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Deductions allowed for future expenditure

Section 24C of the Income Tax Act provides a mechanism through which taxpayers can achieve an extent of matching between the timing when large advance payments are taxed and related expenditure deducted.
In *CSARS v Big G Restaurants (Pty) Ltd* the SCA considered the application of this provision in the context of income earned from operating a restaurant and upgrading or refurbishment expenditure required in terms of a franchise agreement.

Taxpayers are taxed on income at the earlier of the date of receipt or accrual and are entitled to deduct expenditure to produce this income when such expenditure has been incurred. While the these two sets of events may in some instances fall in the same year of assessment this will always be the case. To accommodate taxpayers who receive large advance payments during a year but will only incur expenditure in a subsequent year, section 24C of the Income Tax Act provides an allowance for future expenditure to be deducted from the advance payment rather than for it to be subject to tax in full during the year of receipt.

This article provides a review of *CSARS v Big G Restaurants (Pty) Ltd,* a case where the Supreme Court of Appeal (SCA) considered the application of section 24C.

Facts and dispute

Big G Restaurants (Pty) Ltd ('the taxpayer') operates restaurants in terms of various franchise agreements with Spur Group as the franchisor. In these agreements the taxpayer undertook to carry on specific businesses (Spur Steak Ranch or Panarotti's restaurants) during the period of the agreement. It was obliged to pay the franchisor a monthly franchise and service fee equal to 5% of the gross sales from each restaurant that it operated, subject to a minimum amount. In terms of the franchise agreement the taxpayer was required to upgrade and refurbish its restaurants on a regular basis.

The taxpayer claimed an allowance in terms of section 24C for the future upgrade and refurbish expenditure it was obliged to make in terms of the franchise agreement. SARS disputed this treatment on the basis that the income from which the taxpayer deducted the allowance was not earned in terms of the franchise agreement, which imposed the obligation to upgrade or refurbish, but rather ad hoc agreements with patrons.

Judgment

At the time relevant to this case section 24C(2) read as follows:

> "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 the Commissioner is satisfied that 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 his 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) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount."

The SCA rejected the argument put forward by the taxpayer's counsel that the phrase *'in terms of any contract'* had to be given a wide meaning. Instead, it concluded that a direct and immediate connection is required between the contract from which the income is derived and future expenditure to perform it obligations will be incurred incurred in terms of that contract.

It concluded that in this case the franchise agreement did not provide the taxpayer with any rights to income. It merely provided the taxpayer with the right to conduct business within the franchisor's network using its trademarks, know-how and business methods. The taxpayer earned its income by supplying food to patrons. The fact that the taxpayer agreed in terms of the franchise agreement to operate a business (and by implication sell food to patrons) or that the franchise agreement was useful or necessary to sell this food does not mean that the income is earned in terms of the franchise agreement. Given that the operative concept used in section 24C is a contract, as opposed to a transaction or scheme, in terms of which income is earned, a linkage or proximate cause between income from one contract and an obligation imposed by another is not a sufficient connection for the provision to apply.