

Analysis of “commencement of trade” and “cessation of trade” as applied in the context of Income Tax in South Africa.

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ABSTRACT

In income tax legislation, it is of crucial importance to be able to determine a precise time at which an entity can be said to have commenced and ceased trading. This is due to the fact that in so far as tax on income is concerned, by its very nature, it is a tax that mainly depends on trade, and the tax events that become relevant in terms of deductions and allowances in particular, need to take place within the context of trade.¹ In essence, in order for a tax event or an expense to have any application for the purposes of income tax (as opposed to capital gains, or other non-revenue taxes) it must take place between the times after an entity has commenced trading, and before it has ceased trading.²

As will be shown, this is so stringently applied, that it can lead to unfairness with regards to certain pre-trade revenue expenses, so much so, that in 2003, the Income Tax Act was amended to include an exception for such expenses in the form of section 11A.

An assessment of when a business commenced and ceased can also be relevant in many other areas other than in relation to deductions and allowances, such as in the provisions relating to value added tax, in determining an appropriate tax period for an entity, and in many other instances. It is also relevant in many areas outside of the field of tax.

However, despite the relevance of this issue, and despite the fact that one would have expected the issue to have received judicial attention, there is in fact a paucity of jurisprudence both locally and internationally on the issue of commencement of trade. There are few definitions or guidelines to assist the practitioner, which outline in clear and defined terms, the requirements and elements that must be present, in order to determine that trade has commenced or ceased.

¹ Note that there are exceptions; passive income attracts tax but is not trade.

² There are of course exceptions such as rehabilitation costs, but these do not detract from the general principle.

The goal of this dissertation is to examine South African law and jurisprudence in order to highlight elements and requirements that can assist a practitioner in arriving at a definition if possible, or at the very least, in finding indicators that are easily assessable, and which can assist a practitioner to determine the point in time at which a particular trade commenced or ceased.

This will be supplemented with an examination of certain selected foreign jurisdictions that are well established as first world trading nations and a traditional source of reference for South African tax law, for the purpose of firstly, adding to the definitions that may be found to exist in South African jurisprudence, and secondly, in order to compare South African tax law and jurisprudence, with that of these foreign jurisdictions. This will result in not only a substantive comparison, but also a qualitative comparison. It can only serve to underscore the quality of South African law in this regard, if the provisions of South African law and jurisprudence, are congruent with that of these advanced economies.

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Chapter 1 - Introduction.

1.1 Background and purpose

The purpose of this dissertation is to examine and analyse the meaning of the concepts of “commencement of trade” and “cessation of trade” as applied to South African commercial and tax law.

In so far as commercial tax legislation is concerned, all revenue tax events take place during the process of trade. Tax on revenue is inextricably linked with the process of trade, and it therefore follows that concepts of commencement of trade, and cessation of trade would come to the fore, requiring definition and quantification by the tax authorities, tax practitioners, and all persons involved in the process of trade.

Yet, despite the seemingly important and crucial nature of these concepts and definitions, they have for some reason escaped judicial and jurisprudential scrutiny. One would have expected that the issue of determining when trade has commenced and ceased, would have become a source of much dispute in the interactions between tax authorities and business, but on the whole, this has not occurred. This is especially relevant to the area of pre-trade or incorporation expenses that are incurred in preparing for trade, as on a strict interpretation of section 11 of the Income Tax Act 58 of 1962 (‘the ITA’), such expenses cannot be claimed. The wording of section 11(a) is critical and provides that the only permissible deductions that are allowed are, “expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature.” It could be argued, that certain pre-trade expenses may be excluded from this definition.³

³ It is important to note that the preamble to section 11 is the key in the interpretation of section 11, as only the “intent to produce income” is required and not the actual production of income.

It is for this reason that one would have expected taxpayers to try and stretch the definition of the time at which trade can be said to have commenced, to include the time in which the trade was being set up, prior to its actual commencement in the narrow sense of actually exchanging goods or services for remuneration. Conversely, one would have expected the tax authorities to try and define the time at which business commenced narrowly, so as to adopt as close to a “doors open for business” approach as possible, so as to restrict the deductions that a tax payer would make from their income.⁴

A general practice emerged, that seems to have been applied by tax authorities and business, in terms of which taxpayers would include such expenses in their returns, and these were not challenged by the tax authorities, as an informal recognition that it may be inherently unfair to disallow such expenses.⁵

A later development in South Africa, which gave recognition to this problem (and perhaps codified the above practice), was the incorporation of section 11A into the ITA in 2003.⁶ This section finally made pre-trade expenses deductible, and made the entire question of defining the time that trade commences a moot issue in this context, except to the extent of identifying the year of assessment in which the trade commenced, as the pre-trade expenses are only deductible from that point.

A similar development seems to have occurred in the UK in 1988, with the incorporation of section 401 to the Income and Corporation Taxes Act 1988, which provided an exception to the rule that expenses of a revenue nature can only be deducted if they are incurred during the time when an entity trades, by allowing for the deduction of pre-trade expenses of a revenue nature that occurred within a three year period prior to the date of commencement.

⁴ In this regard, it should be noted that SARS have adopted the strict application of the trade requirement in SARS Interpretation Note 33, which is discussed in greater detail below.

⁵ In this regard, the concessions proposed in the context of assessed losses, in terms of Interpretation Note 33 should be noted. This will also be discussed in greater detail below.

⁶ Section 11A inserted by s. 28 (1) of Act 45 of 2003.

This was extended to a period of seven years in 2005, and confirmed in the Corporation Tax Act of 2009.⁷

The concepts of commencement and cessation of trade, affect any provision in the Income Tax Act that refers to trade, or that contains the word “trade”. The word “trade” refers to the trade in the wider sense of running a business. This is in line with the definition of trade in section 1 of the ITA.⁸

In general terms, whenever the word “trade” is used in the ITA, such as in section 7(2A)⁹ for example, it requires the ability to determine exactly when the trade commenced, and when it ceased. The provisions of section 7(2A), for example, will only apply if the tax event referred to as the basis for the tax being allocated, occurred during the period in which the recipient of the income traded, or in other words, in-between the time when that recipient commenced trading, and the time when he ceased trading. Any event on the other side of this starting and end point will not be subject to this provision.

It should also be noted that, even in the context of income, the concept of trade, as is relevant in this dissertation, does not include all forms of income. As Silke on South African Income Tax points out, trade in this context would exclude certain activities that produce income, such

⁷ The seven year rule is provided for in section 61 of the Corporation Tax Act 2009, and section 57 of the Income Tax (Trade and Other Income) Act 2005.

⁸ See the definition of trade as stated in section 1 Income Tax Act 58 of 1962, as amended by the Taxation Laws Amendment Act 31 of 2013 – ‘trade’ includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act[, 1978 (Act No. 57 of 1978),] or any design as defined in the Designs Act[, 1993 (Act No. 195 of 1993),] or any trade mark as defined in the Trade Marks Act[, 1993 (Act No. 194 of 1993),] or any copyright as defined in the Copyright Act 1978 (Act No. 98 of 1978),] or any other property which is of a similar nature.

⁹ “(2A) In the case of spouses who are married in community of property-

(a) any income (other than income derived from the letting of fixed property) which has been derived from the carrying on of any trade shall, if such trade is carried on-

(i) by only one of the spouses, be deemed to have accrued to that spouse; or

(ii) jointly by both spouses, be deemed, subject to the provisions of subsection (2)(b), to have accrued to both spouses in the proportions determined by them in terms of the agreement that regulates their joint trade or, if there is no such agreement, in the proportion to which each spouse would reasonably be entitled having regard to the nature of the relevant trade, the extent of each spouse's participation therein, the services rendered by each spouse or any other relevant factor.”

as income in the form of interest, dividends, annuities, and pensions.¹⁰ Such income is passive income, which is taxable, but which does not constitute trade.

1.2 Research objective

Quite significantly, and notwithstanding the apparently obvious meaning of these phrases, the legal meaning of the concepts of commencement and cessation of trade remain largely undefined in South African fiscal legislation and the jurisprudence on the issue is rather scant.

A consideration of South African and selected foreign jurisprudence will highlight not only the areas in which these concepts become relevant, but more importantly, the paucity of South African jurisprudence in providing a clear and precise definition of the concept. In tax law, as in all areas of law, it would be extremely useful to have access to a well-defined and established set of criteria to which one can refer, when trying to make a determination for legal and tax purposes as to whether a business was trading at the time that a particular revenue tax event is alleged to have taken place. This is relevant in respect of both the accrual of tax obligations on the part of the trader, and also, more importantly, the right of the trader to claim certain tax deductions, allowances, and rebates that are found in the ITA.

The objective of this research is to put together a legal meaning or definition of the concept of commencement and cessation of trade, largely by looking at the jurisprudence in South Africa, the United Kingdom, Australia and the United States, and distilling from these certain indicators or benchmarks which would confirm the existence or trading activity. In this way, the time at which these indicators or benchmarks first arise or when they eventually cease in

¹⁰ De Koker, A. P. (2013). *Silke on South African Income, Tax Chapter 7*, paragraph 7.2. LexisNexis. Retrieved from <http://www.mylexisnexis.co.za>. See also ITC 1275 (1978) 40 SATC 197 (C) where it was said that the watching over of investments does not constitute a trade, and ITC 496 (1941) 12 SATC 132 where it was said that the earning of interest on funds advanced by a holding company to its subsidiary was held not to constitute the carrying on of a trade. – See also SAIT Compendium of Tax Legislation 2013.

respect of any entity, could also be said to be the time at which trade commences or ceases, as the case may be.

It is unlikely that the concepts of commencement and cessation of trade can be encapsulated into a neat and concise definition, in the form of single sentence or single phrase in the manner that jurists prefer. Some legal concepts simply defy such a simple and concise definition.

Rather, the answer will be unavoidably limited to proposing the existence of certain accepted and recognised indicators or defining certain types of activity, whose presence or absence is indicative of the commencement or cessation of trade. A court would then be guided in determining whether a particular trade can be said to have commenced, by looking for the presence or absence of these indicators and activities.

It is also important at the outset to note that when speaking of trade in this context, we are referring to a commercial activity in the form of running a business. One speaks of a revenue transaction as opposed to a capital transaction. A person can be involved in a trade in the sense of selling a capital asset, but this will not be something that falls within the parameters of this dissertation. This is trade in the sense of a verb, which is an action that can have either capital or revenue implications from a tax perspective. It is only the latter that would be of any concern in the context of this topic.

Perhaps the concept of trade should be understood in its meaning as a noun, meaning business, commercial undertaking and profession. A single trade may or may not suffice. A series of trades with a view of earning revenue and generating income is specifically the context that is being examined.

Furthermore, a person who is employed as an engineer or some such profession, can in loose terms be said to be carrying out his trade, but for the purposes of this topic, the concept of trade refers specifically to a trading activity in the sense of the running of a business that accrues income and incurs expenses within the context of its trading activities. The commencement or cessation of trade will still have relevance for employed persons to qualify

for those deductions permitted by section 23(m). However, the commencement and cessation dates are easier to determine for employment and should therefore be contrasted to the business type commencement and cessation that is the topic of this dissertation, the context of which applies more to a “trader” or an entity that earns its income through trade.

1.3 Research method

The research method to be employed can be best described as a mixture of theoretical non-doctrinal research with doctrinal research underpinning the theoretical research. “Doctrinal research is described as the traditional or ‘black letter law’ approach and is typified by the systematic process of identifying, analysing, organising and synthesising statutes, judicial decisions and commentary. It is typically a library-based undertaking, focussed on reading and conducting intensive scholarly analysis”.¹¹ “Theoretical research is that which fosters a more complete understanding of the conceptual bases of legal principles”.¹²

1.3.1 Doctrinal research

The primary source of research that will be utilised in this dissertation is an examination of legislation, jurisprudence and academic writing on the topic. It is unlikely that a definitive answer can be found in any particular source, and in many ways, the topic has hardly ever been directly addressed by these authorities. Many of the cases that will be referred to will examine whether a particular entity was trading or not at any specific point in time relevant to a tax event, but few directly examine the question of when it can be said that an entity has

¹¹ McKerchar, M. 2008. Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation, *eJournal of Tax Research*, 6:1, 5-22 at 18-19

¹² McKerchar, M. 2008. Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation, *eJournal of Tax Research*, 6:1, 5-22 at 19

commenced trading. The analysis conducted will lead to the theoretical research in line with the stated research objective to determine those indicators or benchmarks which would confirm the existence or trading activity.

In order to supplement and add to the South African jurisprudence, it will also be useful to look at some select foreign jurisdictions, to ascertain from these whether there is a trade requirement or something akin thereto in their tax legislation, which creates a similar need within that jurisdiction, to define the concepts of commencement and cessation of trade. If so, it will be useful and beneficial in developing this definition for South African tax purposes, to examine how these jurisdictions have dealt with the issue.

1.3.2 Theoretical non-doctrinal research

This aspect of the research will draw from the earlier analysis to develop the framework or indicators of the commencement or cessation of trade. Both the concepts of commencement of trade and cessation of trade will be examined in that both contribute to an understanding of the definition, and both are aspects of the same concept. Commencement of trade refers to the positive aspects, that is, the indicators, or conduct that is commenced with, which places an entity within the parameters of trading activity, whilst cessation of trade refers to the same indicators and conduct that cease, and which in so doing remove an entity from the parameters of trading activity. Both of these positive and negative aspects will assist in defining the boundaries or parameters of a definition of what constitutes trade, and of when an entity can be said to have commenced trading for commercial and tax purposes

To define commencement of trade is a far more difficult task than to define a cessation of trade. In order to determine when a company has ceased trading, one merely looks for the cessation of activity that the company performed whilst it was still in business. These would include activities such as purchasing stock, maintaining employees, receiving an income

through these activities, maintaining its premises and other such activity. To determine whether this has ceased may simply be an objective exercise of looking at the books of account to look for cash movement that would be indicative of such activities.

There is jurisprudence and academic commentary on the requirements that need to be examined in order to establish whether a business could be said to have been trading during a particular period. By implication, some of these very same requirements or indicators of trade can also be used as an indicator of when trade commenced, or ceased.

Traditionally, South African tax law has borrowed concepts and principles from certain jurisdictions, prominently from England and Australia. The relevant SARS commentary to this question contained in Interpretation Note 33, also refers to the jurisprudence of the United States, despite the fact that the United States is not a jurisdiction that is traditionally influential in South African Tax Law. Any jurisprudence in these countries that may relate to defining the parameters of trade, or more particularly, when trade commences and when it ceases, will be of great use in South Africa law, and will be influential and useful references in our own jurisprudence in order to develop the necessary guidelines or indicators.

1.4 Limitations

It should be noted that for the purposes of this dissertation, the “Income from Trade” requirement that is or may be applicable to assessed losses and other deductions and allowances will not be considered.¹³ When dealing with any assessed losses that may be claimable or brought forward to a subsequent trading year, many jurisdictions, South Africa included, require that not only must the taxpayer be trading, that is, must have commenced to trade, and not yet have ceased trading, but furthermore also require that the trade results in

¹³ As per section 20 of the Income Tax Act 58 of 1962

income.¹⁴ The first requirement is known as the “trade requirement” and the second is the “income from trade requirement”. In order to claim deductions and allowances in terms of South African tax law, and more practically, for carrying these forward as assessed losses, both requirements are necessary. In other words, not only must there be trade, but there must also be income from trade. It is only the trade requirement that is relevant to this dissertation, and this will therefore not consider the effects or consequences of the second requirement.

1.5 Structure

This dissertation will proceed with a chapter by chapter analysis of various jurisdictions, followed by a concluding chapter which will tie these together in a comparative manner, in order to establish a set of criteria that will be useful as tools to be utilised by the Courts, or by any tax practitioner, in the determination of when an entity can be said to have commenced or ceased to trade. The next chapter to follow will examine the South African jurisprudence and reference material on this topic. In light of the lack of resources that add directly to this definition, this chapter will examine the requirements and indicators that have been examined in our body of case law, and those that have been identified by our various authorities, as indicators that a trade is being conducted. Conversely, in order to establish that a trade is not being conducted, one would look for an absence of these indicators. These same indicators could therefore be used to show the point at which a trade commenced, or the time at which it ceased.

Three sequential chapters will thereafter follow, with each being an examination of the same question, in the England, Australia, and the United States, respectively.

¹⁴ S.A. Bazaars (Pty.) Ltd. v Commissioner for Inland Revenue, 1952(4) S.A. 505.

1.6 Conclusion

The conclusion will highlight areas of commonality and divergence with the international jurisdictions concerned, as these can reinforce the approach that is recommended with regards to South African law. The first area of comparison will be to determine whether a similar issue arises in these jurisdictions, more specifically, whether these countries have grappled with the question of when it can be said that a trade has commenced or ceased. The importance of this issue to the tax law of these jurisdictions will also be examined and most importantly, the manner in which this issue is dealt with by their courts and legislatures, and by their tax authorities. Their respective approaches to this issue may greatly add to the resolution of this issue in South African tax law.

The final chapter will be a conclusion that presents a definition, or something as close thereto as is possible, that one can use to establish primarily when an entity can be said to have commenced trading, and by extension, when it can be deemed to have ceased trading.

This will highlight those indicators that are useful in South African tax law, to determine the question of whether an entity has commenced trading, or conversely, ceased trading for the purposes of South African tax law.

Chapter 2 – Fiscal law of South Africa

2.1 Introduction.

In South African jurisprudence, there are very few cases that specifically define the concept of commencement or cessation of trade. The cases that do touch on the subject tend to look at specific activities that can be used as a measure or indication that trade has commenced or ceased.

Accordingly, one is not likely to find a specific and concise definition that can be referred to as a mantra of case law, to guide the practitioner in a determination as to whether an entity is involved in trade, or rather, whether it finds itself between the time when it can be said that trade has commenced, and before the time when it can be said that its trade has ceased.

This chapter will firstly examine the provisions of the Income Tax Act 58 of 1962 that are relevant to this issue, namely, where the commencement or cessation of trade becomes relevant to the application of such provisions.

Thereafter, it will examine South African jurisprudence in order to see how the trade requirement, and the commencement and cessation of trade are dealt with by South African courts.

There is also the relevant South African Revenue Service (SARS) commentary on the issue which will be examined, in order to ascertain an established practise in the form of interpretation notes published by SARS.

In conclusion, the chapter will highlight relevant criteria that have arisen in the application of South African tax law in the context of commencement and cessation of trade, as well as the indicators and requirements that can be identified in South African jurisprudence that would

be useful in determining the point of time at which the trade of any commercial enterprise can be said to have commenced, and ceased.

2.2 Definition of trade

The phrase “carrying on trade” is not defined in the ITA, but the word “trade” is defined in section 1.¹⁵ It has been held that this definition should be widely construed as it is intended by the ITA to refer to and incorporate every profitable activity that an entity undertakes on a commercial basis.¹⁶ The test to be applied is an objective test. In other words, if an examination of certain objective factors indicates that an entity is trading, then the trade requirement is satisfied. For the purposes of this dissertation we can take this to mean that if certain objective factors are present, then the entity is in between the point where it has commenced trading, and before the point where it ceases to trade. It is these factors that has to be examined by any practitioner in order to determine whether the entity is entitled to the various deductions, allowances and rebates provided for to in terms of the ITA, which are dependent on trading activity. Furthermore, the commencement or cessation of these same factors, can be indicative of when an entity commence or ceased to trade.

¹⁵ See the definition of trade as stated in section 1 Income Tax Act 58 of 1962, as amended by the Taxation Laws Amendment Act 31 of 2013 – ‘trade’ includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act[, 1978 (Act No. 57 of 1978),] or any design as defined in the Designs Act[, 1993 (Act No. 195 of 1993),] or any trade mark as defined in the Trade Marks Act[, 1993 (Act No. 194 of 1993),] or any copyright as defined in the Copyright Act 1978 (Act No. 98 of 1978),] or any other property which is of a similar nature.

¹⁶ ITC 770 19 SATC 216 (T). See also Juta Tax Library. (2013). SOUTH AFRICAN INCOME TAX: Legislation and Commentary, Commentary on Income Tax. Chapter II THE TAXES (ss 5-64C), PART I Normal Tax (ss 5-37H).

2.3 The Income Tax Act No 58 of 1962

In terms of South African Law, the deductibility of expenses and of capital allowances is based strictly on the trade requirement. For example, section 11 commences with the wording: “For the purpose of determining taxable income derived by any person *from carrying on any trade*, there shall be allowed as deductions from the income of such person so derived” (*emphasis added*). It is clear that it is a requirement that the expenses be incurred as part and parcel of the trading operations of an entity, i.e. the taxpayer must be trading, or in other words, in that period between having commenced and having ceased trading.

This same is true for the allowances and deductions provided for in terms of sections 12, 13, 14, and 15 of the ITA.¹⁷ These sections use the same phraseology as section 11, namely, “carrying on of a trade”, or “for the purposes of a trade”. Accordingly, the same qualification applies, i.e. that the expense or tax event must have occurred between the commencement and cessation of trade.

Deductions and allowances are clearly restricted to tax events that occur after commencement of trade and before cessation of trade. However, this can exclude a whole range of trade related expenses that may have occurred prior to the commencement of trade.¹⁸ These can include expenses incurred in preparation of trading operations, or in setting up the trading operations. If such expenses are incurred before trade commences or after it ceases, they would be excluded from allowable deductions against income to be earned once trading commences if one applies the narrow definition of the trade requirement. The result can be

¹⁷ Sections 12B to 12O all relate to equipment, machinery, assets, rolling stock, and other industry specific deductions. Section 13 contains similar provisions relating to building and construction, section 14 deals with ships and aircraft, and section 15 with mining.

¹⁸ This depends of course on the precise definition of commencement of trade, and in particular, how widely it is defined in any particular jurisdiction.

inequitable, and South African legislators have seen it necessary to provide for an exception to this general rule, in the form of section 11A.¹⁹

Even when dealing with this exception it is vital to accurately assess the time that the trade in question commenced, because the expenses are ring-fenced and are only claimable against the proceeds of that specific trade. More importantly, they are claimable only after that trade has commenced. Therefore it is necessary when claiming a deduction of this nature to show, that the trade that was being prepared for and set up, did actually commence and the income against which it is deducted, is income derived from this specific trade.

Notwithstanding the wording of the provisions of the ITA referred to above, no guidance and no provision that will assist in determining the time that trade commences or ceases is provided in the ITA. It can in some instances be obvious when trade can be said to have commenced, for example in small retail businesses, however, with larger and more complex enterprises, especially those requiring large scale investment and development, it is often not that simple.

2.4 SARS Commentary

There is one SARS publication that is of particular interest to the determination of this question, in the form of Interpretation Note No 33 (IN 33).²⁰ This single commentary forms the sole commentary of SARS on the issue of commencement of trade, or of the trade requirement, and it is useful in that it summarises the official SARS position.

¹⁹ Section 11A was inserted by s 28 (1) of Act 45 of 2003

²⁰ SARS Interpretation Note 33. (2010) Assessed losses, trade, and income from trade requirements. Paragraph 5 (First published in 2005)

IN 33 refers to the paucity of South African jurisprudence on the topic, but through an examination of the little case law that does exist in South African and foreign jurisdiction, it provides a commentary of various activities and indicators that could indicate trade activity.

IN 33 was drafted specifically in the context of assessed losses and in particular sought to clarify the circumstances in which a company may forfeit its right to carry forward its assessed loss from the preceding year of assessment. In doing so, it provides specific commentary on the question of defining commencement of trade, and on the trade requirement.

Reference is also made to several South African cases many of which will be examined in more detail in paragraph 2.5 below.²¹

On the question of when trade commences, IN 33 identifies the problem as follows:

“The issue as to when trade commences is important because in some cases it can take several years before a company is in a position to earn income. If the activities in the current year are preliminary to the commencement of trade, the company stands to lose its balance of assessed loss. This could be an issue with the start-up of a new company or the termination by a company of one business while preparing to start another. There is very little guidance to be found on the question as to when trade commences in South African case law.”²²

The commentary proceeds to cite various American cases that were determined in the context of section 162(a) of the Internal Revenue Code which allows a deduction for “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or

²¹ These are CIR v Louis Zinn Organization (Pty) Ltd 1958 (4) SA 477 (A), 22 SATC 85; SA Bazaars (Pty) Ltd v CIR 1952 (4) SA 505 (A), 18 SATC 240; Sentra-Oes Koöperatief Bpk v KBI 1995 (3) SA 197 (A), 57 SATC 109 at 117; Secretary for Inland Revenue v Crane 1977 (4) SA 761 (T); ITC 1275 (1978) 40 SATC 197 (C); ITC 496 (1941) 12 SATC 132 (U); ITC 1274 (1977) 40 SATC 185 (T); ITC 957, (1960) 24 SATC 637 (O); ITC 770 (1953) 19 SATC 216 (T); SARS v Tiger Oats Ltd [2003] 2 All SA 604 (SCA), 65 SATC 281; ITC 1802 (2005) 68 SATC (G); C: SARS v Contour Engineering (Pty) Ltd 1999 (E), 61 SATC 447; ITC 777 (1953) 19 SATC 320 (T)

²² SARS Interpretation Note 33. (2010) Assessed losses, trade, and income from trade requirements. Paragraph 4.1.7.

business”, and concludes that, “[t]he only consistent principle that can be extracted is that the question must be decided on the facts and circumstances of the particular case”.²³

IN 33 also placed importance on Australian cases such as *Esso Australia Resources Ltd*,²⁴ and UK cases such as *J. & R. O’Kane & Co.*²⁵ and *Ransom v Higgs*.²⁶ These cases will be examined in the later chapters of this dissertation, in the chapters dealing with the law of the United Kingdom and of Australia.²⁷

In the context of defining the commencement and cessation of trade, IN 33 provides a good reference to South African and international jurisprudence which is recognised as authoritative by SARS, which can be further examined in order to ascertain a definition, or rather, to establish indicators and define activities, whose presence or absence is useful in establishing the time at which trade commenced and ceased.²⁸

As an interesting digression, IN 33 concludes that a strict application of Section 20 of the ITA, provides for a strict income from trade requirement that precludes assessed losses from being carried forward in its absence. This is particularly important as section 5 of the Tax Administration Act makes use of the concept of a practice generally prevailing.²⁹

²³ The American cases referred to were, *Richmond Televisions Corp. v Commissioner*, 345 F.2d 901 (4th Cir. 1965); *Madison Gas and Electric Co. v Commissioner*, 633 F.2d 512 (7th Cir. 1980); *United States v Manor Care Inc*, 490 F. Supp. 355; 1980 U.S. Dist. LEXIS 9143; 80-2 U.S. Tax Cas. (CCH) P9547; 46 A.F.T.R.2d (RIA) 5331; *Brotherman v United States*, 6 Cl. Ct. 407; 84-2 U.S. Tax Cas. (CCH) P9846; 54 A.F.T.R.2d (RIA) 6179; 1984 U.S. Cl. Ct. LEXIS 1286; and *Blitzer v United States* 684 F.2d 874 (Ct. Cl. 1982).

²⁴ *Esso Australia Resources Ltd v FC of T* 98 ATC 4768, (1998) 39 ATR 394 at 396.

²⁵ *J. & R. O’Kane & Co. v The CIR* 12 TC 303 (HL) at 341/2.

²⁶ *Ransom v Higgs* [1974] 50 TC 1.

²⁷ See chapters 3 and 4 below.

²⁸ This is notwithstanding the fact that IN 33 relates predominantly to the income from trade requirement.

²⁹ See section 5(1) of the Tax Administration Act 28 of 2011 which provides that, ““A practice generally prevailing is a practice set out in an official publication regarding the application or interpretation of a tax Act.” Furthermore, in terms of Interpretation Note 15 (2nd Issue), a practice generally prevailing is one that has been expressly authorised by the Commissioner, personally or through the delegated Head Office Division, and is being applied throughout the country. Although Issue 2 of Interpretation Note 15 was replaced by Issue 3 on 10 July 2013, and although Issue 3 has left out this commentary, it nevertheless remains a useful explanation of what is meant by a “practice generally prevailing.”

Clearly, the commentary in support of a strict application of the income from trade requirement constitutes an interpretation by SARS of section 20 of the ITA, and therefore it constitutes a practice generally prevailing.

Notwithstanding this practice however, SARS adopted the very practical approach of allowing for a concession to this strict application under certain circumstances, “notwithstanding the fact that income may not have accrued from the carrying on of that trade. This concession is limited to cases in which it is clear that trade has been carried on.” It is noteworthy that this note was first issued in 2005, after the introduction of Section 11A in 2003. It is also relevant that the tax court case, ITC 1830,³⁰ specifically rejects that SARS has such a discretion to allow a concession in the face of legislative provisions that require a strict compliance to the trade requirement, and that notwithstanding this judgment, the concession was retained in the second issue of IN33 in 2010.

Notwithstanding the fact that ITC 1830 arguably disposes of the possibility of any such concession, and notwithstanding the fact that IN 33 may therefore have become superseded by the judgment in this matter, IN33 still forms an important commentary as to the possible indicator of trade, and the approach that should be applied in the determination of each matter, in accordance with the specific circumstances of each case.

2.5 South African jurisprudence

In South African Tax jurisprudence, the concept of “commencement of trade” has received attention in the context of assessed losses, and the carrying forward of such losses. The term assessed loss as defined in terms of Section 20(2) of the Act, is the tax loss that arises after

³⁰ ITC 1830 (2007) 70 SATC 123 (G).

the deductions allowed in terms of Sections 11 to 19 of the Act have been subtracted from the income earned by the trading entity.³¹

Before a company is entitled to carry forward its assessed losses from an immediately preceding year of assessment, it must have carried on a trade during the current year of assessment.³² This is in accordance to what has become known as the “income from trade requirement”.³³ Therefore, the company must have commenced trading, and have earned an income from this trade, in order to carry forward the loss.³⁴

As stated above, South African jurisprudence and tax legislation have not defined the concept of commencement of trade. They have however, examined the trade requirement and have assessed what constitutes trade in the context of the trade requirement. This examination is sufficiently similar to that which is required in order to define commencement of trade, and it is for this reason that these judgments are very useful.

It is important to clarify principles as to when trade commences because in some larger trade undertakings, it may take several years of activity before a company is in a position to earn income. In this context it is crucial to determine whether such activities can in any way be considered as an indication that the company’s trading activities have commenced, or whether

³¹ SARS Interpretation Note 33. (2010) Assessed losses, trade, and income from trade requirements. Paragraph 5 (First published in 2005).

³² SAIT (Supra) page 693. See also *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A).

³³ As explained below, the ambit of this dissertation is restricted to the Trade requirement, and does not in any way address the income from trade requirement.

³⁴ The methodology for determining a balance of assessed loss was described by Schreiner ACJ in *CIR v Louis Zinn Organization (Pty) Ltd* (Supra) at 95; “Wherever there has been a trading loss in the tax year, or where there has been a balance of assessed loss brought forward from the previous year, there has to be a determination of the balance of assessed loss to be carried forward into the next year. There may have been a profit in the tax year but not large enough to obliterate the balance of assessed loss carried over from the previous year. Then the new balance of assessed loss will be smaller than the previous one. If there has been a working loss in the tax year the balance to go forward will be increased. If there has been no previous balance the assessed loss in the tax year will be the balance of assessed loss carried forward. The point to keep in mind is that, although at the stage where it is to be used, i.e. when it is to be set off against a profit, a balance of assessed loss looks back to the past, at the stage where it is being determined, i.e. when its amount is being calculated, it looks forward to the future when it will be used. At the determination stage it is being prepared for future use, and it has then no effect on the taxpayer’s liability in respect of the tax year for which the relative notice of assessment is issued.”

they are considered as being merely ancillary to the commencement of trading activities.³⁵

The following principles emerge.

2.5.1 The element of risk.

Trade is often seen as “a transaction in which a person risks something with the object of making a profit.”³⁶ This however, does not necessarily mean that when risk is absent that the trading requirement is not satisfied.³⁷ In ITC 398 the court defined the concept of a venture with reference to the element of risk, as a trading activity, whilst Burgess stated that in the absence of risk, the court must determine whether the entity may fall under another category of trade, other than that of a venture. Similarly the fact that an activity involves a risk does not automatically lead to the conclusion that this must therefore mean that a trade was being conducted.³⁸

Therefore, it may be possible to argue that the presence of an element of risk is indicative of a trading activity. It also therefore follows, that the time at which a certain risk is assumed, may under certain circumstances depending on what follows, be seen as the time at which trade could be said to have commenced.

It is submitted that when discussing the element of risk it is trite that one refers to an economic or financial risk. In other words, such risk involves the laying out of funds or the making of a financial investment for the purposes of commencing with a trade or a commercial activity for profit. For the purposes of establishing a time of commencement of trade, it is further submitted that it would not necessarily make a difference if the outlay or expenditure were of a capital

³⁵ This is as stated in SARS Interpretation Note 33. Note that some relief is found in s11A of the Act, which allows a company to claim its pre-trade expenses once it has commenced with trade.

³⁶ ITC 368 9 SATC 211 at 212.

³⁷ See *Burgess v CIR* 1933 (4) SA 161 (A), 55 SATC 185 at 197.

³⁸ See *Kirsch v CIR* 1946 WLD 261, 14 SATC 72 at 75.

nature. A capital expenditure or outlay, although not deductible in terms of section 11(a), may still very much form the basis upon which one could allege that the entity's trading activities had commenced.³⁹ Furthermore, certain of these capital expenses could very well be subject to certain deductions or allowances, such as the depreciation allowances.

For example, one of the most common financial risks assumed by any business is the acquisition of premises from which to conduct their trade. Other expenses that may constitute such risk would be purchasing stock, staff expenses, and other such business related expenses.

2.5.2 Day to day activity

In ITC 1476 certain factors were identified as indicators of trade.⁴⁰ This case examined whether any of the expenses of the company were indicative of trading activities, the court said:

“When one looks at the expenses for the year, set out above, the auditor's fees were less than those charged in 1986 so that the meetings Mrs A referred to were not frequent. In any event there is no evidence that they were connected with any endeavour to carry on a trade or particular activity. The audit fees were less in 1987 than they were in 1986 and the secretarial expenses for the year amounted to R2,29. All this indicates inactivity by the appellant.”

³⁹ Note that some capital expenses may be deductible if provision is made for such deductions in the Income Tax Act. For example, repairs and maintenance are a capital expense in nature, but section 11(d) permits an override, in terms of which these expenses can be deducted against income, and are therefore treated as a revenue expense.

⁴⁰ ITC 1476 (1989) 52 SATS 141 (T) – This case revolved around the question of whether the income from trade requirement could be satisfied in the context of assessed losses, but in order to determine this question, the court had to examine whether it could be said that the company was trading during the relevant period.

“The only other expense was ‘printing, stationery, telephone, sundries’ which in 1986 had amounted to R248 but in 1987 was less than half, i.e. R120 or R10 per month.”

“What business endeavour does this expenditure indicate? It barely covers the rental of a telephone – let alone the use of a telephone. The appellant incurred no expense for office rent or salaries. There were no travelling or advertising expenses. This is all an indication of no activity at all and the R10 per month is indicative merely of a nominal charge under a globular heading.”⁴¹

From this statement we can deduce that expenses such as these are indicators of trade, and can therefore be seen as markers of commencement of trade, or conversely when such expenses cease, then of markers of the cessation of such trading activities.

In other words, when an entity incurs expenses to acquire a premises from which to trade, whether these be revenue expenditure in the form of rentals or capital expenditure in the form of a purchase of property, then the time of such expenditure, may in conjunction with other factors, be seen as the time at which trade commenced.

Conversely, it must also be kept in mind, that it has also been held that an investment of even large sums of money is not in itself sufficient to constitute a business (trade).⁴²

⁴¹ See ITC 1476 (supra) at page 149.

⁴² ITC 957 24 SATC 637 at 638. Smuts AJ quoted Hannan who stated that, “Investment by an individual of even large sums on mortgages or real estate is not in itself sufficient to constitute a business. See also Hannan, J. P. and Farnsworth, A. (1952). *The Principles of Income Taxation*. By J. P. London. Stevens & Sons, Ltd, at page 165.

2.5.3 The nature of receipts that accrue to the entity

One of the more obvious ways for an entity to confirm its trading activities is to point to its receipts of income, and to allege on the basis of such income earned, that it had therefore at that point commenced trading.

In ITC 1476 the court also examined the nature of certain receipts that were in that matter presented by the taxpayer as indicative of income earning activity, in order to satisfy the income from trade requirement. The taxpayer retained certain shares and investments from which it earned dividends and other returns, and tried to present these activities and the income being earned from these activities, as being indicative of trade.⁴³ The court held that these activities in the circumstances of this particular taxpayer were not indicative of trade, due to the fact that they were activities of a capital nature. Although it could be argued that the court ignored the passive earning of income, nevertheless, the judgment is useful in that the indicators themselves are referred to and identified.

At page 149 the court concludes that:

“The conclusion is that the appellant was totally inactive in the sense that it held shares and had investments made in years prior to the 1987 year of assessment which needed little, if any, supervision as no dividend or interest was to accrue. Mrs A’s statement that the appellant was always looking for trade in the circumstances goes no further than an intention as referred to by Nesor J. She indicated that if she heard of anything or was told of an investment which seemed interesting to her she would investigate it, but she did not testify that she heard of anything or looked out for anything or performed any active step in seeking an investment during the year in question – let alone investigate one single possibility. The appellant’s expenditure indicates a situation of total inactivity.”

⁴³ See ITC 1476 (supra) as page 143.

“If a company once carried on a trade it does not follow that, as long as it retains its investments, it therefore continues to trade. It may retain its shares and investments previously required but cease to carry on a trade for a period.”

It is clear therefore that any profits earned by an entity in such circumstances would not constitute income received from trade, and therefore, the entity could not be said to be trading. According to the court, such income would clearly be of a capital nature, and could not be relied upon as an indication of trading activity.

If, on the other hand, the taxpayer could show that its expenditure in shares and other investments constitute a trade in the traditional sense, in that, for example, the taxpayer is in the business of trading shares, then it is submitted that the trade of that taxpayer could be said to have commenced at the time when it incurred expenditure in acquiring those shares. In this regard, the judgment of Dowling J states,

“The definition of ‘trade’ is to be found in section 7 of Act 31 of 1941,⁴⁴ as amended. It runs: ‘trade’ includes every profession, trade, business, employment, calling, occupation or venture including the letting of any property, and the use of or the grant of permission to use any patent, design, trade mark or copyright as defined in the Patents, Designs, Trade Marks and Copyright Act, 1916 (Act No 9 of 1916), or any other property which, in the opinion of the Commissioner, is of a similar nature.”⁴⁵

⁴⁴ This refers to section 7 of the Income Tax Act 31 of 1941. As indicated in the footnote below, the definition of trade has changed in wording in section 1 of the Income Tax Act 58 of 1962, and in terms of the proposed definition in section 7 of the Tax Laws Amendment Bill of 2013. These changes are however not material for the topic under discussion in this dissertation.

⁴⁵ Note as stated above, that the current definition of trade in section 1 of the Income Tax Act 58 of 1962 is slightly different in wording. This section defines trade as, “includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978 (Act 57 of 1978), or any design as defined in the Designs Act, 1993 (Act 195 of 1993), or any trade mark as defined in the Trade Marks Act, 1993 (Act 194 of 1993), or any copyright as defined in the Copyright Act, 1978 (Act 98 of 1978), or any other property which is of a similar nature.” This definition of ‘trade’ was inserted by s 6 (1)(i) of Act 89 of 1969, by s 2 (1)(d) of Act 129 of 1991 and by s 10 (1)(k) of Act 53 of 1999.] Note also that section 7(1)(zZl) of the Tax Laws Amendment Act 31 of 2013 proposes further changes to the definition of trade, by the substitution in subsection (1) for the definition of “trade” of the following definition: “ ‘trade’ includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any

“A business of investment in shares in companies is a well-established occupation in the business world and in my opinion it falls under all or some of the words “trade”, “business”, “occupation”, or “venture” used in the definition of “trade”, which is obviously intended to embrace every profitable activity and which I think should be given the widest possible interpretation.”⁴⁶

Therefore, in the case of share trading, or trading in immovable property investments, which are traditionally seen as capital investments, in order to establish that the business commenced at the date upon which the relevant shares were purchased, the taxpayer would be required to show that the shares or the immovable property, or any other such asset could be considered as its stock in trade, and that the income derived through the trading of the shares is revenue income. The various requirements to establish that entity’s activities in trading shares or immovable property are beyond the scope of this dissertation, and one must look for guidance to the jurisprudence that may be applicable.⁴⁷

In general terms it can be stated that trade can be said to have commenced as soon as an expense (or risk) is incurred which has a direct link with an activity that is a revenue generating activity, or rather, with activity that can be said to be trading activity. This includes not only such direct expenses as purchasing the stock in trade, but also with regards to ancillary expenses such as rent, salaries etc. As stated in the previous heading, these expenses can form the basis or the starting point when trading commences, but cannot do so in a vacuum and of themselves. These may qualify as indicators of when trade can be said to have commenced, but only if they directly contribute towards subsequent trading activity.

patent as defined in the Patents Act[, 1978 (Act No. 57 of 1978),] or any design as defined in the Designs Act[, 1993 (Act No. 195 of 1993),] or any trade mark as defined in the Trade Marks Act[, 1993 (Act No. 194 of 1993),] or any copyright as defined in the Copyright Act[, 1978 (Act No. 98 of 1978),] or any other property which is of a similar nature.

⁴⁶ ITC 770 (1953) 19 SATC 216 (T) at 217.

⁴⁷ Inter alia; Tati Company Limited v Collector Of Income Tax, Botswana 37 SATC 68 1974(BCA), Berea Park Avenue Properties (Pty) Ltd v Commissioner For Inland Revenue 57 SATC 167, Commissioner For Inland Revenue v Nussbaum 58 SATC 283, Commissioner Of Taxes v BSA Co Investments Ltd (1966) 28 SATC 1, ITC 1427 (1987) 50 SATC 25(T).

2.5.4 The active step requirement

Trading involves more than the mere intention to trade.⁴⁸ This is referred to as the “active step requirement.” Therefore, one cannot merely have a desire to trade. One must actually take steps to put this desire into effect. The active steps that are required must constitute more than the mere laying of plans.⁴⁹

In *SA Bazaars (Pty) Ltd v CIR* the appellant company closed down its general dealer’s business in 1941. From 1941 to 1947 it did not trade, but kept itself alive by maintaining a bank account, paying its annual duty and complying with the Companies Act and Income Tax Act applicable at the time. In 1948 the company resumed trading and sought to set off the assessed loss from earlier years. The court refused to allow the company to set off its assessed loss. Centlivres CJ stated the following:

“The mere fact that it kept itself alive during that and subsequent periods does not mean that during those periods it was carrying on a trade. It is clear from the stated case that it closed down its business and as long as it kept its business closed it cannot be said to have been carrying on a trade, despite any intention it might have had to resume its trading activities at a future date.”⁵⁰

The court has also noted that: “In my view the carrying on of a trade involves an active step – something far more than merely watching over existing investments which are not, and are not intended or expected to be, income producing during the year in question.”⁵¹

⁴⁸ See *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A).

⁴⁹ *SARS v Contour Engineering (Pty) Ltd* 1999 61 SATC 447 (EC).

⁵⁰ *SA Bazaars* (Supra).

⁵¹ As per Kirk-Cohen J in *ITC 1476* (1989) 52 SATC 141(T) at page 148.

In the above, Kirk-Cohen J was examining a company that was undergoing a period of relative inactivity, during which time it attempted to carry forward assessed losses. He was therefore induced to consider the circumstances under which a company could be said to be trading and therefore earning income from trade.⁵² In his judgment, he referred to several authorities on the point.

In reference to ITC 770⁵³, he stated that, “investing in shares (or immovable property) can, if one looks at the personal circumstances of the tax payer, constitute trade.”

ITC 777⁵⁴ assists in an understanding of the active step requirement. In reference to the letting of property, the learned Judge held:

“As the company is not a dealer in shares the sale of certain shares during the year does not constitute the carrying on of a trade as defined.”

“I incline to the view that Mr Kirkup’s submission is sound, but it is not necessary to express a definite opinion on the question as I am of opinion that Mr Tucker’s submission that the company was carrying on a trade in that it endeavoured to let the property during the year in question is well founded. Had the company succeeded in letting the property there can be no question that the rent it received would have been income derived from carrying on a trade. Mr Kirkup submitted that a mere intention to let the property was in itself not sufficient to constitute carrying on trade and submitted that there must be some actual dealing and that in fact the property had not been leased.”

“I agree with Mr Kirkup that a mere intention to let property would not amount to the carrying on of a trade but I do not agree that to constitute carrying on trade there had to be an actual letting. It was the intention of the company if possible to let the property and though its efforts

⁵² This case examined whether the income from trade requirement could be said to have been satisfied, and whether certain income that was put forward by the company as revenue to enable it to carry forward an assessed loss, was indeed income earned from trade.

⁵³ ITC 770 19 SATC 216 as per Dowling J.

⁵⁴ ITC 777 19 SATC 320 as per Neser J.

to do so were not sustained or strenuous it did endeavour to let it to and through associated companies.”⁵⁵

From this we can submit therefore, that a mere intention or desire to let property does not constitute trade, but one does not need to succeed in letting it out in order to be said to be trading. If a taxpayer were to take “active steps” to let the property, such as advertising the property, then even if he were unsuccessful in doing so during the year in question, he would still satisfy the active step requirement.⁵⁶ The point in time at which he commence with such active steps, may very well constitute the time at which he commenced trading.

In practical terms, as with regards to the share investments referred to in ITC 1476, it was determined that;

“The conclusion is that the appellant was totally inactive in the sense that it held shares and had investments made in years prior to the 1987 year of assessment which needed little, if any, supervision as no dividend or interest was to accrue. Mrs A’s statement that the appellant was always looking for trade in the circumstances goes no further than an intention as referred to by Nesor J.”

“The ratio of Nesor J’s judgment is that the mere intention to carry out some business activity or a particular transaction is insufficient to amount to the carrying on of a trade – there had to be an actual endeavour so to do. That there must at least be such an active step is trite.”⁵⁷

The decision was reached by looking at the active step requirement in the context of the taxpayer’s particular circumstances.

⁵⁵ At 321 to 322.

⁵⁶ Note that this might not necessarily of itself satisfy the income from trade requirement.

⁵⁷ As per Kirk-Cohen J in ITC 1476 (1989) 52 SATC 141(T) at page 148.

2.5.5 Frequency of turnover, continuity and structure

It has also been held that a distinguishing feature of a trade is repetitive conduct with regards to turnover. A person who performs an act as part of a trade will, if that act is profitable, be likely to repeat the act in an organised and cost effective manner, and within an organised structure, in order to continue to make a profit.⁵⁸

In practical terms, in order to assess for example, whether an act constituting a risk can be said to be the point at which a trade can be said to have commenced, one would need that act to form part of the conduct that constitutes an active step, and which results in a trade. Whether a trade results depends on the circumstances of each particular case.

Several cases have examined this requirement in the context of moneylending, and the peculiar circumstances that apply to money lending form an excellent context in which to proceed.

In Income Tax Appeal Case No 5243, Nesor J quoted a UK Authority, J P Hannan.⁵⁹

“Whether or not the appellant is a money-lender or carries on the business of a money-lender is a question of fact.” In that connection he quotes Hannan who states, “The principles applicable to such profits apply *a fortiori* to the profits of money-lenders. It has to be remembered that money is the stock-in-trade of a money-lender”.

“Investment by an individual of even large sums on mortgages of real estate is not in itself sufficient to constitute a business.”

⁵⁸ This is probably a feature of most trades, but not necessarily so. See for example, Commissioner for South African Revenue Service v Wyner 66 SATC 1 (SCA) where a single sale of a property at Clifton, was in the circumstances prevailing to that particular transaction, deemed to be a revenue transaction.

⁵⁹ Hannan, J. P. and Farnsworth, A. (1952). The Principles of Income Taxation. By J. P. London. Stevens & Sons, Ltd.

“The main difference between an investor and a money-lender appears to consist in the fact that the latter aims at frequency of turnover of his money, and for that purpose usually requires borrowers to make regular repayments on account of principal. This has been described as a ‘system or plan in laying out and getting in his money [...]’. The question whether a money-lending business is being carried on is always a matter of fact [...], consequently, a person may be a money-lender even though he does not advertise or hold himself out as such.”

This was also favourably referred to by Roper J in ITC 812.⁶⁰

At page 473, Roper J provides a useful reference to Commonwealth Authorities, Challoner and Collins:⁶¹

“The question whether a taxpayer is carrying on the business of lending money is, of course, a question of fact but it has nevertheless caused difficulty in numerous cases. It is only necessary that the business of money-lending be carried on, it need not be the only business or the principal business [...].”

“Whether or not a business of money-lending is carried on is an inference of fact drawn from the surrounding circumstances and transactions. It is not enough merely to show that a man has on several occasions lent money at remunerative rates of interest; there must be a certain degree of continuity and system about the transactions.”

Not only is this authority for the principle of frequency, but it also highlights the requirement that each case must be determined on its own merits and in accordance with its own circumstances.

⁶⁰ ITC 812 (1955) 20 SATC 469 (T) at 469 at page 472.

⁶¹ Challoner, N. E. and Collins, C. M. (1953). *Income Tax Law and Practise (Commonwealth)*. The Law Book of Australasia.

The principle of frequency has its best endorsement by an Appellate Division Judge in the Solaglass matter.⁶²

Friedman J put forward a list of guidelines applicable to the money lending industry, which would serve as indicators of whether a taxpayer could be said to be in the business of moneylending.

The fourth of these stated, “The fact that money has on several occasions been lent at remunerative rates of interest, is not enough to show that the business of money-lending is being carried on; there must be a certain degree of continuity and system about the transactions.”

He also stated that, “The lending must be done on a system or plan which discloses a degree of continuity in laying out and getting back the capital for further use and which involves a frequent turnover of the capital.”⁶³

All of the cases and references made above clearly highlight the principle of frequency, but they are also important in leading to what is perhaps the most important principle which requires a court to take into account the personal circumstances of the taxpayer in every tax matter. It could be argued that this is not so much a principle as it is a directive on how these principles must be applied, however, it is considered as a principle below.

2.5.6 Personal circumstances of every taxpayer

Examining the personal circumstances of each taxpayer is really more of an extension to the principles reflected above and is therefore examined under its own heading. More particularly,

⁶² Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A) as per the judgment of Friedman J.

⁶³ See also ITC 1138, 32 SATC 3 at 6; ITC 812 (1955), 20 SATC 469 at 473; ITC 933, 24 SATC 347 at 348; and Crane’s case supra, at 768D-E.13.

each principle will be applied in accordance to the specific circumstances of each case. Roper J's judgment in ITC 812 serves as a very good practical example of such application.⁶⁴

At page 472 of his judgment he states, "Unfortunately the case does not show what proportion of this taxpayer's capital was used in loans on promissory notes, nor does it give any indication as to the degree of continuity or system involved in this use of his capital, but it is useful as indicating the principle to be applied and it shows the difference between income derived from the use of money invested and income derived from the use of money in a business of lending money or dealing in promissory notes. It is this type of detail that Roper J looked at to come to his conclusion that in this matter, the taxpayer in question could not be said to be engaged in a trade of money lending."

In Solaglass,⁶⁵ in the context of the moneylending industry, Friedman J looked at the company's intention, more particularly, that, "[t]here must be an intention to lend to all and sundry provided they are, from his point of view, eligible."

He also examined whether the provision of security was present in the applicable transactions because, "The obtaining of security is a usual, though not essential, feature of a loan made in the course of a money-lending business."

He also looked at the proportion of the income from loans, to the total income.

In so doing, Friedman J clearly indicated that in every matter where one tries to determine whether the conduct of a taxpayer constitutes a trade, or in the context of this dissertation, as to whether a trade has commenced, one must first examine the nature of the trade, and what would in general constitute indicators of such a trade, and thereafter, look at the particular circumstances of each matter to see whether the taxpayer's conduct reflects such indicators.

⁶⁴ ITC 812 (supra).

⁶⁵ Solaglass Finance Company (Pty) Ltd (Supra).

Furthermore, as will be seen in the context of moneylending, each industry will have its own peculiar requirements and indicators, and accordingly, the question of what serves as an indicator of when a trade can be said to have commenced, will be very industry specific.⁶⁶ It is perhaps in this manner where one can see a similarity in the South African approach when compared to England or Australia, whose tax literature, as seen in the brief introduction, and as will be examined in more detail below, seem to allow for an industry specific approach to answering this question, at least with regards to certain industries, such as oil and gas exploration. The only difference is that in the South African literature, an industry specific approach is not as explicitly adopted. It seems to arise as a necessary implication of the approach adopted in South African jurisprudence.

Lastly, and in the same matter,⁶⁷ the dissenting judgment of Botha JA is illuminating on this point, where he states that, “The truth is, in my judgment, that there are no hard and fast rules for deciding whether a taxpayer’s expenditure falls within or outside the ambit of the section; it is not possible to devise any precise universal test for determining whether expenditure comprises moneys ‘exclusively laid out or expended for the purposes of trade’. In general, one can say no more than that the issue is to be resolved by examining the particular facts of each individual case.”

2.7 Conclusion.

The jurisprudence cited above essentially provides the South African jurisprudential commentary on a definition of commencement of trade. This is not a direct commentary, but rather, inferences and implication that flow from cases such as those discussed. In essence we have the following criteria that the courts have used to define what behaviour constitutes

⁶⁶ Further below in the Chapters 3, it is interesting to note that the commentary by HMRC (Revenue and Customs in the UK) in their various manuals, adopt in many instances a clear industry specific approach.

⁶⁷ Solaglass Finance Company (Pty) Ltd (Supra).

trade, and therefore by extension, the criteria with which to define the commencement of trade, and to determine at what point in time, or more accurately, at the happening of what event or conduct can it be said that, trade has commenced.

Perhaps these can be better illustrated through a practical example of conduct that constitutes trade. The criteria for this conduct would be:

- The element of risk;
- The nature of the receipts that accrue;
- The active step requirement;
- Frequency of turnover, continuity and structure;
- And the personal circumstances of the taxpayer (or rather, all of the above are examined in the context of the particular circumstances of each individual tax payer).

For this purpose, let us assume that a trader has acquired leased premises from where to conduct its trade. It starts to pay rent and to occupy the premises, but this is for the purpose of setting it up for business. It will also proceed to hire staff to help it to set up, acquire machinery and set these up, buy raw materials, commence with a production process, advertise, and finally when the production process is complete for the first time, advertise and distribute its product to the public.

On a strict application of the word trade, it can only be said to be trading at the point when it is in a position to make a sale, provided that it proceeds to make sales or attempts to do so. This landmark in its progress may come several months after it first occupied the premises and paid rent, paid staff salaries for the period that the business was setting up, and other such initial expenses. But for section 11A, all such expenses would fall outside the ambit of section 11, and would therefore not be deductible from income. For the purposes of this example we will proceed as if section 11 A were not applicable.⁶⁸

⁶⁸ Section 11A was inserted into the act in 2003.

It must also be kept in mind that for the purposes of some of the capital allowances, the expenses to which these allowances refer are not revenue expenses. Furthermore, they can only be claimed once trade has commenced. For example, section 11D(2) allows for the deduction of Research and Development costs incurred, if that expenditure is incurred in “the production of income”, and “in the carrying out of a trade”. This is fine for when these expenses occur after trade has commenced and in order to improve the product or come up with new products or variations, but it leaves open the question of similar expenses that are incurred to prepare for trade to commence, or to develop a product in order to trade for the first time.

In our example, a strict interpretation of the commencement of trade could sustain the submission that trade commenced when the company opened its door for business with the public, or at a stretch, at the time when it purchased its raw materials. This would still exclude expenditure such as rentals and salaries that would have clearly constituted revenue expenses if they had been incurred after trade had commenced.

It is therefore vital to try and widen the meaning of commencement of trade, to include expenses that are traditionally viewed as preparatory or pre-trade expenses.⁶⁹ On the other hand, one needs to also clearly demarcate a limit. For example, whilst it may be argued that it would be fair to deduct expenses incurred on researching a manufacturing method which leads up to actual production and trade of that product, it is not fair to deduct the student fees that put the producer of the product through the tertiary studies that gave him the ability to produce the product in the first place. Even in the case of the same expense, such as rent, it would be fair to deduct the rental paid in the months leading to the setting up of a factory, provided that there was an active element of moving forward towards trade as soon as the property was leased. On the other hand, it would be unjust to allow the same deduction if,

⁶⁹ This comment becomes somewhat less relevant in light of the insertion of section 11A into the Income Tax Act 52 of 1968 in 2003. See notes 17 and 64 above.

after acquiring the property, it lay dormant for several months or years while the trader was on extended leave in contemplation of starting the business at some point in the future.

In our example one could apply the principles in the following manner.

The element of risk would come to the fore once the trader signed a lease, and incurred expenses in the form of rent. This risk would become relevant as long as the trader thereafter took active steps in the course of trading. If the trader commenced with renovations forthwith, purchased its machinery, hired staff and the like, then it could be argued that the business commenced at that point when the risk was assumed and further active steps were taken to establish the trade.

Relevant factors that would be taken into account would be the intention of the trader. The trader should have rented the premises with the intention of conducting the trade in question, and thereafter proceed in moving forward, or taken active steps, to fulfil that intention.

Eventually, the trader will earn income that will be revenue in nature, and will it continue to produce with regularity, and within a commercial structure. In so doing, it will be able to claim that its conduct in leasing premises was the first step in a chain of events that constituted its trading operations and therefore by extension, it could be deemed to be the point in time at which it commenced trading.

This is not in itself a definition, but if one were to try to distil a definition out of all of the above, it could perhaps be said that trade commences when an act is conducted that incurs an element of risk for the trader in the form of an expense, that is part of a set of active steps undertaken towards its trading operations. Thereafter, in order for that conduct to have any significance from a tax point of view, the trader will have to reach the stage where it earns an income from its trade, because these expenses only have meaning as deductions, when there is an income from which to deduct these. All of these factors must be looked at in light of the particular circumstances of the particular trader.

From a South African standpoint therefore, this is the closest that we can come to a definition of trade.

Chapter 3 – The law of the United Kingdom

3.1 Introduction

This chapter aims to examine the tax law of the UK, which like that of South Africa, is contained in several statutes, and the extensive official commentary by the tax authorities of the UK. Just as is the case in South Africa, active and ongoing trade is an essential element of the provisions of the various UK tax laws. The definition of when a company can be said to be trading is just as undefined. This chapter will identify these similarities and any differences that may add to our understanding of the topic at hand.

The Statutes contain no guidelines and therefore one has to look at jurisprudence as a source of interpretation, and to the various guidelines published by HM Revenue & Customs, such as the Business Information Manual, and certain industry specific manuals such as the Oil Taxation Manual. These are more extensive commentaries than those of SARS, and will therefore form a larger part of the contributing material.

In this chapter, the definition and meaning of the terms commencement of trade, and cessation of trade are examined as it is to be understood through an examination of various sources, including and foremost, statute, jurisprudence through the Courts, and commentary by HM Revenue and Customs.

The meaning and definitions that can be derived, together with the methods in which these are applied in law and in practise in the UK, to those that have been outlined and proposed with respect to South African law in the chapter above are compared.

3.2 UK statute.

It needs to be determined whether the taxation laws in the UK are similar to those in South Africa, with respect to the use of the trade phraseology identified in chapter 2. In this regard it will be recalled that South African law places a great emphasis on whether a company is trading, or rather, in between the points in time when it has commenced trading and when it has ceased trading, in order to be entitled to certain deductions and allowances. An examination of the relevant UK statutes will reveal a very similar position through the use of similar phraseology.

In South African statutes, the commonly used phraseology is the use of words such as “in the production of the income”, or “arising out of the carrying on of his trade”, or incurred “for the purposes of his trade”.

In the UK, income is calculated for tax purposes in accordance with the principles of sound commercial accounting. Tax is calculated on the basis of the profits shown by any particular trading entity, and this is subject to certain modifications as provided for in the statutes.⁷⁰ Primarily, the modifications which are of interest in this dissertation are deductions from income, and allowances.

With regards to personal taxation, the main governing legislation is the Income Tax Act 2007. Income from trading, property, savings and investment is taxed under the Income Tax (Trading and Other Income) Act 2005 (ITTOA).⁷¹

The wording utilised in section 34(1) of the ITTOA provides that;

“In calculating the profit of a trade, no deduction is allowed for –

⁷⁰ Obuoforibo, B; Heydari, S; D’Auvergne, J. Corporate Taxation-1. Corporate Income Tax. United Kingdom. IBFD. Paragraph 1.4.

⁷¹ Obuoforibo, B. Individual Taxation - 1. Individual Income Tax. United Kingdom. IBFD. Paragraph 1.1.2.

- (a) Expenses not incurred wholly and exclusively for the purposes of the trade, or
- (b) Losses not connected with or arising out of the trade.

The similarity of the wording used in the ITTOA and the South African Income Tax Act⁷² section 11(a), is clear in the use of the words, “for the production of income”, and more so, section 11(c), “arising out of the carrying on of his trade”, and section 11(d), “incurred for the purposes of trade”.

A look at the jurisprudence of the UK will show that these phrases are applied in a manner similar to that adopted by the courts in South African jurisprudence, in that deductions are only permissible after an entity commences with trading activity. Furthermore, a narrow approach is adopted in terms of which the time at which trade can be said to have commenced, requires actual trading to have commenced in a “doors open for business,” sense, thus excluding any pre-trade or preparatory expenses incurred before the commencement of actual trading activity.

The legislation relevant to corporation tax is contained primarily in the Income and Corporation Taxes Act 1988, the Taxation of Chargeable Gains Act 1992, the Capital Allowances Act 2001 (CAA), the Corporation Tax Act 2009 (CTA 2009), the Corporation Tax Act 2010 (CTA 2010) and the Taxation (International and Other Provisions) Act 2010, all as amended by, inter alia, subsequent annual Finance Acts.⁷³

Chapter 4 of the CTA 2009 governs deductions against corporate profits. The wording of section 54(1) of the CTA 2009, is identical to that of section 34(1) of the ITTOA, and therefore, the same consideration apply as to interpretation, as referred to above.⁷⁴

⁷² Income Tax Act 58 of 1962.

⁷³ IBFD, United Kingdom – Corporate Taxation (supra) para 1.1.2.

⁷⁴ Section 54 provides as follows:

“Expenses not wholly and exclusively for trade and unconnected losses
 (1) In calculating the profits of a trade, no deduction is allowed for—
 (a) expenses not incurred wholly and exclusively for the purposes of the trade, or

The CAA contains provisions relating to allowances for capital expenditure. The terminology used in this Act, is a good example of choice of phraseology utilised in the tax laws of the UK, to provide for the requirement, that tax deductions and allowances are allowed only for periods in which an entity or individual is actually engaged in trading activities, i.e. it must have commenced, but not yet ceased to trade.

Capital allowances are provided by allowing for a deduction from the profits of a “qualifying activity” for corporation tax purposes for a chargeable period.⁷⁵ A chargeable period is defined as the accounting period for the relevant tax year for companies “carrying on a trade”.⁷⁶

The definition of the term “qualifying activity” does not really take the matter any further, because although it refers to trading activity, or rather, “a trade”, as a qualifying precondition to any deductions or allowances, it does not define what constitutes such activity, or when it could be said to have commenced and ceased.⁷⁷ It therefore makes it necessary to look at the courts to give meaning to these phrases.

The seven year rule as provided for in section 61 of the CTA 2009,⁷⁸ and section 57 of the ITTOA,⁷⁹ in the UK, is analogous to section 11A in the South African ITA, in that it provides an exception to the rule that expenses of a revenue nature can only be deducted if they are incurred during the time when an entity trades, i.e. after commencement and before cessation of trade. This is interesting in that both jurisdictions have elected to legislate an exception to

(b) losses not connected with or arising out of the trade.”

⁷⁵ Section 2 of the Capital Allowances Act 2001.

⁷⁶ Section 6 of the Capital Allowances Act 2001.

⁷⁷ See section 15 of the Capital Allowances Act 2001.

⁷⁸ See section 61 - Pre-trading expenses.

(1) This section applies if a company incurs expenses for the purposes of a trade before (but not more than 7 years before) the date on which the company starts to carry on the trade (“the start date”).

(2) If, in calculating the profits of the trade—

(a) no deduction would otherwise be allowed for the expenses, but

(b) a deduction would be allowed for them if they were incurred on the start date,

the expenses are treated as if they were incurred on the start date (and therefore a deduction is allowed for them).

⁷⁹ This is phrased in identical wording as S61 above, and therefore does not need to be restated.

the general rule, rather than to widen the ambit of the concept of commencement of trade, to include the time period when an entity incurs what is referred to as pre-trade expenses.⁸⁰

Previously, the provisions for pre-trade expenditure were contained in section 401 of the Income and Corporation Taxes Act 1988, even though this provided for three years as opposed to seven years.⁸¹

3.3 UK jurisprudence.

In the United Kingdom, there is also not much case law on the topic of commencement of trade, but there are excellent guiding principles to be found in the HM Revenue and Customs Business Income Manual.⁸²

Whilst it would seem as if the law of the UK adheres to the “doors open for business” approach that is common in international jurisdictions, HM Revenue and Customs may allow a small measure of flexibility for industry specific definitions.

There is very little case law specifically on when a trade has been “set up and commenced”.⁸³

As in South Africa, the principles, discussed under the various sub-headings that follow, emerge.

⁸⁰ Note that if the definition of commencement of trade were extended to include the time when these type of expenses are incurred, then they would technically not be pre-trade expenses.

⁸¹ 401 Relief for pre-trading expenditure(1)Where a person incurs expenditure for the purposes of a trade, profession or vocation before the time when he begins to carry it on and the expenditure—

(a)is incurred not more than three years before that time; and

(b)is not allowable as a deduction in computing his profits or gains from the trade, profession or vocation for the purposes of Case I or II of Schedule D but would have been so allowable if incurred after that time, the expenditure shall be treated for the purposes of corporation tax as incurred on the day on which the trade, profession or vocation is first carried on by him and for the purposes of relief under Chapter I of this Part as if it were the amount of a loss sustained by him in the trade, profession or vocation in the year of assessment in which it is set up and commenced.

⁸² <http://www.hmrc.gov.uk/thelibrary/manuals-a-z.htm>.

⁸³ BIM70505 <http://www.hmrc.gov.uk/manuals/bimmanual/BIM70505.htm>.

3.3.1 The element of risk

In *Eclipse Film Partners No. 35 LLP*,⁸⁴ the tax tribunal dealing with the matter was tasked with question of making a determination as to whether a trade was being carried on by the taxpayer in question. “In that case, the tribunal had to decide if Eclipse Film Partners No. 35 LLP (Eclipse 35) was trading. The underlying issue was whether the individual members of Eclipse 35 would be entitled to tax relief for interest paid on borrowings to contribute capital to the partnership, on the basis that the capital was used wholly for the purposes of a trade carried on by the partnership (under what is now ITA 2007, section 398).”⁸⁵

The tribunal held:

“We consider that an element of speculation is a characteristic of the concept of trade – if a taxpayer is trading, what he does must, normally at any rate, be speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss).”

“Applying that criteria to Eclipse 35, the tribunal concluded that the transactions entered into by Eclipse 35 did not have the speculative aspect which it would expect to see in trading transactions. The partnership’s activities amounted to a business involving the exploitation of films which did not amount to a trade, i.e. it was considered to amount to a “non-trade business” within ITTOIA, section 609.”⁸⁶

⁸⁴ *Eclipse Film Partners No. 35 LLP v Revenue and Customs* [2012] UKFTT 270 (TC); -*Eclipse Film Partners (No. 35) LLP v HMRC* [2013] UKUT 639 (TCC) (20 December 2013).

⁸⁵ McLaughlin, M. Tax Practice Update. July / August 2012. Retrieved from <http://www.markmclaughlin.co.uk/wp-content/uploads/2008/05/Practice-Update-July-August-2012.pdf>.

⁸⁶ Bloomberg Professional | Tax, Monday September 17, 2012. Retrieved from <http://www.bloomsburypersonal.com/what-is-a-trade/> - ITTOIA is the Income Tax (Trading and Other Income) Act 2005.

3.3.2 Active trading

The classic definition of trade in the House of Lords judgment in *Ransom v Higgs* stresses the active nature of trading, more specifically, the need to be providing goods or services, and to be trading with someone.⁸⁷ As a general rule, the Court adopted a doors open for business approach and stated that a company would only be considered as trading if it had its doors open to trade. The act of keeping a shop was essential to the carrying on of the business of a seller.⁸⁸

The court further stated that whether a trade has commenced or not is a matter of fact. In the absence of any evidence to the contrary, the taxpayer was held to have commenced trading when he entered into his first contract of engagement as an electronic designer.⁸⁹

The Court drew on the example of a business seeking to exploit an item of intellectual property. The court stated that, “At the initial stages no decision may have been taken as to how best to realise the value of the patent. In this regard, the business could develop, manufacture and sell a product, it could license the patent to others to do this, or it could undertake a combination of both. Large sums may be spent on research and development before the business decides what route to follow.”

“Until the business has decided how it will go about exploiting the patent it is unlikely to meet the criteria for commencing to trade. So its activities will be entirely preparatory. One result of this is that the losses arising from the initial activities are not trading losses. So they cannot be offset against other income from, for example, the investment of the initial funding. But some relief may be available under the provisions for research and development tax incentives or as pre-trading expenditure.”⁹⁰

⁸⁷ *Ransom v Higgs* [1974] 50TC1.

⁸⁸ *J & R. O’Kane & Co v The CIR* 12 TC 303 (HL) at 341/2.

⁸⁹ *Napier v Griffiths* [1990] 63TC745.

⁹⁰ Business Income Manual BIM46351, retrieved from, www.hmrc.gov.uk/manuals/bimmanual/bim46351.htm.

Initially it would appear as if courts in the UK took a very narrow view with regards to the determination of whether a taxpayer was trading, or when it could be said that such trade commenced.

In *The Birmingham & District Cattle by-products Co Ltd*, as an example, all of the following were found to be preparatory activities.⁹¹ These included, “viewing other places of business of a similar character in other parts of the country, entering into a contract for the building of a factory, and having that factory built, purchasing machinery and plant for carrying on the business, entering into agreements for the purchase of products to be used in the business and for the sale of finished products, and engaging a foreman of works.”

Having got everything ready, the trade only commenced when the company began to take in raw materials and turn out its product. This principle is applicable to manufacturing in general. Perhaps it would be useful to refer to this time as ‘the raw material’ phase, and it would be safe to conclude that in accordance to this early decision, in the case of manufacturing concerns, their trading commences the moment that they purchase their raw materials with which to produce the product.

These early cases promote the view that obtaining premises, purchasing machinery and other such conduct that may entail an element of risk, is not necessarily to be viewed as activity conducted during the course of trade, i.e. after the time when trade could be said to have commenced, and before it can be said to have ceased. The court in the *Birmingham & Cattle* matter concluded that this activity is merely preparatory activity.

This narrow approach was made even narrower for retail operations in the matter of *J & R O’Kane v CIR*.⁹²

An interesting aspect of this case is that the crux of the matter was to decide whether a business had ceased to trade at a time when certain stock was sold. The appellants carried

⁹¹ *The Birmingham & District Cattle by-products Co Ltd v CIR* [1919] 12TC92.

⁹² *J & R O’Kane v CIR* [1922] 12 TC 303 (HL), at pages 341 – 342.

on business as wine and spirit merchants. They then wished to retire from the business and sent a circular letter to their customers. During the year, they sold their stock to diverse customers, and the question was whether they were still carrying on their trade during that period, and whether the profits were thus made in the ordinary course of trade, and therefore taxable as income.

The King's Bench initially ruled against the Commissioner on the basis that the manner in which the stock was disposed after the decision to retire was made, had changed sufficiently to indicate that it was sold in a process of realisation rather than trade. In this regard they considered the manner in which customers were procured, bulk sales at discounted prices, failure to replenish stock and the like, as indicators of the fact that business had ceased and realisation commenced.

The Court of Appeal in Ireland unanimously reversed the decision of the High Court. Ronan, L. J. pointed out that though the taxpayer had retired from business and had decided not to purchase any more stock, he was still carrying on the business of trading in wines and spirits till his existing stocks were exhausted, and, therefore, the excess obtained by him represented profit. On appeal to the House of Lords, it was held that there was evidence on which the Commissioners could arrive at their finding that trading was, in fact, being carried on.

In the words of Lord Buckmaster: "For in truth it is quite plain that right up to the end of 1917 they were engaged in trading which, so far as the external world is concerned, was the ordinary method of carrying on trade modified only by arrangements which were merely part of the machinery of business dealing adopted to effect their intention to retire. It may well be accepted that they did so intend; yet the intention of a man cannot be considered as determining what it is that his acts amount to; and the real thing that has to be decided here is what were the acts that were done in connection with this business and whether they amount

to a trading which would cause the profits that accrued to be profits arising from a trade or business.”⁹³

Although the courts took different views with regards to the indicators, especially the cessation of stock purchases, that were identified as being relevant to consider, this case is useful in identifying these indicators, which included the cessation of stock purchases, the stated intention of the traders in the circulars sent out to customers, and the manner in which the remaining stock was sold, out of the shop premises, in the same manner as it had been prior to the circular, despite the discounted prices. The different views of the courts that presided over this matter, can be attributed to a different value judgment made on the basis of the same criteria. It is not the difference in the value judgment that is crucial, but rather, the identification of such criteria, which can then be used to determine similar facts in other cases.

3.3.3 Frequency and organisation

The case of *Ransom v Higgs*⁹⁴ also focussed of an examination of the meaning of “trade”.

Lord Reid said at page 8:

“As an ordinary word in the English language ‘trade’ has or has had a variety of meanings or shades of meaning. Leaving aside obsolete or rare usage, it is sometimes used to denote any mercantile operation, but it is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services. The contexts in which the word ‘trade’ has been used in the Income Tax Acts appear to me to indicate that operations of that kind are what the legislature had primarily in mind.”

⁹³ The Judgment of Hidayatullah, J, in *K.M.S. Reddy, Commissioner of Income Tax, Kerala v The West Coast Chemicals and Industries Ltd*, Supreme Court of India 1962, serves as an interesting commentary on *J & R O’Kane* (Supra).

⁹⁴ *Ransom v Higgs* [1974] 50TC1.

Lord Morris at page 13 said:

“To be engaged in trade or in an adventure in the nature of trade surely a person must do something, and if trading he must trade with someone”.

He then quoted with approval the comments of Lord Clyde in *CIR v Livingston* at page 13:⁹⁵

“I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, 'in the nature of "trade," is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.”

Lord Wilberforce discussed the definition of 'trade':

"Trade cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade. Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact-finding body to decide on the evidence whether a line is passed. Trade involves, normally, the exchange of goods or of services for reward—not of all services, since some qualify as a profession or employment or vocation, but there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral – you must trade with someone. ... Then there are elements or characteristics which prevent a trade being found even though a profit has been made—the realisation of a capital asset, the isolated transaction (which may yet be a trade).”⁹⁶

⁹⁵ *CIR v Livingston* [1926] 11TC.

⁹⁶ See also BIM20100 - Trade: general: recent views, retrieved from, www.hmrc.gov.uk/manuals/bimmanual/bim20100.

3.3.4 The facts of each case

The matter of *Fry v Burma Corporation Ltd* was a case that discussed the very question central to this dissertation.⁹⁷ This is especially significant in light of the complete lack of such jurisprudence in South Africa.⁹⁸ However, the question arose in an oblique manner, and the court was called on to decide that the trade had not commenced at the date alleged by the authorities, but rather, significantly prior to that date.

Lord Worrington discussed the meaning of the concept of commencement of trade. The Income Tax Act of 1918 prescribed a tax formula for businesses that had been set up and commenced within a said three year period, the emphasis being on the meaning of set up and commenced.

The Commissioners sought to artificially declare a business to have commenced at the time that the business came into the fold of UK taxation, whereas it had been trading for many years prior to that date. Lord Worrington took a very dim view of this proposition and lambasted the officials for bringing this matter on appeal.⁹⁹

He did start by saying that the words must be given their ordinary meaning, and in order to take this further, he looked at the nature of the transactions, and of the infrastructure of the taxpayer, and noted that there was no distinction between the activities and infrastructure of the taxpayer on the date that he came into the tax fold of the UK, and the years prior to that. Looking at these factors he concluded that it was clear that the taxpayer was already trading for many years as at that date.

⁹⁷ *Fry v Burma Corporation Ltd* [1930] 15TC113 at page 129.

⁹⁸ *Fry v Burma Corporation Ltd* [1930] 15TC113 - In South Africa, the courts have on several occasions been called upon to determine whether a trading entity was trading at a particular point in time, but never has a court determined at what point a business commenced, or what defined this point in time.

⁹⁹ *Fry v Burma Corp*(Supra) at page 331.

Lord Atkin provided a more useful criterion. He stated that “To set up and commence trade seems to me to mean to bring into existence for the first time those activities, which I have just described, which constitute trade; they relate to acts done for the first time to enable a person to engage in manufacture, barter or profitable services as I have dealt with.”¹⁰⁰

These activities were described as, “Trade refers to the various activities of commerce - the winning and using the products of the earth, or multiplying the products of the earth and selling them, or manufacturing them and selling them, the purchase and sale of commodities, or the offering of services for a reward, such as conveyance and the like. To my mind, throughout the Act there is only one meaning to be attached to the word trade.”¹⁰¹

The views contained above with regards to manufacturing and retail activities, appears to be the official view adopted by HM Revenue & Customs.¹⁰²

In *Napier v Griffiths*, the Appellant was a trader who worked through contracts of varying lengths, with gaps of time in between contracts. There was a particularly long gap between May 1980 and May 1981. One of the questions that the court had to consider was whether the Commissioner was correct in holding that for the purpose of computing his liability was to be treated as if he had started a new business in May 1981.¹⁰³ This was the time that he actually commenced with the new contract.

Appellant on the other hand, sought an order that the commencement date of this new business was May 1980, and advanced an argument to the effect that immediately upon termination of his old contract, he began the process of trade that would ultimately culminate in the profits that the Commissioner sought to tax.

¹⁰⁰ *Fry v Burma* (Supra) at page 335 to 336.

¹⁰¹ *Fry v Burma* (Supra) at page 334.

¹⁰² See BIM70510 – Business changes: Commencement: manufacturers and retailers, retrieved from www.hmrc.gov.uk/manuals/bimmanual/bim70510.

¹⁰³ *Napier v Griffiths* [1990] 63TC745.

The Court ruled against him on this point, citing his failure to meet the evidentiary burden that he had to overcome in order to succeed. However, Gibson LJ stated that, “It is true that, although having no contract, Mr Napier might have been carrying on a business, for example doing work on software with a view to earning a profit therefrom at a later date. Mr Napier referred us to section 170(5) of the Income and Corporation Taxes Act 1970. Mr Napier, however, gave no evidence to the Special Commissioner to show that he had been doing anything to that effect.”

In other words, in certain instances, such as software programming activity, it may well be correct to go beyond the “storefront” views expressed in J & R O’Kane¹⁰⁴ and extend the concept of commencement of trade to encompass such activity in preparation of the product or service that will eventually be provided.

To supplement the jurisprudence in the issue of commencement of trade and of the trade requirement, HM Revenue & Customs has published extensive guidelines. It will be useful to examine these in some detail. On the whole, these form a practical guide to the question, which read together with the jurisprudence referred to above, provide for a similar list of indicators as those outlined in the conclusion to the chapter above on South African law. I will therefore proceed to examine these commentaries, before extracting the factors that arise from these sources, as indicators of trade.

3.4 HMRC commentary

The HMRC commentaries are written in the form of specific manuals, such as the Business Income Manual (BIM), the Personal Income Manual (PIM), and Oil Taxation Manual (OT). I will refer to various such manuals in that paragraphs that follow.

¹⁰⁴ J & R O’Kane v CIR [1922] 12TC303.

BIM20070 specifies the approach that is required to determine whether a trade exists. It states that, “The question whether a trade exists is primarily a question of fact. The function of the appeal Commissioners/Tribunal is to find the primary facts and decide the 'trade' issue on the basis of those facts.”

The conclusion that there is, or is not, a trade is itself a finding of secondary fact from the primary facts.¹⁰⁵

BIM70505 deals specifically with the commencement of trade, and examines the matters of *Fry v Burma Corporation*¹⁰⁶, and *Ransom v Higgs*¹⁰⁷, and relies on the requirement of active trading.¹⁰⁸ It confirms that, “Under the current year basis of assessment for income tax the date on which a trade starts is of less significance than formerly. In addition to this, ICTA88/S401 now gives relief for certain pre-trading expenditure. But the point remains important (for example, the date of commencement of trading can determine when an accounting period of a company starts or ends and the timing of capital allowances.”¹⁰⁹

It goes on to confirm that, “There is very little case law specifically on when a trade has been ‘set up and commenced’.”

The answer with regards to a general trader is the following:

“The courts have distinguished between preparing to commence business and actually commencing business. As a general rule a trade cannot commence until the trader is in a position to provide those goods or services which it is, or will be, his or her trade to provide, and does so, or offers to do so, by way of trade.”

¹⁰⁵ BIM20070 - Trade: general: question of fact for Commissioners/Tribunal, retrieved from, www.hmrc.gov.uk/manuals/bimmanual/bim20070.htm.

¹⁰⁶ *Fry v Burma Corporation Ltd* [1930] 15TC113 at page 129.

¹⁰⁷ *Ransom v Higgs* [1974] 50TC1.

¹⁰⁸ Note that this is examined in the context of Section 401 of the Income and Corporation Taxes Act 1988.

¹⁰⁹ BIM70505 - Business changes: commencement: general principles, retrieved from, www.hmrc.gov.uk/manuals/bimmanual/bim70505.htm.

“Note however, that in any event, and even in the absence of ICTA88/S401, and presumably also that of Section 61,¹¹⁰ and Section 57,¹¹¹ one would still be entitled to claim for certain expenses such as an advance purchase of trading stock, or rent paid in advance. In this regard, BIM46351 provides that, “The cost of an advance purchase of trading stock does not qualify for relief under Section 401, since its cost will be deductible in arriving at profits when trading begins. Similarly, to the extent that any other expenditure incurred in the pre-trading period will be deductible in computing taxable profits for a period after trading has commenced, e.g. rent paid in advance, that element of the expenditure will not qualify for relief under ICTA88/S401.”¹¹²

PIM2505 provides that, “The date a rental business begins is a question of fact that depends on the nature of the rental business. Normally a rental business will begin when the taxpayer first enters into a transaction that exploits their land or property in a way which gives rise to a receipt of some kind. Where the rental business is letting property, the business can’t begin until the first property is let. You need to distinguish between activities that are preparatory to letting and those business activities that are part of letting.”¹¹³

OT20250 makes a very interesting concession for petroliferous trade. It provides as follows:

“The date on which a trade commences is a matter of fact. HMRC will take full account of the special features of oil exploration and production activity in determining a date of commencement. HMRC accepts that a petroliferous trade commences as soon as a decision is taken to proceed with the commercial development of a discovery that will lead to production but do not accept that exploration by itself constitutes a trade.”

¹¹⁰ Section 102 of the Corporation Tax Act 2009

¹¹¹ Section 57 of the Income Tax (Trade and Other Income) Act 2005

¹¹² BIM46351 - Specific deductions: pre-trading expenditure: scope, retrieved from, www.hmrc.gov.uk/manuals/bimmanual/bim46351.htm.

¹¹³ PIM2505 - Beginning and end of a rental business: commencement, retrieved from, www.hmrc.gov.uk/manuals/pimmanual/pim2505.htm.

“For North Sea operations, it is often suggested that the decision to proceed with the commercial development of a discovery is the same as the decision that commercial development is considered worthwhile. As there may be a gap, sometimes substantial between these two points, HMRC take the view that it is the decision to proceed which triggers the start of the trade.”¹¹⁴

This is a very significant departure from the general rule, and this approach is definitely not applied across the board. It is suggested that this approach has been devised due to the specific circumstances relating to the Petroleum Industry, and due to the need to promote the development of a key industry sector. This approach is very much the exception, but opens the door for a similar approach in other key industries.

OT20252 qualifies this by providing that, “HMRC does not accept that the sale of a small quantity of oil, produced as a by-product of an unsuccessful exploration, represents the commencement of trading. Similarly, HMRC does not accept that the sale by licence holders of seismic data etc. establishes a petroliferous trade, although such sales may constitute a separate, non-petroliferous, trade.”¹¹⁵

3.5 Conclusion

South Africa and the United Kingdom seem to take a narrow view with regards to the deduction of revenue expenditure or of capital allowances. These can only be deducted if the entity is trading (or has commenced trading), and can only be claimed in the year or the years following the tax period after which the entity has commenced trading. Unfortunately, the very nature of pre-trade expenses or setup costs removes these from the ambit of the trade requirement,

¹¹⁴ OT20250 - Corporation Tax General: Commencement of Trade, retrieved from, www.hmrc.gov.uk/manuals/otmanual/ot20250.htm.

¹¹⁵ OT20252 - Corporation Tax General: Sale of a small quantity of oil, retrieved from, www.hmrc.gov.uk/manuals/otmanual/ot20252.htm.

and it therefore becomes very important to define quite accurately, what the concept of commencement of trade means. The economics of trade also make it quite crucial that the meaning be extended to beyond the limitations of the storefront view.

It seems as if the tendency has been to adopt a narrow approach closer to active trading, and alleviating any difficulties with regards to pre-trade expenses of a revenue nature with provisions such as section 11A in the South African ITA, and the seven year rule as provided for in section 61 of the CTA 2009, and section 57 of the ITTOA, in the UK.

The following basic principles emerge in the UK jurisprudence, which to a large degree display uniformity with the principles that emerge in South African jurisprudence.

- The element of risk;
- Active trading;
- Frequency of turnover, organisation;
- And the personal facts of the taxpayer (or rather, all of the above are examined in the context of the particular circumstances of each individual tax payer).

It will be noted that whilst in respect of activity as an indicator of trade, the courts in the UK require active trading, as opposed to the active step requirement that has been upheld in South African jurisprudence.¹¹⁶ It is submitted that the South African “active steps” requirement is less onerous than the “active trading” requirement of UK law, and that in South Africa, active trading may not necessarily be required.

In terms of the remaining principles, being the element of risk and the frequency of turnover, continuity and structure, these are fairly uniformly applied in the UK as in South Africa.

Perhaps most significantly, both jurisdictions require that the matter be determined taking into account the prevailing facts and circumstance of each case.

¹¹⁶ As per Kirk-Cohen J in ITC 1476 (1989) 52 SATC 141(T) at page 148; SARS v Contour Engineering (Pty) Ltd 1999 61 SATC 447 (EC).

Both jurisdictions however, have through their legislative process, provided an indication that the trade requirement is to have a strict or narrow application, so much so, that both have seen the necessity to include in their tax statutes, an exception for pre-trade expenses.¹¹⁷ By implication, the need for an exception clearly shows legislative intent, in that there is a recognition that the trade requirement was to be applied in a strict and narrow manner, failing which there would be no need for the exception.

In a manner of speaking, these provisions have made the question academic, at least in so far as pre-trade expenditure of a revenue nature is concerned. It may however, still be extremely relevant to other tax issues, such as the question of when a capital allowance can be claimed.

¹¹⁷ South Africa did so in terms of S11A of the Income Tax Act 58 of 1962. S 11A inserted by s 28 (1) of Act 45 of 2003. The UK did so in 1988, by way of s401 of the Income and Corporation Taxes Act 1988, and later by Section 61 of the Corporation Tax Act 2009 , and Section 57 of the Income Tax (Trade and Other Income) Act 2005.

4 Chapter 4 – The law of Australia

4.1 Introduction

Australian Income Tax Legislation is contained in a single act, namely, the Income Tax Assessment Act 1997 (ITAA 1997). This is similar to the position in South Africa, where income tax is largely dealt with in terms of a single act,¹¹⁸ and more recently the Tax Administration Act, which encapsulated the administration of all taxes in 2011.¹¹⁹

The wording of the ITAA 1997 contains a provision that seems to allow for a wider interpretation than the narrow trade requirement that is found in South African and English law, and this chapter will examine whether this view is supported by Australian jurisprudence.

In so far as jurisprudence is concerned, Australian courts have made a distinction between activity that constitutes the carrying on of a business and activity that is preliminary to the carrying on or recommencement of a business. This is provided for as an active provision of the ITAA 1997, and not as an exception, in the likeness of section 11A of the South African Act.¹²⁰

The courts also seem to have identified a unique approach based on the element of “commitment” in order to establish the requisite nexus between expenditure which is deductible and the business which is said to be carried on for the purpose of gaining or

¹¹⁸ This is in terms of the Income Tax Act 58 of 1962, as opposed to the United Kingdom, where the legislation is spread out over several distinct acts, i.e. Income and Corporation Taxes Act 1988; Income Tax Act 2007; Corporation Tax Act 2009; Corporation Tax Act 2010; Taxation (International and Other Provisions) Act 2010; Capital Allowances Act 2001.

¹¹⁹ Tax Administration Act 28 Of 2011.

¹²⁰ Section 11A in the South African Income Tax Act No 58 of 1962, and the seven year rule as provided for in Section 61 of the Corporate Taxes Act 2009, and Section 57 of the Income Tax (Trade and Other Income) Act 2005, in the UK.

producing assessable income, or in other words, in order to establish whether an entity has commenced trading.¹²¹

This concept in Australian Law will be looked at in more detail in this chapter, together with the relevant case law.¹²²

4.2 The Income Tax Assessment Act 1997

The ITAA 1997 is the main statute under which income tax in Australia is calculated. The act is a rewrite in plain English of the prior Income Tax Assessment Act 1936, quite unusually written in the third person. New matters are now generally added to the 1997 Act rather than the 1936 Act.

Division 8 of this Act deals with deductions. This refers to general deductions and specific deductions.¹²³

The ITAA 1997 makes the following provisions.

4.2.1 General deductions

Division 8 of the ITAA 1997 provides as follows:

“8-1(1) You can deduct from your assessable income any loss or outgoing to the extent that:

¹²¹ *Esso Australia Resources Ltd v FC of T* 98 ATC 4768, (1998) 39 ATR 394.

¹²² Such as *Softwood Pulp and Paper Ltd v FC of T* 76 ATC 4439 at 4450, ATC 4004; FLR 195 – 196, ATC 4008; FLR 201. *Fielder Wattie Ltd v FC of T* 91 ATC 4438 at 4448; (1991) 29 FCR 376 at 387; *FC of T v Brand* 95 ATC 4633 at 4649.

¹²³ See Section 8 – 1(1) and (2) of the ITAA 1997.

- (a) it is incurred in gaining or producing your assessable income; or
- (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.”

It is necessary to examine the phrases used in this wording particularly that in sub-clause (b), in order to assess whether the same requirement exists in Australian law, similar to the trade requirement in South African law and that of the United Kingdom.

It is submitted that the words “incurred in carrying on a business,” as per section 8(1)(b) lead to the same requirement that a business must be trading, i.e. within the period after commencement but before cessation of trade.

However, the preceding section 8-1(1)(a) provides that expenses are deductible from income if the expense is “incurred in gaining or producing your assessable income.” The use of the word “or” preceding section 8-1(1)(b) clearly shows that these two requirements can be used in the alternative, and that section 8-1(1)(a), which appears to be a less onerous requirement can be used on its own to justify a deduction. Furthermore, it is submitted that the fact that this distinction exists in the legislation, strongly implies that the words used in section 8(1)(a) are not to be understood as being limited to expenses incurred in actually carrying on a business, but can be said to include pre-trade expenses and setup costs.

In this context it would be useful to examine what Australian authority and jurisprudence have to say about the concept of commencement of trade, and whether there exists a definition as to when trade can be said to have commenced, in order to allow these general deductions

4.2.2 Specific deductions

Deductions such as capital allowances are found in Division 40 of the ITAA 1997, and are referred to as specific deductions.¹²⁴ Division 40 relates specifically to the deduction of depreciable assets¹²⁵, and provides that, “You can deduct an amount equal to the decline in value for an income year (as worked out under this Division) of a depreciating asset that you held for any time during the year.”¹²⁶ It also provides for, “deductions for certain other capital expenditure that is not otherwise deductible.”¹²⁷

The trade parameters of these deductions is referred to in the negative by providing that, “You must reduce your deduction by the part of the asset’s decline in value that is attributable to your use of the asset, or your having it installed ready for use, for a purpose other than a taxable purpose.”¹²⁸ In other words, a reduction is only permissible to the extent that is incurred for a “taxable purpose”.

4.3 Taxable purpose

The third requirement that arises out of Australian legislation with regards to deductions, and within the context of special deductions such as Capital Gains Taxes, is that a deduction is

¹²⁴ 8 – 5(3) of the ITAA of 1997 provides that, “An amount that you can deduct under a provision of this Act (outside this Division) is called a specific deduction”.

¹²⁵ 40 – 15(a) of the ITAA 1997.

¹²⁶ See 40 – 25(1) of the ITAA 1997. Interestingly, the Australian Parliament has utilised the first person in ITAA 1997, and the use of the word “you” refers to the taxpayer.

¹²⁷ 40 -15(c) of the ITAA 1997.

¹²⁸ 40 – 25(2) of the ITAA 1997.

permissible if it is incurred for a taxable purpose. The meaning of taxable purpose is defined in the Section 40 of the ITAA 1997 as:¹²⁹

“40-25(7) Subject to subsection (8), a **taxable purpose** is:

- (a) the purpose of producing assessable income; or
- (b) the purpose of exploration or prospecting; or
- (c) the purpose of mining site rehabilitation; or
- (d) environmental protection activities.”

The important phrase for the purposes of this chapter is the wording of section 40-25 (7)(a) i.e. that a deduction is permissible if it is incurred for the “purpose of producing assessable income.”

This concept of a taxable purpose is capable of encompassing both expenses incurred after trading operations have commenced, and also those incurred prior to the actual commencement of trade.

This approach differs to that of South African and English law, in that Australian law appears to prescribe the right to claim pre-trade expenses, in a clause preceding that which allows for expenses incurred specifically in the course of running a business. In contrast, the statutory provisions of South African and the United Kingdom treat pre-trade expenses as a statutory exception to a broader trade requirement. This is also confirmed in the judgments of Australian jurisprudence which has referred to and upheld the separate and independent applicability of Section 8(1)(a) and 8(1)(b).¹³⁰

¹²⁹ See 40 – 25(7) and (8) of the ITAA 1997.

¹³⁰ Section 8(1)(a) and *(1)(b) of the ITAA 1997. See the judgment of *Spriggs v Federal Commissioner of Taxation* below.

4.4 Jurisprudence

4.4.1 Systematic and organised activity

*Spriggs v Federal Commissioner of Taxation*¹³¹, is an appeal from the Federal Court of Australia. This is an interesting case in that it deals with all of the requirements that are relevant to this topic. The case was heard in the High Court of Australia, having been heard in the Federal Court of Australia before a single judge, then appealed by the Commissioner to the full bench of the Federal Court which upheld the appeal, and finally to the High Court that upheld the appeal of the taxpayers. It also provides a commentary of other decisions that are relevant.

Two professional football players each claimed as a deduction, under s 8-1(1) of the ITA 1997, management fees paid to a manager for negotiating a contract with a new football club. Section 8-1(1) permitted as a deduction from assessable income any loss or outgoing to the extent that (a) it was incurred in gaining or producing the assessable income; or (b) it was necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income. Such a deduction was not available if the loss or outgoing was of a capital nature.

The Commissioner refused to allow the deductions and disallowed the players' objections to their assessments.

It was held that there had been a sufficient connection between the outgoing, the management fees, and the gaining or producing of assessable income from the business of exploiting sporting prowess and associated celebrity for the management fees to be deductible under s

¹³¹ *Spriggs v Federal Commissioner of Taxation* 239 CLR 1 72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633.

8-1(1)(a). The management fees were also necessarily incurred in carrying on the players' businesses so as to be deductible under s 8-1(1)(b).

The judgment of Bell J highlighted the central issue in this matter as being, "The issue, in respect of s 8-1(1)(a), is whether a particular "loss or outgoing" was "incurred in gaining or producing [...] assessable income".¹³² The question which was debated was whether the management fees were incurred "in gaining or producing" the appellants' assessable income.

It is well settled that incurred "in" gaining or producing means incurred "in the course of" gaining or producing assessable income¹³³. In *Ronpibon Tin NL v Federal Commissioner of Taxation*,¹³⁴ this Court explained:

"It is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income."

The essential question, rephrased in *Federal Commissioner of Taxation v Payne*¹³⁵, is: "is the occasion of the outgoing found in whatever is productive of actual or expected income?" In *Federal Commissioner of Taxation v Day*¹³⁶, the majority said:

¹³² See *Spriggs (Supra)* paragraph 54.

¹³³ See also as referred to by the court; *Amalgamated Zinc (De Bavay's) Ltd v Federal Commissioner of Taxation* (1935) 54 CLR 295 at 303 per Latham CJ; at 309 per Dixon J; *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 56-57 per Latham CJ, Rich, Dixon, McTiernan and Webb JJ; *Charles Moore & Co (WA) Pty Ltd v Federal Commissioner of Taxation* (1956) 95 CLR 344 at 350 per Dixon CJ, Williams, Webb, Fullagar and Kitto JJ; *Federal Commissioner of Taxation v Payne* (2001) 202 CLR 93 at 99 [9] per Gleeson CJ, Kirby and Hayne JJ; *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 175 [21] per Gummow, Hayne, Heydon and Kiefel JJ; at 192 [69] per Kirby J.

¹³⁴ See *Ronpibon Tin NL (Supra)*.

¹³⁵ *Federal Commissioner of Taxation v Payne* (2001) 202 CLR 93 at 100 [11] per Gleeson CJ, Kirby and Hayne JJ, noted in *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 179 [30] per Gummow, Hayne, Heydon and Kiefel JJ.

¹³⁶ *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 180 [33] per Gummow, Hayne, Heydon and Kiefel JJ.

“That no narrow approach should be taken to the question of what is productive of a taxpayer's income is confirmed by cases which acknowledge that account should be taken of the whole of the operations of the business concerned in determining questions of deductibility.”

The Court proceeded to quote Professor R W Parsons¹³⁷ in stating that, ““Whether the applicability of the first limb or the second limb is in question, the inquiry must be concerned with the connection between the expense and the particular process of derivation of income.”¹³⁸

The Court went on to identify the relevant factors that are indicative of an ongoing business.¹³⁹

“The existence of a business is a matter of fact and degree. It will depend on a number of indicia, which must be considered in combination and as a whole. No one factor is necessarily determinative.¹⁴⁰ Relevant factors include, but are not limited to, the existence of a profit-making purpose, the scale of activities, the commercial character of the transactions, and whether the activities are systematic and organised, often described as whether the activities are carried out in a business-like manner.”¹⁴¹

Of significance are the findings of the Court in paragraph 67 of the judgment, as it reinforces the submissions made above in paragraph 3.2.1, with regards to the wording of Section 8-1(1) of ITAA 1997. The Court specifically looked at sections 8-1(1)(a) of the ITAA 1997 separately from Section 8-1(1)(b).

¹³⁷ Parsons, R. W. (1985). *Income Taxation in Australia. Principles of Income. Deductibility and Tax Accounting.* Sydney. Law Book Co. page 313 [5.33].

¹³⁸ *Federal Commissioner of Taxation v Day* (2008) 236 CLR 163 at 180 [33].

¹³⁹ See paragraph 59 of the judgment in *Sprigg* (Supra).

¹⁴⁰ See also *Evans v Federal Commissioner of Taxation* (1989) 20 ATR 922 at 939; 89 ATC 4,540 at 4554-4556 per Hill J.

¹⁴¹ *Spriggs v Federal Commissioner of Taxation* 239 CLR 1 72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633. See also *Federal Commissioner of Taxation v Day*. See also *Martin v Federal Commissioner of Taxation* (1953) 90 CLR 470 at 473-474 per Webb J; at 479, 481 per Williams A-CJ, Kitto and Taylor JJ; *Ferguson v Federal Commissioner of Taxation* (1979) 9 ATR 873 at 876-877; 26 ALR 307 at 311 per Bowen CJ and Franki J; *Federal Commissioner of Taxation v Walker* (1985) 16 ATR 331 at 334-335 per Ryan J; *Evans v Federal Commissioner of Taxation* (1989) 20 ATR 922 at 939-943; 89 ATC 4,540 at 4554-4559 per Hill J.

The Court stated that, “The definition of “business” in section 995-1 of the ITAA 1997, set out above¹⁴², also does not require the result contended for by the Commissioner. That definition does not apply in respect of s 8-1(1)(a), where the statute calls, not for the identification of a “business” as defined, but rather for the identification of the means of gaining or producing “income”¹⁴³. Moreover, the definition does not state that a contract of employment cannot form part of a business. What the definition provides is that a person will not be taken to be conducting a business merely because the person earns income under a contract of employment. Something more than that would be required for there to be a business.”

The court concludes that, “Looking at their activities as a whole, the appellants were engaged in the business of commercially exploiting their sporting prowess and associated celebrity for a limited period. Those businesses were well established before the management fees were incurred. Neither of the appellants was exclusively or simply an employee of his club”.¹⁴⁴

There existed here sufficient connection between the outgoing, the management fees, and the gaining or producing of assessable income from the business of exploiting sporting prowess and associated celebrity, for the management fees to be deductible under s 8-1(1)(a) of the ITAA 1997.¹⁴⁵

For the purposes of this dissertation, the Courts examination of section 8-1(1)(b) is of more relevance, because it specifically identifies the indicators that one must look at in order to determine whether a business is being conducted.

¹⁴² In paragraph 24 of *Sprigg* (Supra).

¹⁴³ This is also confirmed by R W Parsons, (1985), *Income Taxation in Australia, Principles of Income, Deductibility and Tax Accounting*, page 313 [5.33], p 131 [2.393].

¹⁴⁴ *Spriggs v Federal Commissioner of Taxation* 239 CLR 1 72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633, in paragraph 69 of the judgment.

¹⁴⁵ See paragraph 73 of the judgment.

It was held¹⁴⁶ that, “a loss or outgoing will be necessarily incurred in carrying on a business if it is clearly appropriate or adapted for the carrying on of the business¹⁴⁷. Restating the test another way, the loss or outgoing will be “necessarily incurred” if it is “reasonably capable of being seen as desirable or appropriate from the point of view of the pursuit of the business ends of the business.”¹⁴⁸

For the reasons already explained, the businesses included repeatedly performing the services of playing for their respective clubs under the playing contracts. Section 8-1(1)(b) is capable of operating in these circumstances.¹⁴⁹

The Court concluded that, “The management fees paid by each of the appellants were deductible under both s 8-1(1)(a) and (b) of the ITAA 1997, and they were revenue expenses which were not covered by s 8-1(2)(a). The orders of the primary judge should be restored.”¹⁵⁰

It should be noted that Spriggs is particularly relevant to this dissertation in so far as the Court, in reaching the conclusion that the taxpayer was involved in an existing business, referred to certain indicators in order to reach this conclusion. It also confirms in its application of section 8(1)(a) of the ITAA1997, that Australian Law can allow deductions that are applied in a manner that may be wider than a strict application of a trade requirement. In Australian law therefore, it may not be as important to assess when precisely a business commenced, and as such, it makes no provision for pre-trade expenses.

Just as in South Africa and the United Kingdom, the question of when a business commenced does become relevant to capital deductions such as those allowed in Division 40 of the ITAA

¹⁴⁶ Spriggs v Federal Commissioner of Taxation 239 CLR 1 72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633, in paragraph 75 of the judgment.

¹⁴⁷ See Ronpidon Tin (Supra) at 55-56 per Latham CJ, Rich, Dixon, McTiernan and Webb JJ.

¹⁴⁸ See also Magna Alloys & Research Pty Ltd v Federal Commissioner of Taxation (1980) 11 ATR 276 at 295-296; 33 ALR 213 at 235 per Deane and Fisher JJ. See further Federal Commissioner of Taxation v Snowden & Willson Pty Ltd (1958) 99 CLR 431 at 437 per Dixon CJ; at 443-444 per Fullagar J.

¹⁴⁹ See paragraph 76 of the judgment.

¹⁵⁰ See paragraph 85 of the judgment.

1997, due to the requirement in the act that these be deducted against assessable income, and this obviously presupposes that a business has commenced in order to put it in a position to declare assessable income, even if it is an assessed loss.

4.4.2 Indicators of trade

In *Ferguson v Federal Commissioner of Taxation*¹⁵¹ the court clearly laid out several indicators of trade. The judgment of Bowen C.J. and Franki J is sufficiently helpful to quote in full:

“Section 6 of the Income Tax Assessment Act defines “business” stating that it includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee. This does not afford much assistance in the present case. It is necessary to turn to the cases. There are many elements to be considered. The nature of the activities, particularly whether they have the purpose of profit-making, may be important. However, an immediate purpose of profit-making in a particular income year does not appear to be essential. Certainly it may be held a person is carrying on business notwithstanding his profit is small or even where he is making a loss. Repetition and regularity of the activities is also important. However, every business has to begin and even isolated activities may in the circumstances be held to be the commencement of carrying on business. Again, organization of activities in a business-like manner, the keeping of books, records and the use of system may all serve to indicate that a business is being carried on. The fact that, concurrently with the activities in question, the taxpayer carries on the practice of a profession or another business, does not preclude a finding that his additional activities constitute the carrying on of a business. The volume of his operations and the amount of capital employed by him may be significant. However, if what he is doing is more properly described as the pursuit of a hobby or recreation

¹⁵¹ *Ferguson v Federal Commissioner of Taxation* 37 FLR 310 9 ATR 873; 26 ALR 307; 79 ATC 4261; 1979 WL 156468; [1979] FCA 29.

or an addiction to a sport, he will not be held to be carrying on a business even though his operations are fairly substantial.”¹⁵²

In *Hope v Bathurst City Council*¹⁵³ Mason J with whose reasons Gibbs, Stephen and Aickin JJ agreed, placed emphasis on the question whether the activities in question could be seen as a “[...] commercial enterprise in the nature of a going concern, that is, activities engaged in for the purpose of profit on a continuous and repetitive basis”.

The Court held that for a business to be carried on the activities must possess something of a permanent character.

4.4.3 The element of commitment

Australian jurisprudence has said very little about the element of risk, which has featured in the jurisprudence of South Africa and the United Kingdom. Perhaps the most analogous provision in Australian law is that of commitment. Whilst this is not the same as risk, and could be considered to be a completely different requirement both in meaning and context, in several ways, there are analogous considerations that can be highlighted.

Both the elements of risk and commitment, show an intention on the part of the taxpayer to initiate a trade. The idea of taking a financial risk can be seen as a form of commitment to establishing a profit-making enterprise. The analogous factor is that both of these elements are a reflection of an intention that takes place early on in the establishment of a business. In South Africa and the United Kingdom, the courts look at the financial risks taken by the taxpayer as one element in determining whether a business has been established.

¹⁵² Ferguson (Supra) page 316.

¹⁵³ *Hope v Bathurst City Council* (1980) 144 CLR 1 at page 8-9.

In Australia, a commitment that is stronger than a mere risk is required. A taxpayer can take a risk by investing in research and development, but the courts will look for a further commitment. The courts will require that such a “risk” must include a further commitment to establish a trade.

In *Goodman Fielder Wattie Ltd v Federal Commissioner of Taxation*¹⁵⁴ the court disallowed research expenses incurred by the taxpayer. The Court said, “For the applicant it was submitted that the income-producing activity or business activity in which the applicant was engaged in the relevant period should be characterised as an activity of researching and developing monoclonal antibody products for manufacture and sale. The difficulty in the path of the applicant, however, is that during the relevant period the element of commitment was absent. The evidence, which I have summarised above, makes it clear that the applicant was engaging in activities of a provisional kind only.” In this instance, the element of commitment was absent.

In the case of *Esso Australia Resources Ltd v Commissioner of Taxation*¹⁵⁵, the taxpayer was in the business of producing and selling oil and gas. It incurred expenditure evaluating potential coal, oil shale, and mineral prospects to ascertain whether it was commercially worthwhile to enter into mining joint ventures. The taxpayer claimed the expenditure to be deductible under s 51(1). However, at the point of incurring such expenses, it was not then committed to commercial production. The transition from exploring and seeking business opportunities to conducting a mining business had not been made.

It would therefore be interesting to note what indicia would have defined such a transition, as this may provide an indicator of commencement.

¹⁵⁴ *Goodman Fielder Wattie Ltd v Federal Commissioner of Taxation* 29 FCR 376 22 ATR 26; 101 ALR 329; 91 ATC 4438; 1991 WL 1121021.

¹⁵⁵ *Esso Australia Resources Ltd v Commissioner of Taxation* 39 ATR 394, 146 ALR 293, 98 ATC 4768, 1998 WL 1672345.

To discern between activity constituting carrying on of a business and preliminary activity, the element of commitment establishes the requisite nexus between the expenditure claimed to be deductible and the business said to be carried on for the purpose of gaining or producing assessable income.¹⁵⁶

Since the 1960s the appellant had explored for and produced oil and gas off-shore as part of its business in Australia of producing and selling oil and gas. From the early 1970s, the appellant was under direction from Exxon to explore for coal, synthetic fuels and certain other minerals. For each of the years of income ended 31 December 1979 through to 31 December 1984 the appellant claimed a deduction under s 51(1) of the ITAA 1936¹⁵⁷ for expenditure in investigating the acquisition of interests in potential joint ventures for the exploration and mining of coal, oil shale and certain minerals. The costs and expenditures incurred were general costs which were preliminary to a decision to acquire a particular tenement, or an interest therein, from which mining production can take place.¹⁵⁸

The appellant contended before Sundberg J that in the relevant years of income its business had extended beyond oil and gas and included exploration for coal, oil shale and certain other minerals. Accordingly, so it was said, the appellant was entitled to an allowable deduction under the second limb of s 51(1) on the basis that the costs were outgoings necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.¹⁵⁹

The Commissioner contended that the appellant had not in the relevant years established an exploration business and that the expenditure was incurred in ascertaining the feasibility of potential ventures, in order to decide whether or not to carry on the business of mining coal

¹⁵⁶ See paragraph 5 of *Esso* (Supra); See also *Warren v Coombes* (1979) 142 CLR 531; *Dawson v Westpac Banking Corporation* (1991) 66 ALJR 94 at 99; *Rennie v Commonwealth* (1995) 61 FCR 351 at 354-356; *Softwood Pulp and Paper Ltd v Commissioner of Taxation (Cth)* (1976) 7 ATR 101 at 115; *Inglis v Commissioner of Taxation (Cth)* (1979) 40 FLR 191 at 195-196, 201; *Goodman Fielder Wattie Ltd v Commissioner of Taxation (Cth)* (1991) 29 FCR 376 at 387; *Commissioner of Taxation (Cth) v Brand* (1995) 31 ATR 326 at 343-344; 95 ATC 4,633 at 4,648-4,649

¹⁵⁷ Note that the period being claimed for was before the Income Tax Assessment Act of 1997.

¹⁵⁸ See *Esso* Supra at Page 550 B & C.

¹⁵⁹ See *Esso* (Supra) Page 551 A.

and oil shale. Accordingly, so it was said, the appellant had never committed itself to the extent of actually producing any of those commodities and therefore had not made the transition from exploring and seeking business opportunities to actually conducting a mining business.¹⁶⁰

The issue of commitment was necessary in the face of a principle established in *John Fairfax & Sons Pty Ltd* in which it is clearly held by Menzies J that, “It seems to me that the deductibility of an outlay cannot be made to depend upon the success or failure of what the outlay was intended to achieve [...] the success or failure of what was attempted can make no difference to the character of the expenditure [...]”¹⁶¹

In other words, although the business may never have been established, it must be examined in addition, whether at the time of incurring the expense, there was a commitment to establishing the business. If so, the implication is that the deduction may have been allowed, despite the failure of the business to actually commence.¹⁶²

As to the definition of this requirement of commitment, the following was said in the *Esso* judgment:¹⁶³

“Intent of the taxpayer alone in respect of the expenditure is not sufficient to establish deductibility under s 51(1) for outgoings or expenditures that are not themselves productive of income, but are intended to lead in the future to the production of income.”¹⁶⁴ In cases where it is necessary to discern between activity constituting the carrying on of a business and activity which is preliminary to the carrying on or recommencement of a business it is the element of commitment that establishes the requisite nexus between the expenditure claimed to be

¹⁶⁰ See *Esso* (Supra) Page 551 B.

¹⁶¹ *John Fairfax & Sons Pty Ltd v Commissioner of Taxation (Cth)* (1959) 101 CLR 30 at 49; As referred to in *Esso Australia Resources Ltd* (Supra) on page 555.

¹⁶² It must be noted in this regard that the courts in these matters were dealing with large corporate entities that pursued more than one line of business. The context of these cases is the deduction of research expenditure and other “setup” costs, relating to a business line of a larger corporate entity, that failed to materialise, and in respect of which the losses of such failure are claimed against the overall income of the entity from all its lines of business. It would not apply if such costs were incurred by an entity who sought to establish the business as its sole business, as the failure to launch would imply no income from whence such deductions could be claimed.

¹⁶³ *Esso Australia Resources Ltd* (Supra) on page 556.

¹⁶⁴ see *Inglis v Commissioner of Taxation (Cth)* (1979) 40 FLR 191 at 195-196 per Brennan J.

deductible and the business said to be carried on for the purpose of gaining or producing assessable income.”¹⁶⁵

On the other hand, cognisance must be had that, “a “hope or expectation” that a taxpayer's mining operations would be resumed and then earn income would not amount to a “present purpose” of gaining income.”¹⁶⁶

The Court in the Esso matter ended off this part of the judgment by ratifying the commitment principle, and elevated it to a fundamental criterion that would indicate trade. The Justices stated that; “In our view it can now be taken to be well established that, in cases such as the present, in determining whether there is a sufficient nexus between expenditure claimed to be deductible under s 51(1) and the prospect of income being earned by a taxpayer's business as a consequence of the expenditure the element of commitment is an important criterion for determining deductibility. The criterion affords a practical and principled basis for ascertaining whether the nexus between the expenditure and the derivation of assessable income is too remote or too tenuous to confer on the expenditure the requisite character under s 51(1).”¹⁶⁷

4.5 Conclusion

In assessing the provisions of Australian law and jurisprudence with regards to the issues relating to, and a definition of relying upon the commencement of trade, the following becomes

¹⁶⁵ See also *Softwood Pulp and Paper Ltd v Commissioner of Taxation (Cth)* (1976) 7 ATR 101 at 115; 76 ATC 4,439 at 4,450 per Menhennitt J; Inglis at 195-196 per Brennan J and at 201 per Davies J; *Goodman Fielder Wattie Ltd v Commissioner of Taxation* at 387 per Hill J; *Commissioner of Taxation (Cth) v Brand* (1995) 31 ATR 326 at 343-344; 95 ATC 4,633 at 4,649 per Tamberlin J. In *Steele v Commissioner of Taxation (Cth)* (1997) 73 FCR 330 at 336 Burchett and Ryan JJ referred to these cases for the proposition that a sufficient connection, for the purposes of s 51(1), between an outlay and the prospect of income requires a degree of commitment on the part of the taxpayer to the relevant income producing activity. The existence of the requisite nexus in a particular case is a question of fact and of degree: see Inglis at 195-196 per Brennan J and at 205-206 per Davies J.

¹⁶⁶ *Ronpibon Tin NL v Commissioner of Taxation (Cth)* (1949) 78 CLR 47 at 57.

¹⁶⁷ *Esso Australia Resources Ltd (Supra)* at page 558.

clear, and in many ways, places Australian law on a different footing to the jurisdictions discussed above.

What is clear is that the line between pre-trade conduct and expenses, and post-commencement conduct and expenses is rather blurred, particularly when dealing with larger corporate entities that have several lines of business. In light of judgments such as *Esso* and *John Fairfax and Sons*, it is clear that an assessment of the point in time in which a trade commenced is not necessarily critical for the purposes of deductions as it is in jurisdictions that apply a strict trade requirement, such as the United Kingdom and South Africa, except for certain practical requirements such as the existence of an income against which to claim these expenses. This is then what makes the concept of commitment such an important one, especially when dealing with larger corporate entities whose income stems from multiple lines of business. It is cautiously submitted that the principle of commitment in Australian tax law, supersedes a strict application of a trade requirement.

It is a pity that the Court in the *Esso* matter did not go further to elaborate on a definition, or some indicia of commitment. The one question that is not answered is whether under certain circumstances, preliminary activity, coupled with the requisite degree of commitment, could lead to the view that business commences from this early stage. Due to the provisions of sections 8(1)(a) and (b) of the ITAA 1997, which soften the need for a distinction between pre-trade and post-commencement expenses, this question has never really been dealt with in Australian law.

Chapter 5 - The law of the United States

5.1 Introduction

Traditionally, the South African Courts do not rely on jurisprudence from the United States, nor do they seem to place much weight on US law as a traditional source of influential jurisprudence. However, in the context of commencement of trade, SARS has relied heavily on US jurisprudence in its IN 33 when dealing with this issue. It would therefore, for the sake of completeness, be necessary to look at US jurisprudence in this regard, and to examine how IN33 views such jurisprudence.

5.2 US statute in brief

The tax laws in the United States are largely contained in the Internal Revenue Code.¹⁶⁸ Section 162(a) of the Code is the part that predominantly deals with deductions for business expenses. It is one of the most important provisions in the Code, because it is the most widely used basis for deductions.¹⁶⁹

The very important requirement of section 162(a) is that the taxpayer must be carrying on a trade or business.¹⁷⁰ This section provides that, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." This wording is very similar to the wording used in the provisions relating

¹⁶⁸ Internal Revenue Code of 1986.

¹⁶⁹ Donaldson, S. A. (2007), *Federal Income Taxation of Individuals: Cases, Problems and Materials*. 2nd Edition. Thompson West.

¹⁷⁰ IRC Section 162(a).

to deductions in South Africa and in the United Kingdom, and also leads to the requirement that a business must have commenced trading in order to claim deductions.

Various other sub-sections relating to specific types of deductions serve to confirm this requirement by the use of the wording such as, “in the pursuit of a trade or business”,¹⁷¹ and, “for purposes of the trade or business”.¹⁷²

The jurisprudence referred to below will show that the United States takes a very narrow approach to the issue of commencement of trade, and pre-trade expenses are treated in a very similar manner as in South Africa and the United Kingdom.

In terms of Section 195 of the Code, start-up expenses are not entirely deductible, but must be spread out over 15 years.¹⁷³ This provision increases the tendency, because business expenses are fully deductible under section 162, for taxpayers to try to argue that expenses were not start-up expenses, but rather, that at the time that these expenses were incurred, the business concerned could be said to have commenced trading.

5.3 United States jurisprudence

5.3.1 Decision to commence business

The earliest possible time it can be claimed that a business had commenced trading, would be at the time that a decision is made to establish a trade. Courts in the United States have two very influential decisions that deal with this very claim.

¹⁷¹ Section 162(2) of the Internal Revenue Code.

¹⁷² Section 162(3) of the Internal Revenue Code.

¹⁷³ Section 195 of the Internal Revenue Code.

As stated in IN33, "One of the cases most often cited in the USA when dealing with start-up costs is that of *Richmond Television Corp. v Commissioner*."¹⁷⁴ Furthermore, it may also be useful to pursue this line of enquiry initiated by SARS in IN33, and look at some of the decisions upon which the judgment in Richmond is based.

The question in the Richmond matter centred on the deductibility of "pre-opening" expenses incurred between the time that a decision was made to establish a business and the actual beginning of business operations. During the three-year period under consideration, Richmond Television had been incorporated for the purposes of running a television station but it had not yet obtained a license or begun broadcasting. The issue therefore is at what point of time did its business begin, and whether at this doubtful, prefatory stage it was carrying on a business.

The court referred to *Frank B. Polachek v. Commissioner of Internal Revenue*.¹⁷⁵ During the latter part of 1947, the taxpayer in the Polachek devoted his time to planning a new business investment advisory service. The business was never formally organized, but the taxpayer spent money for advertising, travelling expenses, secretarial help, printing, mailing, and other business related expenses. In 1948, the taxpayer abandoned the project. The Tax Court found as a fact that, "The expenses incurred in planning and organizing of petitioner's proposed investment advisory service were not incurred in carrying on a trade or business. The petitioner had no business in 1947. At most, he merely had plans for a potential business. Regardless of the time he may have devoted to the project, or the expense in attempting to attract associates and capital and solicit prospective clients, we think that petitioner's idea was still in its formative stages when it was finally abandoned."¹⁷⁶

¹⁷⁴ *Richmond Television Corp. v Commissioner* 345 F.2d 901 (4th Cir. 1965).

¹⁷⁵ *Frank B. Polachek v. Commissioner of Internal Revenue*, 22 T.C. 858 (1954).

¹⁷⁶ See also the following cases which confirm this approach: *Radio Station WBIR v. Commissioner of Internal Revenue*, 31 T.C. 803 (1959); *KW TX Broadcasting Co. v. Commissioner of Internal Revenue*, 31 T.C. 952 (1959), *aff'd per curiam*, 272 F.2d 406 (5th Cir. 1959); *Petersburg Television Corp. v. Commissioner of Internal Revenue*, 20 T.C.M. 271 (1961). The only decision that is contrary to these mentioned above is that in *Southeastern Express Co.*, 19 B.T.A. 490 (1930), but this not been followed in later Tax Court cases.

5.3.2 Doors open for business approach

The principle that emerges from these cases is that, “even though a taxpayer has made a firm decision to enter into business and has over a considerable period of time spent money in preparation for entering that business, he still has not engaged in carrying on any trade or business within the intendment of section 162(a) until such time as the business has begun to function as a going concern and performed those activities for which it was organized.”¹⁷⁷

More widely, the cases emphasises that the particular circumstances of each matter must be examined, and that each case is to be determined on its own merits. This leaves the Courts open to examining specific indicators that would be deemed as relevant taking into account, the individual business’ circumstances at the time. For example, in the Richmond matter, the fact that that taxpayer had not yet obtained a license to broadcast was given central importance. It could therefore be argued that in cases where a trade or business is dependant for legality upon the issuance of a licence, then the absence of a licence is indicative of the fact that business has not yet commenced.

Essentially, courts in the United States adopt an “open for business” approach to this question, as confirmed in *Madison Gas and Electric Co. v Commissioner*.¹⁷⁸ In this matter, an entity that was deemed to have formed a partnership to construct a nuclear plant, could not deduct employee training expenses paid until the actual business operations of this partnership commenced. The business of the individual entity had commenced, but as the new venture was conducted in an expanded definition of partnership as defined by the Internal Revenue Code¹⁷⁹ it was determined that the business of the partnership had not yet commenced, and

¹⁷⁷ *Richmond Television Corp. v Commissioner* (Supra) at Page 907.

¹⁷⁸ *Madison Gas and Electric Co. v Commissioner* 633 F.2d 512 (7th Cir. 1980).

¹⁷⁹ See Section 1111(a) of the Revenue Act of 1932 which was carried over to Section 3797(a)(2) of the Internal Revenue Code of 1939.

therefore the expenses were held to be pre-operational and had to be capitalised. The basis of the argument was that the business had not yet “opened its doors for trade.”

As to this open for business requirement, in the case of retail stores, this would be a simple matter of determining whether the business had actually opened up its doors for trade. However, this requirement can also be more abstract, such as in Richmond, where the lack of a licence was indicative of the fact that the business had not yet “opened up its doors for trade”.

5.3.3 Individual circumstances

However, even within this requirement, individual circumstances must be examined. For example, in *United States v Manor Care Inc*¹⁸⁰, in which a construction company had not yet obtained its licence to construct care homes for the elderly, it was decided that this should be distinguished from Richmond,¹⁸¹ as the obtaining of the licence was a mere formality.

As an example of trade indicators, the court cited the following passage from a US Regulation with approval: “Ordinarily, a corporation begins business when it starts the business operations for which it was organised. If the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, however, it will be deemed to have begun business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the beginning of business.”¹⁸²

As further referred to in IN33, there are several other exceptions to this Richmond approach of “no licence, no open doors”. It seems that courts in subsequent matters were concerned by

¹⁸⁰ *United States v Manor Care Inc*, 490 F. Supp. 355; 1980 U.S. Dist. LEXIS 9143; 80-2 U.S. Tax Cas. (CCH) P9547; 46 A.F.T.R.2d (RIA) 5331.

¹⁸¹ *Richmond Television Corp. v Commissioner* 345 F.2d 901 (4th Cir. 1965).

¹⁸² *Manor Care Inc (Supra)* at page 362.

the rigid approach of the Richmond Court, and although bound by the decision in Richmond, bent over backwards to find grounds to distinguish the matters, so that they could hand down a judgment contrary to this decision. The distinguishing factors that were upheld, all based on the particular circumstances of each matter, were as follows:

In *Brotherman v United States*¹⁸³ a partner in a cable television business was held to be carrying on business as he had acquired the necessary equipment to conduct the business, even though he had not yet acquired the necessary statutory licence at that stage. It was also important that the business was thereafter commenced, and that such expenses could therefore be claimed. In *Blitzer v United States*¹⁸⁴ a partner in a low income housing project was allowed to deduct an administration fee before construction had commenced, as the partnership had acquired the land, prepared the construction plans and obtained the necessary finance.¹⁸⁵

5.4 Conclusion

The approach adopted by the United States in dealing with pre-trade expenses is similar to the approach adopted in South Africa, and in the United Kingdom. The tax laws in their strict application do not allow for pre-trade expenses due to the strict application of the trade requirement. However, due to the economic inequity that would occur if such expenses were disallowed, the United States, like South Africa and the United Kingdom, wrote exceptions into the laws to allow for such expenses.

¹⁸³ *Brotherman v United States*, 6 Cl. Ct. 407; 84-2 U.S. Tax Cas. (CCH) P9846; 54 A.F.T.R.2d (RIA) 6179; 1984 U.S. Cl. Ct. LEXIS 1286.

¹⁸⁴ *Blitzer v United States* 684 F.2d 874 (Ct. Cl. 1982).

¹⁸⁵ See generally, SARS Interpretation Note 33 at page 8.

5.4.1 Statutory Provisions

Section 162(a) of the Code¹⁸⁶ is interpreted to provide for a strict application of the trade requirement. The courts have applied this in accordance to a strict “doors open for business” requirement, which takes pre-trade outside the ambit of deductions in terms of section 162(a).

Pre-trade expenses are therefore provided for by way of section 195 of the Code, which allows for such expenses to be capitalised and deducted over a period of 15 years. South Africa by way of section 11A¹⁸⁷, and the United Kingdom by way of sections 61 and 57,¹⁸⁸ also provide for exceptions. The differences are however also quite profound. The United States treats both revenue and capital expenditure as expenses that need to be capitalised and deducted over 15 years, whereas in the case of revenue expenses, South Africa and the United Kingdom allow for the deduction of these expenses as a full deduction against income once trading has commenced. South Africa and the United Kingdom, therefore allow for more a more liberal and generous deduction of revenue expenses once trade commences. Capital expenses are also capable of being deducted in terms of capital allowances that are contained in both acts. It is also noteworthy that as in terms of sections 61 and 57 of the United Kingdom legislation,¹⁸⁹ these deductions are allowed for a period limited to seven years from date before trading commenced, whereas the legislation of South Africa and Australia have no such limitation.

5.4.2 Jurisprudence

The Courts in the United States have interpreted the requirements of Section 162(a) by adopting a strict “open for business approach”.¹⁹⁰ This approach was to a great degree played

¹⁸⁶ Internal Revenue Code of 1986

¹⁸⁷ The Income Tax Act 58 of 1962; Section 11A inserted by Section 28 (1) of Act 45 of 2003

¹⁸⁸ Section 61 of the Corporation Tax Act 2009 , and Section 57 of the Income Tax (Trade and Other Income) Act 2005

¹⁸⁹ See note 173 above.

¹⁹⁰ See *Madison Gas and Electric Co. v Commissioner* 633 F.2d 512 (7th Cir. 1980).

out in the context of business licences, where the courts were charged to determine if an entity was capable of passing the doors open for business approach when it had not yet received a licence to trade.¹⁹¹ It was strictly applied in the Richmond case, but in subsequent cases, the Courts went out of their way to find distinguishing circumstances in other similar matters. This has led to a strong affirmation that the circumstances of each and every matter are to be examined, and the Courts have indicated that they are more than willing to find exceptions based on individual circumstances.

¹⁹¹ See *Richmond Television Corp. v Commissioner* 345 F.2d 901 (4th Cir. 1965); *United States v Manor Care Inc*, 490 F. Supp. 355; 1980 U.S. Dist. LEXIS 9143; 80-2 U.S. Tax Cas. (CCH) P9547; 46 A.F.T.R.2d (RIA) 5331; *Brotherman v United States*, 6 Cl. Ct. 407; 84-2 U.S. Tax Cas. (CCH) P9846; 54 A.F.T.R.2d (RIA) 6179; 1984 U.S. Cl. Ct. LEXIS 1286.

Chapter 6 – Conclusion

6.1 Introductory remarks

It is clear from all jurisdictions that have been analysed, that the concept of commencement of trade is not defined in the tax legislation of any of the jurisdictions. It has been left up to the courts of each country, to interpret the provisions of their tax legislation, in relation to the trade requirement. In the process, each has also provided commentary on the question of when a business can be said to have commenced for tax purposes. This is due to the fact that the same indicators that are used to analyse whether a business could be said to be trading in order to satisfy the trade requirement, are the same indicators that indicate the time of commencement, in the sense that one would ascertain when these indicators of trade first came into existence in each particular instance.

No court has given a definition in the traditional sense of jurisprudence, in order to test for, or establish the time that a business may have commenced. Rather, they have, across the board, sought to define indicators, that, if present, indicate that the business has commenced. The difference between the jurisdictions arises in the manner in which they have worded these indicators, both in a specific and general sense.

The wording used in the legislation and the jurisprudence of the jurisdictions that have been examined, has for ease of reference, been reduced to the two tables contained in annexure one. The first table compares the wording used in the various legislative provisions that are applicable to deductions, and the second compares the approaches of the various courts in the wording that they have used to apply and interpret the provisions of their respective legislation.

In making these comparisons, the focus will be on the South African provisions and jurisprudence. It should be noted, that the international jurisdictions with which these have been compared, are essentially first world economies with advanced financial sectors, and accordingly, if it is found that the South African provisions and jurisprudence indicate a similarity to these jurisdictions, then this is an indication that the South African law is on a very secure footing in so far as its fiscal policy relating to this topic is concerned. Furthermore, in light of any such similarities, the approach of the courts of these jurisdictions can only serve to add to and compliment South African jurisprudential commentary.

In presenting arguments or analysing issues relating to the topic of commencement of trade, South African judges and practitioners will be well served to examine the provisions of these jurisdictions in addition to that of South Africa, and to shape their assessments and presentations, in reference to these international jurisdictions as additional resources.

6.2 Comparative analysis

In order to tie up everything that has been referred to in the chapters above, it will be useful to finish this dissertation with a summarised comparative analysis of the principles that are outlined in these chapters.

6.2.1 Deductions as provided for in legislation

An examination of table one indicates the similarity of South African legislation in comparison to that of the international jurisdictions that were examined in this dissertation. The provisions of all jurisdictions clearly refer to a trade requirement as a prerequisite for deductions. The use

of phrases referring to the expenses arising out of the trade, or during the carrying on of the trade, or producing income for the purposes of trade or for the business, are found as a common factor in the legislation of all four jurisdictions.

It therefore follows that the jurisprudential commentary of these international jurisdictions with regards to these provisions, are entirely suitable as a reference source and a guide for the interpretation and application of the South African provisions. This accords with the approach taken by South African courts, who very often and quite liberally refer to this foreign jurisprudence, foremost that of the United Kingdom and Australia (as a commonwealth country) in order to find guidance when South African jurisprudence on a specific topic is scarce or non-existent. With regards to the United States, SARS has drawn extensively on this jurisdiction in its IN 33, its official policy guide on assessed losses, in which commentary relating to the commencement of trade was also offered.

A reference to table two will highlight the manner in which the use of wording of the various legislative provisions, as summarised in table one, are applied in the various jurisdictions. It also highlights the fact that across the board, save for certain minor differences in approach in respect of certain details, the same criteria and indicators are used to interpret and apply these provisions. These can be said to broadly fit into certain general categories that can be used by the practitioner for interpretation and analysis.

6.3. Jurisprudence

In light of the fact that this dissertation is written from the reference point of South African law, when examining the various categories that arise in the jurisprudence, the categories that arise out of the South African jurisprudence serve as the reference point.

6.3.1 Element of risk

A starting point for the analysis of whether a trade can be said to have been established at any specific point in time, begins in South Africa and the United Kingdom, with an analysis of whether the taxpayer has assumed an element of risk. This is very much a reflection of an intention to trade manifested in a concrete act. In Australia the courts have adopted a slightly different approach, by looking for an element of commitment. As seen in *Esso Australia Resources Ltd*,¹⁹² Australian courts are not satisfied with a mere risk or investment. Australian judges also look for an element of commitment, which is established by looking at the other factors referred to in the categories below.

In contrast to the approach of these three countries, the approach in the United States is far more strict and narrow. Notwithstanding any decision to enter into business, in other words commitment, and despite the fact that a taxpayer may have over a considerable period of time spent money in preparation for entering that business, in other words, risk, he still has not "engaged in carrying on any trade or business" within the intendment of section 162(a) until such time as the business has begun to function as a going concern and performed those activities for which it was organized.¹⁹³ The United States therefore, has a very inflexible, doors open for business approach.

¹⁹² *Esso Australia Resources Ltd v Commissioner of Taxation* 39 ATR 394, 146 ALR 293, 98 ATC 4768, 1998 WL 1672345.

¹⁹³ *Richmond Television Corp. v Commissioner* 345 F.2d 901 (4th Cir. 1965).

6.3.2 Active Steps.

In South Africa and in the United Kingdom, a mere assumption of a risk is not necessarily sufficient to establish trading activity.¹⁹⁴ Both jurisdictions require something more. In South Africa this has been stated as the taking of active steps. It is this requirement that brings the South African law more in line with the going concern or doors open for business approach adopted in the United States, even though it may not be as stringent. For example, in the case of a company that lets property, an attempt to let such property constitutes an active step, sufficient to bring the entity within trading activity.¹⁹⁵ On the other hand, Australia does not spell out such a requirement, but merely refers to a commitment, taking into account the operations of the business,¹⁹⁶ the scale of activities, and the commercial character of the transactions.¹⁹⁷

The next two categories that will be examined are perhaps the most useful, because these are found across the board, to be similar in all of the jurisdictions examined. Furthermore, they constitute concrete examples of trade indicators that can be examined in a very real and practical manner, in that one would look for concrete trading activity, such as the purchase of stock, invoicing, books of account, and the specifics of how a particular business is run.

6.3.3 Day to day activity

There is perhaps no area where the jurisdictions are more in agreement. Courts across all jurisdictions determine the question of whether trading activity is taking place, by assessing

¹⁹⁴ Kirsch v CIR 1946 WLD 261, 14 SATC 72 at 75.

¹⁹⁵ See ITC 1476 (1989) 52 SATC 141(T).

¹⁹⁶ Federal Commissioner of Taxation v Payne (2001) 202 CLR 93.

¹⁹⁷ Martin v Federal Commissioner of Taxation (1953) 90 CLR 470.

concrete activity or indicators such as the various expenses referred to in ITC 1476,¹⁹⁸ the purchase of raw materials,¹⁹⁹ the scale of activities and commercial character of the transactions,²⁰⁰ and performing the activities for which it has been organised.²⁰¹ The useful aspect of this category is that a court would have access to books of accounts, documents, minutes, and other concrete forms of proof to make the necessary decision as to whether there was trading activity at any particular point in time, and can use these indicators to determine when a particular trade commences or ceases.

6.3.4 Frequency of turnover, continuity, and structure

Coupled with the day to day activity, another concrete way of making the assessment is to look at whether a taxpayer has the necessary infrastructure that one would expect, in order to enable trading activity. This requires an organisation that most likely repeats certain activities in a profitable manner, according to an organised system, and in a business-like manner. This category has been specifically referred to by courts in South Africa, the United Kingdom, and in Australia, using wording that differs slightly, but which retains the same essential meaning. The cases examined from the United States do not refer to this category by name, but make mention of a going concern requirement, being open for business, and having commenced with actual business operations. All of these require the same indicators specifically identified in South Africa, the United Kingdom and Australia, namely, organisation, structure, repetition, and the like.

¹⁹⁸ ITC 1476 (1989) 52 SATS 141 (T) – These include auditors fees, secretarial expenses, printing, stationery, telephone, rentals sundries etc.

¹⁹⁹ *The Birmingham & District Cattle by-products Co Ltd v CIR* [1919] 12TC92.

²⁰⁰ *Martin v Federal Commissioner of Taxation* (1953) 90 CLR 470 at 473-474 per Webb J; at 479, 481 per Williams A-CJ, Kitto and Taylor JJ; *Ferguson v Federal Commissioner of Taxation* (1979) 9 ATR 873 at 876-877; 26 ALR 307 at 311 per Bowen CJ and Franki J; *Federal Commissioner of Taxation v Walker* (1985) 16 ATR 331 at 334-335 per Ryan J; *Evans v Federal Commissioner of Taxation* (1989) 20 ATR 922 at 939-943; 89 ATC 4,540 at 4554-4559 per Hill J.

²⁰¹ *Richmond Television Corp. v Commissioner* 345 F.2d 901 (4th Cir. 1965).

6.3.5 Personal circumstances of each taxpayer

Due to the fact that this approach relies largely on indicators of trade, and due to the diversity of needs, requirements, procedures, and methodology employed by businesses depending on their diverse needs within specific industries and individually, all jurisdictions have adopted an approach that examines the specific circumstances of each case. This is adopted across the board, and is an important concept that is found in tax law generally.

6.4 Pre-trade expenses

All of the jurisdictions, save for Australia, have sought to deal with these as an exception to this requirement. Provisions relating to pre-trade expenses in the form of section 11A,²⁰² sections 61 and 57,²⁰³ and section 195,²⁰⁴ all make special provision for such expenses. In the United Kingdom, the 7 year rule applies; in the United States these are capitalised and deducted over 15 years; and in South Africa, a provision for these expenses was only introduced in 2003.²⁰⁵

In Australia, section 8(1)(a) and (b) provides that “You can deduct from your assessable income any loss or outgoing to the extent that: (a) it is incurred in gaining or producing your assessable income; or (b) it is necessarily incurred in carrying on a business for the purpose

²⁰² Income Tax Act 58 of 1962 (South Africa).

²⁰³ Section 61 of the Corporation Tax Act 2009 , and Section 57 of the Income Tax (Trade and Other Income) Act 2005 (United Kingdom).

²⁰⁴ Internal Revenue Code of 1986 (United States).

²⁰⁵ S. 11A inserted by s. 28 (1) of Act 45 of 2003.

of gaining or producing your assessable income.”²⁰⁶ The sub-clause (a) read with (b) clearly allows for the deduction of pre-trade expenses as a matter of course, provided that they were incurred in gaining or producing income. This is very wide, and has been interpreted widely by the courts. Perhaps of all jurisdictions, it is South Africa that gets the closest to this wide approach, without any of the time period limitations imposed by the United Kingdom and the United States.

6.5 Relevance of the topic

In light of the provisions of section 11A in the ITA, it would seem that pre-trade or preparatory expenses that a taxpayer was unable to claim on a strict application of section 11 prior to 2003,²⁰⁷ are now capable of being claimed. However, the relevance of establishing the time at which an entity has commenced trading is still extremely relevant, due to the fact that these expenses under section 11A, can only be claimed against income, or attributed towards an assessed loss, after the entity has commenced to trade.

Furthermore, in respect of all capital allowances that are allowed in terms of the ITA, these are also claimable only once an entity starts to trade.

6.6 Final Remarks

This dissertation demonstrates that it is clear that an examination into the issue of commencement of trade will require a practitioner to engage in a very practical exercise in most instances. In practice, all deductions and expenses need to be claimed against income

²⁰⁶ Income Tax Assessment Act 1997.

²⁰⁷ S 11A inserted by s 28 (1) of Act 45 of 2003.

and income can only arise when an entity trades. In the case of an assessed loss, it is moot as to precisely when this is written into the books, because again, it only becomes relevant against income, that is, after an entity has begun to trade.

Furthermore, due to the income from trade requirement, an assessed loss only becomes relevant after an entity has commenced trading.

An assessment of when an entity has commenced trading will most likely involve a practical enquiry into such issues such as the purchase of raw materials, payments for the expenses identified in ITC 1476, such as auditors fees, secretarial expenses, printing, stationery, telephone, rentals sundries, an examination into the infrastructure, stock, and the day to day activities of the trader, and other such practical factors.

Lastly, the indicators and principles identified in this dissertation in relation to deductions, would be applicable in any instance where a practitioner or a court has to assess for tax purposes, or even for general commercial purposes, a time at which an entity could be said to have commenced or to have ceased trading.

ANNEXURE 1

Table 1. Comparative table of wording used to legislate deductions in the various jurisdictions.

South Africa	United Kingdom	Australia	United States
<p>"For the production of the income".²⁰⁸</p> <p>"Arising out of the carrying on of his trade".²⁰⁹</p> <p>"Incurred for the purposes of his trade".²¹⁰</p>	<p>"Wholly and exclusively for the purposes of the trade".²¹¹</p> <p>"Connected with or arising out of the trade".²¹²</p> <p>"Qualifying activity for a chargeable period".²¹³</p> <p>(A chargeable period is defined as the accounting period for the relevant tax year for companies "carrying on a trade".)²¹⁴</p> <p>("Qualifying activity" is defined as "a trade".)²¹⁵</p>	<p>"Incurred in gaining or producing your assessable income".²¹⁶</p> <p>"Incurred in carrying on a business".²¹⁷</p> <p>"Taxable purpose."</p> <p>(A Taxable purpose is defined as, "The purpose of producing assessable income".)²¹⁸</p>	<p>"Incurred during the taxable year in carrying on any trade or business".²¹⁹</p> <p>"In the pursuit of a trade or business".²²⁰</p> <p>"For purposes of the trade or business".²²¹</p>

²⁰⁸ Section 11(a).

²⁰⁹ Eg. Section 11(c), 11(cA).

²¹⁰ Eg. Sections 11(d).

²¹¹ Section 34(1)(a) of the Income Tax (Trading and Other Income) Act 2005, and section 54(1)(a) of the Corporation Tax Act 2009.

²¹² Section 34(1)(b) of the Income Tax (Trading and Other Income) Act 2005, and section 54(1)(b) of the Corporation Tax Act 2009.

²¹³ Section 2 of the Capital Allowances Act 2001.

²¹⁴ Section 6 of the Capital Allowances Act 2001.

²¹⁵ Section 15 of the Capital Allowances Act 2001.

²¹⁶ Section 8-1 (1)(a) of the Income Tax Assessment Act 1997.

²¹⁷ Section 8-1 (1)(b) of the Income Tax Assessment Act 1997.

²¹⁸ Section 40-25 (7) of the Income Tax Assessment Act 1997.

²¹⁹ Section 162(a) of the Internal Revenue Code.

²²⁰ Section 162(2) of the Internal Revenue Code.

²²¹ Section 162(3) of the Internal Revenue Code.

Table 2. Comparative table of wording to define trade, used in the jurisprudence of the various jurisdictions.

South Africa	United Kingdom	Australia	United States
<p><u>The element of risk.</u></p> <p>“A transaction in which a person risks something with the object of making a profit.”²²²</p>	<p><u>The element of risk.</u></p> <p>Trade must be, “speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss)”.²²³</p>	<p><u>The element of commitment.</u></p> <p>The element of commitment establishes the requisite nexus between the deductions and the trade.²²⁴</p> <p>“Whether at the time of incurring the expense, there was a commitment to establishing the business”.</p>	<p><u>Open for business.</u></p> <p>(See below.)</p>
<p><u>Day to day activity.</u></p> <p>Identifying indicators of trade, such as auditors fees, secretarial expenses, printing, stationery, telephone, rentals sundries etc.²²⁵</p>	<p><u>Day to day activity.</u></p> <p>“Trade only commenced when the company began to take in raw materials and turn out its product.”²²⁶</p> <p>“What were the acts that were done in connection with this business and whether they amount to trading.”²²⁷</p>	<p><u>Day to day activity.</u></p> <p>“Account should be taken of the whole of the operations of the business”.²²⁸</p> <p>“a profit-making purpose, the scale of activities, the commercial character of the transactions...”²²⁹</p>	<p><u>Day to day activity.</u></p> <p>A taxpayer has not engaged in carrying on any trade or business until such time as the business has begun to function as a going concern and performed those activities for which it was organized.²³⁰</p>

²²² ITC 368 9 SATC 211 at 212.

²²³ Eclipse Film Partners No. 35 LLP v Revenue and Customs [2012] UKFTT 270 (TC); -Eclipse Film Partners (No. 35) LLP v HMRC [2013] UKUT 639 (TCC) (20 December 2013).

²²⁴ Esso Australia Resources Ltd c Commissioner of Taxation 39 ATR 394, 146 ALR 293, 98 ATC 4768, 1998 WL 1672345.

²²⁵ ITC 1476 (1989) 52 SATS 141 (T).

²²⁶ The Birmingham & District Cattle by-products Co Ltd v CIR [1919] 12TC92.

²²⁷ J & R O’Kane v CIR [1922] 12 TC 303 (HL).

²²⁸ Federal Commissioner of Taxation v Payne (2001) 202 CLR.

²²⁹ Martin v Federal Commissioner of Taxation (1953) 90 CLR 470 at 473-474 per Webb J; at 479, 481 per Williams A-CJ, Kitto and Taylor JJ; Ferguson v Federal Commissioner of Taxation (1979) 9 ATR 873 at 876-877; 26 ALR 307 at 311 per Bowen CJ and Franki J; Federal Commissioner of Taxation v Walker (1985) 16 ATR 331 at 334-335 per Ryan J; Evans v Federal Commissioner of Taxation (1989) 20 ATR 922 at 939-943; 89 ATC 4,540 at 4554-4559 per Hill J.

²³⁰ Richmond Television Corp. v Commissioner 345 F.2d 901 (4th Cir. 1965).

<p><u>Active step requirement.</u></p> <p>“The carrying on of a trade involves an active step”.²³¹</p> <p>“There must be some actual dealing”.²³²</p>	<p><u>Active trading.</u></p> <p>“Active nature of trading, more specifically, the need to be providing goods or services, and to be trading with someone”.²³³</p> <p>The taxpayer was held to have commenced trading when he entered into his first contract of engagement.”²³⁴</p> <p>Acts done in connection with a business amounting to a trading which would 'cause the profits that accrued to be profits arising from a trade or business.’²³⁵</p>		<p><u>Going concern.</u></p> <p>The business must have, “begun to function as a going concern and performed those activities for which it was organized”.²³⁶</p> <p>Open for business. Actual business operations must have commenced.”²³⁷</p>
<p><u>Frequency of turnover, continuity and structure.</u></p> <p>“A person who performs an act as part of a trade, will if that act is profitable, be likely to repeat the act in an organised and cost effective manner, and within an organised structure, in order to continue to make a profit”.²³⁸</p> <p>“Frequency of turnover”, and “A system or plan in laying out and getting in his money”.²³⁹</p> <p>“There must be a certain degree of continuity and</p>	<p><u>Frequency, and organisation.</u></p> <p>“The question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention”.²⁴²</p>	<p><u>Systematic and organised activity, permanence.</u></p> <p>“Whether the activities are systematic and organised, often described as whether the activities are carried out in a business-like manner”.²⁴³</p> <p>“Repetition and regularity of the activities is also important... organization of activities in a business-like manner, the keeping of books, records and the use of system may all serve to</p>	

²³¹ ITC 1476 (1989) 52 SATC 141(T) at page 148, SA Bazaars (Pty) Ltd v CIR 1952 (4) SA 505 (A).

²³² ITC 777 19 SATC 320. This was stated in the context of rental property.

²³³ Ransom v Higgs [1974] 50TC1.

²³⁴ Napier v Griffiths [1990] 63TC745.

²³⁵ J & R O’Kane v CIR [1922] 12 TC 303 (HL).

²³⁶ Richmond Television Corp. v Commissioner 345 F.2d 901 (4th Cir. 1965).

²³⁷ Madison Gas and Electric Co. v Commissioner 633 F.2d 512 (7th Cir. 1980).

²³⁸ ITC 1476 (1989) 52 SATC 141(T).

²³⁹ Income Tax Appeal Case No 5243.

²⁴² CIR v Livingston [1926] 11TC.

²⁴³ Martin v Federal Commissioner of Taxation (1953) 90 CLR 470 at 473-474 per Webb J; at 479, 481 per Williams A-CJ, Kitto and Taylor JJ; Ferguson v Federal Commissioner of Taxation (1979) 9 ATR 873 at 876-877; 26 ALR 307 at 311 per Bowen CJ and Franki J; Federal Commissioner of Taxation v Walker (1985) 16 ATR 331 at 334-335 per Ryan J; Evans v Federal Commissioner of Taxation (1989) 20 ATR 922 at 939-943; 89 ATC 4,540 at 4554-4559 per Hill J.

<p>system about the transactions".²⁴⁰</p> <p>"There must be a certain degree of continuity and system about the transactions".²⁴¹</p>		<p>indicate that a business is being carried on".²⁴⁴</p> <p>For a business to be carried on the activities must possess something of a permanent character.²⁴⁵</p>	
<p><u>Personal circumstances of each taxpayer.</u></p> <p>One must first examine the nature of the trade, and what would in general constitute indicators of such a trade, and thereafter, look at the particular circumstances of each matter to see whether the taxpayer's conduct reflects such indicators.²⁴⁶</p> <p>"There are no hard and fast rules for deciding whether a taxpayer's expenditure falls within or outside the ambit of the section; it is not possible to devise any precise universal test... one can say no more than that the issue is to be resolved by examining the particular facts of each individual case."²⁴⁷</p>		<p><u>Activity of each business as a whole.</u></p> <p>The existence of a business depends on, "on a number of indicia, which must be considered in combination and as a whole. No one factor is necessarily determinative"²⁴⁸</p>	<p><u>Facts of each case.</u></p> <p>The particular circumstances of each matter must be examined, and that each case is to be determined on its own merits.²⁴⁹</p>

²⁴⁰ ITC 812 (1955) 20 SATC 469 (T).

²⁴¹ Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A).

²⁴⁴ Ferguson v Federal Commissioner of Taxation 37 FLR 310 9 ATR 873; 26 ALR 307; 79 ATC 4261; 1979 WL 156468; [1979] FCA 29.

²⁴⁵ Hope v Bathurst City Council (1980) 144 CLR 1 at page 8-9.

²⁴⁶ Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A).

²⁴⁷ See the dissenting judgment of Botha AJ in Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue 1991 (2) SA 257 (A).

²⁴⁸ Spriggs v Federal Commissioner of Taxation 239 CLR 1 72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [72 ATR 148; 83 ALJR 749; 256 ALR 596; 2009 ATC 20-109; 2009 WL 1679949; [2009] HCA 22; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633. See also Evans v Federal Commissioner of Taxation (1989) 20 ATR 922 at 939; 89 ATC 4,540 at 4554-4556 per Hill J.

²⁴⁹ Richmond Television Corp. v Commissioner 345 F.2d 901 (4th Cir. 1965).

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