THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Not reportable
Case No: 195/11

In the matter between:

EVEREADY (PTY) LIMITED **Appellant**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

Neutral citation: *Eveready v The Commissioner for the SARS* (195/11) [2012] ZASCA 36 (29 MARCH 2012)

Coram: NUGENT, HEHER, MALAN and TSHIQI JJA and BORUCHOWITZ AJA

Heard: **2 MARCH 2012**

Delivered: **29 MARCH 2012**

Summary: **Tax – Income Tax Act 58 of 1962 – s 22(4) – trading stock – whether acquired for 'no consideration'.**

ORDER

On appeal from: Tax Court, Port Elizabeth (Chetty J with Messrs P Ranchod and Z Mzimela as assessors) sitting as court of first instance):

1. The appeal is dismissed with costs.
2. The cross-appeal is dismissed with costs that include the costs of two counsel.

JUDGMENT

NUGENT and TSHIQI JJA (HEHER, MALAN JJA and BORUCHOWITZ AJA CONCURRING)

[1] Before us is an appeal and a cross-appeal against orders made by the Tax Court sitting at Port Elizabeth (Chetty J with Messrs P Ranchod and Z Mzimela as assessors). The appeal concerns s 22 of the Income Tax Act 58 of 1962 and in particular s 22(4).

[2] Section 22 determines the value to be attributed to trading stock when it is taken into account in determining taxable income. The value to be attributed to closing stock is dealt with in s 22(1). In broad terms its value is

to be the cost price of the stock, less any allowance that the Commissioner might consider to be just and reasonable for any diminution in its value. Section 22(2) determines the value to be attributed to opening stock. If it was held as closing stock in the previous year, it is to be the value that was attributed to the stock in determining taxable income for that year. If it was not held as closing stock for the previous year then its value is to be its cost price. The manner in which the cost price of stock is to be determined for the purpose of those sections is specified in some detail in s 22(3).

[3] The appeal centres on s 22(4), which determines the value to be placed on trading stock that was acquired 'for no consideration'. It provides that the cost price of such stock for purposes of s 22(3) – and hence for determining its cost price where applicable in the earlier subsections – is deemed to be its current market price at the date of acquisition.[1]

[4] At one time Gillette Group South Africa (Pty) Ltd (Gillette) had a division of its business that manufactured, distributed and sold zinc batteries under the name 'Eveready'. On 18 November 2002 Gillette sold the business as a going concern to Friedshelf 243 (Pty) Ltd, a shelf company that changed its name to Eveready (Pty) Ltd, which is the appellant in the appeal (we will refer to it hereafter as Eveready). The effective date of the sale was 1 March 2003.

[5] In its income tax return for the 2004 year of assessment – which spanned the period 1 March 2003, when Eveready commenced trading, to its

1 S22(4) 'If any trading stock has been acquired by any person for no consideration . . . such person shall for the purposes of subsection (3) . . . be deemed to have acquired such trading stock at a cost equal to the current market price of such trading stock on the date on which it was acquired by such person . . .'

accounting year-end on 30 June 2004 – Eveready claimed a deduction from income of R103 532 179 for the trading stock that it had acquired from Gillette pursuant to the purchase of the business. It said that was the market value of the stock at the date of acquisition, and that it was entitled to deduct its market value because it had acquired the stock from Gillette 'for no consideration' as contemplated by s 22(4).

[6] In an additional assessment issued by the Commissioner after an audit of Eveready's business the deduction was disallowed. At first the deduction was disallowed altogether, but later the Commissioner allowed a deduction of R21 562 918 for reasons that we come to later. Interest on the allegedly unpaid tax was levied under s 89*quat*(2).

[7] Objections by Eveready to the disallowance of the deduction and to the levying of interest were rejected by the Commissioner and Eveready appealed to the Tax Court. The Tax Court dismissed its appeal against the disallowance of the deduction but upheld its appeal against the levying of interest. Eveready now appeals against the former order, and the Commissioner cross-appeals against the latter order, with the leave of the court below.

[8] The Commissioner accepts that the trading stock acquired from Gillette (which constituted the opening stock of Eveready's business) is deductible from its income.[2] What is in dispute is the amount to be attributed to the stock for purposes of the deduction. The Commissioner disputes that

2See de Koker and R C Williams *Silke on South African Income Tax* Memorial Edition (2011) Vol 2 pages 8-290-1 to 8-290-2.

Eveready is entitled to deduct its market value because, so he says, it was not acquired 'for no consideration'. He contends that the stock was acquired for consideration and thus it falls to be deducted at its cost price as contemplated by s 22(2)(*b*), which he estimated to be R21 562 918, the amount that he allowed.

[9] The sole question in the appeal is thus whether Eveready acquired the trading stock from Gillette 'for no consideration' (in which case it falls to be deducted at its market value at the date of acquisition as provided for in s 22(4)) or whether it was acquired for consideration (in which case it falls to be deducted at its cost price as provided for in s 22(2)(*b*)). In either event we are not called upon to pronounce upon the quantum of the deductions that have been claimed by Eveready or allowed by the Commissioner as the case may be.

[10] Whether or not the stock was acquired for no consideration is a question of fact that depends upon what was agreed between the parties for its acquisition. In the court below Eveready sought to advance oral evidence as to the meaning of the written agreement in that regard but that evidence was rightly ruled to be inadmissible.[3]

[11] The case advanced by Eveready turns solely upon the construction that it gives to schedule 6 of the agreement. That schedule must be seen in the context of clause 5.1, which provides as follows:

'The purchase consideration payable by the Purchaser to the Seller for the Business is the amount of R80 000 000 (Eighty million rand). The purchase consideration will be

3The correctness of that ruling was placed in issue in the notice of appeal but was not pursued in argument before us.

allocated amongst the Business Assets as set out in **Schedule 6**.'

[12] Schedule 6 makes that allocation in the following terms:

'Allocation of purchase price

Purchase price to be allocated in the order below, each up to the maximum value shown.

Description	**Maximum Value**
Immovable Property	R30 million
Other Fixed Assets	R25 million
Trademarks	R25 million
Display Inventory	[*left blank*]
Inventory	[*left blank*]
Receivables less payables	[*left blank*]'

[13] Eveready construes that schedule to mean that where the column under the heading 'maximum value' has been left blank alongside a particular item – amongst which are the trading stock of the business, which is called 'inventory' in the schedule and in the remainder of the agreement – the parties intended that the allocation should be nil. On that basis it submits that the schedule demonstrates that the parties intended that no part of the purchase price was to be paid for the trading stock and thus it was acquired 'for no consideration'. That is the long and the short of its submission.

[14] In our view the submission has no merit. Not only does the submission ignore the context in which the schedule must be read but it is also inconsistent with the language of the schedule itself.

[15] The subject of the sale is recorded in Clause 4.1 of the agreement as

being 'the Business as a going concern'. The 'Business' is defined to mean

'that part of the business carried on by the Seller . . . as a going concern and as a separate division under the name "Eveready" . . . using the Business Assets and including the Transferred Liabilities and involving the manufacture, distribution marketing and sale of zinc chloride and zinc carbon batteries.'

The 'Business Assets' are in turn defined to mean

'those specified assets owned or used by the Seller in or in connection with the Business at the Effective Date, comprising: Contracts; Moveable Assets; Display Inventory; Immovable Property; Intellectual Property; Trade Marks; Customer Orders; Licences; Inventories; Goodwill; and Sundry Debtors.'

[16] It is apparent from the subject matter of the sale alone that the purchase price was paid at least partly for the trading stock, but the matter goes further than that.

[17] Clause 5.1 is not exhaustive of the purchase price that was to be paid for the business. That clause does no more than to set a base price that is subject to adjustment once the value of the working capital at the effective date of the sale had been determined, which included determining the value of the inventory in accordance with clause 8.

[18] Clause 8 required a stocktaking to be done on the day prior to the effective date and the preparation of schedules reflecting all inventory and display inventory that existed on that date.[4] Once those schedules had been agreed (or determined by Gillette's auditor in the event of disagreement) the value of the inventory and the display inventory (excluding that which was

4Defined to mean 'display racks and other point of sale promotional materials exclusively exhibiting the Trade Marks or any of them . . .'

damaged or otherwise reduced in value) was to be valued on a specified basis. When the value of the inventory and the display inventory had been agreed (or determined by the auditor in the event of disagreement) clause 8.5 provided that those values were to be 'used for the purposes of the Effective Date Accounts and the Working Capital Statement'.

[19] The Working Capital Statement, as its name implies, was a statement that was to be prepared as soon as possible after the effective date reflecting Working Capital at that date. 'Working Capital' is defined to mean 'the aggregate of (i) Sundry Debtors, (ii) Display Inventory and (iii) Inventories less the Accounts Payable of the Business as at the Effective Date'. A statement reflecting the calculation of working capital at June 2002 and September 2002 appears as schedule 12 to the agreement. Working capital at the former date was R34 997 (calculated as debtors of R1 637 729 + display inventory of nil + inventories of R44 779 730 – accounts payable of R11 420 418).

[20] The significance of the Working Capital Statement appears from clause 5.5:

'The purchase consideration referred to in clause 5.1 [R80 million] shall be adjusted up or down to the extent that the Working Capital as reflected in the Working Capital Schedule on the Effective Date is less than or greater than, as the case may be, R34 997 041. The Purchaser shall pay the Seller the amount by which the Working Capital exceeds R34 997 041.00. The Seller shall pay the Purchaser the amount by which R34 997 041.00 exceeds the Working Capital, ...'

I think it can be inferred that the base amount of R34 997 041 referred to in that clause was the amount of working capital of the business at June 2002 as reflected in schedule 12.

[21] The purchase price of the business was thus not R80 million as averred on behalf of Eveready. It was that amount adjusted after the working capital at the effective date had been established – which entailed determining the amount of sundry debtors and display inventory and inventory and accounts payable on that date. Needless to say, if the value of the inventory at the effective date was found to be R54 779 730, and the other items in schedule 12 had remained unchanged, thus taking the working capital to R44 997 041, then Eveready would have been required to pay the excess of R10 000 000 to Gillette. Conversely, if the value of the inventory at the effective date was found to be R34 779 730 then Gillette would repay the shortfall to Eveready. The payment by one to the other of the excess or shortfall in the value of the inventory so far as it served to increase or decrease the working capital above or below R34 997 041 is hardly consistent with the inventory having been given away for free.

[22] It is in that context that we return to schedule 6. The schedule does not purport to allocate R80 million, which was the basis for the submission made by counsel for Eveready. It purports to allocate 'the purchase price', which remained undetermined until such time as the working capital at the effective date had been fixed. In its terms the schedule determines, first, the order in which that price is to be allocated once it has been fixed, and secondly, the *maximum* amount that is to be allocated to each item. The blank space alongside inventory – and those alongside display inventory and receivables less payables (debtors less accounts payable) – clearly do not signify that the amount to be allocated to those items is nil. If that had been the case one might ask where the excess was to be allocated if the purchase

price turned out to be more than R80 million? The blank spaces alongside those items signify only that an amount as yet undetermined was to be allocated to each. It was only once the effective date was reached that the value of sundry debtors, and display inventory, and inventory, and accounts payable – the items that go towards calculating working capital – would be capable of determination.

[23] The only basis for the contention by Eveready that no consideration was paid for trading stock was that the amount that the parties were said to have intended to allocate to inventory was nil. Seen in its context that is not what the schedule means. Indeed, it would be most extraordinary if Gillette had given away trading stock for free that Eveready says had a market value of over R100 million. It is quite apparent from the agreement read as a whole that part of the purchase price was paid for the trading stock. Precisely what portion of the purchase price was paid for the trading stock is not a matter that is before us in the appeal and I need say no more about that.

[24] In our view the finding by the Tax Court on that issue cannot be faulted and the appeal must fail. We turn then to the cross appeal.

[25] Section 89*quat*(2) levies interest on unpaid tax in certain circumstances but the Commissioner may in his discretion waive that interest. On appeal from his decision it is for the Tax Court to exercise that discretion. The Tax Court found that Eveready had claimed the deduction in good faith on the basis of opinions that it had received from two professional advisers. We are not sure that those opinions were quite as unequivocal as Eveready suggests but that is immaterial. It is open to us to interfere only if

the Tax Court failed properly to exercise its discretion.[5] We do not think that there are any grounds for finding that it did so and the cross-appeal must fail.

[26] The following orders are made:

1. The appeal is dismissed with costs.
2. The cross-appeal is dismissed with costs that include the costs of two counsel.

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R W NUGENT

JUDGE OF APPEAL

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Z L L TSHIQI

JUDGE OF APPEAL

5 *Commissioner of Inland Revenue v Da Costa* 1985 (3) SA 768 (A) at 775C-G.

APPEARANCES:

For appellant:	P J J Marais SC
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