

Judgment elicits collective sigh of relief

THE recent judgment handed down by the Supreme Court of Appeal in the matter of *BP (Southern Africa) (Pty) Ltd v C:SARS* will come as a relief to tax advisors and businessmen alike.

The judgment overturned the earlier decision of the Cape Tax Court, which had held that an annual royalty paid by BP SA to its UK parent company for the use of the parent's trademarks and marketing get-up was of a capital nature and not tax deductible.

At the time it was delivered, the Cape Court's judgment came as something of a shock. It had traditionally been accepted that, apart from exceptional circumstance, recurrent payments made for the use of another person's assets (such as royalties for the use of trademarks) were tax deductible under section 11(a) of the Income Tax Act. The Cape Court's erosion of this position was of concern to anyone involved in intellectual property (including those in the franchising, brand management and licensing industries), and it had potentially negative ramifications for other leasing activities.

BP SA had only shortly before been involved in another tax case, in which lump-sum payments made to secure long-term lease agreements were held to be of a capital nature. In that case, despite the court's finding that there were special circumstances preventing the deduction of the payments under section 11(a), the South African Revenue Service (SARS) conceded that they were deductible on a spread basis in terms of section 11(f), which allows "premiums" paid for the right to use certain assets to be deducted.

It seems inconsistent to the authors, who represented BP in both cases, that on the one hand SARS had allowed the deduction of a lump-sum payment to secure a long-term lease of fixed property, but on the other hand had disputed the deductibility of regular royalty payments for the use of trademarks on an annual basis.

Thankfully, the Supreme Court of Appeal has reconfirmed the basic principle that recurrent payments made in return for the use of an asset over short periods, are generally deductible under section 11(a).

In BP SA's case, the court found that the following facts supported the conclusion that the royalty pay-



ments were deductible:

- The payments were made on a regular annual basis and were calculated with reference to the volume of product sold by BP SA under the BP brand.

- BP SA did not acquire ownership of or any enduring right to the trademarks, but merely paid for their use. In this regard, the court highlighted certain features of the licence agreement that BP SA had concluded, including the fact that the licence was nonexclusive, nontransferable and would endure for an initial two-year period, whereafter it could be terminated by either party upon provision of six months notice.

- BP SA's parent company remained the sole rightful owner of the licensed marks, and all rights and goodwill attaching to or arising out of their use accrued to the benefit of the parent company.

Upon termination of the licence agreement, BP SA would no longer be entitled to use the name, BP, or any of the licensed property.

The appeal court's judgment provides useful guidance to tax planners and attorneys alike, who could seek to emulate the terms set out above to

ensure the deductibility of royalty payments. However, the judgment is not only interesting for the matters that were expressly dealt with, but also for those that were not.

In particular, as BP SA's main argument that the royalties were deductible under section 11(a) was upheld, no decision was made on the alternative argument that they would have been deductible under section 11(f) even if they were capital in nature. As a result, the question of whether the "premiums" referred to in section 11(f) include amounts of a capital nature, still remains to be settled.

While the judgment may foreshadow a future dispute about section 11(f), it has nevertheless brought a large degree of certainty back into the way that the basic tax principles relating to deductions and the identification of capital expenditure are applied.

It will also provide a useful precedent within the intellectual property and other industries, and for this, it is to be praised.

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