated. The appeal was upheld, and the decision of the Tax Court was then set aside.

3.2.1.4 Constitutional court review

The issue under review at the Constitutional Court was whether the income generated from customers of some franchise restaurants could be deducted in terms of section 24C subsection 2 or not. Big G had sought leave from the Constitutional Court to contend against the Supreme Court's decision. Big G contended that the overall fundamentals of clarification require an exhaustive exercise of analysis and should make business sense. Big G further submitted that the interpretation it suggested is the sole interpretation that has a commercial perspective and is in line with the tone of section 24C subsection 2 and does not disrupt the intention of section 24C.

The Constitutional Court's understanding of section 24C was that the agreement of which the income is generated to fund future spending ought to be an identical contract in which the expenditure was going to be incurred. It was acknowledged that multiple contracts may be so intertwined that they may satisfy the prerequisite. It, therefore, had to be determined whether the franchise agreements and contracts of sale of meals to the patrons were so intertwined as to fall within the ambit of section 24C. The court was not content that Big G had been able to place the contracts in terms of which it earned an income from its customers within the ambit of the income-earning contract intended under section 24C(2). The obligations to Big G were imposed by the franchise contract not the contract in relation to offering meals to its patrons. That absence of connection between the revenue-generating contracts and the obligation-imposing contracts simply made section 24C(2) irrelevant and not applicable.

The appeal by Big G was thus dismissed and the court found in favour of the Commissioner.

3.2.2 Clicks Retailers (Pty) Limited v C:SARS (2021) ZACC 11

3.2.2.1 Background

The applicant had owned and operated the Clicks retail business which entailed selling merchandise under various categories nationwide. The applicant conducted a loyalty

programme and granted points to its customers on the presentation of a Clicks ClubCard ('loyalty card') when making purchases. A customer had to put on an application to join the loyalty programme and once granted, a Clicks loyalty card was supplied to the member. This agreement was referred to as 'a loyalty card contract'. In terms of the loyalty card contract, a customer earned loyalty points when purchases were above a specified amount at any of the Clicks retail outlets upon presentation of the loyalty card.

Clicks included in its gross income for tax purposes amounts to cover potential discounts on the card had claimed a section 24C based on the valuation of the loyalty card points that the applicant had anticipated to convert into reduced purchases in future was claimed. The Commissioner had disallowed the deduction and issued a further assessment of which Clicks lodged an appeal in the Cape Town Tax Court.

3.2.2.2 Income Tax Court appeal (ITC 1915 (2018) 81 SATC 214)

The case was heard by judge Nuku in the Cape Town Tax Court. The Commissioner had contended that section 24C only permitted an allowance when an income and the obligation to perform arose from the same contract. Clicks had lodged an appeal against the disallowance of the objection in the Tax Court contending that given the close and inextricable connection between the initial purchase and sale contract entered into in relation to the loyalty card contract, these cannot be treated as a completely isolated contract from the loyalty card contract.

Judge Nuku indicated that:

> '…the interpretation given by the courts to the provisions of section 24C is that for any allowance to qualify for the deduction, the income must have been earned under the same contract as that from which the obligation to incur future expenditure arose.'

Nuku J referred to three judgments from Tax Courts where section 24C allowance was of contention, ITC 1667 (1999) 61 SATC 439; ITC 1697 (1999) 63 SATC 146 and in ITC 1890 (2016) 79 SATC 62. Judge Nuku specified that whilst there is consensus in the above-mentioned court cases, however, in ITC 1905 judge Cloete upheld the taxpayer's appeal in circumstances where the income was not earned from the same contract with the obligation to incur future expenditure. Cloete J approached the matter on the foundation that the agreement which initiated the responsibility to expend future

expenditure was a necessary reason in absence of which the applicant could not generate the income even though the income was earned under unalike contracts. The court consequently established that there is an inextricable link between the income from the contracts earned and the agreement with the obligation to pay for future expenditure.

In conclusion, Nuku J stated that the appeal will succeed.

3.2.2.3 Supreme Court of Appeal review

The Commissioner appealed in the Supreme Court stating that the deduction was properly disallowed due to the contract of purchase and sale being distinct from the loyalty card agreement. The loyalty card agreement by its very nature did not generate any earnings for Clicks as it was issued with no charge and no concealed charges to members. The requirement of Clicks to award loyalty points in relation to qualifying sales and to issue vouchers was a result of the loyalty card contract. Clicks was expected to incur future expenditure when a member redeems a voucher and supplied the member with goods to the value of the voucher at no charge. The obligation was under the loyalty card contract, which was unlike the contract from the purchase and sale of which the income was received.

The right to receive and income by Clicks is inconsequence from the initial contract of sale and the loyalty card contract is the one that Clicks has an obligation to honour the vouchers and thereby incur expenditure. Therefore, the expenditure incurred by Clicks to honour the vouchers did not come about in terms of the same contract, but in terms of an isolated loyalty card contract. Missing the loyalty card contract, a patron receives no right to earn points and thereafter vouchers hence Clicks has no obligation to fulfil.

The Supreme court held that the argument presented by the Commissioner ignored the true nature of the arrangement where three contracts are effective, the first and second contracts of sale and the loyalty card contract. In order for the customer to obtain vouchers and for Clicks to earn an income with the obligation to award vouchers and supply merchandise to the customer in return, all three contracts are mandatory. Consequently, the income received and the future expense to be deducted is not from the same contract and the Commissioner correctly refused to section 24C allowance. The order of the Tax Court was set aside and the appeal at the Supreme Court of Appeal was upheld.

3.2.2.4 Constitutional court review

After the Commissioner's successful appeal on the Supreme Court of Appeal, Clicks approached the Constitutional Court to determine whether it can deduct section 24C allowance in relation to the income earned from its loyalty programme. Subsequent to the Constitutional Court decision in Big G section 24C allowance might be claimed when identical contract requirements exist or when the income and the obligation to finance expenditure arise from more than one contract that is so inextricably linked that they meet the requirement of 'sameness'. Clicks had contended that it could claim a section 24C allowance on a same contract basis or a sameness basis with reliance on the contract of sale as the income-producing-contract. To establish whether Clicks could claim a section 24C allowance, attention must be given to the sale contracts entered into with a patron that presents their loyalty card at the point of sale. Sales contracts may be entered with customers who are not loyalty programme members, or with loyalty programme members who do not present their loyalty card at checkout, and Clicks does not claim section 24C allowance in respect of income earned under those sale contracts.

With the Constitutional Court decision in Big G, a taxpayer can claim a section 24C allowance even if the income and the related obligation to finance future expenditure are generated by different intertwined contracts, as long as those contracts meet the requirement of 'sameness'.

Clicks sought to prove that the contracts function together in producing its income and in generating its obligation to finance future expenditure. Clicks highlighted that the issuing of the loyalty card contract on its own did not create any responsibilities and the responsibility to offer points is only activated. This would create a connection between the 'income generating contract' and 'obligation imposing contract'.

The Commissioner, however, submitted that 'inextricably linked' would mean unable of being separated. Should the loyalty card contract and the sale contract can be detached, they are not inextricably linked. On page 1116 2021 (10) BCLR 1102 (CC) the Commissioner contended that:

> '…a loyalty programme member can buy products at Clicks without presenting her loyalty card (and thus without earning loyalty points), and a person can become a loyalty programme member

without making any qualifying purchases (again, without earning any loyalty points), each of the two contracts can stand on their own'.

The contract of sale and the loyalty card contract are merely isolated from each other to be considered for the sameness requirement. Even though they might function together within a framework of a loyalty programme the connection is insufficient to regard the contracts the same for the determination of section 24C. The contracts, therefore, fall short of the sameness that is required by section 24C. Clicks could not claim section 24C allowance on the 'sameness' basis and the appeal by Clicks was unsuccessful.

3.2.3 ITC 1697 (1999) 63 SATC 146

The case was heard at the Natal Special Court presided by Galgut J. The taxpayer operated a share block company and offered membership to a timeshare scheme. The taxpayer collected a levy from each member in order to meet the running costs of the scheme. The taxpayer, however, earned interest on the levies invested and the investment income was not exempt by the express wording of para (e). A 'Use Agreement' was part of the Sale Agreement whereby each member acquired a share block. With regard to the Use Agreement, the shareholders were expected to pay their levies, and the taxpayer incurred the concerned future expenditure on fulfilling its obligations. The Use Agreement provided in one of the clauses for the directors to make levies upon members in such amounts as are 'in their opinion' sufficient for the necessary administration and maintenance. The Use Agreement provided further that 'the directors shall estimate the amount' required by the taxpayer to meet the aforesaid expenses during each operational year, and 'may' include in such levies an amount to be held in reserve to meet any anticipated future expenditure, not of an annual nature.

The taxpayer had applied the provisions of section 24C for the running costs of the scheme and claimed a deduction. The Commissioner had contended that the taxpayer was not entitled to section 24C allowance due to the structure or terms of the 'Use Agreement' between the taxpayer and each individual member of the scheme. The obligation did not arise from the Use Agreement as the incurring of the future expenditure was left entirely to the discretion of the taxpayer's directors. He further contended that the Use Agreement did not enable him to make a reasonable estimate of the quantum of the future expenditure. This submission suggested that, for the allowance to be available, it was

necessary that the amount of the individual items of expenditure must be apparent from the Use Agreement.

Judge Galgut addressed the Commissioner's contention by stating that the individual members are not obliged to install fittings and preserve their own units. It is the taxpayer who bears that obligation, and in fulfilling it, the taxpayer does so uniformly. The Use Agreement in this case is an ongoing contract, but there is no difference in principle because the Use Agreement simply creates a set of rights and obligations that arise each and every year. In terms of the agreement, each member is obliged to pay his levy to the taxpayer annually. In return, the taxpayer must fulfil its obligation to administer the scheme and maintain the taxpayer's fixed and movable property. By its very nature, this obligation requires the taxpayer to provide for whatever becomes necessary in the future.

The subject of this case is the future necessities to only be attended in the later tax year. The discretion of the directors takes nothing away from the fact that it is in the Use Agreement that the taxpayer's obligations are contained, and the taxpayer undertakes to fulfil those obligations. It is therefore not as if the directors would be entitled, in their discretion, to ignore attending to future items that are or will become necessary. If the taxpayer fails to provide for any item of administration or maintenance that is reasonably necessary, a member affected thereby, relying on the Use Agreement, will have every right to approach a court for an order compelling the taxpayer to fulfil its obligations. The Commissioner's first submission must therefore fail.

The Commissioner's second submission was that the Use Agreement does not enable him to make a sensible estimation of the quantity of the future expenditure. This submission suggests that, for the allowance to be available, it is necessary that the amount of the individual items of expenditure must be apparent from the Use Agreement.

Judge Galgut cited ITC 1601 (1995) 58 SATC 172 at 179 that there must be *'. . . a clear measure of certainty as to whether the expenditure in contention is quantified or quantifiable'*. It was held that such claims because they might never arise, were purely contingent, and therefore not allowable. In the current case, the evidence establishes that not only the appellant's obligation for future expenditure is absolute, but moreover, in each case the amount concerned is certain. In any event, as was said in Edgars Stores

Limited v Commissioner for Inland Revenue 1988 (3) SA 876 (A) at 889DG (50 SATC 81 at 90), in this sort of situation the quantum concerned should be fixed on the basis of a fair and reasonable estimate. Judge Galgut concluded the review by addressing that the Commissioner's representative failed to recognise that it was the Use Agreement that was the contract relevant to section 24C. In short, she failed to apply the relevant statutory requirement and thereby failed to apply her mind properly to the question.

In conclusion, Galgut J indicated that both the review and the appeal by the taxpayer must therefore succeed, and the matters will have to be referred back to the Commissioner for reassessment.

3.3 Timing issue on receipt of an income and actually incurred expenditure

3.3.1 ITC 1660 (1999) 61 SATC 249

The case was heard at the Gauteng Special Court presided by President, Kirk-Cohen J. The appellants were three taxpayers who owned a portion of a property that was part of a private game reserve. All three appellants operated as a unit known as B and their properties were adjoining as per the evidence submitted. The appellants had similar memoranda and articles of association and one board of directors. All three appellants have erected chalets on their properties and their shareholders are entitled to timeshare facilities in those chalets. The shareholders paid levies (and at times additional special levies) to the appellants for the operation, upkeep, and improvement of all the facilities. The three appellants jointly operated two banking accounts, a current account, and a call account with the same bank. All monies received and which were not required at any given time were transferred to the call account upon which the appellants received investment interest from their banker. It was this investment interest which was the issue before the court.

The appellant's board of directors drew up budgets by estimating the total expenditure for each year. The estimated accrued interest is calculated and subtracted from the estimated expenditure and the balance of the expenditure is then raised by way of annual levies. The board of directors were obliged to maintain and repair, inter alia, the chalets and keep

their contents in good condition and from time-to-time items had to be renovated or replaced. The board of directors had adopted a long-term refurbishment policy when determining the levies payable. The policy was to refurbish without disruption to the shareholders and moreover without substantial once-off special levies for this purpose. With the new approach, it was possible to budget in advance the requirements of the appellants far more accurately and it resulted in continuous upgrading of all facilities. Appellants submitted that the shareholders were therefore contributing on an ongoing basis to future expenditure and upkeep determined in the annual budgets. Appellants contended that, in regard to the interest income, they were entitled to relief in terms of s 10(1)(e) and/or section 24C of the Act.

It was common cause that the appellants were companies referred to in section 10(1)(e) of the Act. Appellants contended, relying on section 10(1)(e) of the Act, that the interest received had been received from transactions with or on behalf of the members and for the direct benefit of the individual members and was therefore exempt from tax. Alternatively, they contended that the interest received was taxable in terms of section 10(1)(e) but expenses, both in regard to levy income and investment income, should be allowed as deductions against the interest income, apportioned in the ratio of the interest income to the total income.

Section 10(1)(e) contains an exemption from tax but there is an exclusion from that exemption, the exclusion being profits or gains from investments. Appellants contended that any interest received from transactions with or on behalf of the members for the direct benefit of the members was exempt from tax. Subsection (e) exempts from tax *'. . . the receipts and accruals . . . the profits or gains of which . . . are derived solely from transactions with or on behalf of its individual members*'. Excluded from the exemption are 'profits or gains from investments' accruing to the company. Appellants additionally contended that, in terms of section 24C of the Act, they were entitled to an allowance as therein provided.

Appellants contended that the investment income was money received for the refurbishment of chalets and their contents and the contract in question was one between the taxpayers and their respective shareholders in terms of which they have undertaken to execute the refurbishment.

The tax court held that there was no link between the interest received and the maintenance of the property:

1. The interest obtained from the call account cannot be categorised as earmarked money or money paid to the appellants for the purpose of carrying out the refurbishments.
2. The manner of investment as described by the appellants fell short of a contract as was envisaged in section 24C;
3. Additionally, it had not been shown that the interest received in any one year would of necessity be used in fulfilling a refurbishment contract with shareholders in the future.

That, the taxpayers had not made a case entitling them to rely upon the provisions of section 24C and their appeal was refused.

3.3.2 ITC 1890 (2016) 79 SATC 62

The case was heard at the Cape Town Tax Court presided by Boqwana J. The issue for consideration was whether the appellant was entitled to claim a deductible allowance for future expenditure in terms of section 24C for its 2011 year of assessment. The appellant was a private company managing retirement villages acquired by means of an amalgamation transaction. The appellant was a party to a deed of sale in terms of which some units in the village were sold from a current resident owner ('the seller') to a new owner ('the purchaser'). The appellant earned a return when a sale was concluded, an amount equivalent to 40% of the enhancement value of the unit ('the enhancement'). In addition, the appellant was obliged contractually to incur future expenditure on behalf of the new owner.

The deed of sale provided that the resident owner pays a levy to the appellant, out of which the appellant undertook to pay to the body corporate a monthly subsidy towards certain expenses incurred by the owner. The attainment of the unit was referred to as a first contract and thereafter, disposal of the unit was regarded as a second contract. The terms of the first agreement made it a condition that the second contract will be in effect on similar terms as the first contract. The appellant contended that it had accepted an obligation to pay the monthly levies to the body corporate for the benefit of the new owner

in terms of section 24C and claimed an allowance in respect of its 2011 year of assessment.

Commissioner subsequently audited the appellant in 2014 and informed the appellant that the section 24C allowance had been erroneously claimed. The Commissioner indicated that the provisions of section 24C were not applicable to the appellant's income as the enhancement had accrued in terms of the initial contract. The obligation had been discharged when the unit was sold, and the amount was paid by the seller and not by the purchaser. There were no future expenditures that had to be incurred by the taxpayer which were in relation to the enhancement income received when the unit was sold because the seller would have left, and the obligations had been discharged. The enhancement income was not an income in relation to future expenditure to be incurred as per section 24C. Lastly, section 24C was not applicable and the appellant was not eligible for section 24C allowance against the enhancement.

The appellant contended that it had acted on tax advice received and that its section 24C claims had been allowed by the Commissioner previously and was certain that the basis upon which it had claimed the allowances was accurate

Judge Boqwana, on review, held that:

> '…there were two contracts under consideration in this matter; the first contract was one between the original seller and first purchaser ('owner 1/resident owner') and the second contract was between the resident owner, subsequent purchaser and the appellant ('the purchaser/new owner'). These two agreements are incorporated in one deed of sale for purposes of tax despite them being two separate agreements. The appellant could never receive the enhancement amount until another deed of sale was concluded.'
>
> '…it was in terms of the second contract that levies were expended by the appellant on behalf of the purchaser and that occurred only after the income had been received'.

With reference to ITC 1697 63 SATC 146 at 158, judge Boqwana indicated that for the allowance to be available in terms of section 24C, *'it must be in terms of the very contract in respect of which the income is received that the future expenditure is payable'*. The only connection that arose between the two contracts was the conclusion of the second contract activated the terms of which the enhancement value was payable by the seller.

The second contract which had the effect of activating a consequence in the first contract could not mean that the two agreements were 'inextricably linked'. Despite the link between the two agreements, it should fulfil the requirements of section 24C being the connection between the income received and the obligation to finance future expenditure. The only link that can be shown in this case is the triggering of the payment of the enhancement value undertaken in the first contract, at the sale of the unit and nothing more.

The court found that the taxpayer was not permitted to deduct section 24C allowance and that the contract being evaluated must contain both income and the obligation of future expenses.

3.3.3 ITC 1918 (2019) 81 SATC 267

The case was heard at the Cape Town Tax Court presided by Binns-Ward J. Appellant had carried on a business as a retailer of clothing. As part of the facilities offered to its customers, gift cards were sold that could be exchanged for goods at any of its stores. The taxpayer had argued that the amount from the 'sale' of the gift cards was not an initiation of a contract *per se*. The customer was making a prepayment in respect of the supply by the taxpayer of unknown goods when the gift card is used at a later stage by the bearer of the gift card. The bearer was then eligible for the benefit of the prepayment *in the place of* payment of the whole or part of the purchase price. The income from the sale of the gift cards all or part of that amount appears to have been kept aside until a bearer of the card redeems or the card expires. The taxpayer did not request identification to verify that the sale of the gift card was concluded with the same customer that redeems the card. As section 24C(2) requires existence of a contract, in this instance, parties to the initial agreement – the sale of the gift card – cannot be identified at the time of sale nor when the card is redeemed. Should the card not be redeemed by the stated expiry date, the taxpayer would then only recognise the amount as part of its 'gross income'.

The Commissioner argued that the taxpayer's receipt of the proceeds of the 'sale' of gift cards was delayed pending the redemption or expiry of the card, whichever occurred later. The Commissioner furthermore contended that the facts presented that the appellant had become the owner of the moneys received for the gift cards when the moneys were

included with its other receipts. Subsequently segregating the funds to comply with the provisions of the Consumer Protection Act ('the CPA'). The CPA required the appellant to take hold of the receipts for the card bearers and to refrain from applying them as if they were its own property, and the appellant was forbidden from receiving the monies taken in for gift cards for itself until the cards were redeemed and this meant that the gift card receipts were 'received' by the appellant not for itself, however, to be held for the card bearer.

Judge Binns-Ward's decision concluded that it was clear that the transactions in terms of which the taxpayer's customers acquired the gift cards were actually not contracts of sale. A sale in the true sense only took place when the card was presented in partial or complete redemption of the purchase price of goods selected by the customer who was the bearer of the card at the time. The judge held accordingly that the receipts in question constituted 'gross income' for the purposes of the Act only when the gift card was redeemed, or having not been redeemed, had expired. Consequently, the court upheld the appeal and the additional assessment raised by the Commissioner was set aside.

3.4 Binding Private Rulings ('BPR') to the application of section 24C

A BPR is issued by the SARS responding to a certain anticipated matter. The ruling clarifies how the Commissioner intends to illuminate, clarify, and apply the requirements of the tax laws with reference to the identified transaction. The ruling is only obligatory to a specific dealing and typically only in force for a definite period.

3.4.1 BPR 006: The application of section 24C in the context of a repair and maintenance contract

The ruling under BPR 006 was only relevant to a repair and maintenance contract entered into after 31 May 2007. The applicant manufactured items that required repair and maintenance. A contract was entered with customers with regard to the repair and maintenance of each item. The provisions of the contract included services to be distributed by the taxpayer in relation to the repair and maintenance selection chosen by its customer. The agreement further provided that the service was not a warranty but covered recognized and expected repair and/or maintenance costs of the said items that need repairs and maintenance for the agreed price paid monthly. The monthly fee was

determined based on the estimated costs of the repairs that the taxpayer was compelled to execute in proportion to the asset in relation to the agreement. According to the ruling, the applicant was eligible to claim section 24C with regard to the charges accumulating under the agreements to be concluded with its customers. It is interesting to note that no distinction was made by the Commissioner between contingent maintenance costs and unconditional maintenance costs (Calitz, 2015:82).

3.4.2 BPR 106: Application of section 24C to a maintenance trust

The BPR was issued in March 2011 and is valid for a specified period from the date of issue. The description of the anticipated transaction was as follows:

> 'Company A intends to operate a private cemetery on land that it will lease from a third party. Applicant was a Trust setup as a vehicle to carry out the maintenance and upkeep of the burial grounds over the period of its existence. Company A will enter into burial agreements with its clients in terms of which they will acquire the right to be buried or to have their ashes scattered on the burial grounds (final resting right). An amount will be payable to company A for the final resting right service and another amount will be paid to the Applicant for the maintenance of the burial grounds. In terms of the burial agreements, the applicant will assume the maintenance liability of the burial grounds in perpetuity. The applicant will receive the maintenance fee directly from the clients of Company A and will incur the maintenance costs as and when required'.

Consequently, should some of the responsibilities to accomplish a taxpayer's duties under an agreement are dependent upon the occurrence of an indefinite event, section 24C will not be available for the impending expenditure (Calitz, 2015).

3.5 The judicial summary and discussion

3.5.1 Summary of the cases and core findings

C:SARS v Big G Restaurants (Pty) Ltd (2019 (3) SA 90 (SCA)) 81 SATC 185, [2018] JOL 40625 (SCA)

At the Supreme Court, Big G's justification for the application of section 24C was disallowed on the reasoning that their receipts were earned in consequence of the contracts concluded with its customers and the income did not arise in terms of the agreements with the franchisor. To be entitled to section 24C allowance, the Big G's

income must be received from a similar contract as the responsibilities arose. The notion that the income and obligations must arise from the same contract, indicates an implication that section 24C was envisioned to have a bearing in situations where an income is received in relation to a contract prior to the expenditure being incurred under the same contract. The Supreme Court further refused Big G's line of reasoning that the franchise agreement and the contracts with its customers were both interlinked. As per the court, section 24C required Big G to incur expenditure in the performance of its obligations in terms of the same contract under which income is received compelling the concept of 'sameness'.

Big G Restaurants (Pty) Limited v C:SARS 82 SATC 403 (CC), (2020) JOL 47786 (CC), (2020) ZACC 16 (CC), 2020 (11) BCLR 1297 (CC), 2020 (6) SA 1 (CC)

The Constitutional Court concluded that the issue required an understanding of the relevant contracts to ascertain if the contracts were intertwined to fall into the realm of section 24C(2). Big G representative had argued that the innumerable contracts related to the sale of meals can be regarded as a portion of the franchise contract. Consequently, the income generated from the sale of meals to its patrons (with the transactions being regarded as oral contracts concluded) is an income earned in relation to the same franchise contract. Big G relied on the judgment in ITC 1905 presided by Cloete J where the court had concluded that the franchisee had an obligation as per the franchise agreement to sell food and consequently the income earned from the sale of the meals was the result of the agreement.

In accordance with the Constitutional Court's view the agreement in which the income is received must be an identical agreement that enforces the responsibilities. This will then establish a 'sameness' requirement. The Constitutional Court had not read the 'sameness' prerequisite in section 24C to imply that there must be a singular contract specifying the receiving of the advance income and the imposition of future expenditure. Multiple contracts may be so inextricably linked that they may satisfy the sameness requirement.
The Constitutional Court was moreover unsatisfied that Big G was capable to put the contracts in terms of which the taxpayer earns an income from its clients within the realm of the income-earning contract as envisioned under section 24C. Moreover, the obligations that Big G must perform are imposed, not by the sale of food contracts, but

by the franchise agreements. This deficiency of correlation between the income-earning contracts and obligation-imposing contracts plainly made section 24C inapplicable. Furthermore, according to the Constitutional Court, Big G was not without recourse as it would be entitled to a deduction in terms of section 11 of the Act. It is just that it will not be able to make an upfront deduction under section 24C.

C:SARS v Clicks Retailers (Pty) Ltd (2020 (2) SA 72 (SCA)) 82 SATC 167

The Supreme Court of Appeal, however, held that is the loyalty card contract between Clicks and the customer that established the right in terms of which the customer would receive points and thereafter vouchers that would be redeemable against subsequent purchases. The Supreme Court of Appeal further rejected the notion that section 24C applies to situations where there are different contracts at play that are all inextricably linked. In this regard, the Supreme Court of Appeal was of the view that the fact that the loyalty programme could not function without the link between qualifying sales and the loyalty card contract was of no consequence. The Supreme Court of Appeal further rejected Click's contention that it was the loyalty card contract together with the qualifying purchase that gave rise to income and thereby qualified the sale for the allowance provided by section 24C.

The Supreme Court of Appeal reasoned that the income that would be derived through such sales would be used to finance the acquisition of further stock for future sales; the expenditure would then be incurred in performing Clicks' obligations under the loyalty card agreement and sales subject to redeemed vouchers. Accordingly, the contract giving rise to the income was the qualifying purchase and the contract incurring expenditure was the loyalty card contract, and consequently, the contract giving rise to the expenditure incurred in redeeming the vouchers would not arise out of a similar contract. The Supreme Court of Appeal accordingly rejected Click's contention that the relevant relationship between the patron and Clicks could be reduced to a sole contractual relationship. Instead, three distinct contracts existed: the initial qualifying purchase; the sale contract in which vouchers are redeemed; and the loyalty card contract. All three contracts are required for customers to earn and receive vouchers and for Clicks to earn income and incur obligations in terms of the loyalty card programme. For this reason, the appeal was upheld, and the Tax Court's decision was overturned. The Supreme Court of Appeal

found that the right to the income and the obligation under the loyalty programme arose in terms of two separate contracts, the income in terms of a contract of sale and the obligations under a separate contract regulating the loyalty programme. The fact that the two contracts were inextricably linked was regarded as irrelevant. Accordingly, the court concluded that the taxpayer was not entitled to the section 24C deduction. De Koker (2021:8.60) indicated that the Supreme Court of Appeal summed up the proper interpretation of section 24C as:

> 'The interpretation of s 24C is straightforward. First, it requires the conclusion of a contract under which revenue is received by the taxpayer. Second, it requires the taxpayer to undertake obligations under that contract to be performed in the following tax year. Third, the performance of those obligations must oblige the taxpayer to incur expenditure in the future. Fourth, the revenue received from the contract must be used to finance the performance of the taxpayer's obligations under the contract.'

Clicks Retailers (Pty) Limited v C:SARS (2021) ZACC 11

Consistent with the principles that had been established in the Big G case and the finding of the Click Supreme Court of Appeal case, the Constitutional Court determined that the contract under which income accrues (the contract of sale) and the contract under which the obligation to finance future expenditure arises (the loyalty card contract) are simply too independent of each other to meet the requirement of 'contractual sameness'. Whilst they may operate together within the context of the loyalty programme, and in that sense are inextricably linked or connected, this link is not sufficient to render the contracts the same for the purposes of section 24C. The contracts, therefore, fall short of the sameness that is required by section 24C of the Tax Act and the appeal by Clicks was unsuccessful.

ITC 1527 (1991) 54 SATC 227

The applicant was a furniture vendor on instalment sale agreements and following this had incurred expenditure in fulfilling the obligations under the Usury Act 73 of 1968. The tax court had concluded that the expenditure to be incurred in the future was not expended under the agreement under which the income arose. The case confirmed a link between the expending of an expenditure and the obligation to perform under a contract in order for section 24C to apply. In its crux, the future expenditure is essential to be disbursed by the taxpayer in carrying out the taxpayer's obligations under the same contract as the

contract in which the income was received by or accrued to the taxpayer. In *Silke on South African Income Tax* commentary, de Koker on section 8.60 noted that the judgment in Big G Constitutional Court where it says that numerous contracts might be so inseparably connected as to result in the future expenditure falling in the realm of section 24C. Although the word 'inextricable' does not admit of degrees of comparison, it appears from the utilisation of the word 'may' that in some circumstances where the connection amongst the income and the future expenditure is indeed 'inextricable', the expenditure may nonetheless not be allowed under section 24C. The court showed that the agreement ought to specify a responsibility and the performance thereof must connect to the incurral of the future expenditure. The applicant shall not allocate extensive overhead costs to section 24C allowance except where an absolute link exists. In the non-existence of this absolute connection, it will be uncertain that future expenditure will be expended by the applicant in the fulfilment of the responsibilities under the agreement contract.

ITC 1601 (1995) 58 SATC 172

The prominent details of the case were that the appellant supplied computers and measuring instruments. The taxpayer provided the services of programming and setting up the hardware and instruments to the clients' requirements. The contracts with the clients contained a warranty against defective workmanship and materials supplied. In addition, all manufactured goods contained a manufacturer's warranty. A warranty claim arose on almost all contracts because of the technical nature of the work. The taxpayer's claim for an allowance for future expenditure was disallowed by the Commissioner. The court held that in considering the facts before him, the Commissioner was entitled to conclude that he was not satisfied that future expenditure would be incurred and that he could not be satisfied that future expenditure will be incurred when a contingent liability is recoverable or partly recoverable under a guarantee.

ITC 1660 (1999) 61 SATC 249

The appellant owned a portion of a property that was part of a private game reserve and shareholders paid levies for the operation, upkeep, and improvement of all the facilities. The levies paid by the shareholders were invested and interest was earned accordingly. The appellant contended that the investment income was money received for the

refurbishment of chalets and their contents and the contract in question was one between the taxpayers and their respective shareholders in terms of which they have undertaken to fulfil the refurbishment. The tax court held that there was no link between the interest received and maintenance of the property and was not an advance payment in terms of an agreement as envisaged by section 24C.

ITC 1667 (1999) 61 SATC 439

The appellant had entered rental and maintenance contracts (of which the court had assumed were one contract) under which the customer agreed to rent copy machines for an agreed monthly rental and the taxpayer agreed to maintain the copy machines. Subsequently, the taxpayer entered into a discounting agreement under which it ceded its rights to the future rental income in return for an up-front lump sum. The court held that the rental and maintenance agreements were legally independent and separate from the discounting agreement. The taxpayer was therefore not entitled to a section 24C allowance as the performance of the taxpayer's obligations (that is, maintaining the copy machines) was not under the same contract under which the lump sum income was received. The income must be received by or accrued to the taxpayer in terms of the same contract from which the obligation to perform arises.

ITC 1697 (1999) 63 SATC 146

An appellant earned a levy from shareholders that held shares in its Share-Block company. As per the Usage Agreement, the appellant was expected to fulfil specific responsibilities. The responsibilities among others comprised attending to the restoration, management, and admin duties of the company. The court had established that the applicable contract for section 24C was the Usage Agreement of which the levies were received, and the obligations were attended to. This agreement was different to the contracts that the appellant would have concluded with the providers of supplies to perform under the Usage Agreement. This was confirmed by de Koker (2021:8.60):

> '…the Tax Court that (as is explicit in the words of the statute) the income and the future expenditure envisaged in s 24C must arise from the same contract and it was further held that it does not suffice that a second contract served as a mere trigger for that expenditure.'

ITC 1739 (2002) 65 SATC 43

An appellant produced some parts sold to Original Equipment Manufacturers (OEMs) that produced and supplied vehicles to distributors and dealerships. These motor vehicles were disposed to customers with warranty contracts. In the occurrence of a warranty claim, the appellant would provide the relevant parts required and the dealer would then perform the required service and/or repairs. The tax court held that the appellant was not eligible to deduct section 24C allowance for the future cost of the parts that it may be compelled to make available under the warranty requirement. The costs associated with producing the parts did not represent future costs, it amounted to losses already expended when its trading stock was used to replace the defective parts. The court contended further that in terms of section 24C, the amount of expenditure (different from losses) will be incurred, and that the income received in advance is intended to be utilized in entirety or in portion to fund future expenditure to be incurred by the taxpayer in the delivery of obligations under an agreement had to assure the Commissioner.

ITC 1890 (2016) 79 SATC 62

The appellant was a private company managing retirement community centres and a party to a deed of sale in terms of which units in the village were sold and transferred from the seller to the purchaser. There were two contracts in which a person acquired a unit and one in terms in which the owner disposed of that unit. The Commissioner disallowed the deduction on the basis that the enhancement had accrued to the appellant in terms of the 'acquisition' contract. On disposal of the unit, no future expenditure had to be incurred by the appellant because the resident owner had departed and all obligations of both the resident owner and the appellant had been discharged. The enhancement income was therefore not income against which future expenditure would be incurred as contemplated in section 24C. On review, the judge concluded that there were two contracts under consideration, both income and future expenditure must be from the same contract and, thus, there must be a link between the enhancement value and the obligation.

ITC 1905 (2017) 80 SATC 223

The applicant was Big G a franchisee operating numerous chain eateries in connection to various franchise agreements. The main issue at the court was whether the income received by Big G from sales of meals to its customers can be regarded as arising directly from or accruing in terms of the franchise agreement which imposed the obligation to refurbish the restaurants. The Tax Court held that the franchise agreements imposed an obligation on Big G to actively provide and sell meals to patrons and although the patrons were not parties to those agreements, the proximate cause of those sales was this obligation. It further held that the expenses to be incurred in making the refurbishments by Big G were sufficiently certain to warrant an allowance in terms of section 24C. The Tax Court, therefore, concluded that Big G was entitled to claim the allowance under section 24C for the 2011-2014 years of assessments. This is one of the tax court cases where the concept of 'inextricably linked' was first introduced to section 24C. The court a quo found for the taxpayer. It held that the taxpayer's income was earned for the purposes of section 24C under the same contract as that under which the taxpayer's future expenditure was to be incurred. Consequently, it made an order to set aside the additional assessments raised by the appellant for the taxpayer's 2011 to 2014 years of assessment.

ITC 1915 (2018) 81 SATC 214

The applicant had conducted a loyalty programme in terms of which points were awarded to its customers on the presentation of a Clicks loyalty card when making purchases. An allowance for future expenditure in terms of section 24C calculated on the value of loyalty card points that the applicant expected to convert into free or discounted purchases in future was claimed. The Commissioner had disallowed the section 24C claim as a result of the customers purchasing the goods having concluded a different contract to the loyalty programme. Judge Nuku referred to ITC 1905 where the court found there to be an 'inextricable link' between the contracts from which the income was earned and the contract giving rise to the obligation to incur future expenditure. The appeal succeeded.

ITC 1918 (2019) 81 SATC 267

Appellant had carried on business as a high street retailer of clothing, comestibles, and general merchandise. The appellant sold gift cards which could be redeemed for goods at

any of its stores. the beneficiary of the prepayment is whomsoever happens to be the bearer of the card when it is redeemed and at the initial agreement parties cannot be identified. Judge Binns-Ward's decision concluded that the transactions in terms of which the taxpayer's customers acquired the gift cards were not contracts of sale. A sale in the true sense only took place when the card was presented in partial or complete redemption of the purchase price of goods selected by the customer who was the bearer of the card at the time. The court upheld the appeal and the additional assessment raised was set aside.

ITC 1958 (2021) 84 SATC 432

The appellant provided outsourced staffing services and payroll administration for clients principally operating in the construction and civil engineering sectors. The appellant would enter into a staffing services contract with its client and a separate contract of employment with each of its employees. The appellant's charge-out rate to clients included a component for accrued leave and bonus liabilities payable to the employees. A portion of the rate included a bonus accrued and was treated for accounting purposes as a liability. Employees received pro rata payment of the bonus when their services were terminated through no fault of their own. Additionally, the employees were paid leave accrued should the employment terminate with unused leave days. A specific provision was made by the taxpayer to pay a cash amount in lieu of notice where the employee is unable to work in their notice period. The appellant had claimed a section 24C as an alternative in respect of the leave and the bonus payable to the employees. The Commissioner had, however, disallowed the section 24C deduction as the appellant's contract with its clients had no specific provision that created an obligation to incur future expenditure.

The court held that the accrued bonus and leave pay liabilities did not constitute future expenditure for purposes of section 24C as the provision did not apply to bonus and leave pay amounts.

ITC 1953 (2021) 84 SATC 268

Appellant, a waste management company, constructed landfill cells used to store waste and an ancillary treatment of leachate and the production of 'treated leachate'. The

taxpayer had appealed against an additional assessment raised by the Commissioner in relation to, inter alia, whether the taxpayer was entitled to section 24C allowance in respect of amounts included for deduction for the 2015 and 2016 years of assessment. The amount was calculated as an unwinding effect charged to interest as per accounting standards. This was an accounting adjustment of all provisions, contingent liabilities, and contingent assets to reflect their present-day values to account for the time value of money. The appellant explained the unwinding effect as a difference between the present value and the future costs to be incurred by the taxpayer (i.e., *the discounting effect of revaluing the face value of the future expenditure for accounting purposes, to today's money*). The amount was based on an estimate of future costs claimed under section 24C over the best estimate of the period it will take for the cell to be finally capped, closed, and rehabilitated.

The appellant had contended that as section 24C makes provision for an allowance on the total future expenditure and not just the discounted amount, the accounting adjustment should form part of the future expenditure. Accordingly, the *'unwinding effect charged to interest'* would fall within the ambit of section 24C as this was common cause to include in the total deduction claimed for future expenditure in respect of the treatment of leachate, rehabilitation capping costs and post-closure rehabilitation of the landfill cells. The Commissioner disallowed the deduction on the basis that the adjustment was in relation to finance costs and the taxpayer had not discharged the onus of proving the quantification of the amounts.

Cloete J had held that, in relation to the Commissioner's contention that the adjustment of the face value of future expenses were finance costs, these were not finance costs but have been reflected as such to comply with the accounting standards practice. In consequence, the appellant had discharged the onus of proving the section 24C requirements and the appeal succeeded.

CHAPTER 4: RECOMMENDATIONS TO SECTION 24C

4.1 Future expenditure definition

Regarding the stock on hand, once a taxpayer incurs an expenditure in obtaining the items of trading stock, the closing stock at the end of an assessment does not constitute future expenditure. Section 22(1) requires the trading stock held and not disposed of by the taxpayer at the end of a year of assessment to be included in the taxable income. In ITC 1739, the Commissioner disallowed the deduction of section 24C in relation to the utilisation of the parts on hand treated as trading stock. Judge Joffe dismissed the appeal on the basis that the taxpayer had incurred a loss when using the parts to meet the contractual obligation and this was not an expenditure. This issue was evident in the Clicks case where a loyalty programme provided members with loyalty points for shopping at Clicks that could be converted into cash vouchers which may be offset against the trading stock on condition that the customer accrues the necessary loyalty points within a prerequisite period. The Constitutional Court did not address the deemed gross income in relation to Clicks closing stock held at the end of a tax period and was included in the taxable income. A section 24C relief could have been claimed by Clicks in relation to the loyalty card contracts with future redemption by loyalty members.

The section 24C relief in relation to trading stock to be used to adhere to contract obligations was noted in the commentary by Juta Law in ITC 1739. The editor noted that when the OEM used available stock on hand to honour the warranty responsibility in a succeeding year of assessment, the manufacturer will incur ‘future expenditure’. Therefore, a section 24C allowance should have been available to the manufacturer limited to section 22(1) trading stock on hand and not sold at the end of a year of assessment.

4.2 Amount received by or accrued in terms of any contract

In section 24C(2), the provision states that should the income of a taxpayer in a year of assessment consist of an amount accrued to a taxpayer with regard to any contract and the related income will be put into operation in its entirety or partly to fund future expenditure which is meant to be incurred by the taxpayer in the delivery of the taxpayer’s

obligations under the contract, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (limited to the income received in advance) with regard to so much of such future expenditure as it relates to the income amount. The wording of section 24C(2) gives the impression that multiple contracts may be concluded in relation to an amount received in advance.

The Commissioner has been of the view that the receipt and/or accrual of an income and the obligation to incur future expenditure must be contained in one contract. In Big G at the lower case, the Commissioner had contradicted itself by arguing that two distinct contracts existed, and no income was accrued to the appellant as per the franchise agreement and hence no expenditure was going to be incurred in terms of the sale transactions to its patrons and consequently section 24C was not applicable. The Constitutional Court, however, concluded that the same-contract requirement of section 24C does not imply that an individual document must exist stipulating the receipt of an income and the relevant future expenditure. Multiple contracts perhaps may be so inseparably connected, and they satisfy the sameness prerequisite.

The Commissioner in 7.1 of IN 78 indicates that in certain circumstances quite possibly hard to scrutinise the future expenditure and connect the amount to a specific contract. In these circumstances, as long as the contracts are similar in nature and the taxpayer has identical responsibilities to execute under the contracts then, when calculating future expenditure, the contracts may be grouped together, and the taxpayer may combine the income received in advance and the future expenditure. An overall gross profit percentage may be used to calculate section 24C allowance for contracts which have been grouped together. Botha (2020:5) noted that:

> '…there are two important issues that emerge from the Big G judgement, the first being that from a practical perspective in order for a taxpayer to claim the allowance in terms of section 24C, there is a sameness requirement that it must satisfy. The second issue is that whereas the Supreme Court of Appeal rejected the argument that two separate contracts could be so inextricably linked as to meet the requirements of section 24C, it appears that the Constitutional Court accepted this argument.'

Section 24C does not disqualify the presence of numerous contracts that are quite possibly inextricably linked of which the allowance could hypothetically be claimed. It appears

that the Constitutional Court did not resolve the query with regard to the degree to which multiple contracts had to be interwoven to meet the sameness requirement in section 24C.

4.2.1 Section 24C application to the warranty contract

IN 78 addressed the treatment of warranty claims under 4.2.5 by referring to the judgment in ITC 1601 (1995) 58 SATC 172 where in the case, the claim for an allowance by the taxpayer under section 24C was disallowed by the Commissioner.

> '[T]he appellant carried on a business of selling computer hardware and measuring instruments as well as the service of programming and setting the hardware and instruments to the specific requirements and needs of its customers. The contracts with the clients contained a warranty against defective workmanship and materials supplied. In addition, all manufactured goods contained a manufacturer's warranty. A warranty claim arose on almost all contracts because of the technical nature of the work.'

In delivering the judgment, Van Niekerk J stated, among other factors that the Commissioner in terms of section 24C will be unsatisfied that future expenditure will be expended where there is only a conditional liability. Certainty must be clearly measured as to whether the expenditure can be measured or quantifiable and the responsibility that the appellant had was to satisfy the Commissioner that the agreements would have led to deductible expenditure in a subsequent year of assessment.

IN 78 has limited clarification of the treatment of extended warranty income received in advance. The Note in 4.2.5 indicates that the event which possibly can result in the warranty claim is not only dependent on the item being returned by the customer, but the asset purchased by the customer being non-functional. This would mean that there is inadequate inevitability that the related warranty claim will be made, and the expenditure incurred subsequent. Taxpayers have offered their clients an option to extend the manufacturer warranty to cover defects beyond a certain time. In the vehicle manufacturing industry, the Original Equipment Manufacturer ('OEM') would initially cover the warranty claims for the first few years of a vehicle's life and the taxpayer can extend this cover to further years. Taxpayers with a functionality pattern of a product and the historic information on when a claim could be made by a client could determine exactly when the client will exercise the extended warranty and return the purchased item.

Authors of Income Tax in South Africa: Commentary Clegg and Stretch critiqued the judgment in ITC 1601 (2011:11) with reference to the reality that the Commissioner is unable to be content that expenditure will be incurred if there is only a contingent liability stating that:

> '…if expenditure is not contingent, then there will be no need for the section, as the liability would be absolute and a deduction under section 11(a) could be claimed. The wording requires the Commissioner to be satisfied that expenditure 'will be incurred after the end of such year', making it clear that it is the incurral itself which arises thereafter, and which must, by definition, be uncertain and contingent as at the end of the year in question. It is submitted that there must be in existence an enforceable and un-contingent obligation to perform under a contract, which performance will lead to the incurral of expenditure. With reference to case law, when the word 'incurred' is used in section 11(a) it indicates that the taxpayer has, during the year of assessment, incurred an unconditional obligation to pay for expenditure'.

4.2.2 Section 24C application to a short-term insurance contract

IN 78 is silent on the treatment of an income received in advance in relation to short-term insurance policy contracts offered by the Short-term Insurers as per section 28(1) of the Act definition. For the definition of insurance, the Act relies on the Short-term Insurance Act. Section 28(2)(*a*) indicates that a premium received by or accrued to that person in relation to a short-term insurance policy supplied by a resident Insurer preceding the date of origination of the risk covered by the policy should be deemed to have been received or accrued to that short term insurer on the date of origination of the risk covered under that policy. This amount would meet the requirements of 'income' as stated in section 24C(2) and will be taxed as an advanced income with the future expenditure being the expected claims as per the short-term policy. There is a relief under section 28(3) of the Act:

> '…there shall be allowed as a deduction from the income of that short-term insurer an amount equal to the sum of liabilities on investment contracts relating to short-term insurance business in accordance with IFRS as reported by that short-term insurer in its audited annual financial statements, and amounts recognised as insurance liabilities, in accordance with IFRS by that short-term insurer in its audited annual financial statements…'

With the uncertainty of when these claims will be lodged, resident Insurers apply the services of actuaries who can determine with a high degree of precision when contracts

of a similar nature to a claim will be paid out. Resident taxpayers are only able to utilise section 28(3) relief.

4.2.3 Section 24C application to a maintenance contract

Part 4.2.6 of IN 78 states that:

> '…the Commissioner will not be satisfied that the expenditure will be incurred in the future on after-sales maintenance contracts under which the maintenance will only be required if something breaks or malfunctions.'

IN 78 further indicates that the accessibility of a section 24C allowance will be dependent on the taxpayer's responsibilities to be completed are dependent on something besides just a customer making the asset available for maintenance. An assessment of whether there is an adequate inevitability to gratify the Commissioner that expenditure will be expended in the future must be established. Similar to the short-term contracts and warranty contracts if the expenditure were not contingent the taxpayers would make use of section 11(a) for the deduction.

4.3 Clarity on the deemed income as per section 24C(3)

De Koker et al. (2021: 8.60) considered the application of section 24C as follows:
According to the 'Explanatory Memorandum on the Income Tax Bill, 1980, in the succeeding year of assessment 'a new reserve will, if necessary, be calculated for that year'. On this point, a little difficulty may be encountered, since the operation of the allowance depends upon the receipt or accrual of an amount of income in advance in the assessment year for which the allowance is deducted. *'…[i]f a taxpayer derives such an amount, say, of R1m in year 1 to cover his expenditure in years 2 and 3, in these later years he will derive no further payments in advance. How, then, may he claim a further allowance in year 2 to set off against the inclusion of the allowance granted in year 1?...'*

The answer lies, perhaps, in the provision deeming the allowance of one year to be income derived in the following year (section 24C(3)). If this deemed inclusion in income may be construed as an amount received or accrued to the taxpayer in relation to any contract, the problem is then solved, and a fresh allowance may be claimed. The wording of this provision could perhaps have been more precise if this procedure were meant to be

adopted, but the comments in the ‘Memorandum’ appear to indicate that it was. If it were not, the allowance would provide inadequate relief whenever a payment in advance is intended to cover expenditure (or allowances, for example, on machinery or plant) to be deducted over a longer period than the succeeding year.

CHAPTER 5: CONCLUSION

Section 24C can be condensed into an allowance in respect of an expenditure to be expended subsequent to the end of a year of assessment, furthermore, the expense is going to be allowed as a deduction from the income in a later year of assessment; or is in respect of an acquisition of any asset of which any deduction will be permissible under the provisions of this Act. Applying the requirements of the general and/or special deduction formula, the future expenditure does not qualify for an outright deduction. The requirements of section 11 referred to as the general deduction formula (read with section 23(g)) allows for a deduction when the expenditure has been actually incurred. As the Act does not define the meaning of 'actually incurred', the courts applied numerous expressive arguments for clarification. In ITC 969, judge Bliss indicated that for an expenditure to be actually incurred, it has to be a definite and unqualified liability. As the future expenditure does not meet the definition of actually incurred, section 24C allows for future expenditures to be deducted.

The operative word in section 24C(2) is 'will be incurred' which appears to reinforce the requirements stated in section 24C(1)'s definition of what constitutes future expenditure. In ITC 1601 (1995) 58 SATC 172 at 179 judge Van Niekerk stated that:

> '[T]he Counsel for the Commissioner correctly contended that the Commissioner would not be satisfied that future expenditure will be incurred where there is only a contingent liability. There must be a clear measure of certainty as to whether the expenditure in contention is quantified or quantifiable. The onus that the appellant bears here is to satisfy the Commissioner that the agreements relied upon will lead to deductible expenditure, in the following year. The appellant's contention that the use of the word 'will' relates only to time and not to the certainty of the expense, cannot be correct. Since a deduction is sought, this must arise from an obligation and must be quantifiable'.

The words 'will be incurred' further demonstrates that the Commissioner must be satisfied that there is a '*high degree of probability and inevitability'* that the expenditure will be incurred by the taxpayer. Even though the expenditure is contingent in a year of assessment, a high degree of certainty that the expense will be incurred in a subsequent year is mandatory.

With the introduction of IN 78, the Commissioner would have intended to clarify the interpretation and application of section 24C. An interpretation note is merely a guide to the taxpayer with no powers to enforce the law. Taxpayers will have to rely on the provisions of the law in assessing whether section 24C can be deducted. Section 24C requires that the amount received in advance must be as a result of a contract. There appears to be uncertainty as to what these contractual arrangements will be allowed under section 24C allowance, especially in circumstances where multiple contracts are involved. In Big G Restaurants (Pty) Limited v C:SARS (2020) 6 SA 1 (CC) court case, the court stated that:

> '…section 24C allowance may be claimed either when the traditional same contract requirement is met or when the income and the obligation to finance expenditure arise from two or more contracts that are so inextricably linked that they meet the requirement of "sameness".'

Section 24C addresses the timing issue where a taxpayer receives an income in advance and the related expenditure will only be actually incurred in the future. The income received by the taxpayer must be in relation to a contract or multiple contracts that are linked. As the income is taxed on receipt, the future expenditure will only be deductible when it is actually incurred. Therefore, section 24C addresses this timing issue by bringing forward the expenditure. This is a temporary receipt as the deduction has to be treated as income received in advance in the following year. At the introduction of section 24C, the Commissioner had discretionary powers to review the application. This was however changed when the Commissioner's discretion was removed by section 42 of the Taxation Laws Amendment Act 25 of 2015. The taxpayer, however, still has the burden of proof in terms of section 102 of the Tax Administration Act, 2011 that the provisions of section 24C are adhered to.

The amount of any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment. The relief is temporary as the taxpayer has to reverse the deduction in the following year of assessment, in essence treating the amount as part of the income received in advance. At face value, the application of section 24C can be viewed as straightforward, however, taxpayers had to approach courts for clarity as a result of the Commissioner disallowing the deduction. The courts have been inconsistent in interpreting the application of section 24C, causing more confusion to the taxpayers. The

report reviewed the judicial effects of section 24C by analysing the lower tax courts prior to the introduction of section 24C and up to the recently reviewed Constitutional Court cases. Taxpayers have challenged the Commissioner's interpretation of section 24C with numerous tax court cases. The only pitfall with these cases is that they do not have legislative and judicial powers to be binding. In order to demonstrate the taxpayers' frustration with the Commissioner's interpretation of section 24C, it is worth noting the principles from these tax court decisions with regard to the application of the section. It is furthermore evident that the tax court judges had a challenge on the interpretation of section 24C, as shown by the inconsistency in the judgments.

Recommendations to section 24C and consequently IN 78

1. The Constitutional Court did not address the deemed gross income in relation to Clicks closing stock held at the end of a tax period and was included in the taxable income. A section 24C relief could have been claimed by Clicks in relation to the loyalty card contracts with future redemption by loyalty members. IN 78 could further clarify the treatment of deemed income under section 22(a) with a relief claimed under section 24C.
2. The Commissioner is of the view that warranty contracts are not eligible for section 24C deduction due to the occurrence of an event that in theory gives rise to the warranty claim being reliant on and is not only dependent on the item being returned by the client in addition the asset bought shall or shall not breakdown. There is an inadequate inevitability that the associated warranty claim will be incurred in the future. Section 24C addresses circumstances where there is uncertainty (contingent obligation) of when the expenditure will be incurred hence an annual review of the allowance has to be performed. Should the expenditure not be conditional there will be no need for section 24C, and the deduction will be claimed under section 11(a) as indicated by Clegg and Stretch.
3. Section 24C(3) assumes the allowance of one year to be 'an income received in advance' in the following year, giving the impression that a taxpayer could 'reuse' the prior year's allowance as an income received in advance to meet the requirements of section 24C(2). This could be beneficial to taxpayers with *'once-off'* advance

income and future expenditure over a longer period. The wording of this provision could have been more precise if this procedure were meant to be adopted.

Future research

1. The Constitutional Court has not clarified the question regarding the degree to which two or more contracts had to be interlinked to satisfy the sameness requirement in section 24C. The judgment in the Big G, the Constitutional Court where says that two or more contracts 'may be' inextricably linked as to result in the future expenditure falling within the ambit of section 24C. Although the word 'inextricable' does not admit of degrees of comparison, it appears from the utilisation of the word 'may' that, in some circumstances where the link between the income and the future expenditure is indeed 'inextricable' the expenditure may nonetheless not be deductible in terms of s 24C.
2. Despite the IN 78's extensive analysis of section 24C requirements necessary to deduct an allowance in terms of section 24C, there appears to remain a degree of ambiguity as to what contractual agreements will enable such an allowance, specifically in situations where there are numerous contracts involved.
3. The words 'will be incurred' show that there should be a higher degree of likelihood and that it is inevitable that the taxpayer will expend the expenditure. A taxpayer must be able to establish that, even though the expenditure is conditional at the end of the year of assessment that there is primarily high certainty that the expense ought to be incurred in a succeeding year.
4. As warranty contracts are contingent obligations as stated by IN 78, would these contracts not meet the provisions of section 24C as section 11(a) would otherwise be available to an uncontingent liability?
5. Short-term insurers are taxed on the short-term premium received of which the amount will be expended in the future by the taxpayer as a pay-out in proportion to a claim by policyholders with relief offered by section 28(3) of the Act. There are some shortcomings on the application of this relief with further analysis required to determine whether taxpayers might be advantageous to apply for section 24C relief.

APPENDIX

Section 24C extract as per the Act:

24C. Allowance in respect of future expenditure on contracts. — (1) For the purposes of this section, "future expenditure" in relation to any year of assessment means an amount of expenditure which will be incurred after the end of such year—

a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or

b) in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.

(2) If the income of any taxpayer in any year of assessment includes or consists of an amount received by or accrued to him in terms of any contract and such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of the taxpayer's obligations under such contract, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) in respect of so much of such future expenditure as relates to the said amount.

(3) The amount of any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment.

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