



Tax Alert



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Tax court judgements on section 24C of the Income Tax Act – Allowance in respect of future expenditure

In 2 recent decisions, the tax court opined on the application of section 24C of the Income Tax Act (“ITA”). This section allows taxpayers to claim a deduction for expenditure to be incurred in future tax years by the taxpayer in the performance of the taxpayer’s obligations under a contract.

B v The Commissioner for SARS

Background

In this case the court dealt with an appeal by the taxpayer against additional assessments raised by SARS for its 2011 to 2014 years of assessment. These additional assessments arose from SARS’ refusal of deductions claimed by the taxpayer as allowances in respect of future expenditure (for refurbishing and/or upgrading) in terms of section 24C of the Income Tax Act. The taxpayer operated certain chain restaurants in terms of various agreements between itself and the franchisor, the terms of the agreements were virtually identical. The franchise agreement required the taxpayer to *inter alia* upgrade and/or refurbish the restaurants at reasonable intervals as determined by the franchisor.

The Taxpayer claimed a section 24C allowance in respect of future expenditure that was to be incurred to finance the refurbishments or upgrades required by the agreements. SARS disallowed the 24C expenditure on the basis that the income from sales is not accrued in terms of the franchise agreement and that there was no certainty that the expenditure will be incurred in future as it is subject to a suspensive condition.

Court decision

Having regard to the language used in the franchise agreement; the context and apparent purpose to which section 24C is directed; the interpretation note; and other case law, the court found that the franchise agreement and the sales of meals to customers were inextricably linked. In other words they were not legally independent and separate.

The court concluded that the primary obligation is that the refurbishment expenditure will be incurred at reasonable intervals determined by the franchisor and that the expenses to be incurred in making the refurbishments are sufficiently certain to warrant an allowance in terms of section 24C, even though it is uncertain exactly what the refurbishments would look like. The franchisor’s approval related to the precise

manner in which the refurbishment obligation would be fulfilled, and not the actual fulfilment of the obligation by the Taxpayer. The court therefore found in favour of the taxpayer.

ABC (PTY) LIMITED v The Commissioner for SARS

Background

This case dealt with the application of section 24C allowances to a retail loyalty programme granted to customers by a taxpayer. The loyalty programme requires customers to join the programme by completing an application form that sets out the terms and conditions of the programme. Loyalty points are awarded to the customer only if the loyalty card is produced at point of sale. The number of points earned is reflected on the till slip in respect of the purchase. Points can thereafter be redeemed and used to pay for future purchases.

The taxpayer disclosed the amount of ZAR 58 550 602 in its gross income for 2009 financial year as Loyalty card deferred income and claimed a section 24C allowance of R44 275 965 in this regard. SARS disallowed the section 24C allowance on the grounds that the purchase and sale contract in respect of which the income was earned was not the same contract giving rise to the future expenditure. Initially SARS argued that the obligation to incur the future expenditure arose under the loyalty programme contract but subsequently changed its view and argued that the obligation to incur the expenditure only arose once, having been awarded the loyalty points, a customer entered into a further purchase and sale contract and redeemed those points to pay for the goods.

The taxpayer argued that loyalty card contract and the initial sale and purchase contract were so inextricably linked that one cannot meaningfully separate the two factually or legally. *Inter alia*, the sole object of the loyalty card was to bring about the sale and purchase contract. The loyalty points and hence the future expenditure is recorded on the till slip relating to the purchase and sale. The purchase and sale contract is a necessary causal link for the awarding of the points. Whilst the taxpayer acknowledged that there was more than one contract between itself and its customer, it relied on case law, including *B v The Commissioner of SARS*, which allowed a section 24C allowance where the contract under which the income was earned and the contract giving rise to the obligation to incur future expenditure were inextricably linked.

Court decision

In arriving in its decision the court stated that, it is both artificial and factually incorrect to regard the future expenditure that the taxpayer will incur when a customer redeems a voucher as arising under a different contract to the first purchase and sale contract concluded with the same customer. The first purchase and sale agreement incorporates the terms of the loyalty card contract and triggers both the earning of income by the taxpayer as well as an obligation by the taxpayer to incur future expenditure. It was held therefore that based on the finding that the income is earned on the same contract that gives rise to the obligation to incur future expenditure, the future expenditure meets the requirements of section 24C of the ITA.

What we can learn from these cases?

What we can learn from these two cases is that it is important when dealing with section 24C allowances to consider whether the contract under which income is earned and the contract giving rise to the obligation to incur future expenditure are the same or are at least inextricably linked. In addition one also needs to consider whether the obligation to incur any future expenditure is subject to certain conditions or not. The judgement in the ABC case may well have been different if SARS argued that there was a suspensive condition to incur the future expenditure by the taxpayer.

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