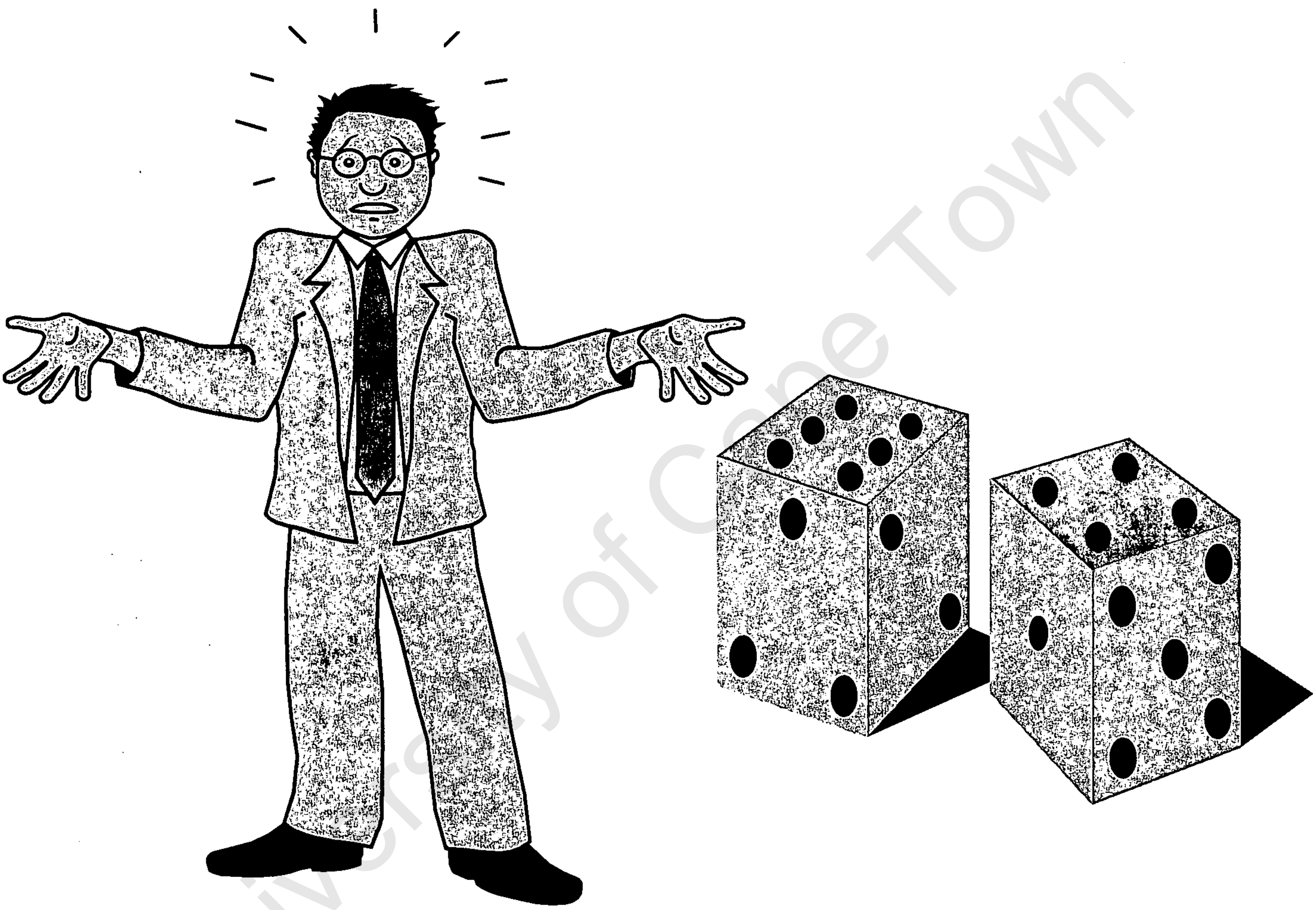
78%
JR

THE PERENNIAL PROBLEM: A CRITICAL ANALYSIS OF THE INCOME VERSUS CAPITAL DISTINCTION IN RESPECT OF SHARE TRANSACTIONS IN THE NEW "DIGITAL" ECONOMY



NAME: DAMIAN FRANE JURIC

STUDENT NUMBER: JRXDAM001

DEGREE: MASTER OF LAWS (LLM)

SUPERVISOR: PROFESSOR RICHARD JOOSTE

DATE: JULY 2000

"Research dissertation presented for the approval of the Senate in fulfilment of part of the requirements for the degree of Master of Laws in approved courses and a minor dissertation. The other part of the requirement for the degree was the completion of a programme or courses."

1. INTRODUCTION

This dissertation will examine the application of the test used to distinguish income from capital in South African Income Tax law and critically analyse the problems associated therewith. Such problems relate to the nature of a receipt or accrual upon the disposal of an asset as well as a range of other receipts and accruals including royalties, compensation, interest, rental and foreign exchange gains. The scope of this dissertation will be limited to an analysis of the problems of application in respect of the disposal of an asset, more specifically the case of share transactions on the Johannesburg Stock Exchange in the light of the development of the new or "digital economy". Following such an analysis of the inherent problems of the test as currently applied by courts in South Africa to such a situation, a brief summary is given of the legislative and other attempts made to resolve such a problem. The effectiveness of such solutions is further examined, particularly the proposed capital gains tax in the light of the experience of other comparative tax jurisdictions in dealing with the problem. Finally two suggested solutions are outlined to the problem, the acceptance of which it is contended will depend on the weighing up of the competing values of certainty versus equity in the South African tax environment at any given time.

CONTENT

NO		PG
1.	INTRODUCTION	2
2.	THE INCOME VERSUS CAPITAL TEST: THE BASIC INTENTION OF THE TAXPAYER	4 - 10
3.	CRITIQUE OF THE APPLICATION OF THE TEST IN RESPECT OF SHARE TRANSACTIONS IN THE NEW DIGITAL ECONOMY	11 - 39
4.	LEGISLATIVE AND ATTEMPTS MADE IN COMPARATIVE JURISDICTIONS TO RESOLVE THE PROBLEM	40 - 55
5.	QUO VADIS: SUMMARY OF THE CURRENT PROVISIONS AND PROPOSED SOLUTIONS TO THE INCOME / CAPITAL PROBLEM	56 - 62
6.	BIBLIOGRAPHY	63 – 66

2. THE BASIC INCOME /CAPITAL TEST: THE GOLDEN RULE OF INTENTION OF THE TAXPAYER

The current definition of "Gross Income" for the purposes of Section 1 of the Income Tax Act 58 of 1962, as amended, excludes from its ambit receipts and accruals of a "capital" nature from being subject to income tax -

"Gross Income, in relation to any year or period of assessment means, in the case of any person, the total amount in cash or otherwise, received by or accrued to or in favor of such a person during such year or period of assessment from a source within or deemed to be within the Republic, ***excluding receipts or accruals of a capital nature***." [1]

Consequently it is necessary to classify any particular receipt as being either of a capital or revenue nature, for as stated in *Pyott v CIR 1945 AD 128, 13 SATC 121* "there exists no halfway house" between these two concepts. [2] It is however possible to apportion a single receipt or accrual between its capital and income elements.[3]

Despite the pivotal nature of the distinction in the practical application of the Act, there exists no definition in the Act of what constitutes a "capital" receipt or accrual as opposed to an "income" receipt or accrual, on the basis that any attempted definition would have inherent limitations and further be extremely complex. The problematic side of such an approach as stated by Silke is that: " From the large mass of judicial decisions on the question whether a receipt or accrual is of a capital or income nature, it is obvious that the definition of a capital nature is not precise and that there is no infallible test for the question whether a particular receipt or accrual is income or capital." [4]

[1] Section 1 of the Income Tax Act 58 of 1962, as amended

[2] As stated by Maritz J in *CIR v Visser 1937 TPD 77 at 81*: " If we take the economic meaning of "capital" and "income" the one excludes the other "

[3] *Tuck v CIR 1988 (3) SA 819 (A), 49 SATC 28, 1988 Taxpayer 149*

[4] Silke Silke on South African Income Tax Vol. 1 par 3.12

The basic nature of the two distinct concepts as gleaned from the case law can be summarised as follows –

An **income receipt or accrual** will exist where an asset is disposed of or acquired by the taxpayer as stock - in - trade in the carrying on of a business for the purpose of resale at a profit in a scheme of profit making. As stated in *Lace Proprietary Mines v CIR 1938 AD 267, 9 SATC 349 at 358*: " Is the accrual the result of the productive use of capital employed to earn profits ? If so, it is income within the meaning of the Act for it is not accrual of a capital nature." In *Overseas Trust Corporation v CIR 1926 AD 444, 2 SATC 71 at 75*, Innes CJ further described income as : "a gain made by operation of a business in carrying out a scheme of profit making."

A **capital receipt or accrual** will exist where an asset is disposed or acquired not for the purpose of resale at a profit, but rather to produce income in the form of rent, interest, dividends and the disposal of the asset therefore constitutes the mere realisation of the asset at an enhanced value. The nature of the asset also surmises a degree of "permanence" in respect of retention thereof or as stated in *SIR v Aveling 1978 (1) SA 862 (A) at 880 E*: " soos blyk uit ….. hierbo, het 'n mens in die geval van vaste kapitaal 'n element van permanentheid, in die sin dat daar 'n bedoeling is om die bate min or meer permanent te hou met die doel om inkomste voort te bring" as well as *Barnato Holdings v SIR 1978 (2) SA 440 (A) at 454* :" that would tend to indicate that the shares were not acquired for better or worse or relatively speaking for keeps (i.e only to be disposed of if some abnormal, unexpected or special circumstance, warranting or inducing disposal intervened), which is the usual badge of a fixed capital investment."

The simplicity of the theoretical distinction, which belies the problems involved in practical application thereof by the courts, is most aptly captured by the following *dictum* of Maritz J in *CIR v Visser 1937 TPD 77, 8 SATC 271 AT 276*: " if we take the economic meaning of 'capital' and 'income', the one excludes the other. 'Income' is what 'capital' produces or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is often a matter of great difficulty for what principal or tree in the hands of one man may be interest in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller are a trade asset. A farm owned by a farmer is a capital asset, in the hands of the land jobber it becomes stock- in - trade."

The basic test applied and developed by the courts remains on the one hand subjective and is concerned with the state of mind or intention of the taxpayer in the acquisition and holding of the asset as gleaned from his *ipse dixit*.. Such subjective intention is assessed against the objective facts and circumstances surrounding such an asset in order to bypass the perceived problems with subjectivity, self-interest and the uncertainties of recollection on the part of the taxpayer.[5] The intention remains a question of fact and the onus of establishing such intention rests on the taxpayer by virtue of Section 82 of the Income Tax Act 58 of 1962, as amended. The following objective factors are utilised by the courts in assessment of the taxpayer's *ipse dixit* -

- <u>The duration for which the asset was held -</u>[6]

  A lengthy holding period is regarded as indicative of an asset of a capital nature, but the length of the holding period does not in itself raise such an inference. Thus in the case of <u>*Durban North Traders v CIR 1956(4) SA 594 (A), 21 SATC 85*</u>, the proceeds of an asset held for a period of eighteen years was held to be a receipt of an income nature, while in the case of <u>*ITC 862 (1958) 22 SATC 301*</u>, the asset disposed of had been held for a lengthy period of fifty years and nevertheless the proceeds on disposal were regarded as being of an income nature. A short holding period on the other hand provides a *prima facie* inference that the asset was held as stock in trade. This inference can be rebutted by the taxpayer adducing evidence to the contrary to the court.

- <u>The frequency and volume of the transactions involving the asset disposed of</u> –

  A large scale and volume of transactions in respect of the asset disposed of provides support for the view that the assets constituted stock - in - trade used for the purposes of a scheme of profit making. [7]

- <u>The nature of the taxpayers business</u>

  If the taxpayer's business involves the use of such assets as stock- in- trade, then the courts will be hard pressed to find that any transactions in respect of similar assets were not

[5] Silke <u>Silke on South African Income Tax</u> Vol.1 par 3.9
[6] De Koker and Urquhart <u>Income Tax In South Africa</u> Vol. 1 March 1988 Issue 13 par.5.17
[7] De Koker and Urquhart <u>Income Tax In South Africa</u> Vol. 1 March 1988 Issue 13 par.5.20

conducted in the course of the taxpayer's usual business such that the proceeds on disposal of such assets would be of an income nature.[8]

- <u>The method of realisation of the asset</u>[9]

  This factor involves two distinct inquiries namely (1) the reasons for realisation or the circumstances surrounding same and (2) the method chosen for realisation.

  In respect of the first inquiry it has been laid down by the courts that the following constitute reasons for the realisation of a capital asset –

- the asset is no longer of use for the business purposes of the taxpayer;[10]

- the asset is offered at an advantageous price;

- there is a serious change in business conditions necessitating the sale of the asset;[11]

- the taxpayer is legally obliged to sell the asset e.g in the case of expropriation;[12]

- the taxpayer is under pressure from creditors to sell the asset;[13]

- the failure of the taxpayers trade;[14]

- the dissolution of a partnership conducting business using the asset.[15]

In respect of the second inquiry the subtle distinction remains whether it can be said that the taxpayer was engaged in the "realisation of the capital asset to best advantage" or whether the realisation formed part of "the disposal of stock - in - trade for a scheme of profit making."

---

[8] See page 30; See also *SIR v Trust Bank Of Africa Limited 1975 (2) SA 440 (A), 37 SATC 87, 1978 Taxpayer 209*
[9] De Koker and Urquhart <u>Income Tax In South Africa</u> Vol. 1 March 1988 Issue 13 par.5.20
[10] De Koker and Urquhart <u>Income Tax In South Africa</u> Vol. 1 March 1988 Issue 13 par.5.20
[11] *CIR v Richmond Estates 1956 (1) SA 602 (A), 20 SATC 355, 1956 Taxpayer 32*
[12] *Greenband Properties (Pty) Ltd v CIR 43 SATC 151*
[13] *ITC 1431 (1986) 50 SATC 60*
[14] *ITC 706 (1950) 17 SATC 218*
[15] *ITC 743 (1951) 18 SATC 294*

- The circumstances of acquisition or disposal

The question here as stated in *Californian Copper Syndicate v Commissioner for Inland Revenue (41) Sc LR* remains whether " the gain was made by the operation of a business in the carrying out a scheme of profit - making." The presence of a motive other than profit does not however change the nature of shares as assets held as part of stock - in - trade as a profit motive is not a prerequisite for the carrying on of a trade. Thus in the case of *COT v BSA Co Investments Ltd 1966 (1) SA 530 (SRAD), 28 SATC 1*, a company had acquired as part of a large portfolio certain loan stock in respect of which there was no intention to sell at a profit. The court held that the loss made on disposal of such stock was deductible as stock in trade despite the lack of a profit motive. Therefore if an asset is acquired as an integral part of the normal trading business of a taxpayer, the fact that no profit motive exists does not change the nature of such assets.

Despite the large myriad of jurisprudence on the subject of the application of the test, the test itself remains extremely complex and uncertain, spawning a mass of litigation on point. It is submitted that the test is clearly unsatisfactory for the following reasons -

1. There is always confusion and tension between the subjective versus the objective elements of the test.[16] As stated in *CIR v Richmond Estates (Pty) Ltd 1956 (1) SA 602 (A), 20 SATC 355, 1956 Taxpayer32, at 610* by Schreiner JA: " there is no legislative provision that makes the intention of the taxpayer decisive of whether the receipt or accrual was of a capital nature or not." Certain *dicta* unequivocally support the acceptance of the taxpayer's *ipse dixit* in the assessment of intention, while others approach the honesty and / or reliability thereof with more suspicion. [17] The question also remains what objective criteria to use and the relative weights of each in deciding whether a receipt or accrual is of a revenue or capital nature. Differing approaches by the courts in this regard has led to inconsistencies and thus inequity for the taxpayer;

2. The original intention of a taxpayer may change between the time of the acquisition and disposal of an asset. More however is required to metamorphose the nature of a capital asset into a revenue asset than the mere fact that the asset is sold at a profit or that the asset is

[16] Emslie and Davis " Taxation of employee share incentive schemes – A polemic at the heart of the distinction between capital and revenue" 1990 SALJ Vol. 107 p. 1

[17] See *CIR v Middelman 1991 (1) SA 200 (C), 52 SATC 323, 1990 Taxpayer 232*, in which Berman J took a favorable approach in strong contrast to that of the court in *Malan v KBI 1981 (2) SA 91 (C)*

adapted to the exigencies of the marketplace in order to realise it to its best advantage.[18] Further something more is required than a mere change of intention to change the character of the assets.[19] The precise factors which infer such a change of intention are however undefined and seemingly contingent on the facts of each case.[20]

3. A taxpayer may have a mixed purpose in the dealing with an asset. The question then arises whether one purpose "can be regarded as dominant or whether the two purposes are merely co - existent or a dual purpose." As stated in *COT v Glass 1962 (1) SA 872 (A) at 884*: " A dominant purpose exists where the alternative objective, although in contemplation, and even a material factor in the general decision to buy, was entirely secondary and did not operate to a substantial extent in the taxpayer's mind. If his real motives were so mixed that it may be firmly said to have been substantial and almost equally contemplating both, the fact that he preferred one potential purpose to another would not amount to a dominant purpose." Such an inquiry is once again uncertain in that whether one purpose can be regarded as dominant "is essentially a matter of degree" [21] dependant upon the facts of each case.

4. The test of intention is also applied to juristic entities, however as a company is regarded as a separate legal entity from its shareholders and management, the test in this context requires an elusive search for what can be termed as "the intention of the company". As stated in *CIR v Richmond Estates (Pty) Ltd 1956 (1) SA 602 (A), 20 SATC 355 at 361*: " A company is an artificial person with no body to kick or soul to damn." Generally the formal acts of the directors of a company will be regarded as inferring the intention of the company for as stated in *Elandsheuwel Farming (Edms) Bpk v SBI 1978 (1) SA 101 (A), 39 SATC 163 at 175*, by Wessels J: " die doen en late van 'n regspersoon deur lewende wesens beheer word, en date hulle die brein en tien vingers daarvan is." [22] There exist however many instances in which the courts have been required to look beyond such directors and formal acts to ascertain the intention of the company from the actions of other persons deemed to be in effective control thereof. Thus the actions of a "management committee" [23] or "investment committee"[24] or majority shareholders have been used by the courts to infer such intention.

[18] *John Bell and Co v SIR 1976 (4) SA 415 (A) at 103; CIR v Stott 1928 AD 252 at 263, 3 SATC 253*
[19] *CIR v Richmond Estates (Pty) Ltd 1956 (1) SA 602 (A); 20 SATC 355*
[20] Silke Silke on South African Income Tax Vol.1 par 3.24; *Natal Estates Ltd v SIR 1975 (4) SA 177 (A)*
[21] See Steyn CJ in *African Life Investments Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163*
[22] See *Wilson v CIR 1926 CPD at 63* in which Benjamin J stated that " a company being an artificial entity, its intentions must be determined from its formal acts." In *SIR v The Trust Bank of Africa Ltd 1975 (3) SA 652 (A), 37 SATC 68 at 75*, Botha JA however argued that this dictum did not seek to lay down a general rule that a company's intention cannot be ascertained in any other way than by reference to its formal acts.
[23] *SIR v The Trust Bank of Africa Ltd 1975 (3) SA 652 (A), 37 SATC 68 at 75*

The uncertainty of the test is most evident in the following *dicta* of Kriegler J in *CIR v Guardian Assurance SA Ltd 1991 (3) SA , 1991 Taxpayer 212, at 212*: " a variety of circumstances come into play e.g. the nature of the asset, the character of the investor, the intention with which the asset was acquired ...... The distinction is a subtle one and is to be made upon an analysis of the respective facts. There is no simple and universally valid litmus test to decide whether particular income falls on the one divide of the ill defined borderline or the other is a matter of degree depending upon the facts and circumstances of the case." Smalberger J further indicates the uncertainty by implying the existence of a range of tests in *CIR v Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A), 54 SATC 271, at 56:* " There are a variety of tests for determining whether or not a particular receipt is one of a capital or revenue nature. They are laid down as guidelines only – there being no single infallible test of invariable application. In this respect I agree with the following remarks of Friedman J in *ITC 1450 51 SATC 70 at 76*: " But when all is said and done, whatever guidelines one chooses to follow, one should not be led to a result in one's classification of a receipt as income or capital which is, as I have had occasion previously to remark, contrary to sound commercial and good sense." He then seemingly contradicts the above by stating that the "appropriate test in the matter such as the present is a well established one." [25] The *dictum* of Friedman J clearly disregards precedent and further increases the vague and uncertain nature of the test.

[24] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163*
[25] *CIR v Pick 'n Pay Employee Purchase Share Purchase Trust 1992 (4) SA 39 (A), 54 SATC 271, 1991 Taxpayer 192, at p.56*

3. CRITIQUE OF THE APPLICATION OF THE TEST IN RESPECT OF SHARE TRANSACTIONS IN THE NEW DIGITAL ECONOMY

Clearly the uncertainty and complexity surrounding the test to distinguish capital from income is not particular to share transactions. Yet, as has been commented, shares differ from any other forms of assets in that there are daily reports of share movements, analysis of experts as to future prospects, which are valuable to both the share dealer and the investor. It would certainly make no commercial sense for an investor to ignore market information and hold shares on the basis of a long term investment where the state of the market / forecast for such shares is dismal and his portfolio is in danger of complete ruin.[26] As stated by Williams: " Unless the holder of shares puts the share certificates in the desk drawer and does not read the daily stock market reports, its is difficult to resist responding to fluctuations in value, especially where the share is on a downward trend." [27] The distinction between the investor in shares who "changes his investment (probably for sound reasons) and the share dealer (to whom the same reasons are open) is much blurred these days as a result of the tremendous market activity" spurred on by the rush out of the old economy to the new or "digital economy" Internet shares as well as the advent of online share trading.[28] As aptly noted in the Australian case of *Board Of Revenue 1979 (CTBR) NSW Vol. 23 CR 64*: " A trader and investor might have much the same intention of protecting their money and may each be obliged to sell." It is contended however that on the basis of the test currently applied, especially the approach to the concept of the " dominant versus co – existent intention", if the investor is educated enough to protect his investment and follows thereby an "active investment policy" [29]or "farms his portfolio assiduously"[30] involving a frequent and large turnover of share counters or where there is evidence of "careful portfolio management" [31],

[26] " Share Investor or Share Dealer" The Taxpayer 1986 (45) p. 142 - 143
[27] Williams " Share dealers and Income Tax" 1997 SALJ Vol. 114 p.481. A daily share report contains a myriad of information such as the price/ earnings ratio, Dividend Yield, days volume, days move, ruling price
[28] "Share Dealer or Share investor" 1996 (45) Taxpayer p. 144. Currently all buy / sell orders on the JSE are executed by way of communication by the investor of trading instructions to registered stock brokers on the JSE. Future technology however envisages that in the near future buy/sell orders will be directly entered into the JSE computer trading system by the investors themselves directly from their own personal computers as occurs in the United States. It has to be noted that currently the online trading phenomenon which has taken the US by storm is unlikely to immediately hit South Africa given the fact that Internet use is largely limited to the upper end of the socioeconomic scale and this is reflected by the statistic that by December 1999 there were only 1.8 million Internet users in the country. The expansion potential of the market as the technology becomes more widespread has however been accepted as exponential.
[29] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259(A), 31 SATC 163, at p.267*
[30] *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 163, at p. 1156*
[31] *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 163 at p. 1161*

current case law dictates that he may "cross the Rubicon" [32] and be classified by the SARS as a share dealer with obvious adverse tax consequences. [33]

Consequently it is contended that statements like "transactions in shares are for tax purposes essentially the same as thing as dealings in any other kind of property" [34] and " the fact that one is investigating a share dealing transaction makes no difference to the principles involved in deciding whether the proceeds of a particular transaction are capital or revenue" [35] cannot be accepted as an accurate reflection of an equitable tax policy given the complex structure of the emerging financial markets, particularly the new "digital economy." [36]

The response by the proponents of the traditional test would be that in such a case an investor will escape classification as a share dealer if he is able to establish that the shares were held on a long term basis and that the sale or purchase transactions were merely concluded for the protection or maintenance of capital or in other words that " faced with the definite danger of the loss of a substantial portion of a share portfolio, a prudent investor, although holding shares as a long term investment, could argue successfully that he sold his shares in order to protect his capital."[37]

Such an approach is however unworkable in practice given that there exist a number of inherent problems with the application of the test to share transactions as gleaned from the case law, particularly in the light of the development of the new or "digital economy"–

- The tendency will be for the SARS to raise an assessment on the proceeds of such transactions if there is any doubt as to the nature thereof, particularly more so in the case of share transactions it is contended, as there has always been a suspicion by the SARS that wealthy taxpayers have avoided income tax via "investment in shares" and the reporting of such as capital assets for tax purposes. As stated as far back as 1969: " There is also a very practical aspect that a goodly percentage of share and property dealers are in fact escaping tax on income under the guise of capital gains.

[32] *Natal Estates Limited v SIR 1975 (4) SA 177 (A), 37 SATC 193, 1975 Taxpayer 161, at p. 203*

[33] Other regulations also remain problematic in the Internet area of share trading such as the Securities Control Act, the Banks Act Exchange Control Act as well as the Exchange Control Regulations. The question remains in respect of shares offered by foreign exchanges – when is such an offer of shares over the Internet and offer of shares in South Africa and what regulations are applicable ?

[34] Statement made by President in unreported judgment of the Special Court for the Hearing Income Tax Appeals. Silke Silke on South African Income Tax Vol.1 par 3.94

[35] Niland C B "An inquiry into the nature of capital with special reference to CIR v Middelman" University of Cape Town Unpublished LLM Dissertation October 1990 p.7; See also Smalberger JA in *CIR v Pick 'n Pay Employee Share Trust 1992 (4) SA, 54 SATC 271, 1992 Taxpayer 192 at p.56*

[36] See also Meyerowitz Meyerowitz on Income Tax 1999/2000 The Taxpayer par.8.36

The ever increasing daily turnover in share transactions is clear evidence of speculation. How many of these "investors" who are in and out or who stag their shares, pay tax on their resultant profits ? " [38] Where an assessment has been raised by the SARS that a receipt or accrual is either capital or income, the procedure requires that the taxpayer pay the assessed amount and then lodge an objection with the Special Court. [39] Such proceedings are inevitably arduous and expensive such that any action may not be worthwhile for the taxpayer to pursue. The SARS may further extend the matter beyond the Special Court to the Appeal Court, especially if the matter at hand constitutes a test case which will have far reaching financial implications for the fiscus. [40]

Throughout all such proceedings the taxpayer is further faced with the onus of proving the nature of the transactions concluded, an onus which albeit contentiously, has been phrased by the Appeal Court as "formidable and difficult". This raises the question whether in fact the onus requires a higher standard of proof than the conventional balance or preponderance of probabilities traditionally applied in civil cases. As stated by Trollip J in *Barnato Holdings Limited v SIR 1978 (2) SA 440 (A), 40 SATC 75, 1978 Taxpayer 209, at 454*: "hence a "formidable and difficult" onus rested on the appellant to convince the court a quo that the shares disposed of during the relevant period were originally acquired as fixed capital, or putting it another way, that such shares were not disposed of in the course of the appellant conducting an additional, secondary business of dealing in those shares for profit." In *CIR v Nussbaum 1996 (4) SA 156 (A) 58 SATC 283, at 1165*, Howie JA approved of the above *dictum* as quoted in *Barnato Holdings Limited v SIR 1978 (2) SA 440 (A), 40 SATC 75, 1978 Taxpayer 209*: "It is clear from the evidence that all three of the abovementioned considerations which motivated the respondent, exist in the present case. He was therefore saddled with a formidable and difficult onus."

In CIR v Middelman 1991 (1) SA 200 (C), 52 SATC 323, 1990 Taxpayer 323, at p.202, Berman J reasoned that the description of the onus as 'formidable and difficult' did not seek to lay down a different or higher standard of proof than that resting on a balance of probabilities. He contended rather that in the prior cases the reference to "formidable and difficult" related to the particular circumstances of each case in which the evidence seemed

---

[37] See for example the *dicta* of Kriegler JA in *Guardian Assurance Company SA Ltd 1991 (3) SA 1 (A), 153 SATC 129*; See also "Capital vs Revenue: The Perennial Problem" 1978 (27) No.5 The Taxpayer p.1
[38] "Capital gains Tax" 1969 (18) The Taxpayer p.62
[39] Section 82 of the Income Tax Act 58 of 1962, as amended
[40] "Capital Gains Tax" 1979 (28) Taxpayer p.66

heavily stacked against the taxpayer (*although the existence of such factors it will be argued later does not necessarily justify such a conclusion*) and did not lay down a higher standard of proof than that resting on a balance of probabilities.[41]

Meyerowitz, although conceding that only *dicta* exist that the onus of proof remains that on a balance of probabilities, merely concludes that there is no doubt that such is the onus on the basis of the general standard of proof applicable to all civil cases. [42] Irrespective of the above debate, the fact that the taxpayer in the majority of reported cases has failed to discharge such an onus, is indicative of the harsh reality of the application of the current test by our courts.

- Further as pointed out by Silke, [43] although it has been suggested that because the inquiry is a matter of inference from the facts and thereby a question of law [44] such that the onus resting on the taxpayer is not relevant [45], the reality is that there are innumerable cases on point in which the taxpayer has been found not to have discharged the onus. In particular certain cases have the characteristic in which a question of law, "not even dealt with during the proceedings, turned out to be found critical to the court's decision, in which case the taxpayer is precluded from repairing such deficiency" and thus found not to have established "proof" on such an element on which the case is finally decided. [46]

- Despite the fact that the taxpayer's intention is regarded as relevant, such subjective intention has to be verified with reference to objective facts and circumstances and certain *dicta* from the courts express an unmistakable suspicion and contempt for the honesty or reliability of such subjective intention of the taxpayer. As stated in *ITC 1185 35 SATC 122 at 123:* " It is often very difficult to discover what (*the taxpayer's*) true intention was. It is necessary to bear in mind in that regard that the *ipse dixit* of the taxpayer should not lightly be regarded as

[41] An extensive analysis of Section 82 and the burden of proof is detailed by Rubinsztein who concludes that: " There have been a number of cases and articles which seem to indicate that the onus of proof which must be discharged is on a preponderance or balance of probabilities." Rubinsztein A Burden of Proof: An historical and theoretical analysis of some aspects of the Income, Assessment and Objection and Approval in relation to the interpretation of Section 82 of the Income Tax Act 58 of 1962 Unpublished LLM Dissertation University of Cape Town September 1992; See also the following early cases in which such an onus was discussed on the basis of a balance of probabilities: *Reliant Land and Investment Co (Pty) Ltd v CIR 1946 WLD 177, 14 SATC 47 and CIR v Goodrick 1942 OPD 1, 12 SATC 229.*
[42] See also Meyerowitz Meyerowitz on Income Tax 1999/2000 The Taxpayer par. 8.70
[43] Silke Silke on South African Income Tax Vol.1 p.ar 3.4
[44] See the comments made by Smalberger JA in *Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A), 54 SATC 271, 1992 Taxpayer 192 at p.56*
[45] *ITC 1450 (1988) 51 SATC 70 at 77; Platt v CIR 1922 AD 42 at 49 – 50*: " The proper rule has, I venture, been laid down by Lord Parker in *Farmers Cotton Trustee (1915) AC 922*, and its seems to me to be confirmed by the weight of judicial decision in the English courts. He said: "Where all the material facts are fully found, and the only question is whether the facts are such to bring the case within the provisions properly construed of some statutory enactment, the question is one of law." See also Nicholas JA in *CIR v Pick 'n Pay Employee Share Purchase Trust1992 (4) SA 39 (A), 54 SATC 271, 1992 Taxpayer 192*
[46] Silke ibid 3.4

decisive. It is the function of the court to determine an objective review of all the relevant facts and circumstances what the motive, purpose and intention of the taxpayer were.... Direct evidence of intent and purpose must be weighed and tested against probabilities and inferences normally to be drawn from the established facts." The court in *Malan v Komissaris van Binnelandse Inkomste 1981 (2) SA 91 (C) at 96 F – G*, displays a further contempt for the acceptance of the taxpayer's *ipse dixit*: " mense se bedoelings is dikweld wisselend, ongevorm en ongeformuleer, en hule *ex post facto* getuienis daaroor, hoewel eerlik, is dikwels onbetroubaar of bestaan uit blote rekonstruksie." Thus because of potential subjectivity, dishonesty, self interest, the uncertainties of recollection and the possibility of mere reconstruction on the part of the taxpayer, the courts will scrutinise the evidence of the taxpayer as to his *ipse dixit* in the light of the surrounding facts and circumstances as well as "general human and business probabilities" in order to assess what may be termed the "true intention" of the taxpayer. [47] Even Berman J in the case of *CIR v Middelman 1991 (1) SA 200 (C), 52 SATC 323, 1990 Taxpayer 32*, conceded that the frequent approach of the courts has been to reject the *ipse dixit* of the taxpayer, not on the basis of dishonesty, but rather because of the inherent subjectivity of recollection connected with same.

It is accepted however that an investor's reasons for sale / purchases of shares is a subjective matter difficult to verify objectively as demonstrating a consistent soundness of logic. A large number of share investors work on "hunches, newspapers as well as tips received at social gatherings." [48] The movement of the shares themselves is often based on supply and demand created by market expectation, rather than the financial performance of such companies. [49] An excellent example of this phenomenon is to be seen in the information technology industry, specifically in relation to e-commerce or **dot.com** companies on listed exchanges. Share analysts from Morgan Stanley recently estimated that 70.0 % (seventy per centum) of the Internet companies that have already gone public will never make any money and that over 90.0 % (ninety per centum) are already fully priced.

[47] Silke ibid 3.4; In *CIR v Richmond Estates (Pty) Ltd 1956 (1) SA 602 (A), 20 SATC 355 at p.365*. Schreiner J commented : " There is no legislative provision that makes the intention of the taxpayer decisive of whether the receipt or accrual was of a capital nature or not." The following quote from Halsbury's Laws of England further adds to this critical sentiment: " On the other hand, intention can in may cases be properly out in issue, and when his is done it becomes the subject of evidence, for the state of a man's mind is as much a matter of fact as the state of his digestion." *ITC 1308 (1978) 42 SATC 154 at 158* per Melamet J.

[48] "Share Transactions" The Taxpayer April 1978 Vol.27 No.4 p. 62

[49] "Share Transactions" The Taxpayer April 1978 Vol.27 No.4 p. 62

Despite this prediction market hysteria has provided the following examples which run contrary to traditionally accepted financial investment principles – [50]

1. **Amazon.com,** an Internet retailer, increased its market capitalisation between 1997 and 1999 from $USD 2 billion to almost $USD 30 billion despite the fact that the company's recorded net loss increased from $USD 2 million to $USD 30 million over the same period;

2. **Softbank**, a giant Internet conglomerate, whose shares are now worth 100 (one hundred) times forecast revenues;

3. **Ito Yokado**, a respected Japanese supermarket chain which has a market capitalisation of Y 3.5 trillion (approximately $USD 32 billion). Its 50.7 % (fifty point seven per centum) stake in Seven Eleven, a convenience store chain which has recently ventured into the Internet arena, is now valued at Y 5.4 trillion (approximately $USD 49 billion), suggesting an irrational conclusion that the rest of the group is worth less than nothing;

4. **Qualcomm**, a US Internet company recorded a 2 500 % (two thousand five hundred per centum) increase in its share price during the course of 1999, in contrast to a modest turnover and net profit over the same period;

5. **The US NASDAQ Index**, "home of the technology shares", doubled in value between August and December of 1999.

In contrast "old economy" shares which have been recording solid profit and dividend yields have fallen markedly owing to the frenzy surrounding capital flight to the Internet. **Whitbread** for example, a large brewer with a turnover of some 3 billion pounds, now risks being relegated from the **FTSE 100 Index** and replaced by **Baltimore Technologies**, a software group with an annual turnover of a mere 23 million pounds. [51] The share values of the major consumer giants such as **Heinz**, **Kellogg**, **Mcdonalds**, **Gillette** and **Coca - Cola** have on average fallen by 30 % (thirty per centum) and the recent announcement by giant **Procter and Gamble** of a mere 10 % (ten per centum) drop in earnings caused the

[50] Lindsay R "Dotcomuppance !" Business Day July 14, 2000 as found at http:///www.thisislondon.co.uk/

[51] Lindsay R "Dotcomuppance !" Business Day July 14, 2000 as found at http:///www.thisislondon.co.uk

company's share price to drop from $ 87.00 (eighty seven dollars) to $ 60.00 (sixty dollars), effecting a marked loss of almost 1/3 (one third) of the company's current market capitalisation.[52]

Investors are therefore clearly taking a huge gamble with technology stocks based primarily on fear than optimism: fear of rising interest rates (*against which Internet shares are seen as a hedge*), fear of missing out on new developments which have the potential to transform the marketplace and fear of underperformance. [53] Thus a massive shift has occurred throughout the major markets into such shares. Individual investors hooked on online trading have been at the forefront of this movement followed by institutional investors, which has further increased the upward momentum. This momentum has in turn by its sheer force pulled in further institutional investors who have had to follow such a lead or risk underperforming against their rivals.[54] Index tracking institutional investors as well as hedge funds have also magnified the momentum on the basis that the increased weight in the market of such shares is huge when compared with the "free float" of such shares available, with the result that the effect of such institutional purchases is often magnified.

The incoherence of investment strategies in such technology shares is further promoted by the fact that the traditional mechanisms used to assess the value of shares do not operate effectively when dealing with such technology shares – [55]

- The price to net asset value ratio (**P / NAV**) is not useful as the value of such technology companies is to be found in the highly mobile intellectual capital of its personnel or intangible property such as software, rather than in any physical or tangible fixed assets;

- The **debt to equity ratio** (**D / E**) is not effective in that many of the Internet companies have been able to gain funds from the issuing of new shares rather than the incurring of debt. Given that there is no perceived risk of high interest repayments affecting future profitability the balance sheets of such companies would reflect a healthy position;

[52] "Trouble in Brand City" Time Magazine March 20, 2000 Vol. 155 No.11
[53] Cameron "Picking shares like the pros" Personal Finance Vol. 4 July 7, 2000 p.37
[54] Cameron "Picking shares like the pros" Personal Finance Vol. 4 July 7, 2000 p.38
[55] Cameron "Picking shares like the pros" Personal Finance Vol. 4 July 7, 2000 p.38

- The **Earnings Per share (EPS)** figure is misleading in that many of such companies would reflect a growing EPS as a result of an aggressive acquisitions policy, despite the fact that long term management is weak and the pace of acquisitions unsustainable;

- While the cost of capital increased during the course of 1999 for those companies raising money via debt issue owing to increased interest rates, the cost of capital for share issuing technology companies on the **NASDAQ** was actually declining owing to the rapid increase in their share prices. The top end of the technology market (such as **Qualcomm** for example) seemed almost to reflect a zero cost, with the result that management was able to justify investing in projects that generated even marginal returns. This meant that companies with business models that did not promise profits or dividends for years could push such profits or dividends further into the future by acquiring new businesses and their revenues or simply acquire new customers by pouring the money raised from share issues into marketing. Analysis of the company's investments on the basis of a cost of capital versus return would therefore yield an inaccurate picture of the stability and performance prospects of such investments.

- As such companies have only recently emerged from the explosion of the Internet and related e-commerce applications, there is no track record on which to analyse the operating and financial structure and thereby evaluate future performance. Technology related to the Internet is further developing at such a rapid pace that many of such companies may be surpassed by such developments at any time, making a long term forecasts exceedingly difficult;

- The business of such companies often relates to technical aspects of Internet e-commerce and is not fully understood by investors, such that it is difficult to do an effective risk analysis or monitor the operations of the company;

- The valuation of the company reflects an improper picture as most of such growth has been unprofitable and relied solely on the cheap cost of capital reflected in an overinflated share price;

- The traditional use of the **Dividend Yield (Dividend / Share Price)** is not useful in that technology shares have only projected long term earnings while their share price remains overinflated, meaning that their dividend yields are fairly low even for those with promising long term earnings potential. This it is contended is not inconsistent with an investment policy aimed at long term growth. The use by the courts of such a yardstick in the application of the test remains further problematic in that general practice indicates that proceeds from the sale of shares with a low dividend yield are regarded as *prima facie* income, the inference being that such shares are held not for a return in the form of dividends but rather for resale at a profit on expectation of a share price increase. This inference may become more problematic where it can be established that the taxpayer has borrowed funds in order to purchase such shares and the interest rate on such a loan exceeds the current dividend yield of the shares purchased. Thus in the case of *ITC 122 (1974) 37 SATC 17,* such an inference was raised where the taxpayer purchased shares with a dividend yield of 0. 2 % (zero point two per centum) with a loan bearing interest at 9.5 % (nine point five per centum). [56] There would seem however no reason given the above why, as the taxpayer commented in *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283, at p.1159,* that "an investment decision cannot be based on the expectation that a share will pay adequate dividends later on rather than in the near term."

The court in *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283* seems to suggest that the criterion to be used by an investor to switch shares should relate to the quantum of the dividend rather than to the dividend yield relative to current market value, the latter case involving an active investment policy which contemplates profits such that the reasoning of *Barnato Holdings* becomes applicable in ascribing a secondary purpose of share dealing. The fact however remains that the mere quantum of dividend alone does not allow an investor to make an accurate assessment of the inherent value of a share as a long term prospect and consequently some comparison is required for such a variable to be meaningful.

During the first half of 2000 however, such technology shares experienced an unprecedented crash as investor concerns regarding the viability of many of the e-commerce companies emerged coupled to the antitrust efforts to break up the most valuable technology company in the world being Microsoft, as well as moves by the Federal Reserve in the US to raise interest rates in order to prevent inflation of the already "over heated" US economy. Between March 10 and April 4 of 2000, the combined value of the technology stocks on the **NASDAQ** fell by

[56] De Koker and Urquhart Income Tax in South Africa Vol.1 (1988) Issue 13 par 5.17 – 5.20; see also *ITC 1482 (1990) 52 SATC 298*

a massive $USD 1.1 trillion dollars or 13.6 % (thirteen point six per centum), sparking a worldwide decline in technology share markets as investors scrambled to sell declining shares as expectations of the market folded. [57]

The rapid meltdown in confidence was most evident in the shares of the so called **dot.com** companies, the bulk of whose shares have plunged between 50 % (fifty per centum) and 75 % (seventy five per centum) below their initial 12 (twelve) month highs, with many in fact trading below their initial purchase offers (IPO), including –[58]

1. **Drugstore.com**, an online pharmacy that went public during the course of 1999 at a price of $ 65.00 (sixty five dollars), is now trading at a mere $ 10.88 (ten dollars and eighty eight cents);

2. **Thestreet.com**, an online financial news and advice site that went public during the course of 1990 at a price of $ 71.25 (seventy one dollars and twenty five cents), is now trading at a mere $ 7.63 (seven dollars and sixty three cents);

3. **DrKoop.com**, an e-tailer that went public during the course of 1999 at a price of $ 36.90 (thirty six dollars and ninety cents), is now trading at a mere $ 3.06 (three point zero six dollars);

4. **Lastminute.com**, an online service site's share price has lost 44.0 % (forty four point zero per centum) since its debut in March of 2000;

5. **Beyond.com**, an online software seller that went public during the course of 1999 at a price of $37.0 (thirty seven dollars) is now trading at a mere $ 3.75 (three dollars and seventy five cents).

There further seems to be currently some confusion between investors regarding the relationship between the inherent value of the "old economy" blue chip shares represented on the Dow Jones and the new or "digital economy" shares represented on the **NASDAQ**, which promise the undeveloped market potential of the Internet. Investors are aware that these two

[57] West "The Top 13 Reasons for the NASDAQ crash" as found at http://www.sistenb.com
[58] West "The Top 13 Reasons for the NASDAQ crash" as found at http://www.sistenb.com

markets have to come together, however there is no certainty on how such relationship will be constituted. As has been pointed out "the current volatility of the markets says nothing about where the markets are headed – only that confusion reigns." [59]

The world's best known investors have begun to pull money out of the markets after heavy losses on the basis that the market has become irrational, being one in which the trusted ways of valuing shares no longer works and the relationships between assets and economic variables no longer applies.

Examples include –[60]

- **George Soros**, who recently closed down his two largest hedge funds, being **Quantum** and **Quota;**

- **Warren Buffett** of **Berkshire Hathaway Investments**, who recently warned that the company's equity exposure was too high given the volatility of the market and that such exposure should be drastically reduced;

- **Julian Robertson**, another well-known financier, who recently closed down **Tiger** a large and influential global hedge fund.

Given the current fluid and irrational trend of the world share markets it is and will become increasingly more difficult for an investor to show a consistent method or logic to investment practice required to escape the classification as a "share dealer". The current test is thus ill - suited to the exigencies of the new market.

[59] "Monopoly Money" The Economist 8 April 2000 as found at http://www.economist.com
[60] "Monopoly Money" The Economist 8 April 2000 as found at http://www.economist.com

The developments will further not escape emerging markets such as South Africa and the Johannesburg Stock Exchange on the basis that –

- as an emerging market and the due to the effects of globalisation, the Johannesburg Stock Exchange will follow the trends of the major exchanges such as the **NASDAQ, Dow Jones, FTSE, Hang Seng** etc.;

- there are attempts being made to link certain of the exchanges worldwide which will have the effect of producing 24 (twenty four) hour exchanges, increasing the globalisation effect (*the Frankfurt Exchange and the London Exchange have been involved in recent discussions for such a link*);

- as Internet technology becomes more widespread in application in South Africa, the potential exists for a separate exchange from the main body of the Johannesburg Stock Exchange dealing only with technology shares similar to the **NASDAQ** in the USA.

- It is unclear whether the test gives enough attention to the impact of inflation and thus distinguishes between real and nominal rises in share value when considering the "profit motive" of the investor. In the Nussbaum case for instance the taxpayer lamented that: "in the prevailing inflationary environment it was almost impossible to make losses." [61]

Howie JA however did not countenance such a reason as valid and merely reasoned that (1) the dividend yield had not decreased as a result of the decrease in quantum of dividends and that (2) it was inherently improbable that a decline in dividends would not be accompanied by a fall in market value [62]; such that (3) the decrease in dividend yield was the result of the increase in the market price and it was this factor irrespective of the length that the shares had been held that occasioned profit: " Given the close watch that the taxpayer kept on his portfolio and on every shareholding within it, and bearing in mind his meticulous attention to detail, it is most unlikely that he was aware of the profit implications in selling when the dividend yield had fallen .... Not only was the profit inherent in the sale of shares whose

[61] CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283, at p.1159

[62] The correctness of this assertion is questionable. A company may retain earnings for investment purposes and the market price may in fact react positively to such as a sign of long term investment potential. The assumption here made by Howie J in respect of the relationship between the market price and dividend yield is therefore far too simplistic

dividend yield had dropped, but the taxpayer manifestly worked for it. He farmed his portfolio assiduously." [63] [64]

Clearly, with respect to Howie J, the market price might have increased but was this merely a nominal increase caused by inflation over the prolonged period over which the shares were held (as contended by the taxpayer), rather than a real increase or profit which would provide evidence of a secondary purpose of the sale of shares as stock- in- trade in a scheme of profit making ? Mcmenamin is of the opinion that the courts have in fact referred to the impact of inflation although not directly on point. Thus he refers to Hefer JA's statement in *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353 (A), 52 SATC 9, 1990 Taxpayer 70, at 367* in respect of the current valuation of amounts to be received in future: " It is the right to receive payment that accrued to the taxpayer; it is that right which has to be valued and as stated before its value is obviously affected by its lack of immediate enforceability". [65] This minor concession is hardly evidence of an overall acceptance by the courts of the impact of inflation on the determination of capital versus revenue in terms of the traditional test applied. A legislative amendment to the Income Tax Act during the course of 1990 provides that the present value of such a right be utilised. The basis of such calculation relies on the face value of a debt discounted at some acceptable rate determined by the market's view of the future movement of interest rates rather than an assessment of the inflation rate.[66]

The erroneous view of what constitutes *a profit* is strengthened by the absence of any comprehensive inflation indexing to be found in the current capital gains tax proposals introduced by the government in the 2000 Budget. This omission runs contrary to the recommendations of the Katz Commission (1995), which advocated that if such a capital gains tax was introduced: " a suitable index to deflate the nominal gains in an inflationary environment" was required to ensure equity. [67] The current proposals seek to deal with this issue by merely having a low inclusionary factor 25 % (twenty five per centum) in the case of individuals and 50 % (fifty per centum) in the case of companies and fails to introduce at

---

[63] *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283 , at p. 1165*

[64] See Howie J's comments in *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283, at p. 1165*

[65] Mcmenamin M S "Taxation of Capital in South Africa" University of Cape Town Unpublished LLM Dissertation Sept. 1991 p.35

[66] Emslie Davis Hutton Income Tax cases and Materials (1990) at p. 42; As stated by Williams: " It also has to be remembered that income tax is levied on the nominal value of gains, and the affects of inflation are ignored." Williams "Share dealing and Income Tax" 1996 SALJ Vol.107 p.485; Although the inflation rate is a factor considered in the assessment of future interest rates

[67] Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par. 12.10 See also the debate in the US for indexing of capital gains "Capital Gains Tax: Fairness ?" Joint Economic Committee of the Senate at http:www.senate.gov/comm/jec/general/capgntstax.html

this point any comprehensive inflationary index. The unfairness of the failure to give attention to the effects of inflation and the consequent failure to make the real versus nominal return distinction, can easily be viewed by way of an example: An investor purchases shares for R 100,000 (one hundred thousand rands) on the Johannesburg Stock Exchange during the course of 2000 and sells the shares in 2005 for a price of R 130,000 (one hundred and thirty thousand rands), making a nominal return of R 30,000 (thirty thousand rands). According to the Consumer Price Index (CPI) inflation rose by 40.0 % (forty point zero per centum) over the 5 (five) year period. The investor consequently owing to the lackluster performance of the shares over the period on the Johannesburg Stock Exchange in comparison to the inflation rate, made a real loss of R10,000 (ten thousand rands) or 10.0 % (ten per centum) on the investment.

Now if we apply the traditional test to such an investor, surely when we analyse the profit motive of the investor it is necessary to examine the real return (*which in this case is negative*) rather than the nominal return ? Any gains which fail to match the general increase in the price level are illusory and therefore should not be assessed as "profit" when assessing the profit motive of the investor in the application of the test. [68] It is submitted that a major deficiency exists in the current approach by the courts to such an issue, being divergent from the realities of basic macroeconomic principles.

- It is submitted that the scale and frequency of share transactions has been given undue importance in the application of the test by the courts. <u>As Silke reminds us</u>: " It must be emphasised that profits on share transactions do not become taxable only when the frequency and scale of the of the transactions are so great so as to constitute the carrying on of a business." [69] The *dicta* that appear from the jurisprudence of the courts seem however to place great weight on such a factor. In <u>*CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283, at 1165*</u>, Howie J for instance states that: " Reverting to the facts, one is immediately struck by the scale and frequency of the respondent's share transactions. These considerations are of course not conclusive, but they are of major importance."[70] Niland further concludes on this issue in a similar vein " the question whether the taxpayer has gone over to trading in either

[68] Interim report of the Commission of Inquiry into certain aspects of the tax structure of South Africa (1994) (The Katz Commission) par. 6.3.28
[69] Silke <u>Silke on South African Income Tax</u> Vol. 1 par 3.93
[70] See also <u>*Barnato Holdings Limited v SIR 1978 (2) SA 440 (A) at 458*</u>

case depends largely upon scale." [71] Increasingly aggressive trading by Funds and individuals via the introduction of low cost switching services, the new computerised trading system STRATE to be used on the JSE, the emergence and uncertainty of the new "digital economy" as well as the development in future of direct online trading of shares, means that there is a substantial risk of the SARS taking aggressive action in future on a routine basis except in cases where only a small volume of shares is involved, despite the fact that such aggressive trading is a basic requirement for survival in the current market even for non – share dealers hoping to merely maintain their capital investment. As pointed out further, even if in any particular year the SARS accepts that there is no share dealing, the taxpayer remains in jeopardy in successive years as his transactions proceed and the SARS examines the cumulative total of such transactions. The SARS may then decide to tax not only the profits in the current year "but also to re open the assessment of for previous tax years. The taxpayer regarding himself as an investor will also not during any such periods claim losses incurred as deductions."[72]

A taxpayer in such a case may well find that he may be deprived of the losses / expenses associated with such transactions (*on the basis of the accounting principle of "matching"*) while reassessment at the ends of the period might classify such transactions as share dealing and the proceeds thereof therefore subject to taxation.[73] The exigencies of the new market would require a review of the approach taken toward the nature of a capital investment as traditionally cited by Trollip JA in *Barnato Holdings Ltd v SIR 1978 (2) SA 440 (A), 40 SATC 75, 1978 Taxpayer 209, at 454*: " That would tend to indicate that *prima facie* that those shares were not acquired for better or for worse, or relatively speaking for "keeps" (Only to be disposed of if some unusual, unexpected or special circumstance, warranting or inducing disposal supervened) which is the usual badge of a fixed, capital investment", especially in relation to the definition of what could be termed "long term" versus "short term" length of the holding of the asset for the purposes of such an inquiry. The traditional approach may have been accurate during the period when the Johannesburg Stock Exchange was isolated from the world markets and the technology era had not as yet arrived. It is however clearly deficient in the new technology driven global economy.

[71] Niland C B "An inquiry into the nature of capital with special reference to CIR v Middelman" University of Cape Town Unpublished LLM Dissertation October 1990 p. 13
[72] "Share transactions" The Taxpayer April 1978 Vol.27 No.4 p. 64
[73] "Share transactions" The Taxpayer April 1978 Vol.27 No.4 p. 63

The aggressive and suspicious nature of the SARS is further likely to be fueled by the rapid development of direct online share trading, which will allow individual and small businesses to trade in shares without the SARS being able to keep effective track of the proceeds of such transactions as – [74]

1. many of the electronic payment systems, such as electronic cash and stored value cards are being designed to operate like cash such that their use cannot be associated with a particular operator;

2. source documents such as invoices and receipts traditionally used by the SARS to assess the date and value of such transactions will now exist in electronic format which can be altered and further may be encrypted making access difficult;

3. the link between the taxpayer and the transaction is weakened in the electronic commerce environment;

4. issues relating to jurisdiction and the institutional roles relating to tax collection under electronic commerce are extremely complex and challenge existing legislation. Operating within cyberspace means that the physical location of a business is almost irrelevant as undetectable a data files and related hardware can easily be moved from one location to another, challenging the traditional operation of basic Income Tax concepts like "source", "deemed source" and the apportionment provisions under the existing Income Tax dispensation;

5. effective collective and administrative mechanisms are under challenge because the traditional leverage point the "middlemen" forming the link between the share dealer and the share transaction (*being the stock brokers*) are under threat due to the process of the Internet known as "disintermediation."

   The aggressive tendency is likely to be fueled by the projected statistic that business to business electronic commerce will reach $ USD 4 (four) trillion dollars by the year 2003, thereby increasingly making up a larger percentage of trade and potential

---

[74] Report on Electronic Commerce 26 Nov.1999 at http://www.ecomm-debate.co.za/

revenue.[75] In the United States the policy of the Internal Revenue Service has been to adopt a "hands off " approach, via the passing of the **Internet Freedom Act of 1998**. This controversial legislation involves the placing of a moratorium on the imposition of new taxes for a period of three years on Internet transactions and is designed to "establish a national policy against state and local interference with interstate commerce over the Internet." [76]

Critics of such legislation have however argued that the effect of such a moratorium in the United States will be -[77]

1. to drastically reduce the revenues of the respective states and counties. Internet Server Provider (ISP) receipts from access charges it is estimated are in the region of $ 50 billion dollars annually, meaning that potential revenue of $ 500 million dollars will be lost to the fiscus from such a source. Sales transactions over the Internet it is estimated will further reach $ 344 billion dollars by 2002, meaning that another large portion of potential revenue may be lost;

2. to benefit the wealthy taxpayers. Surveys conducted in the United States have confirmed that over 80.0 % (eighty per centum) of high income households (being those with an average annual income of over $ 100,000 (one hundred thousand dollars) had personal computers while only 25 % (twenty five per centum) of low income households (being those with an average annual income of less than $30,000) had personal computers and thus access to the Internet.

   Clearly therefore a great inequity would arise where wealthy taxpayers are able to avoid sales and other taxes by conducting transactions over the Internet, while poorer taxpayers are forced to use customary physical purchase channels subject to such taxes;

[75] Report on Electronic Commerce 26 Nov.1999 at http://www.ecomm-debate.co.za/

[76] Section 1101 of the Internet Tax Freedom Act of 1998 as found at http://www/cdt.org; Mazerov and Lav "A Federal moratorium on Internet taxes would erode state and local revenues and shift the burden to the lower income households" Centre on Budget and Policy Priorities May 11, 1998 as published at http://www.cbpp.org; See also Kaufman "Internet Tax: An uncharted Sea" July 7, 1999 National Law Journal as published at http://www.law.com

[77] Mazerov and Lav "A Federal moratorium on Internet taxes would erode state and local revenues and shift the burden to the lower income households" Centre on Budget and Policy Priorities May 11, 1998 as published at http:///www.cbpp.org;

3. to delay the efforts to produce a compromise between government and industry on fair and equitable tax policies in respect of the Internet. During the course of 1997, the US National Tax Association was able to get a significant amount of consensus between the various interest groups on the policy to be adopted in this regard. The introduction of the legislation eliminates the incentive for the parties to reach agreement on the basis of the moratorium and delays the search and implementation a global solution, as clearly no coherent global policy can be derived without the involvement of the United States.

Any potential moratorium on such indirect taxes (*such as VAT, General Sales Tax*) however has the further consequence that direct taxes (*income tax, capital gains* tax) would have to be increased dramatically to account for any shortfall in revenue, meaning that the SARS will be more aggressive in its scrutiny of proceeds potentially subject to such direct taxes. [78]

The uncertainty in respect of taxation and the Internet is further increased by the fact that both the Department of Finance and the SARS have adopted a "watching brief" in respect of international developments prior to the introduction of any domestic legislative amendments to deal with this complex issue on the basis that international consensus on such issues will be required. [79]

As stated by the Project Committee Co – ordinating the development of South Africa's Electronic Commerce policy: " It is imperative that South Africa develop a policy that is in harmony with the international practices so that it is not excluded from electronic trading with global partners. In South Africa the intention is not to reinvent nor work in isolation. Internationally many players are moving to explore e-commerce and its implications. South Africa is therefore monitoring developments that take place around the world." [80] Currently a number of international organisations including the European Union (EU), the Global Infrastructure Commission, Organisation for Economic Co - operation and Development (OECD) as well as the World Trade Organisation (WTO) are examining the issue, however there is as yet no international established consensus.[81]

[78] Mazerov and Lav "A Federal moratorium on Internet taxes would erode state and local revenues and shift the burden to the lower income households" Centre on Budget and Policy Priorities May 11, 1998 as published at http:///www.cbpp.org;
[79] Report on Electronic Commerce 26 Nov.1999 at http://www.ecomm-debate.co.za/
[80] Report on Electronic Commerce 26 Nov.1999 at http://www.ecomm-debate.co.za/
[81] Report on Electronic Commerce 26 Nov.1999 at http://www.ecomm-debate.co.za/

- The question remains whether the test for the intention of the taxpayer is subjective or objective. The application of the "scheme for profit making" element of the test implies a reference to the subjective motive of the taxpayer rather than to the objective intention thereof. Uncertainty remains as to the correct approach to be taken where such motive and intention diverge in any particular case.

  The question therefore remains the following: If there exists no profit motive from the sale / purchase of shares, but as a result of legal and economic factors such profits are foreseeable, are such profits capital or revenue ? The answer to this question, as pointed out by Davis and Emslie, depends upon whether a subjective or objective test is applied in the ascertainment of the taxpayer's intention.[82]

  The objective intention test is most aptly visible in the case of *ITC 1418 (1986) 49 SATC 42*, in which Conradie JA was faced with the determination of proceeds of sale of property where there was clearly no profit motive, the taxpayer in the case in question being an estate agent who had purchased the property to avoid the embarrassment of the deal falling through. Conradie JA held that the proceeds of the disposal were revenue despite the lack of a profit motive: " A taxpayer may have several motives for the purchasing of property. His intention is however going to be inferred from his uses and dealings with the property. If his intention was to use the property as floating capital, not to hold it to derive income from it, then I do not believe that this motive for the acquisition of the asset can, in an income tax context, play any role at all. As in criminal law a person must have been assumed to have intended the reasonable and natural consequences of his acts..." In *ITC 1413 (1985) 48 SATC 167*, Friedman J supports the subjective intention approach and states clearly that: " It was never the intention of the taxpayer to make profits out of its share trust." Emslie and Davis support the acceptance of the objective intention test on the basis that this is in accordance with the principles of criminal law and further is consistent with what they contend remains an objective description of the "capital" contained in the broad definition of "Gross Income". Thus the objective intention should prevail in situations where such differs from the subjective motive of the taxpayer. The existence of a profit motive is clear indication of a revenue asset, however the absence of such a motive does not necessarily allow for the

[82] Emslie & Davis "Taxation of an employee share incentive schemes – A polemic at the heart of the distinction between capital and revenue" 1990 Vol. 107 SALJ p.1 - 3

conclusion that the asset is necessarily of a capital nature and the court will have to have reference to the objective intention of the taxpayer. [83]

In the case of CIR v Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A), 54 SATC 271, 1992 Taxpayer 192, the majority led by Smalberger JA clearly rejected the subjective motive approach in favor of the objective intention test. Smalberger J approved of the following *dicta* in SIR v Trust Bank of Africa Limited 1975 (2) SA 652 (A), 37 SATC 87, 1978 Taxpayer 209, at 669 E – G: " In an enquiry as to the intention with which a transaction was entered into for the purpose of the law relating to income tax, a court of law is not concerned with that kind of subjective state of mind required for the purpose of the criminal law, but rather with the purpose for which the transaction was entered into." The dissenting minority led by Nicholas JA rejected such an approach and favored the subjective intention test. Smalberger JA however, after supposedly clarifying such an issue, states that the outcome of the case might have been different if "the making of profits was inevitable". An interpretation of this statement seems to suggest that even if the taxpayer has no ascertainable profit purpose, the fact that the profits were inevitable means that the proceeds will be regarded as being of a revenue nature, an outcome which has been described by Jooste as "untenable." [84] It is clear from the above discussion that this issue cannot be taken as settled law.

- Even where a taxpayer can establish that his main or primary intention was to maximise dividend income rather than make a profit on the sale / purchase of his shares, such intention may be characterised by the courts as not being dominant " in the sense that another co – existing purpose may effected at a profit without attracting liability for tax .... A purpose may be a main purpose without being dominant in this sense."[85]

In the case of *African Life Investment Corporation (Pty) Ltd 1969 (4) SA 259 (A), 31 SATC 163,* the taxpayer company had been formed as a wholly owned subsidiary of an insurance company and the objects of the company were to take over and administer various equities shareholdings acquired by the parent company and to build up productive investments by the purchase of good securities with the expectation of growth. The company was further

[83] Emslie & Davis "Taxation of an employee share incentive schemes – A polemic at the heart of the distinction between capital and revenue" 1990 Vol. 107 SALJ p.1 - 3
[84] Jooste " The role of the profit motive in the capital / revenue inquiry" 1993 SALJ Vol. 114 p. 212
[85] *African Life Investment Corporation (Pty) Ltd 1969 (4) SA 259 (A), 31 SATC 163, at 269E – 270 B*

empowered to realise the securities and reinvest the funds so derived and there were no restrictions placed on the distribution of dividends made from the sale of such securities. The company followed what was termed an "active investment policy" in its dealings of shares, and in attempting to secure the optimum yield in dividends made frequent realisations and reinvestments. The majority of the court found that co-existent with its intention to earn dividends was a secondary intention to earn profits on the realisation of such shares which could not be seen as incidental to the former purpose, such that the proceeds of the sales were to be regarded as income and therefore taxable.

Steyn CJ in *African Life Investment Corporation (Pty) Ltd 1969 (4) SA 259 (A), 31 SATC 163, at p.269* was however unable to provide a definitive test to distinguish when an intention would be "dominant" or merely "co-existent" and added unhelpfully that: "I shall not attempt a precise definition of the distinction" and " whether or not a purpose is dominant in that sense is a matter of degree depending on the circumstances of the case", leaving future interpretation a matter of subjective assessment by the courts and thereby further promoting uncertainty. Howie J in *CIR v Nussbaum 1996 (4) SA 1156 (A), 58 SATC 283* extended the application of the principle to an individual natural taxpayer, however did not attempt to clarify the situation any further.

- Even where a taxpayer can establish that share dealing is a business conducted secondary to the primary business of holding shares as investments in order to maximise dividend income, it is difficult to prove that a particular shareholding was acquired and held as a capital asset and not disposed of in the course of the taxpayer's share dealing business.[86] As stated by Botha JA in *SIR v The Trust Bank of South Africa Ltd 1975 (2) SA 652 (A), 37 SATC 87, 1978 Taxpayer 209, at p. 668*: " In such a case it is extremely difficult for the company to show that a particular share transaction falls outside of its normal trading activities in the sense that the shares were not acquired for profitable resale but to be held purely as an investment." [87]

[86] Silke Silke on South African Income Tax Vol.1 par 3.95; see also *African Life Investment Corporation v SIR 1969 (4) SA 259(A), 31 SATC 163; Barnato Holdings Ltd v SIR 1978 (2) SA 440 (A), 40 SATC 75 at 91.*

[87] See also *COT v Glass 1962 (1) SA 872 (A); Sec 'B' Company Investment Limited v COT 1965 (2) Sa 370 (SR), 27 SATC 81 at 85; see contra ITC 1412 (1983) 48 SATC 157 at 160* in which Friedman J emphasised that: " It is possible for a taxpayer.... involved in the share market and the buying and selling of shares, that his intention in regard to different shares may differ. In other words the mere fact that he is dealing in quoted shares on the stock exchange does not mean that what he acquires and sells are necessarily treated as revenue proceeds. It is necessary to look at the purpose with which the taxpayer acquires the counter and the particular circumstances under which he comes to sell that particular counter."

In the case of an investment dealing company, it has further been held that the objective factors such as the objects of the company set out in its Memorandum of Association, the actual nature of the company's business, the normal business of the companies of that type carried on and the nature of the transaction may, in an enquiry as to the purpose for which the specific shares were acquired, assume greater significance than the intention with which those shares were acquired.[88]

In *LHC Corporation of SA (Pty) Ltd v CIR 1950 (4) SA 640, 17 SATC 75, at 645 – 646,* Schreiner J added that it would only be in "exceptional cases" where shares disposed of by a share dealing company would be regarded as fixed capital and that it "was not law that when such a company purchases shares which will be held for a prolonged period, that such shares are for that reason to be regarded as fixed capital, the enhanced value of which is a capital accrual." [89]

A Memorandum issued by the SARS in respect of such issues during the course of 1997 indicates a clearly aggressive approach, evidently on the basis of the vague jurisprudence laid down by the courts in *African Life* and *Nussbaum* – [90]

1. While a taxpayer may have the intention of acquiring an interest in quoted shares as a long term investment, there ***always*** exists a secondary objective to dispose of such shares at a profit for one reason or another and should a profit be realised from the disposal of such shares, this profit would constitute revenue and thus be included within Gross Income;

2. The very fact that a portfolio is being managed on a proactive basis, will have the result of the reviewing of the portfolio on an ongoing basis. Periodic review will of necessity have the effect of considering the value of the investments on an ongoing basis, which act would then be subjecting any resultant profits realised from such management of the portfolio to tax on the grounds of dual intention. According to the ratio of Trollip JA in *Barnato Holdings Ltd v SIR 1978(2) SA 440 (A), 440 SATC 75, 1978 Taxpayer 209, at 453*, the existence of proactive management and resultant switching of share counters provides the court with a basis for

[88] *LHC Corporation of SA (Pty) Ltd v CIR 1950 (4) SA 640 at 645 – 646*; see also *SIR v Trust Bank of Africa Ltd 1975 (2) SA 652 (A), 37 SATC 87, 1978 Taxpayer 209, at p. 668.*
[89] See also *Punjab Co – operation Bank Limited Amritsor v Income Tax COR (Lahore) 1940 AC 1055*
[90] "Share transactions revisited" The Taxgram Issue No. 11 November 1997 at p. 1 - 3

concluding that a "formidable and difficult" onus rests on the taxpayer to prove that the shares are to be regarded as fixed capital.

3. Only if shares are acquired which will never be disposed of during a portfolio review, can such shares be viewed as part of the permanent investments of the taxpayer. Such shares would be those where the taxpayer exercises control over management or receives some benefit which facilitates the taxpayers business activities. Therefore a decision to dispose must relate to the management of the company rather than to a shift in the policies of the company as a result of a portfolio review decision.

It is contended that this view represents a distortion of the ratio of the *African Life* and *Nussbaum* cases and largely relies on an incoherent *dicta* from Rumpff J in the *African Life* case, which with respect, displays an ignorance of the delicate nature of the issue at hand. Rumpff J's reasoning was as follows –[91]

1. The purchase / sale of shares was a *sine qua non* in order to achieve the dividends desired and therefore was an integral part of the business;

2. The portfolio therefore included two types of income, dividends and profit from the sale of the shares;

3. Because the sale / purchase was a *sine qua non* to get the dividends required, it was not necessary to examine the dominant purpose;

4. The "active investment policy" represented a difference from the "conventional or orthodox investment policy" such that if it was desirable or necessary to transpose the shares in a portfolio to maintain or increase the level of dividends in order to secure this, the company must have had the intention of dealing in the shares.

[91] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, at p.278 - 279*

Rumpff J 's reasoning ignores the fact that it is the desire of every investor to maintain the quality of his investment and income therefrom. By implication however, if the investor is sapient enough to switch his portfolio in order to preserve the capital value of his investment, he is likely to be classified as a share dealer.[92]

The **first contention** by the SARS, namely that the existence of the intention to hold as a long term investment necessarily implies the existence of a secondary intention to deal in such shares, certainly does not find any support in the case law other than possibly in the much maligned ratio of Rumpff J discredited above. The case law certainly emphasises to the contrary the existence of an independent purpose not derived merely from the primary purpose (*although not unrelated thereto*). As stated by Steyn CJ in *African Life*: " the profits were anticipated and fully expected. The appellant had in mind a definite purpose distinguishable from the purpose directed at dividends." [93] Mere contemplation of such profits is further not sufficient to constitute such a purpose. As aptly noted by Smalberger JA *in CIR v Pick n Pay Employee Share Trust 1992 (4) SA 39 (A) at 58*: " contemplation is not to be confused with intention in the above sense. In a tax case one is not concerned with any possibility, apart from his actual purpose that the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose ....". In *COT v Levy 1952 (2) SA 413 (A) at p.421*, the court further emphasised that the existence of the dominant purpose theory was crucial unless " one were to hold what the legislature could not have intended, namely that the taxpayer must exclude the slightest contemplation of a profitable resale ...."

Trollip J in *Barnato Holdings v SIR 1978 (2) SA 440 (A), 40 SATC 75, 1978 Taxpayer 209, at p. 453*, also stresses that the existence of such a secondary purpose is not merely assumed: " At the outset I should observe that, according to the *African Life* case, an investment shareholding company may also carry on a secondary business of dealing in shares for profit. **Whether or not it does so depends entirely on the facts....**". The use of the permissive "may" and reference to an assessment of the facts, clearly supports such a contention.

The **second contention** seems to ignore the fact that an investment policy may still be proactive and considered as an orthodox investment policy (contrary to the ratio of Rumpff J in *African Life*) if it is designed to maximise dividends. In the *African Life* case Steyn CJ defined an "active

[92] Share transactions" The Taxpayer 1978 (27) No. 4 p.63
[93] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, at p.272*

investment policy" in the following terms: " An active policy is said to mean seeking a portfolio of sound shares and securities, well spread over a number of business fields, which would show rising dividends over the years, watching the portfolio the whole time and watching critically every share comprised in the portfolio and effecting realisations of shares or securities from time to time, whether at a profit or loss, whenever reasons exist for supposing that the investor could do better by switching to other shares or securities." [94]

Further on in the judgment Steyn CJ concedes that the existence of such a policy would not necessarily lead to a conclusion that such realisations were part of a scheme of profit making: " It must be conceded I think that, whether or not the appellant set out to deal in shares for profit, the varying of its many risk investments would be an inherent feature of its activities. It may be that such variations, however gainful, need not in themselves, in the case of an investment company, necessarily lead to the conclusion that the resultant profits are to be regarded as income." [95] In this sense he allows for the fact that the motives and purposes underlying the sales of shares and the manner in which such were conducted, may be fully accounted for by the requirements of an active investment policy aimed at ensuring and preserving a durable yield of dividends at the best general level.[96]

In the case of *CIR v Guardian Assurance Co South Africa Limited 1991 (3) SA 1 (A)*, the SARS was faced with the scenario that the number of share transactions conducted by the taxpayer company over the period in question were fairly insignificant making it difficult to confidently infer the existence of a secondary purpose of share dealing. Counsel for the SARS reverted to reasoning substantially similar to that found in the 1997 Memorandum discussed above. Counsel for the SARS advanced the following argument on the basis of certain *dicta* in *CIR v Richmond Estates 1956 (1) SA 602 (A), 20 SATC 355, 1956 Taxpayer 32, 610 A – 611 B; LHC Corporation of SA (Pty) Ltd v CIR 1950 (4) SA 640 (A)* -

1. It is inherent in the management of any share portfolio that a measure of share dealing for profit is involved;

2. Shares are by their very nature "risk investments" which have to be reviewed from time to time;

[94] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, at p. 267*
[95] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, at p.271*
[96] *African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, at p.272*

3. A portfolio comprising a number of varied counters of shares will therefore necessitate constant review and administration;

4. Therefore an investor in shares has of necessity to deal with such shares and the simple intent to hold for an indefinite period makes no difference;

5. Unless and until shares are made part of the permanent structure of the investor in which its business rests and the shares in effect are taken out of the business, such shares will constitute floating capital.

Kriegler JA rejected such an argument and added that the two cases adduced by the SARS did not provide support for the proposition implied in the SARS argument, namely that an investor in long term dividend producing shares is obliged to hold onto each and every counter in his portfolio irrespective of his fortunes – or the possible demise of the companies concerned or to run the risk of being taxed as a sharedealer.[97] Nor he added did such cases support the further proposition adduced by the SARS that the management of a wide and varied share portfolio, irrespective of the long term investment intention with which it has been compiled, cause it to be regarded as floating capital.[98]

Kriegler JA further concluded that neither in law nor logic can a dogged adherence to a counter or counters in the management of a portfolio be stated as prerequisites for qualification as a capital investor. Prudence and foresight he added could not therefore be equated with an intention to speculate. [99]

Niland further echoes similar sentiments in respect of this issue based upon an analysis of the case of *CIR v Middelman 1991 (1) SA 200 (C) , 52 SATC 323, 1990 Taxpayer 32 :* " The other side of the coin must surely be that it can never be expected of an investor in shares that he cannot relinquish ownership of a particular share without the shadow of the Receiver looking over him. It is inherent in such investment that each share must be reviewed from time to time and that, in the nature of things, certain shares will deteriorate in value and the prudent investor will replace

[97] *CIR v Guardian Assurance Co Africa Ltd 1991 (3) SA 1(A) at 17 D – E*
[98] *CIR v Guardian Assurance Co Africa Ltd 1991 (3) SA 1(A) at 17 G – H*
[99] *CIR v Guardian Assurance Co Africa Ltd 1991 (3) SA 1(A) at 17 I – J; 18 A – B*

them with shares of a better quality. It cannot be expected that an investor must stand idly by and watch his capital assets being eroded through factors well beyond his influence..." [100]

The approach by Kriegler J is also supported with reference to the approach of comparative jurisdictions. In the Australian case of *Trent Investments (Pty) Ltd v FCT (1976) 6 ATR 201*, Mahoney J was faced with the situation where a taxpayer company was involved as the investment arm of a parent company and had conducted numerous share transactions in order to secure the maximum dividend yield. The Revenue argued that in the relevant tax year, the taxpayer had conducted systematic variations in the portfolio in order to take advantage or market fluctuations and to disinvest out of overpriced shares into shares with more growth potential, such that it was clear that the share dealing constituted a purpose of such a company. Mahoney J however rejected such an argument and stated clearly that this fact " should not lead to the conclusion that the various shareholdings, albeit made with an eye to fluctuations, must cease to be investments in this sense. The variation of investments in order to preserve the value of capital is, in any sense, a normal investment procedure." [101]

The first sentence of the **third contention** finds no support in the available case law and it is submitted that this represents merely the stated policy of the SARS itself. The last sentence would seem to look for credibility to two cases where the taxpayer was able to establish the intention to hold shares as a capital investment by establishing the existence of an alternative collateral purpose. Thus in *CIR v Nedbank 1986 (3) SA 59 (A) 600, 48 SATC 73, 1986 Taxpayer 170*, the taxpayer discharged the onus that the purchase of shares constituted a fixed capital investment on the basis that the collateral purpose of the acquisition was a desire to obtain more banking business from the target company. [102]

In *CIR v Trust Bank 1975(2) SA 652 (A), 37 SATC 87, 1978 Taxpayer 209*, the taxpayer who had disposed of shares in a Mutual Fund set up by it, was able to discharge the onus that the shares were held as a capital investment on the basis that the following collateral advantages to the business of the taxpayer existed as a result of the purchase , including the fact that –

[100] Niland C B "An inquiry into the nature of capital with special reference to CIR v Middelman" University of Cape Town Unpublished LLM Dissertation October 1990 p.45

[101] *Trent Investments (Pty) Ltd v FCT (1976) 6 ATR at 201*

[102] The court held further that the failure to achieve the collateral advantages was not relevant as long as the achieving of such advantages was the purpose of the transaction. *CIR v Nedbank 1986 (3) SA 59 (A) 600, 48 SATC 73, 1986 Taxpayer, at 603*

- the banking business of the taxpayer would increase as a result of its involvement in the target company;

- the taxpayer would gain great prestige and enhance its market position by being associated with the other partners of the target company;

- the taxpayer would be able to provide added service to its existing customers.

The above cases support the proposition that a taxpayer may establish that shares were held as a capital investment if he is able to establish the existence as a primary purpose of the collateral advantages alluded to above. They do not however prescribe that the existence of such an advantage is the only way in which the taxpayer can establish the existence of such a "capital investment" intention, such that any decision to dispose "must relate to the management of the company rather than to a shift in the policies of the company as a result of a portfolio review decision."

The result of the above problems with the application of the current test, as interpreted by the SARS in the above Memorandum, can easily be seen by way of an example - An investor sells a large volume of shares held for a long period at a profit and such shares further had a low dividend yield. Such investor has been engaged in share dealing previously. The rationale of the SARS in building a case under the current test would run as follows – [103]

1. The shares were sold at a profit;

2. An investor holds shares as a long-term investment and should not therefore react to short term downturns in the market given that his objective is to secure long term dividend gains. Thus an investor should take account of the volatility of the market in assessing his actions;

3. The shares were sold on a large scale, which is clear evidence of speculative intent;

4. The shares had a low dividend yield and it is trite that a reasonable dividend yield is required for investment purposes;

5. The onus remains on the taxpayer to establish that the nature of the proceeds of the sale of the shares is of a capital nature once the SARS has raised an assessment, an onus which can be described as "formidable and difficult" given that proactive management and the switching of share counters was unavoidable;

6. The investor has engaged in share dealing activities previously and such transactions merely constitute a continuation of past activities, even if the taxpayer utilised a separate portfolio for the so called "long term investments" separate from the "share dealing portfolio", it being accepted jurisprudence that the courts will only in exceptional cases regard shares disposed of by a share dealing company as fixed capital;

7. Even if it can be established that the primary intention of the taxpayer was to maximise dividend income, the nature of the proactive investment policy necessitates the conclusion that a secondary intention of share dealing co-exists therewith and the primary intention is not dominant thereby absolving the taxpayer from tax liability, as the switching out of such share investments was unavoidable and always contemplated as part of the taxpayer's business;

8. Even if it can be established that the taxpayer acquired the asset with the intention of retaining same as long term capital investment, subsequent conduct by the taxpayer in the handling of the asset represents clear change in intention to use the asset as "stock- in- trade for a scheme of profit making" such that the proceeds of the sale of the shares would be of a revenue nature and therefore included within Gross Income.

---

[103] "Share dealer or share investor" The Taxpayer Aug 1996 Vol.45 No.8 p.143

4. LEGISLATIVE AND ATTEMPTS MADE IN COMPARATIVE JURISDICTIONS TO RESOLVE THE PROBLEM

The capital / revenue distinction has long been recognised as problematic for income tax purposes, specifically in relation to the negative impact of the uncertainty of the test on the level of share transactions on the Johannesburg Stock Exchange (JSE). As conceded by the Minister of Finance in 1990: " The distinction between capital and revenue is basic to our tax system, but neither concept has prove capable of a satisfactory definition in the Income Tax Act. In spite of guidelines laid down by the case law, uncertainty remains in some areas, and it is maintained that this is an important reason for the low turnover of shares on the Johannesburg Stock Exchange (JSE) and for the fact that large financial investments are not made available for direct application in other investment areas." [104]

- The Margo Commission (1986)

The Margo Commission recognised at the outset of its investigations that one of the most serious defects which existed in the South African tax system was the uncertainty which existed, especially as regards securities and immovable property, when determining whether the proceeds on disposal were capital or income. This uncertainty the Commission added had the " deleterious consequence of undermining the ability of the taxpayer to assess the financial implications associated therewith with certainty and thus impairs their ability to plan their affairs. Thus the normal elements of uncertainty in a Free market economy are added to in a significant and some consider intolerable manner."[105]

[104] "Distinction between capital and revenue for income tax purposes" (1990) (39) The Taxpayer at p.46. Comparative figures revealed that on an annual basis the level of turnover as a percentage of market capitalisation on the JSE was a paltry 4.75 % compared with that of the NYSE with a percentage of some 45 %. Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.24; Of course the isolation of the Johannesburg Stock Exchange from world markets for political reasons also contributed to the lack of turnover

[105] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.21; See also "Capital Gains Tax" The Taxpayer 1989 (38) at p.43: " It is also maintained that many investors in South African shares are loathe to sell such shares for the reason that the consequential profits will attract (at the income tax rate) a very high rate of tax. A more reasonable tax on capital gains...could therefore increase the mobility of large share investments, which in turn would lead to faster national development."

The Commission examined a number of proposed solution to the problem –

1. Classify all transactions in shares on the Johannesburg Stock Exchange as being of a capital nature [106]

The Commission rejected such a proposal on the basis that such an approach would favor a particular market and would not address the problems of classifying the many transactions that took place outside of the Johannesburg Stock Exchange.

2. The "Badge of Trade" Test[107]

This proposal involved the classification of particular dealers as "share dealers" by the SARS. The Commission found this proposal unappealing in that the result would merely be that the *ex post facto* determination by the courts as to whether share dealing was occurring would be replaced by the *ex ante* assessment by the SARS of such a fact. In both instances the subjective criteria of the traditional test would be utilised.

3. The introduction of a Capital Gains Tax

The Commission noted that the only way in which such introduction could be effective as a solution would be if the capital gains tax rate was equal to the income tax rate, such that the test would become irrelevant in terms of the quantum of tax liability. For various macroeconomic reasons however it was clear that from a comparative perspective -

"in most jurisdictions where there are capital gains taxes, capital gains are taxed at a lower rate than that which applies to ordinary income. This fact is neutral to the principles that must be applied for distinguishing capital from income. At most it could be said that in jurisdictions with a capital gains tax, the revenue authorities tend to take a more lenient view in marginal cases – knowing that they will collect tax at least at the lower rates applicable to capital gains than they do in jurisdictions without a capital gains tax."[108]

[106] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.27
[107] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.28
[108] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par. 12.5

4. Retention of the test and the introduction of binding pre - assessment by the SARS

Two Commissioners on the Commission proposed that the traditional test be retained, however that the staff of the SARS be increased and the Income Tax Act be amended to allow taxpayers to approach the SARS for rulings on transactions proposed by the taxpayer prior to the conclusion of same. Niland contends that this is a workable solution which would introduce a measure of certainty and that amendments be effected to the Income Tax Act 58 of 1962, as amended, to allow –

- taxpayers as a matter of right to request from the SARS an advanced ruling on a transaction and to receive a response within a reasonable period of submission of all the relevant facts and supporting documentation;

- the decision by the SARS to be binding on the treatment of such transactions provided that the taxpayer makes full disclosure to the SARS of all aspects of the transaction;

- any such decision by the SARS to be subject to the existing objection and appeal procedures provided for in the Act.[109]

The final recommendation of the Commission was however rather that the subjective criteria applied to determine whether a profit is of a revenue or capital nature under the current test be replaced by more objective criteria in order to introduce an element of certainty. Such objective criteria it was suggested would include *inter alia*, the following: the duration and period of the holding of the asset, the frequency and scale of the transactions, the trade carried on by the taxpayer, the way in which the asset was treated in the books of account of the taxpayer as well as the turnover in the year in which the asset was disposed of in respect of all assets falling within the category of which the disposed asset formed a part. Any legislative amendment for clarificatory purposes was rejected on the basis that any such attempted definition would have inherent limitations owing to the complex nature of the problem. [110]

[109] Niland C B "An inquiry into the nature of capital with special reference to CIR v Middelman" University of Cape Town Unpublished LLM Dissertation October 1990 p. 59 - 60

Such suggestions of the Commission did not however further the matter as such criteria were already being employed by the courts when verifying the subjective intention of the taxpayer. In fact the Commission referred favorably in this regard to the test formulated by Miller J in *ITC 1185 35 SATC 122*.

The use of such objective criteria raises a number of additional vexing problems. **Firstly**, the question arises of exactly how many of the criteria would have to be present for a decision to be made as to the capital or revenue nature of a transaction and further the respective weights to be attached to each criteria. **Secondly**, the utilisation of a completely objective test may be inequitable in some cases and produce arbitrary results. **Thirdly**, it is foreseen that careful tax planning may allow the taxpayer to ensure that the proceeds of his transactions fall outside of the income tax net. **Fourthly**, there remain inherent difficulties in jettisoning the considerable body of jurisprudence under the current test and replacing same with an incomplete and uncertain list of objective criteria, for as the Commission conceded in relation to such criteria, "the results of the endeavors reflect deficiencies which still require further research."[111]

- The "Safe Haven" Section 9 B of the Income Tax Act (1990)

The Tax Advisory Committee (TAC), constituted during the early part of the 1990's, was given the task of again examining possible solutions to the income / capital problem. After an analysis of comparative jurisdictions like Canada and the United Kingdom, the Tax Advisory Committee concluded that any benefits to be had by the introduction of aspects of such systems would be outweighed by the uncertainty created owing to the jettisoning of the large body of jurisprudence developed by our courts in respect of the income / capital question. Such systems it was further felt would only marginally reduce uncertainty as subjective elements were an inherent part of the tests used by such systems.[112]

The Tax Advisory Committee therefore finally recommended a legislative amendment to the Income Tax Act designed to introduce certainty by the introduction of a mechanistic objective test. The solution proposed again however abandons the search for a conclusive and certain test

[110] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.29
[111] Report of the Commission of inquiry into the tax structure of the RSA 1986 (The Margo Commission) par 12.29
[112] SARS Practice Note 18 Circumstances in which certain amounts received or accrued in relation to the disposal of listed shares are deemed to be of a capital nature: Section 9 B of the Income Tax Act, 1962 (The Act) as found at http://www.fnb.co.za/legislation

and provides a so called "safe haven" for shares which are listed on the Johannesburg Stock Exchange and which have been held by the taxpayer for a period of more than 5 (five) years.

Section 9B of the Income Tax Act therefore practically provides for a deeming provision whereby a taxpayer may elect that any amount which accrues to him as a result of the disposal of an affected share (being a listed share held for a continuous period of more than 5 (five) years on a listed stock exchange[113]) on or after 14 March 1990, be treated as being of a capital nature in the application of the definition of "Gross Income" in terms of Section 1 of the Income Tax Act. If the taxpayer does not make such an election or sells the shares within the 5 (five) year period, the SARS will examine the transaction on the basis of the traditional test to determine whether the proceeds thereof should be considered as a revenue or capital gain.

The problem inherent in the section is that it remains a solution limited to a narrow range of share transactions. Evidence placed before the Margo Commission indicated that the level of inactivity on the Johannesburg Stock Exchange was compounded by the fact that certain investment companies had large shareholdings held for periods in excess of 5 (five) years, but which could not be disposed of without adverse tax consequences owing to other activities undertaken by such companies. The framing of Section 9B seems aimed at the resolution of these specific instances. As commented by Niland: " From the nature of share investments many shares may be sold for a variety of reasons within the 5 (five) year period and the section will not apply to them such that the traditional test is once again of application reintroducing the inherent defects associated therewith." [114] Clearly commentators did not at the time envisage the section as a final solution to the income / capital problem. As was stated by the Tax Advisory Committee in relation to the introduction of the section: "It must be stressed that this proposal is not the final solution. This system and its effects on the mobilisation of capital, will be examined to determine whether a more refined and efficient system can be developed and expanded. It is for this reason that the proposals are initially limited to listed shares where a major problem has been identified and it is possible to reduce manipulation." [115]

---

[113] In terms of the Stock Exchange Control Act 1 of 1985, the Johannesburg Stock Exchange (JSE) is the only exchange regarded as a listed exchange

[114] Niland C B "An inquiry into the nature of capital with special reference to CIR v Middelman" University of Cape Town Unpublished LLM Dissertation October 1990 p. 60

[115] "Distinction between capital and revenue for Income Tax purposes" 1990 (39) The Taxpayer p.48

- <u>The Katz Commission (1995)</u>

The Commission recognised that although a large body of jurisprudence had been developed by the courts in respect of the income / capital distinction, "admittedly the subjectivity of the test undermines certainty." [116]

The Commission examined as a solution to this persistent problem the introduction of a capital gains tax, however was at pains to stress that there were two separate inquiries that had to be dealt with and should not be confused, namely (1) whether a receipt / accrual was of a capital nature ?; and if so (2) whether such capital receipt or accrual should be subject to tax.[117] The Commission, like the Margo Commission, noted that in most jurisdictions with a capital gains tax, the capital gains tax rate is generally lower than the income tax rate such that it could be concluded that in respect of the first inquiry: " in the absence of a comprehensive income tax which taxes capital gains and current revenue at the same rate, the problem of distinguishing capital from revenue cannot be avoided. Certainty is not simply achieved by the introduction of a capital gains tax."[118]

This statement is borne out empirically upon an analysis of comparative tax jurisdictions. In Australia for example, the introduction of a capital gains tax did not have the effect of clarifying the income / capital uncertainty as the capital gains tax rate is different to that of the normal income tax rate for macroeconomic reasons, indexing for inflation only exists in the case of capital gains and capital losses may only be offset against capital gains. Consequently the quantum of tax liability based on the classification differs, thereby making the test indispensably relevant.

In the case of <u>*IRC v British Salmson Aero Engines (1978) 2 KB 482 at 482*</u>, Lord Greene MR reflects on the failure to have developed a clear and certain test: " There have been many cases that fall on the borderline. Indeed, in many cases it is almost true to say that a spin of the coin would decide the matter almost as satisfactorily as an attempt to find reason." [119] <u>*In Scott v COT (NSW) (1935) SR NSW at 215*</u> the court stated that: " The word 'income' is not a term of art, and

[116] Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.2.6

[117] Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.20; see also Katz " The impact of a capital gains tax in South Africa" <u>Personal Finance</u> Vol. 4 July 7, 2000 p.74, where Michael Katz confirms this idea.

[118] Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.2.7

[119] Lehman and Coleman <u>Taxation Law in Australia</u> (1989) par.2.1

what forms of receipts are comprehended within it and what principles are to be applied to ascertain how much of these receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind."

In the case of *Hallstroms (Pty) Ltd v FCT (1946) 3 AITR 436* Dixon J referred to Greenes' *dictum* and stated that the question remained on of fact (*with no legal principle involved*) to be decided on the basis of general accounting principles and economic concepts: " what is outgoing on account of capital and what is outgoing on account of revenue, depends upon what the expenditure is designed to affect, from a practical and business point of view, rather than upon the classification of legal rights, if any, secured embedded or exhausted in the process." [120]

The *dictum* has been frequently used in the Australian courts to justify bypassing usual legal principle to arrive at a more practical result. What is clear from this synopsis is that Australian tax law has not been able to rid itself of the uncertainty of the subjective intention test via the introduction of a capital gains tax.[121]

During the course of 1986, the Johannesburg Stock Exchange suggested to the Margo Commission (1986) that the "simple test now operating in the United States to define capital and income be introduced. In the United States an asset held for more than 6 (six) months is of a capital nature. This proposal which is so clear and effective, would end the constant corrosive uncertainty as to what is income and what is capital under our tax laws." [122] This quote however belies the complexity and idiosyncratic nature of the current US Federal Income Tax law. In the United States net capital gains and losses are included within gross income, subject to special deductions provided for. The application of the Internal Revenue Code involves the computation of what are called long term capital gains (being capital assets held for a period of more than 1 (one) year and net short term capital gains (being capital assets held for a period of less than 1 (one) year for the tax year. [123] The net position of the taxpayer is then calculated by comparing the net gain or loss in respect of long and short term gains respectively. Short term capital gains, unless cancelled out by short term capital losses, are taxed at the ordinary income tax rate of 39.6 (thirty nine point six per centum), while long term capital gains receive a more favorable tax

[120] Lehman and Coleman Taxation Law in Australia (1989) par.2.1
[121] Lehman and Coleman Taxation Law in Australia (1989) par.2.1
[122] "The Capital Gains Problem" 1986 (35) Taxpayer p.156
[123] Section 1223 of the Internal Revenue Code as found in Lathrope Selected Federal Taxation Statutes and Regulations (2000)

treatment and are taxed at a rate of 20 % (twenty per centum).[124] Capital assets held for a period of more than 5 (five) years are taxed at an even more favorable rate of 18 % (eighteen per centum).

The fact that an asset has been held for a period of 1 (one) or 5 (five) years or more does not determine whether an asset will be regarded as a capital asset or not. Rather if the asset is determined as a capital asset on the basis of classifications provided for in the Internal Revenue Code and held for the relevant periods, this gives rise to the favorable tax treatment. An asset which is not determined as a capital asset under such provisions, will therefore attract full income tax irrespective of the period for which it is held. The 1 (one) or 5 (five) year rule as applied in the United States does not therefore dispose of the income / capital inquiry as suggested by the JSE above.

The test developed by the <u>Internal Revenue Code,</u> as interpreted by the courts, displays a considerable amount of confusion and uncertainty.

<u>Capital assets</u> are defined negatively in S 1221 of the <u>Internal Revenue Code</u> as including all assets held by the taxpayer (whether or not connected with his trade or business), except –[125]

- stock-in-trade of the taxpayer or other property of the kind which would be property included in the inventory of the taxpayer if on hand at the end of the tax year;

- real or personal property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, including property which will become part of the merchandise for sale;

- accounts or notes receivable acquired in the ordinary course of the taxpayer's trade or business;

- literary or artistic property held by its creator;

- depreciable or real property used in a trade or business;

---

[124] The maximum rate was reduced by the passing of the <u>Taxpayer Relief Act of 1997</u> which reduced the maximum rate from 28 % (twenty eight per centum)

- US government publications received from the government at a price less than that which the general public is charged.

"Gross Income", in contrast, is defined in S 61 of the Internal Revenue Code as including all income from whichever source derived, including "but not limited to compensation for services rendered, income derived from the operation of a business, rent, interest, dividends, annuities, alimony, income from an interest in a trust or estate, income in respect of a decedent and income from life insurance." [126]

The simplicity of such definitions belies the quagmire of uncertainty created by judicial interpretation of such provisions and other statutory enactments in the Internal Revenue Code (IRC) –

- There remain two diverse interpretations of the capital asset definition contained in Section 1221 of the IRC. The first interpretation contends that the list of exceptions contained in S 1221 is merely illustrative rather than exhaustive of the property which is not to be regarded as a capital asset. The second interpretation contends in contrast, that any item of property not specified in the exceptions in S 1221, is of necessity a capital asset. The courts have varied in their application of the two interpretations. In the case of *Corn Products Refining Co v Commissioner of Internal Revenue 350 US 45 at 46*, the Supreme Court endorsed the first interpretation and thereby contracted the definition of a "capital asset" so as to exclude shares acquired for the purpose of conducting a trade / business as opposed to shares acquired for an investment purpose. The court further outlined that the test to be utilised was based upon an assessment of the subjective motive of the taxpayer in the handling of the asset, which remained a question of fact (*the so called "business versus investment motive"* test). In the case of mixed motives the *"substantial investment test"* was to be applied which practically provided that where shares had been purchased with a substantial investment purpose, such would be regarded as capital assets, even if a more substantial business purpose existed for the purchase. The tax implications of such an interpretation were significant as taxpayers could now deduct

[125] Section 1221 of the Internal Revenue Code as found in Lanthrope D J Selected Federal Statutes and Regulations (2000)
[126] Section 61 of the Internal Revenue Code as found in Lanthrope D J Selected Federal Statutes and Regulations (2000)

share losses from ordinary income, even if the asset did not fall within the explicit statutorily defined exceptions contained within S 1221. [127]

Almost thirty years later, the Supreme Court in the case of _Arkansas Best Corporation v Commissioner Internal Revenue 485 US 212, 108 S Ct. 971_, rejected the _Corn Products doctrine_ and adopted the second interpretation to S 1221 of the IRC. The court held that – [128]

1. The taxpayer's motive in purchasing an asset is irrelevant to the question of whether it falls within the broad definition of a "capital asset" under S 1221. The "business – motive test" as developed in _Corn Products_ finds no support in S 1221's language which makes no mention of such a test and further such interpretation remains in direct conflict with S 1221's broad definition of a "capital asset";

2. The contention that the section is merely illustrative rather than exhaustive of the statutory exceptions, is refuted by the phrase " does not include" in the statute as well as by the legislative history and regulations of the provision;

3. Such an interpretation also conflicts with the exceptions mentioned in S 1221. These exclusions would be superfluous if assets acquired for business as opposed to investment purposes were not capital assets, as inventory and real or depreciable property would undoubtedly satisfy such a business purpose test;

4. Although the _Corn Products Doctrine_ stood for a period of some 30 (thirty) years unchallenged without any indication of disfavor from Congress, the unambiguous language of the statute cannot be ignored. If a broad exclusion for a capital asset is to be created for assets acquired for business purposes, then Congress must directly and explicitly create same; [129] and

[127] Corporate taxpayers may only deduct capital losses to the extent of capital gains, while ordinary taxpayers may deduct up to $ 3,000 of capital losses against ordinary income where the losses exceed the capital gains. Graetz G J & Schenk D H Federal Income Taxation 3rd Ed. (1995) p. 569; See also S 1211 of the Internal Revenue Code

[128] At 109 - 110

[129] Although not conveyed in the form of a statute, support for the Corn Products Doctrine appears in Congressional reports from both houses. Cartee B J "Note an historical essay and economic assay of the capital asset definition: The taxpayer and courts are still mindfully guessing while Congress does not seem to have a mind" 1993 34 William and Mary Law Review p. 13

5. The business connection, although irrelevant to the initial determination of a capital asset, is relevant in determining the application of certain of the statutory exceptions contained in S 1221, including the inventory exception. [130]

- Statutory provisions 1231 and 1234 A of the IRC further blur the capital income distinction. Section 1231 treats gains in excess of losses for the disposition of property used in trade / business as a short term capital gains, but treats the excess of losses over gains as an ordinary loss. Section 1234 A stipulates that the nature of the gain or loss in respect of certain options is determined by looking at the character of the property underlying the option in the hands of the taxpayer.[131]

The US courts have identified three distinct classes of taxpayers holding shares, the tax treatment of which varies depending upon the classification –

1. ***A dealer in shares***, being a person who purchases the shares or commodities with the expectation of realizing a profit not because of the rise in value during the interval of time between the purchase and resale, but merely because they hope to find a buyer willing to purchase at a price in excess of their cost. A dealer has customers for the purpose of S 1221. A dealer therefore falls within the ambit of the first exception to the capital asset definition such that gains on shares are regarded as ordinary income and losses on such shares may be deducted in full against ordinary income (*which translates into a significant tax advantage*); [132]

2. ***A trader in shares***, being a person who sells shares and depends upon such circumstances as a rise in value to enable them to sell a price in excess of cost. A trader performs no merchandising functions as opposed to a dealer. Unlike an investor a trader seeks profit from short - term market swings and receives income principally from selling on the exchange rather than from interests, dividends, interest or long term appreciation. If the dealings of the trader are substantial and frequent, he may be deemed to be engaged in a business or trade, however does not have customers as defined in S 1221.[133] This further has the unusual implication that a

[130] Tolman D "The Arkansas Best decision: Taking Corn products off the taxpayer menu" 8 Virgina L Review 705 (1989)
[131] Section 1234 & 1234 of the Internal RevenueCode as found in Lanthrope D J Selected Federal Statutes and obligations (2000)
[132] *United States v Wood 943 F 2d 1048 (9th Circuit 1991);* See S 1211 of the Internal Revenue Code found in Lanthrope D J Selected Federal Statutes and obligations (2000)
[133] *Groetzinger v Commissioner 771 F 2d 269, 274 - 275*

trader may engage in a trade or business, which nevertheless produces capital gains and capital losses rather than ordinary income and losses. As a trader does not fall within the first capital gains exception he may therefore only deduct capital losses on shares to the extent of the capital gains;

3. ***An investor in shares***, being a person who, like a trader, makes purchases for capital appreciation and income. Unlike a trader however, an investor makes such purchases usually without regard to short - term developments that would influence prices on the daily market. An investor will never be considered to be engaged in a trade or business with respect to his investment activities, regardless of the extensiveness of his activities. [134] An investor does not fall within the ambit of the first capital gains exception and may only therefore deduct capital losses on shares to the extent of capital gains;

Clearly the test as utilised in the United States struggles with the similar subjective versus objective problems of our own jurisdiction and goes no further than our own in terms of providing a broad objective criteria *i.e* it is necessary to establish that the assets constitute stock-in-trade for the purposes of a business undertaking to be determined as income on the basis of the facts of each case.[135] As noted by Cartee the adoption of the literal interpretation of S 1221 by the courts is further problematic for US tax law in that the definition "describes only literal exceptions, while commercial and economic realities demand a definition capable of recognizing the characteristic economic nature and use of an asset at a point in time." [136]

The experience of the United States also provides empirical evidence for the contention that the abolition of differential between capital gains tax and income tax is not an acceptable option for macroeconomic reasons. During the course of 1986, the **Tax Reform Act** was introduced in the United States, which eliminated the differential between corporate capital gains and corporate income tax. Such a move was vehemently attacked by economists, who argued that such an increase in the capital gains rate translated into an increase in the overall cost of capital, thereby reducing investment and leading to unemployment and lower economic growth. In response to

[134] See *United States V Wood 943 F 2d 1048 (9th Circuit 1991); Higgins v Commissioner 312 US 212, 216 (!941)*
[135] "Federal Income Tax" American Jurisprudence 2 Ed. 1999 Vol. 33 A
[136] Cartee B J "Note an historical essay and economic assay of the capital asset definition: The taxpayer and courts are still mindfully guessing while Congress does not seem to have a mind" 1993 34 William and Mary Law Review p. 17

such vehement criticism the capital gains tax rate was lowered below that of the income tax rate during the course December 1999. [137]

Given the above comparative analysis, it is clear that the solutions utilised by many prominent and progressive tax jurisdictions, including the introduction of a capital gains tax, has not been successful in solving the problems surrounding the formulation of an accurate income / capital test. Further no system exists which can be summarily incorporated into our own jurisdiction. The systems in each country have been developed across the "background of their own tax structure, the extent to which capital is subject to capital gains and the importance of certainty as opposed to equity." [138]

Most jurisdictions which have introduced a capital gains tax, have further done so because their systems include an aspect not found in the South African jurisdiction being the deductibility of consumer interest or interest paid on money borrowed to acquire assets that are not used in the production of income.[139]

The Commission further identified that in respect of the second inquiry, a capital gains tax has a number of other unwanted macroeconomic effects including the fact that such a tax– [140]

- is not equitable in that wealthy taxpayers -

    1. have access to an array of financial expertise which allows them to avoid such tax through innovative financial planning, leaving the middle class to bear the brunt of such taxes; [141]

---

[137] "Capital Gains Taxes and US Economic Growth: A retrospective look" July 1999 at http: www.accf.org/ p 1 - 3
[138] "Distinction between capital and revenue for income tax purposes" 1990 (39) Taxpayer at p. 46
[139] Section 11 (a) of the Income Tax Ac 58 of 1962, as amended, which provides for the deduction of "expenditure and losses actually incurred in the Republic ***in the production of income***" . S 103 of the Internal Revenue Code of the US allows for example the deduction of interest expenditure incurred in the purchase of a primary personal residence. Lanthrope D J Selected Federal Statutes and regulations (2000)
[140] Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.4.9 – 6.4.16; see also Divaris " Capital gains Tax" Income Tax Reporter Vol.9 Part.1 15 February 1990 who advocates similar arguments against the introduction of a Capital Gains tax in South Africa
[141] Examples include: (1) ***The Zero Cost Dollar with debt attached*** – A large investor in ABC Co sets up a hedge the consists of two option contracts in ABC shares. One protects against a dip in the share price and the other lets him keep a portion of any price increase. Bankers then lend to ABC investor up to 90.0 % (ninety per centum) of the value of such shares held.
(2) ***The Equity Swap*** – An owner of 500,000 shares in A Co sells all economic rewards and risk in such shares worth $ 13.5 million to Bank B, but retains the legal title to such shares ("bare dominium"). Bank B gets the dividend on such shares during the period and reaps any gain in the share price over such a period. Bank B in return compensates the owner for any money that he could have earned on an alternative $ 13.5 million less the Banks fee and reimburse the owner for any increase in the price of the shares over the period. As the shares have not been sold, there is no capital gains tax payable by the owner on such shares. "The Wealthy Find New Ways to avoid tax on profits " at http://www.stern.nyu.edu

2. have portfolios large enough to contain losses to offset any gains that might otherwise attract tax;

3. can afford to sit on their gains and thereby avoid tax unlike the middle class who are forced to realise their gains in order to obtain cash.

- may not be inflation indexed such that the capital gain may largely be artificial and does not reflect as a gain in real terms, creating an inequitable result for the taxpayer;[142]

- the inflation indexing of capital gains remains problematic especially if interest income is not indexed as this opens the way for tax arbitrage. Holders of monetary assets and fixed income earners are therefore placed at a disadvantage;

- an unqualified indexation system remains discriminatory as different assets are affected by inflation in different ways;

- under inflationary conditions there is, even in theory, no single and objective measure of "income" which is widely acceptable to economists, tax experts and taxpayers;

- the capital gains tax increases the cost of capital, reduces saving and thereby investment stifling economic growth and eroding the tax base in the long term;

- leads to a reduction in capital flows from foreign investors who relocate to more favorable tax regimes thereby further increasing the cost of domestic capital;

---

[142] Although precisely what index to use here as a price deflator is questionable. The following are options –

1. The Consumer Price Index (CPI), as used in Argentina, Israel and Sweden. It does however have the disadvantage that it relates to food prices and not to the value of capital assets.
2. The Producer Price Index (PPI), which has the advantages of being explicit, monthly, long term, representative of more than 1000 capital and intermediate goods represented by 150 manufacturing establishments.
3. Various indices for different types of assets
4. Index designed specifically for capital assets

Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.3.31

- leads to a misallocation of capital resources as taxpayers hold assets in order to avoid tax, rather than reinvesting the proceeds of the sale of such assets in more allocatively efficient investments;

- requires complex legislation which is expensive to administer reducing the overall net gain in revenue from its application;[143]

- the constant rollover of gains where business assets are replaced leads to a growing deferral of tax liability which eventually weakens the financial position of businesses and creates and artificial need to stay invested;

- generates the problem of "pyramiding" which erodes the original capital gain. Company A (owned by Company B) makes a gain subject to a 30.0 % (thirty point zero per centum) tax and retains the balance. If B then sells A, the price is likely to reflect the value of 70.0 % (seventy point zero per centum) retained. This will now attract a 21.0 % (twenty one per centum) tax in B's hands such that the effective tax rate is now 51.0 % (fifty one per centum) . If the pyramid extends further the total tax bill will eventually exhaust the original capital gain.

- <u>The proposed Capital Gains Tax (CGT) Budget 2000</u>

The rationale for the introduction of the capital gains tax in the 2000 budget makes no reference to the income / capital problem, but rather focuses on the perceived "overall efficiency and equity of the tax system" mooted by such a tax, such that it may be inferred that the introduction of such a tax was not perceived as a mechanism to resolve the income / capital problem. [144]

The introduction stands in strong contrast to the international trend where the move has been to reduce or to zero capital gains taxes. This trend is based on the economic principles that the new world economy is to be built on information technology and human capital rather than "bricks

[143] The IMF Fiscal Affairs Department projected during the course of 1995 that the potential revenue to be collected from the implementation of a CGT is limited. At best it has been estimated to generate in tax revenue an additional 0,1 – 0,3 % of the country's current GDP. Based on the fact that the 1995/ 1996 GDP of SA amounted to some R 500 billion, the projected additional revenue would amount to between R 500 million and R 1,5 billion less the costs of administering the tax itself. The estimated revenue increase in the UK over the same period was a similarly paltry 0.4 % of GDP. Interim Report of the Commission of Inquiry into certain aspects of the tax structure of the RSA (1994) (The Katz Commission) par 6.5.3. During the course of 1992 Canada found that its capital gains tax produced only 0..3 % of total tax revenue.
[144] See SARS <u>Guidelines on Capital Gains Tax</u> p.21 in the 2000 Budget as published at <u>http://www.sars.gov.za</u>

and mortar." Traditional forms or debt financing are not however conducive for such new enterprises owing to the lack of physical collateral. The result is that equity financing becomes a significant tool for the development of such enterprises and a capital gains tax merely frustrates such development by increasing the cost of capital.[145] What is even more significant is that such new economy enterprises are mainly small to medium size businesses (SME' s) which account for a large proportion of the new job creation in an economy.[146]

[145] The Nordic countries such as Finland, Norway, Sweden had high capital tax rates during the course of the 1990's and have been forced to reduce same as a result of massive capital flight into foreign tax havens. Australia has recently reduced its maximum CGT rate from 47.5 % to 23.5 %. Germany has announced its intention to eliminate completely all such taxes as applicable to share sales by companies and has already provided for a system where assets held for more than 6 (six) months are exempt from such taxes. The United States has reduced its CGT from 28 % to 20 % and has further introduced an 18 % tax rate for assets held longer than 5 (five) years. Kolber 5th Report of the Standing Senate Committee on Banks,Trade and Commerce May 3 , 2000 as found at http://www.parl.gc.ca

5. QUO VADIS: SUMMARY OF THE CURRENT PROVISIONS AND PROPOSED SOLUTION TO THE INCOME CAPITAL PROBLEM

The current situation therefore in respect of the taxation of the proceeds of share transactions, following the introduction of the proposed Capital Gains Tax, can be summarised as follows –

1. If a taxpayer elects to utilise the "Safe Haven Rule" as provided for in Section 9B of the Income Tax Act 58 of 1962, as amended, and holds his shares for more than 5 (five) years on the Johannesburg Stock Exchange, the transaction will be treated as a capital gain. This remedy, as has been stated, is however limited to a narrow band of transactions;

2. If the taxpayer does not make the election under the "safe haven rule" or sells his shares prior to the elapse of the 5 (five) year period, then the SARS will use the traditional test to determine whether the gain is a revenue or capital gain and tax same accordingly. It is contended that given the exigencies of the new markets and the development of the new or digital economy, the bulk of future share transactions will fall under such a category;

3. The portion of any capital gain to be included in taxable income for an individual is 25 % (twenty five per centum) and for a company or trust 50 % (fifty per centum). The effective tax rate taking into account the normal income tax rates allows for a tax of between 0 – 15 % (zero to fifteen per centum) for individuals and 15 % (fifteen per centum) for companies (assuming that they do not qualify for any special treatment);[147]

4. There are thus still advantages to a taxpayer to have a receipt or accrual classified as capital rather than income on the basis that –

   (a) the capital gains tax rates are more favorable than the marginal income tax rates reducing the total tax bill;

---

[146] In Canada it has been estimated that SME's accounted for 60 % of the new jobs created in the Canadian economy during 1995 – 1997 and 60.2 % of the jobs created during the course of 1998/ 1999. Kolber 5th report of the Standing Senate Committee on Banks,Trade and Commerce May 3 , 2000 as found at http://www. parl..gc.ca

[147] See SARS Guidelines on Capital Gains Tax p.21 in the 2000 Budget as published at http://www.sars.gov.za

(b) such tax is only payable upon realisation of the asset, the timing of which is usually under the control of the taxpayer, unlike income receipts and accruals such as dividends or interest.

5. The differing rates between the capital gains tax and the normal income tax rate and the areas in which the traditional test will still be of application, means that the problem of distinguishing capital from income is still relevant in terms of the quantum of tax liability, such that the income / capital distinction remains problematic on the basis of the current subjective test utilised.

6. The introduction of the Capital Gains Tax (CGT) it is contended will further not make the SARS less aggressive in terms of the scrutinising of share transactions given the emergence of the new digital economy, the resultant threat to the stability of the fiscus caused by the non - collection of indirect taxes and the absence of international consensus on how to deal with such new developments. These factors will produce a paralysis in terms of current domestic policy given the necessity of a global solution and the inherent delay in achieving such solution caused by the current " moratorium approach" adopted by the United States. The recent statement by Michael Katz therefore that: " Since the SARS will at least receive some tax in the case of capital gains, as opposed to all or nothing in the past, it does not have the same imperative to contest every capital versus revenue matter " cannot be seen as accurate. [148]

Based on the above analysis it is submitted that the complex nature of the problem precludes broad legislative intervention to attempt to define the concepts of "income" and "capital" in the Income Tax Act. The introduction of a capital gains tax it has been shown will not clarify such distinction, while at the same time carries with it fairly detrimental macroeconomic consequences. Most comparative tax jurisdictions have further not been successful in clarifying the problem, while the idiosyncratic nature of such systems in attempting to balance the competing interests of equity versus certainty makes the imposition of the principles of such systems in South Africa unworkable.

[148] "The impact of capital gains in South Africa" Katz M Personal Finance July 7, 2000 Vol.4 p.75

Any suggested solution it is submitted has to face the reality that a tradeoff will always exist between the competing values of certainty inherent in a more objective mechanistic approach and that of equity inherent in a more subjective approach.

It is suggested therefore that a possible solution emphasising the value of certainty, would seem to be the following, as previously advocated in 1986 –[149]

(a) A taxpayer should have the option to declare himself as a share dealer or share investor in respect of counters of shares;

(b) If he declares himself as a share dealer then his profits and losses should be included in Gross Income as well as allowable deductions to determine the taxable income;

(c) If he declares himself to be a share investor, his shares should be excluded from the computation of taxable income however his profits and losses as capital gains and capital losses on realisation should be included in determining taxable income on a graduated time scale *e.g.* treat shares disposed of within 1 (one) years 100 % (one hundred per centum) on revenue account and as the period of holding lengthens reduce the taxable revenue percentage to zero at the end of the third year. At the end of the third year, the disposal of the asset would render same subject to the standard capital gains tax rate.

This approach would certainly completely jettison the application of the traditional test in respect of such share transactions introducing an element of certainty desperately required as well as extend beyond the limited scope currently traversed by Section 9 B of the Income Tax Act. As has been stated: " the proposal removes entirely from the scene the enquiry (which remains inherent in the recommendations) as to whether a profit is ordinary income or a capital gain. It is this very inquiry which, in the case of shares, is the bugbear and the source of inequity in practice, however unintended in law." [150] This solution would sort out the speculator from the investor, in that the speculator is looking for short- term gains, whereas the investor will hold on to his good investments. The solution further meets the adverse arguments as to the effect of a capital gains tax on risk taking and investments, however it is not advanced as a broad capital

[149] "The Capital Gains problem" 1986 (35) The Taxpayer p.166
[150] "Capital Gains Tax" 1979 (28) The Taxpayer p.66

gains tax but rather as a solution specifically designed to deal with share transactions. [151] There would further be an incentive for investors to sell shares on which they are losing in order to set off the losses against taxable gains such that the market would be encouraged to become more liquid. The mechanical nature of the test would however cause inequity where the investor cannot for some reason postpone realisation of the asset in that for the fact that he cannot hold such asset he would be liable for the payment of capital gains tax on the proceeds of the asset. As has been stated however " but once this tax is imposed only on realisations – which is the only way short of a wealth tax – this inequity must exist unless, as in the United Kingdom, there is a deemed realisation on death." [152] The solution is further proffered as an alternative to a capital gains tax , however is inconsistent with the reality of the introduction of such tax. The inequity identified however might become substantial given the exigencies of the new digital economy that requires frequent switching of share counters probably well within any arbitrarily defined 5 (five) year period.

Example: Assume a share investor's taxable income or deduction of 100 % in respect of sales within one year of purchase, 80 % in respect of sales in the second year, 60 % in the third year etc.[153]

Year 1	
Sale of shares held for less than one year, profit	R 100.00
Sale of share held for less than two years, loss	R 100.00
Taxation	
Proportion of profit taxable LESS	R 100.00
Proportion of loss deductible	R 80.00
Net Taxable amount	R 20.00

[151] "Capital Gains Tax" 1969 (18) The Taxpayer p.63
[152] "Capital Gains Tax" 1969 (18) The Taxpayer p.63
[153] "Share Transactions" The Taxpayer April 1978 Vol.27 No.4 p. 64

Year 2	
Sale of shares held for less than three years, profit	R 100.00
Sale of share held for less than one year, loss	R 100.00
Taxation	
Proportion of profit taxable LESS	R 60.00
Proportion of loss deductible	R 100.00
Deduction carried forward to year three	R 40.00

Alternatively, a more equitable solution would be to retain the current subjective test, however to substantially remodel the traditional application thereof by the courts. Such a "remodeling" would involve -

- the acceptance that shares are inherently different when compared with other assets such that the traditional test utilised has to be adapted in light of the peculiarities thereof. Shares differ from land as an asset for example as – [154]

  (a) an individual taxpayer might hold a number of share counters (*e.g the taxpayer in Nussbaum had shares in over 140 companies listed on the JSE*), but will generally only own a few fixed properties;

  (b) the yield of a share is readily calculable at any given time as the market value of listed shares is quoted daily in the press allowing fluctuations in value to be readily discernible. The value of fixed property in contrast can only be determined *ex post facto* after the realisation thereof;

[154] Williams " Share dealers and income tax" 1996 SALJ Vol. 114 p. 484

(c) shares can be easily and cheaply transferred while land involves an arduous and expensive registration process.

- the recognition that the development of the new or "digital economy" has further rendered the current test inapplicable to shares on the basis that –

(a) the markets are currently in confusion and conducive to wild swings necessitating that an investor keep a careful watch on his portfolio to maintain his capital and switch counters where necessary; and

(b) the traditional mechanisms for share valuations have been rendered nugatory in the case of new technology stocks such that it is difficult for a taxpayer to show a consistent logic in terms of a coherent investment strategy.

- the application of the following principles to ensure equity in the application of the test –

(a) the restatement of the fact, as emphasised by Smalberger JA in *CIR v Pick 'n Pay,* that the "operation of a business in a scheme of profit making" remains the only test to be utilised contrary to Friedman J 's broad statement in *ITC 1450* that all the various tests are guidelines only to be adopted in each case according to "sound commercial and good sense";

But PnP specifically approved this test.

(b) the development of a comprehensive list of objective factors to be considered as a guidelines by the courts as suggested by the Margo Commission (1986);

(c) a reassessment of the dominance of the element of "permanency" as currently utilised in the test. In this respect the importance of the element of "permanency" needs to be reduced as well as the time period for what is regarded as "permanent" revised. The 5 (five) year period as utilised in Section 9B of the Income Tax Act 58 of 1962, as amended, is far too long given the exigencies of the new markets.

There is further already a body of precedent which supports this approach of the reduction of the importance of such a factor in the inquiry;[155]

(d) a reassessment of the frequency and scale as a factor. This would involve a realisation of the fact that the globalisation of the world markets, the development of online share trading and the development of the new economy, all necessitates share transactions on a much greater scale than before, even for a share investor hoping to merely to maintain the value of his capital investment;

(e) the rejection of the approach taken by the SARS in its 1997 Memorandum, to the extent that it is based on the *African Life* case, in regard to the concept of the "dominant versus co-existent intention" and acceptance in this regard of the ratio of Kriegler J in *Guardian Assurance* discussed earlier;

(f) the recognition of the impact of inflation when assessing the "profit motive" of a taxpayer (*real versus nominal return*) ;

(g) a less critical assessment of the *ipse dixit* of the taxpayer on the basis that the market uncertainty as well as new or "digital economy" presents problems in presenting an objectively coherent investment strategy backed by documentary evidence;

(h) a rejection of the onus on the taxpayer described in *Barnato* and *Nussbaum* as "formidable and difficult" on the basis of the facts presented of "an active investment policy ."

Clearly therefore whichever solution is adopted would involve an assessment of the relative value of the need for certainty versus that of equity in the South African tax environment at any given time.

---

[155] Jooste contends that the element of "permanency" has already been eliminated as a dominant factor in the test on the basis that –
(a) the permanence element was clearly absent in the case of *CIR v Paul 1956 (3) SA 535 (A)*, however the receipt in question was nevertheless held to be capital;
(b) the permanence element clashes with the realisation company / trust concept, where the absence of such a factor does not characterise the proceeds as revenue;
(c) the element was clearly ignored by the AD in the case of *CIR v Pick 'n Pay Employee Share Incentive Trust 1992 (4) SA 39 (A), 54 SATC 271, 1992 Taxpayer 129*;
(d) proceeds derived by way of donations / inheritance are regarded as capital regardless of the permanence elements;
Jooste "The role of the profit motive in the capital / revenue inquiry" 1993 SALJ Vol. 114 p. 220 - 221

6.BIBLIOGRAPHY

American Jurisprudence	Federal Income Tax	American Jurisprudence 2 Ed. Vol. 33 A (1999)
American Council for Capital Formation: Center for Policy Research	Capital gains taxes and US Economic Growth: a retrospective look	July 1999 as found at http://www.accf.org/capgains
Cameron	Picking shares like the pros	Personal Finance Vol.4 July 7, 2000
Cartee R	Note: An historical essay and economic assay of the capital asset definition: The taxpayer and courts are still mindfully guessing while congress doesn't seem to have a mind	34 William and Mary Law Review (1993) 885
De Koker and Urquhart	Income Tax In South Africa	Vol. 1 March 1988 Issue 13
Graetz M J & Schenk D H	Federal Income Taxation	3rd Ed (1995)
Divaris C	Capital Gains Tax	The Income Tax Reporter 15 Feb 1980 Vol. 9 1
Emslie T R Davis D M Hutton	Income Tax Cases and materials	1990
Jooste R D	The role of the profit motive in the capital / revenue enquiry	1993 SALJ Vol. 114 p.212
Katz M	Interim report of the Commission of Inquiry into certain aspects of the tax structure of South Africa	1994
Katz M	The impact of a capital gains tax in South Africa	Personal Finance Vol. 4 July 7, 2000
Kaufman J	Internet tax: An uncharted sea	National Law Journal July 7 1999 as found at http://www.law.com
Kolber E L	Fifth report of the Standing Senate Committee on Banks, Trade and Commerce	May 3, 2000 as found at http://www.par.gc.ca
Lanthrope D J	Selected Federal Statutes and Regulations	May 2000
Lindsay R	Dotcomuppance !	Business Day July 14, 2000

Lehman & Colman	Taxation law in Australia	1989
Margo C	Report of the Commission of inquiry into the tax structure of the RSA	1986
Mazerov L Lav S	A Federal moratorium on Internet taxes would erode state and local revenues and shift the burden to lower income households	Center on Budget and Policy Priorities May 11 1998 as found at http://www/cdt.org
Mcmenamin M S	Taxation of Capital in South Africa	Unpublished LLM dissertation UCT September 1991
Meyerowitz M	Meyerowitz on Income Tax	1999/ 2000 The Taxpayer
Niland C B	An inquiry into the nature of Capital with special reference to CIR v Middelman	Unpublished LLM Dissertation UCT October 1990
Report on Electronic Commerce in South Africa	Report on Electronic Commerce in South Africa	26 November 1999 as found at http://www.ecomm-debate.co.za/
Rubinsztein R	A burden of Proof	Unpublished LLM Dissertation UCT September 1992
Silke J	Silke on South African Income Tax	Vol. 1
South African Revenue Service (SARS)	Guidelines on Capital Gains Tax	Budget 2000 as found at http://www.sars.gov.za
South African Revenue Service (SARS)	Practice Note 18: Section 9 B of the Income Tax Act 58 of 1962	http:www.fnb.gov/legislation
Tolman D P	Note: The Arkansas Best decision: Taking Corn Products off the taxpayer menu	8 Virginia Tax Review 705 (1989)
West R	The top 13 reasons for the NASDAQ crash	http: //www.sistenb.com
Williams R C	Share dealers and income tax	1996 SALJ Vol. 114 p.480
The Economist	Monopoly money	The Economist 8 April 2000
The Taxgram	Share transactions revisited	The Taxgram Issue No. 11 November 1997
The Taxpayer	Capital Gains Tax	The Taxpayer 1969 (18) 62
The Taxpayer	Share Transactions	The Taxpayer 1978 (27) No.4 62
The Taxpayer	Capital versus revenue: The perennial problem	The Taxpayer 1978 (27) No.5
The Taxpayer	Capital gains Tax	The Taxpayer 1979 (28) 66

The Taxpayer	The Capital Gains problem	The Taxpayer 1986 (35) 156
The Taxpayer	Share Investor or share dealer	The Taxpayer 1986 (45) 142
The Taxpayer	The distinction between capital and revenue for income tax purposes	The Taxpayer 1990 (39) 48
Editorial	The Wealthy find new ways to avoid tax	As found at http://www.stern.nyu.edu
Williams R C	Sharedealing and Income Tax	1997 SALJ Vol. 114 p.480

CASES

South Africa:

Platt v CIR 1922 AD 42, 32 SATC 142
Overseas Trust Corporation v CIR 1926 AD 444, 2 SATC 71 at 75
CIR v Stott 1928 AD 252, 3 SATC 253
CIR v Visser 1937 TPD 77, 8 SATC 271
Lace Proprietary Mines v CIR 1938 AD 267, 9 SATC 349
CIR v Goodrick 1942 OPD 1, 12 SATC 229
Pyott v CIR 1945 AD 128, 13 SATC 121
ITC 1450 (1988) 51 SATC 70
LHC Corporation of SA Limited v CIR 1950 (4) SA 640 (A), 17 SATC 125
ITC 706 (1950) 17 SATC 218
ITC 743 (1951) 18 SATC 294
COT v Levy 1952 (2) SA 413 (A)
CIR v Richmond Estates (Pty) Ltd 1956 (1) SA 602 (A)
Durban North Traders v CIR 1956 (4) SA 594 (A), 21 SATC 8
ITC 862 (1958) 22 SATC 301
COT v Glass 1962 (1) SA 872 (A)
COT v BSA Investments Ltd 1966 (1) SA 530 (SRAD), 28 SATC 1
African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A), 31 SATC 163, 1969 Taxpayer 167
ITC 122 (1974) 37 SATC 17
SIR v Trust Bank of Africa Ltd 1975 (2) SA 652 (A), 37 SATC 87, 1978 Taxpayer 209

Natal Estates Limited v SIR 1975 (4) SA 177 (A), 37 SATC 193

John Bell and Co v SIR 1976 (4) SA 415 (A)

ITC 1308 (1978) 42 SATC 154

Elandsheuwel Farming (Edms) Bpk v SBI 1978 (1) SA 101 (A), 39 SATC 163

SIR v Aveling 1978 (1) SA 862 (A)

Barnato Holdings Ltd v SIR 1978 (2) SA 440 (A), 40 SATC 75 , 1978 Taxpayer 209

Malan v Komissaris Van Binnelandse Inkomste 1981 (2) SA 90 (C),

ITC 1412 (1983) 48 SATC 157

ITC 1431 (1986) 50 SATC 60

CIR v Nedbank 1986 (3) SA 59 (A), 48 SATC 73, 1986 Taxpayer 170

Tuck v CIR 1988 (3) SA 819 (A), 49 SATC 28, 1988 Taxpayer 149

ITC 1482 (1990) 52 SATC 298

CIR v Peoples Stores (Walvis Bay) Ltd 1990 (2) SA 353 (A), 52 SATC 9, 1990 Taxpayer 70

CIR v Guardian Assurance SA Ltd 1991 (3) SA, 1991 Taxpayer 212

CIR v Middelman 1991 (1) SA 200 (C)52 SATC 323, 1990 Taxpayer 32

CIR v Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A), 54 SATC 271

CIR v Nussbaum 1996 (4) SA 1156 (A),

Australia:

Scott v COT (NSW) 1935 SR NSW 215

Hallstroms (Pty) Ltd v FCT (1946) 3 AITR 436

IRC v British Salmson Aero Engines (1978) 2 KB 482

Board Of Revenue 1979 (CTBR) NSW Vol. 23 CR 64

Trent Investments (Pty) Ltd v FCT (1976) 6 ATR 201

United States:

Corn Products Refining Co v Commissioner of Internal Revenue 350 US 46

Arkansas Best Corporation v The Commissioner of Internal Revenue 485 US 212; 108 S Ct 971

Groetzinger v Commissioner 771 F. 2d 269, 274 - 277

Higgins v Commissioner 312 US 212, 216 (1941)