# Analysis – Stellenbosch Farmers' Winery v CSARS

We previously reported on the Western Cape Tax Court (Tax Court) case involving Stellenbosch Farmers' Winery Limited (Farmers) and the Commissioner for the South African Revenue Service (SARS).

The parties in the meantime appealed to the Supreme Court of Appeal (SCA). The SCA handed down its judgment on 25 May 2012 (Stellenbosch Farmers' Winery v Commissioner for SA Revenue Service (511/2011 and 504/2011) [2012] ZASCA 72.

To recap, in 1991 United Distillers plc (Distillers), a United Kingdom company, and Farmers, a local company, signed a distribution agreement in terms of which Farmers was appointed as the exclusive distributor for resale in Southern Africa of the Bell's, Haig and Dimple whiskies for a period of 10 years.

In 1997, the group that Distillers formed part of was restructured. As a result Distillers approached Farmers to end the distribution agreement about 41 months early. In 1998 the parties concluded a dissolution agreement to this effect.

Distillers agreed to pay Farmers compensation of R67 million.

Two questions arose: first, was the compensation amount of R67 million subject to income tax because it was of a revenue nature (and not of a capital nature)? Second, was the amount subject to VAT at the rate of 14% or at the rate of 0% because Farmers had made a supply of services to a non-resident?

The Tax Court answered the first question in the affirmative. It held that the amount paid by Distillers to Farmers was of a revenue nature, and not of a capital nature as Farmers had contended.

In regard to the second question, the Tax Court held that the supply made by Farmers was zero-rated as Distillers was not resident in South Africa.

The SCA did not agree with the Tax Court on the first issue. The SCA found in favour of the taxpayer holding that, on the facts of the case, the amount of the compensation was of a capital nature and, accordingly, was not subject to normal tax.

The SCA found that the Tax Court had erroneously focused on only physical assets and should have focussed instead on the much more valuable incorporeal assets constituted by the exclusive distribution rights that were lost. The Court held that the 'compensation for the impairment of the taxpayer's business constituted by that loss is properly to be viewed as a receipt of a capital nature'.

The following are the important principles that can be distilled from the case:
•If, in the valuation of the right to receive compensation for giving up a right, a taxpayer has regard to the profits anticipated from the use of the right, it does not necessarily mean that the compensation for giving up the right is of a revenue nature.
•The way that a receipt is subsequently dealt with for accounting purposes does not determine the nature of the receipt (revenue or capital) for income tax purposes.
•The way that a receipt is subsequently dealt with by the taxpayer (e.g. by paying a dividend), does not determine the nature of the receipt for income tax purposes.
•The SCA emphasised that the dissolution agreement referred to payment of full compensation for the closure of Farmers' business relating to the exercise of the distribution rights; the agreement made no reference to a payment for loss of profits. Taxpayers should accordingly know that, particularly where uncertainty may arise as to the treatment of amounts for tax purposes, the words they use in agreements (provided of

course that the words accord with their intentions) are of great importance. Taxpayers should get advice from tax professionals when drafting agreements.

The SCA agreed with the reasoning and finding of the Tax Court in relation to the second issue, relating to VAT, and again held in favour of the taxpayer.

However, the SCA also said obiter (in passing) that it agreed with the finding of the Tax Court that the exclusive distribution right, which was incorporeal property, was not situated in South Africa but was situated where the debtor resides (in this case, in the United Kingdom).

This is an important (albeit, non-binding) finding because – by analogy – it implies that persons who are not resident in South Africa and who make available incorporeal property in South Africa against, say, payment of a royalty need not register for VAT in South Africa for that reason alone.

The taxpayer was successful in the SCA on all fronts.

ADDITIONAL ANALYSIS

Stellenbosch Farmers' Winery v C:SARS