"Capital or Revenue: A Critical Analysis of the Treatment of Realisation Companies and the judgment of Lewis JA"

A RESEARCH REPORT

BY

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Introduction

The treatment of realisation companies is not directly dealt with by South Africa legislation and the jurisprudence focused thereon has developed in accordance with the needs of commercial entities to dispose of property. The relevant terms of our governing legislation has, in response to this solution, enveloped the idea of a realisation company through the results of the judicial system.

In this paper the general income tax principles that relate to realisation companies will be evaluated. A synopsis will be provided, beginning with the *locus classicus* set out in the case of Berea West, thereafter the most recent case, Founders Hill, the effect thereof, and the general principles and cases exhibiting these principles, relating to the treatment of realisation companies by South African Court.

Founders Hill

AECI formed in 1934 and acquired 4100 ha of land at Modderfontein in Johannesburg. An explosives factory had been built on the land in 1896 and was extended in 1937, but much of the land was vacant and constituted a buffer between the factory and occupied land.

By the mid-1980's the circumstances had changed significantly in respect of the decentralization of local government, town planning responsibilities having devolved on AECI and technology in respect of explosives manufacturing such that the buffer around the factory was no longer required to be so extensive.

The need for housing in the area led to AECI and the Johannesburg City Council engaging in a planning process to alleviate this need. AECI decided to develop or sell the land and this decision was implemented *inter alia* by the incorporation of the taxpayer as a “realization company” and the sale of the land to the taxpayer, which proceeded to sub-divide, develop and dispose of the land. Other subsidiaries of AECI were involved in the process.

The assets was accepted as being of a capital nature when acquired by the taxpayer (Founders Hill), but the commissioner alleged that the taxpayer had changed its intention and the sale of land was treated as being of a revenue nature.

It was held that a realization company, in this context, was one formed for the purpose of facilitating the realization of property and that the company do no more than act as a means by which the interests of the shareholders in the property could be realized. However, such a company may change its intention from holding the asset as capital to revenue.

The initial question posed by Lewis JA was whether the taxpayer had acquired the asset as stock-in-trade or as a capital asset. The Court stated that only if the property had been acquired at the outset as capital did the second question arise, namely whether the Rubicon had been crossed by the taxpayer commencing to engage in business of trading in property.

In the court *a quo*, the formation of the issue between the parties, via the legal representatives, was whether the taxpayer had realized the erven, a capital asset, to

best advantage or whether it had changed its capital intention by embarking on a business of selling land. This was trite and not in dispute in the lower courts. It is therefore strange the Lewis JA posed the question as to what the nature of the asset was on acquisition.

The Court stated, on the facts, that the taxpayer had acquired the erven with the express intention of selling the land i.e. carrying on the business of selling land.

The Court stated that merely calling an entity a 'realisation company' and limiting its objects and selling activities was not a magical act that inevitably resulted in the proceeds derived from the sale of the asset amounts of a capital nature.

The Court found that the taxpayer had not merely been AECI's alter ego. The Court found that it had been formed solely for the purpose of acquiring the property, developing and selling it at a profit, and no reason existed to explain why the property was not stock-in-trade in it hands on the acquisition thereof. This was deduced with reference to the memorandum of association, the minutes of the board of directors, the evidence of the witnesses, and the manner in which the taxpayer had dealt with the properties. The mere fact that the taxpayer had said that it acquired the property as a capital asset did not make it such.

It was decided that the gains by the taxpayer were "*made by an operation of business carrying out a scheme of profit making*", where revenue was derived from capital productively employed and it therefore constituted taxable income. The Court

found that the taxpayer had acquired the property as stock in trade, conducted business by trading the property and the profits made constituted taxable income.[1]

Lewis JA highlights the fact that Founders Hill was described as a realisation company and notes that it was formed with the avowed purpose of realising certain property. Lewis JA further states that such a company is formed for the purpose of facilitating the realisation of property whereby the company does no more than act as means by which the interests of its shareholders in the property may be realised. Lewis JA therefore sets out the standard description of a realisation company. She further points out that the activities of such a company vary in degree and may be as wide as dividing land, rezoning, supplying services, marketing and selling. This is also accepted as per the case law.[2]

Lewis JA notes that the land held by AECI was a capital asset as may be determined from the intention of the shareholders given the context of the acquisition and the history of holding the asset. This is mentioned, in *SIR v Trust Bank of Africa,* as the incorrect position with regard to determining intention of a company. The intention of the directors sitting as board defines the company's intention and not the shareholders. [3]

The Court states that the question would normally be whether Founders Hill "*crossed the Rubicon*" after having held the property as a capital asset by beginning to trade in property.

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[1] Paragraph 3, *CSAR v Founders Hill (Pty) Ltd* SCA 10 May 2011 Case No. 509/10.
[2] Ibid.
[3] Ibid.

However in this case, the question is posed as to whether the property was in fact a capital asset to begin with, but rather was it stock-in-trade. Lewis JA notes that both sets of counsel agreed that the property was held as a capital asset and not stock-in-trade. She notes that the question of a change of intention or "crossing the Rubicon" is only relevant if the asset is acquired as capital.

Lewis JA deemed that Founders Hill had acquired the property from AECI with the intention of selling same – therefore with the intention of carrying on the business of selling land.

She finds further fault with the labelling of Founders Hill as a realisation company on the basis that no special need or circumstances required the transfer of the property to Founders Hill from AECI to allow for the property to be realised. She deduces that if the sole purpose of the transfer to Founders Hill is that the property may be realised, that the only inference may be that the property was held as stock-in-trade and was therefore never acquired as a capital asset.

The point, with regard to the origin of the asset, is made to distinguish the case of Founders Hill with a situation where a number of individuals hold a property and the realisation company is required to realise the property as one and thereafter to account to the beneficiaries as per their shares held in the company. This is seen as a requirement by Lewis JA to provide a practical or commercial reason for interposing the realisation company.[4]

[4] Paragraph 49, *CSAR v Founders Hill (Pty) Ltd* SCA 10 May 2011 Case No. 509/10.

Based on her findings as set out herein above, Lewis JA found that the property had been acquired as stock-in-trade. She also found that the intention of Founders Hill, as determined by the intention of AECI as its sole shareholder, was to realise the property. That it was engaged in the trade of selling land and that no commercial reason existed for disposing of the property via a realisation company. Furthermore, that the situation did not require the interposition of the realisation company unless special circumstances exist and as a general rule, a realisation company holds property as stock-in-trade rather than capital. It was decided that Founders Hill was subject to income tax as the proceeds on the property were not of a capital nature.

***Berea West Estate (Pty) Ltd v SIR* 1976 (2) SA 614 (A)**

Founders Hill, set out above, exhibits the most recent and authoritative judgment in respect of realisation companies. The judgment that Founders Hill departed from, Berea West, is set out in full herein below. Founders Hill exhibits a violent break from the precedent set by Berea Estate, as will be evident from the facts and *ratio*.

An undivided half share in land was donated in 1922 by one K to a trust for his 13 children and transferred to the trust after his death in 1927. The remaining half share was bequeathed to his children under his will. The land was transferred to a company and that the consideration thereof should be satisfied by the issue to the beneficiaries as shareholders of shares and debentures. The land consisted of 620 acres to which prior to transfer to the company, approval had been obtained to establish a township and sub-divisional plans had been approved. The conditions of development were that the owner was responsible for *inter alia* road-making, water supply and physical surveys. Over 20 years the company spent R 95 496.00 on

roads, survey, and water reticulation and like. The *modus operandi* was to develop one area, sell the plots and use the money to develop further. It acquired no other land and undertook no development other than this one. The profits were taxed as income. The taxpayer objected on the basis that it was realizing a capital asset to best advantage. The Special Court found that while the original intention was to facilitate the administration and distribution of the estate the company's subsequent actions over a long period indicated that it had deviated from its original intention.

The judgment by Holmes JA stated that the company was a realization company and not a company carrying on business and that the finding of deviation could not reasonably have been reached on the evidence and therefore the profits were of a capital nature.

The concept of a realization company was important. As an example: A and B and C own land not having acquired it with a view to sell, and they wish to realize the capital asset. They promote a company and become exclusive shareholders. Thereafter they transfer the land to the company for the purpose of realizing the asset and when it has been sold the company is wound up and its assets distributed among the shareholders. The company would be regarded as a realization company and not a company trading for profits and the surplus would be regarded as a capital receipt unless the company conducted itself as a business trading for profits, using the land as stock-in-trade.[5]

[5] Page 628, *Berea West Estate (Pty) Ltd v SIR* 1976 (SA) 614 (A).

Holmes JA set out the position as per Simon's Taxes 3 edition at p B 1.214, "*If a company does no more than act as a means whereby the interests of its shareholders may be properly realized in the property, surpluses made from sales of the property are not taxable as trading profits since such surpluses are capital receipts*."[6]

It was concluded by the Court that the taxpayer was a realisation company and acquired the property as capital based on the principal objects of the company, the fact that the whole property was to be realised and that there were no other shareholders. It was therefore only relevant as to whether the initial intention, to hold the property as capital, had changed or crossed the Rubicon.
Of the various points raised that countered the Special Court's reasoning, the Court found that the allegation that the beneficiaries had fulfilled their expectations by accepting shares in the company was to be disregarded. This would lead to the unwanted situation where the surplus of every realisation company would always be taxable.[7]

Further points that were countered were *inter alia* the drawing of objects of the company in wide terms, the long time it took to realise the property and expenditure of large sums of money in developing the property. None of these had the effect of changing the taxpayer's intention.

[6] Page 628, *Berea West Estate (Pty) Ltd v SIR* 1976 (SA) 614 (A).
[7] Page 634, *ibid.*

The position set out in Berea West is clear and unequivocal, if an entity does not trade in land, does not enter into a scheme of profit making, as the plain and clear interpretation of this phrase suggests, it does not trade, and thus cannot be said to be trading in land and undertaking a scheme of profit making. Merely realising is not, in every instance, trading, and a taxpayer is entitled to realise an asset to best value. In light of the concise summation of the ratio of Berea West, it is clear that the accepted position at the time of this judgment was that realisation companies executing the sale of a capital asset would not attract liability for income tax in light of the fact that no trade was executed.

Effect of *Founders Hill*

The effect of the above case is quite dramatic given the history of case law dating back to the early 1900's. Briefly, the *locus classicus* with regard to realisation companies may be set out as follows:

1. Realising an investment does not subject the profit with respect to the gains on realisation to income tax;
2. Where there is not merely the act of realisation but rather what is done is the *carrying on or the carrying out of a business* [carrying on a trade] the proceeds will be subject to income tax;
3. Each case must be considered according to its facts;
4. Cutting up land and selling is not definitive in determining whether a profit-making scheme was undertaken, but gain must be acquired by operation of a business in carrying out a scheme of profit-making;

5. Every person who invests his surplus funds in land or stock or any other asset is entitled to realise such asset to the best advantage and to accommodate the asset to the exigencies of the market in which he is selling;
6. The intention with which an article is acquired is not conclusive as to whether the proceeds therefrom are taxable or not as income;
7. Where a taxpayer had not one single purpose or intention the dominant intention must be regarded as decisive;
8. The *ipse dixit* of the taxpayer as to its intent and purpose should not be regarded as decisive;
9. The conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or participation in similar transactions are part of a *numerus clausa* of factors to consider when determining intention. The testimony of the taxpayer and witness must be balanced against the inferences to be drawn from the established facts;
10. When there is a *novus actus interveniens* the facts and objectively viewed intention may be disregarded;
11. The contemplation that an asset or property may be sold in the future is of no consequence in determining intention;
12. Factors are not individually decisive and the list is not exhaustive.

The judgment in Founders Hill ignores these principles and veers away from the tested precedent by suggesting that the starting point should be that property acquired by a realisation is stock-in-trade.

The judgment has received attention from academics, professionals and judicial officers who have noted its peculiarity.

The golden rule of South African tax law governing tax treatment of the proceeds of the disposal of asset is that the proceeds on the disposal of an asset will be of a capital nature unless they are derived from the conduct of trade or in the case of an isolated transaction, from a "venture in the nature of trade". As put by Smalberger JA in *CIR v Pick-n-Pay Employee Share Purchase Trust*[8] "Where no trade is conducted there cannot be floating capital".[9]

It is important to bear in mind the notion of carrying on of a scheme for profit whereby in order to gain profit or revenue a taxpayer must be carrying on a trade. There cannot be trade without an intention to trade. Assessing the idea from the perspective of tax morality it may be said that the Income Tax Act only seeks to tax proceeds on assets disposed of in the course of trade, and only permits the deduction of expenditure incurred for the purpose of trade.[10]

The principle of no trade without intention to trade for profit was the decisive issue in *CIR v Pick-n-Pay Employee Share Purchase Trust*. In the aforementioned case it was never the intention of the trust when purchasing shares that it would retain those shares. It was always that the shares would be resold at market value as soon as circumstances permitted. The likelihood of the trust making profit was due to the fact that the shares increased in value over time, same was inevitable. The scale of the

[8] 1992 (4) SA 39 (A).
[9] Paragraph 10 page 188, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.
[10] Paragraph 14 page 189, ibid.

buying and selling of shares contributed to the inference that the trust was conducting a business of share trading. However what was decisive was the fact that it was no concern of the trust whether the trust made profits or losses. The aim of the scheme was the operation of an employee share incentive scheme and not to trade in shares. For this reason the proceeds from sales were deemed of capital nature.[11]

The ratio in *CIR v Pick-n-Pay Employee Share Purchase Trust* was ignored by Lewis JA as well as the consideration that an asset must have been resold in an operation of business in a scheme of profit making: the purpose being to trade for profit.[12]

The failure to possess the intent to trade is decisive – the fact that a realisation company acquires the asset with the intention to dispose of it is not by itself adequate to render it a stock-in-trade. The purpose of the entity is not to trade, but to realise the assets on behalf of the shareholder.[13]

Holmes JA in *Berea West* never suggested that it was a *facta probanda*[14] that in order for the proceeds to be recognized as being of a capital nature that without the realization company the realization of the assets would have been difficult or impossible. This was not included in his list of factors (objects as stated in the Memorandum of Association, the provisions of the sale and purchase agreement to wind up the company when all property sold and the remaining funds distributed, that

[11] Paragraph 16, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.
[12] Paragraph 18 page 189, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.
[13] Paragraph 21, page 190, ibid.
[14] Essential elements to be proven in order to sustain a claim in law.

the company allotted 720 shares to the beneficiaries allowing for precise allocation and the fact that there were no other shareholders).[15]

The only issue was whether or not Founders Hill had embarked upon the trade of selling land for profit.[16]

The importance of carrying on a trade and effect thereof on the proceeds of the disposal may be illustrated by *ITC 1283* 41 SATC 36 where an Angolan national fled his native country and was forced realise his fixed assets as coffee beans and transported them by truck over the border to South West Africa (Namibia) and there sold the beans and trucks at a profit. It was held that he was merely realizing his capital and not trading for a profit.

The basic principle may be stated as follows – a realization company does not possess the intention to trade in land for profit as the sole purpose is to realize the property to the best advantage of the shareholders.

The reasoning of Lewis JA that since it is the intention of a realization company to acquire an asset for an agreed sum and to sell it for as much as possible, the realization company is trading, the asset it acquires is trading stock. This is the true position according to Lewis JA. The true position was dealt with by Holmes JA in *Berea West*, in which he rejected the above reasoning. He states that the motive for the formation of the appellant company is not the same thing as the intentions of the

[15] Paragraph 40 and 41, page 192, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.
[16] Paragraph 5, page 187, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.

appellant company. The motive for the formation of the appellant company was doubtless to realize the assets of the company [parent company] but the intention of the company was to acquire those assets for an agreed sum and to sell them for as much as possible.[17]

Holmes JA goes on to quote another case of *COT v British Australian Wool Realisation Association Ltd* [1931] AC 224:

"*Merely realizing is not trading. It is no good saying it is a trade of realizing." A realization company does not acquire its assets in order to trade for profit on its own account, and its assets are, therefore, acquired as fixed capital*."[18]

Lewis JA's contention that only special circumstances allow for the treatment of profits from realization companies as being of a capital nature, such as where multiple parties own the property, was discredited by reference to *Realisation Company v COT* 1951 (1) SA 177. This was confirmed by Holmes JA in *Berea West* where he quoted that "a company can be formed to realize certain assets and to realize them without being liable to tax on any profit resulting from realization, provided always that the company does not more than realize and does not trade or as long as there is no trade embedded in the realization."[19] Attention once again needs to be drawn to the phrase "does not trade or as long as there in no trade embedded in the realization."[20]

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[17] Paragraph 43, page 193, *NWK and Founders Hill* by Eddie Broomberg SC, The Taxpayer Vol. 60 No. 7 July 2011.
[18] Paragraph 44, page 193, ibid.
[19] Paragraph 53, page 194, ibid.
[20] Page 123, *Floundering up Founders Hill,* Dennis Davis, The Taxpayer Vol. 60 No. 7 July 2011.

The most recent confirmation of the position regarding realisation companies, *Berea West*, where the Court found that property held by a trust and transferred to a company which acted as a realisation company allowed the property to remain capital may be juxtaposed to Founders Hill.

Based on the similarity of facts it would have been expect that Lewis JA would have followed the precedent established *by Berea West*. However, as in case of *NWK*, Lewis JA chose to depart from the near centaury old legal dogma.[21]

Her reasoning was presumably based on a version of the label principle, being that merely calling an interposed company a realisation company does not automatically entitle it to claim that the proceeds of a disposed asset are of a capital nature. Furthermore, it was stated that the only basis on which a realisation company may hold an asset as capital is in special circumstances such as when multiple parties hold the asset jointly or the asset is not readily capable of liquidating. [22]

The court *a quo* dealt with the question by posing a less murky issue, that AECI was a trading company and wished to dispose of a capital asset that it had held for a number of years. It was more convenient for the land to be realised via a separate company as in *Berea West*. However, if any company, including a realisation company, carries on trade or a business of making profits from the sale of land,

[21] Page 123, *Floundering up Founders Hill,* Dennis Davis, The Taxpayer Vol. 60 No. 7 July 2011.
[22] Ibid.

using the land as stock-in-trade, the profits will be gained from the capital employed as stock in hand.[23]

In *Berea West*, Holmes JA assessed the manner of disposition of the land and found that the size of the property, the nature of the expenditure of the realisation company and lack of deviation from the initial intention of the realisation company supported the treatment of the proceeds as those of a capital nature. This illustrates that it is the conduct of the taxpayer that is critical.

By contrast with the issue as set in *Berea West*, the question in Founders Hill may be framed as follows: the sole purpose of Founders Hill was to sell of land which AECI had held for decades and its intention was to realise capital assets to best advantage. That begs the question of whether it acquired the assets as capital or stock-in-trade.[24]

The Court declared that the property was acquired as stock-in-trade. This could only have been so if the taxpayer traded or carried on business making profits on the sale of land. The very purpose of the taxpayer was to realise the capital asset it held as was stated in its objects, and as determined by the board of directors. Furthermore, the activities of Founders Hill did not mirror the level of business activity as detailed in *Natal Estates Ltd v Secretary for Inland Revenue* 1975 (4) SA 177 (A) and therefore could not have been trading in land.

[23] Page 123, *Floundering up Founders Hill,* Dennis Davis, The Taxpayer Vol. 60 No. 7 July 2011.
[24] Ibid.

This judgment has attempted to sweep away important precedent by way of misunderstanding significant implications of critical tax cases and long standing precedent.

Gross income not of a capital nature (Capital versus Revenue)

The norm or principle on which this discussion is grounded on is the notion of capital versus revenue and how the distinction results in the differing treatment of revenue or gross income. The first port of call is the Income Tax Act 1962 Act 58 of 1962 ("the Act") and the sections relevant to our analysis. The definition of gross income states is as follows in Section 1 (1), the definition section of the Act:

"Gross income"

> *in relation to any year or period of assessment, means,*
>
> *i)in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, or*
>
> *ii)in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature.*

The final portion of the definition which states "*excluding receipts of a capital nature*" is of importance in this analysis as it is a principal of taxation to tax income and capital receipts differently and hence the definition of gross income which forms the base for determining taxable income, excludes receipts of a capital nature.

Unfortunately the Act goes no further in fleshing out the substance of this phrase. As is the case in common law countries it is for the judicial system to supplement the law where the legislation provides little guidance. This is provided by way of legal decisions resolving disputes that mould what is promulgated as a single phrase of 7 words into a complex legal principle with numerous requirements, themselves which are sometimes vague and uncertain.

The backdrop from which to assess the treatment of realisation companies is that of the treatment of receipts and accruals. It is first necessary to understand this treatment and this distinction.

The distinction is clear and any amounts that are not of a capital nature will be regarded as income, as no halfway house exists.[25]

It must first be determined whether income derived from an asset is deemed as being of a capital or revenue nature. This is decided with reference to the intention of the taxpayer at the time that the asset was acquired and thereafter to determine whether there has been a change of intention prior to disposal of the asset. The intention may be to hold an asset as stock-in-trade which intention then may metamorphose into holding said stock as capital and *visa versa*.

If there has been no change of intention then the intention at the time of acquisition is decisive.

[25] Pyott v CIR 13 SATC 121 at page 126.

Where over time the taxpayer has displayed an array of intentions, via secondary or peripheral activities, it is the dominant intention that evolves over times that shall prevail and determine the nature of the asset.

Various factors are to be considered when assessing the intention of the taxpayer such as the taxpayer's *ipse dixit*, the length of time an asset is held, the frequency of such transactions, the nature of the taxpayer's business, the existence of an income flow from holding the asset and the reason for disposal of the asset. None of these are individually decisive and the paramount test is always the taxpayer's intention.

The acid test for determining the taxpayer's intention when disposing of an asset and whether the receipts or accruals derived therefrom are of a revenue or capital nature is the inquiry as to whether the taxpayer was engaged in a 'scheme of profit-making'. This notion implies that the receipts or accruals bear the imprint of revenue in that they have been designedly sought or worked for and were not fortuitous. Even when a clear business was undertaken, profits from the business will only be considered as being not of a capital nature if the business was conducted with a profit-making purpose. The embarking of a trade and having sought profits from such trade are essential elements in determining whether a taxpayer has engaged in the aforementioned scheme.

The test is based on the taxpayer's "object, aim and actual purpose" and not with what might have been contemplated or foreseen. The only exception to this is if generating a profit was inevitable. As mentioned above the element of trading is essential and where no trade is conducted there cannot be floating capital or trading

stock and there cannot be revenue. To generate revenue without trading stock is a nonsensical deduction.

The cases display an array of nuances on questions such as the determination of a company's intention and change of intention.

Important concepts

"Profit-making scheme"

The leading authority on the nature of an amount is *CIR v Pick-n-Pay Employee Share Purchase Trust* 54 SATC 271. A trust was formed to provide shares to company employees. The trust acquired shares at market value from the company and on-sold them on a continuous basis to the employees. Although the trust had no intention of making a profit as it had to dispose of the shares to employees at a fixed price, profit was generated. The question was whether the profit was of a capital nature. This profit-making scheme was the test applied in *CSARS v Wyner* 66 SATC 1 and has its origins in the *Californian Copper Syndicate* case devolved onto our law via English Law. [26][173]

The first question was whether the taxpayer had objectively conducted a business or carried on trade and secondly whether it was the objective of the taxpayer to conduct a business. The first leg is to be determined objectively and the second subjectively.[27]

[26] Page 173, L Olivier, De Jure 2012.
[27] Ibid.

The minority took the view that the test to determine the nature of an amount should be a purely objective test; on the facts of each case to decide whether a business was carried on and whether the amount received was in the ordinary course of business.[28]

The majority applied the subjective test. The majority relied on *Natal Estates* and *Elandsheuwel* while the minority relied on *Stott* and *Overseas Trust Corp*.[29] The profit-making scheme test is the most applied in recent judgments.

Determinant Factors

The cases do not provide clarity as to whether the "object", "motive", "intention", "contemplation" or *ipse dixit* of the taxpayer is decisive in determining whether a profit-making scheme was carried out. These words are used interchangeably by the courts.[30]

In *CIR v Pick-n-Pay Employee Share Purchase Trust* 54 SATC 271 at 281 the Court stated that "*contemplation is not to be confused with intention…In a tax case one is not concerned with possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose*."

From *Pick-n-Pay* and *Trust Bank*[31] cases it seems that the word "object" is synonymous with "intention" and "purpose" and that the test to determine the nature

[28] Page 173, L Olivier, De Jure 2012.
[29] Ibid.
[30] Page 174 ibid.
[31] *SIR v The Trust Bank of Africa Ltd* 1975 (2) SA 652 (A).

of an amount depends on whether it was derived as part of a profit-making scheme. Contemplation of a profit is not to be taken into account. *Trust Bank* relies on the definition of contemplation in *CIR v Paul*.[32]

What is to be established is the object of the scheme and to this end a person's intention is not always equal to his *ipse dixit*. That is to say that the person or taxpayer's *ipse dixit* is not decisive but merely forms one of the factors to consider.[33]

Intention

Intention of a company

This is particularly difficult to determine as it has "no body to kick and no soul to condemn"[34]. Case law has however given an indication as to how to determine a company's intention.

In *Lace Proprietary Mines v CIR* 9 SATC 349 it was held that the name of company, its policy and its activities may be taken into account when intention is determined.

SIR v Trust Bank of Africa Ltd 37 SATC 87 held at 105 that the intention of a company should be determined by the "state of mind or intention of the persons in effective control of the company" hence the directors sitting as a board.

Elandsheuwel Farming (Edms) Bpk v SBI 39 SATC 163 illustrates the danger of attributing an intention to a company by reference to the shareholders rather than those in effective control. This case attributed the intention of the new shareholders to the company as the new shareholders were speculators. This position has been criticised by academics and commentators as the policy and management of a

[32] Page 175, L Olivier, De Jure 2012.
[33] Ibid.
[34] *CIR v Richmond Estate*(Pty)Ltd 1956 1 SA 602 at 606F.

company is determined not by its shareholders but by its directors sitting as a board.[35]

Change of intention

Disposing of a capital asset obtained as such does not always result in the proceeds being of a capital nature. Change of intention may have occurred such as in *Natal Estates Ltd v SIR* 1975 4 SA 177 (A) where at 202 – 203 the Court stated that "from the facts one has to enquire whether it can be said that the owner had crossed the Rubicon and gone over to a business, or embarked upon a scheme, of selling land for profit, using the land as his stock-in-trade", however, in *John Bell and Co* (Pty) Ltd v SIR 1976 4 SA 177 (A) the Court stated that the mere change of intention to dispose of an asset hitherto held as capital does not *per se* subject the resultant profit to tax.[36]

Something more is required in order to change the character of the asset and to render its proceeds gross income. For example, the taxpayer must already be trading in the same or similar kinds of assets and he then and there starts some trade or business or embarks on some scheme for selling such assets for profit, and, in either case, the asset in question is used as his stock-in-trade. It is therefore essential to show that the taxpayer is trading prior to disposal or has taken on further assets as stock-in-trade to be able to successfully allege that a scheme of profit making has come to be.[37]

[35] Page 175, L Olivier, De Jure 2012.
[36] Page 176, ibid.
[37] Ibid.

Realisation Companies

The following cases set out the treatment of realisation companies and realisation of assets and the different factual circumstances and considerations to be applied.

COT v Booysens Estate Ltd 1918 AD 567

The taxpayer was a company formed to acquire certain mining claims, to purchase mining property, and carry on mining operations for gold etc. The articles of association specifically provided that the taxpayer should have power to sell, lease, mortgage, abandon claims and rights, give in exchange, turn to account or otherwise deal with, all or any part of the profits and rights of the company and to sell the undertaking of the company, or any part thereof for such consideration as the company may deem fit in, particular shares, stock, debenture, or securities of any other company having similar objects. In 1915 the company sold all their mining property to R Company and thereafter went into voluntary liquidation. It was held that the profit realised by the taxpayer on the sale of the assets to R Company was not taxable as income.

Booysens case cited *Commissioner of Taxes v Melbourne Trust Company* (1914) A.C. 1001 which cited as law stated in *Californian Copper Syndicate v Inland Revenue* (anno 1904) 41 Sc. L.R. 691) in which a company was formed for the purpose of acquiring certain mineral fields. These were purchased at a price which left the company with a share capital quite inadequate for the working of minerals. During the two year succeeding the formation of the company the mineral fields referred to were sold at a large profit, in exercise of powers conferred by the company's articles of association, the company taking payment of the purchase price

in fully paid-up shares of another company, which shares were not converted into cash. It was held that the profits arising from the purchase and re-sale of the mineral rights, whether received in cash or shares of another company, were assessable to income tax. The commissioner found that by the purchase and resale the company carried on an adventure or concern in the nature of trade in the meaning of the first case of the Sch. D of the Income Tax Act.[38]

Lord Justice Clerk stated: "It is quite a well settled principle in dealing with questions of assessment of income tax that where the owner of an ordinary investment chooses to realise it and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Sch. D of the Act and therefore assessable to income tax. But it is equally well established that enhanced values obtaining from realisation or conversion of securities may be so assessable where what is done is not merely realisation or change of investment but an act done in what is truly the *carrying on or the carrying out of a business* [carrying on a trade]. The simplest case is that a person or association of persons buying or selling lands or securities speculatively in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that where they make a gain by a realization, the gain they make is liable to be assessed for income tax."[39]

[38] Page 579, *COT v Booysens Estate Ltd* 1918 AD 567.
[39] Pages 579 – 580, *ibid.*

What is the line which separates the two classes of cases may be difficult to define and each case must be considered according to its facts, the question to be determined being: is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it gain made by an operation of business in the carrying out of a scheme for profit-making. By carrying on a trade and trading in that asset.[40]

After holding that the main purpose of the company pointed to a highly speculative business, he continued, “This Company was in its inception a company endeavouring to make a profit by a trade or business, and that the profitable sale of its property was not truly a substitution of one form of investment for another. It is manifest that it never intended to work this mineral field with the capital at its disposal. Such a thing was quite impossible. Its purpose was to exploit this field and obtain gain by inducing others to take it up on such terms as would bring substantial gain to themselves. This was, that the turning of investment to account was not to be merely incidental, but was, as Lord President put it in the case of the *Scottish Investment Company*, the essential feature of the business, speculation being among the appointed means of the company’s gains.”[41]

The court in this case went on to state that the question we have to ask ourselves is: is the amount in question profit or gain flowing form a business or trade which the company was carrying on in the union; and if so, can it be said to be derived by or accrued to or in favour of the Company in the year in which the assessment is made,

[40] Page 580, *COT v Booysens Estate Ltd* 1918 AD 567.
[41] Ibid.

or was the Company primarily a gold mining company and did it eventually sell not as part of its business, but as any private owner might have sold who realizes an investment?[42]

It was decided by the court that the eventual sale of the properties which remained to the taxpayer can only be regarded as realization of its assets as any owner might have done for the purpose of liquidation and cannot therefore be considered a sale in the way of trade.[43]

CIR v Stott 1928 AD 252, SATC 253

The taxpayer was an architect and land surveyor and had made a number of investments in immovable property over a 20 year period. In 1920 he purchased 54 acres of coastal land with the intention of building a seaside residence. Later he subdivided the property in half and divided one half into lots which he sold for a profit over several years. In 1921 he bought a small fruit farm subject to a long lease. The lessee breached and the taxpayer cancelled the lease and re-let the property and subdivided the land and sold the plots off at a profit. The Commissioner included the profits of the sales in respect of both pieces of land as being of a revenue nature and taxable as gross income. The court of first instance found that the purchase, sub-division and sale of the land at profit exhibited a change of intention in that the taxpayer had engaged in a scheme of profit-making.

[42] Page 580, *COT v Booysens Estate Ltd* 1918 AD 567.
[43] Ibid.

The question that the court dealt was whether proceeds in respect of the land at Ifafa and the Bluff which was sold was to be regarded as part of the taxpayer's gross income or as receipts or accruals of a capital nature.

The land transactions of the taxpayer in total were to be considered and not solely the transactions regarding the Bluff and Ifafa properties.

The taxpayer was an architect and land surveyor. He held three classes of investments: stock, mortgages and land. His first investment in land was some 30 years ago. He had on various occasions purchased property and either let or sold same at a later date.

The tax court found that by putting his brains into it and organizing a trade in selling of lots, he converted his initial intention in buying to bring it within the scope of a profit-earning initiative and by cutting up the land and selling it as plots he was carrying on business as part of his business as a surveyor and therefore the profits could not be regarded as being of a capital nature.

The Court may only determine whether proceeds of any asset sold is capital or gross income when it has considered under what circumstances the asset was sold. This is to be gleaned from the evidence and surrounding facts. Merely cutting up land and selling is not definitive in determining whether a profit-making scheme was undertaken. The gain must be acquired by operation of a business in carrying out a scheme of profit-making.

Every person who invests his surplus funds in land or stock or any other asset is entitled to realise such asset to the best advantage and to accommodate the asset to the exigencies of the market in which he is selling.

The intention with which an article is acquired is not conclusive as to whether the proceeds therefrom are taxable as income. It is sufficient to say that intention is an important factor, unless some other factor intervenes to show it was sold in a scheme of profit-making, it is conclusive in determining whether same is capital or revenue.

CIR v Paul 1956 (3) SA 335 (A), 21 SATC 1, 1956 Taxpayer 176

The taxpayer, who was a land surveyor, approached a landowner to acquire 30 to 40 acres of land and develop it as a smallholding. The landowner refused to sell less the 167 acres. The taxpayer persuaded his brother in law to purchase the full 167 acres with him as co-owner, their intention being to retain the piece of land originally sought and to sell the remainder to their best advantage. The taxpayer eventually acquired the necessary funds to secure the purchase solely and concluded a fresh sale agreement. The taxpayer then sub-divided the surplus and sold same off over several years at a profit. Profit was made on three lots which the commissioner sought to include in the taxpayer's taxable income.

The Court decided that there was ample evidence to find that the taxpayer did not purchase the property for speculative purposes but rather as a capital investment. The dominant purpose in acquiring the land was to obtain a small holding a not to make a profit. The fact that he intended to sell the surplus land at the best possible

price was expected and did not render his purpose speculative. The fact that the taxpayer sub-divided the land and sold it off in plots could not *per se* render the proceeds of a revenue nature.

The real question was whether no reasonable person could have arrived at the finding that the respondent (Paul) intended to make a capital investment, that the decision under appeal was incorrect.[44]

The question whether a person bought a property for a specific purpose is a question of fact and in no sense a question of law. The test to be applied is therefore to be determined objectively with reference to the surrounding circumstances and facts as derived from the evidence.

The point made by the commissioner that the Respondent at all times intended to sell the surplus at a profit was countered by the Court that it would be contrary to human nature for any person to intend to sell an asset at a loss and when circumstances are such that he decides to sell he naturally endeavours to get the best possible price.

The Court noted that despite the fact that the taxpayer sub-divided the land and sold the plots at profit, that there was no case where a taxpayer, who owns a capital asset and sub-divides it and sells the sub-divisions at a profit, has been held on that account alone to be taxable on such profit. The mere sub-division does not result in the profits realized as being of a revenue nature, as established in *CIR v Stott* 1928

[44] Page 340 *CIR v Paul* 1956 (3) SA 335 (A).

AD 252.[45] A taxpayer is therefore free to sub-divide a piece of land and sell the resultant plots in order to accommodate the exigencies of the market without rendering the proceeds gross profit.

The Appellant sought to suggest that the change in tact by the Respondent when first approaching his brother to purchase the land and thereafter receiving a windfall in respect of an inheritance and purchasing the land on his own exhibited a change in intention as the only reasonable inference is that he wished to make a profit on the surplus land. The Court posited an array of personal and financial reason as to why the Respondent would have chosen to release his brother from the transaction and therefore the buying of the land as a whole did not show a change in intention.

ITC 1185 32 SATC 122

The taxpayer purchased three properties from an estate agent acting for a deceased estate in 1968. Later in 1968 and early 1969 it was established the certain industrial organization would be relocated. The site for the relocation was to be the area where the taxpayer purchased the properties. After the announcement in respect of the above mentioned relocation the property prices in the area rose significantly. Shortly thereafter the taxpayer received an offer for the property which he concluded and derived a significant profit from the sale.

The court found that that intention of the taxpayer was to acquire an investment in property on a long-term basis and therefore the profit made on the sale was of a capital nature.

[45] Page 342 *CIR v Paul* 1956 (3) SA 335 (A).

The fundamental enquiry is whether, in buying and selling the property and thus earning a profit the taxpayer was engaged in carrying on a trade or a scheme of profit-making. If that is the case then the profits are taxed in the taxpayer's hands as income. However if the asset was held as an investment in capital the realization of that asset would simply be a conversion of the capital asset to cash to be held as capital and not as revenue. The most decisive test is intention with which or the object for which the property was acquired.[46]

However the initial intention of the taxpayer is not decisive and may change over time to that of holding the asset as stock-in-trade and then any profit made on realization of the property would be of a revenue nature. Same was established in *CIR v Stott*[47] and *CIR v Lydenburg Platinum Ltd*[48].

Where the taxpayer had not one single purpose or intention then the dominant intention must be regarded as decisive.[49]

The determination of the taxpayer's intention on acquisition is a difficult task. The *ipse dixit* of the taxpayer as to his intent and purpose should not be regarded as decisive. It is for the Court to determine on an objective review of all the relevant facts and circumstances what the motive, purpose and intention of the taxpayer was. The conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or

[46] Page 122 *ITC 1185* 35 SATC 122.
[47] 1928 AD 252.
[48] 1929 AD 137.
[49] *COT v Levy* 1952 (2) SA 413 (A) at 421.

participation in similar transactions are part of a *numerus clausa* of factors to consider when determining intention. The testimony of the taxpayer and witness must be balanced against the inferences to be drawn from the established facts.

The sale of property for a significant profit shortly after acquiring is usually an important factor to consider when determining the intention of the parties, but this loses a great deal of weight when there is a *novus actus interveniens* (a *bona fide* unforeseen intervening event), and the announcement as to the relocation of the industry was undoubtedly such an intervening factor.[50]

The Court made a point with regard to duality. It was stated that the duality in the mind of a taxpayer to hold an asset as an investment and at the same time be open to the option to sell the property at a profit is the form of duality that exists almost ubiquitously in the minds of those who acquire property even when doing so to acquire a dwelling. Thus the contemplation that an asset or property may be sold in the future is of no consequence in determining intention and answering the question as whether a taxpayer was engaged in a scheme of profit-making.

ITC 1191 35 SATC 194

The taxpayer purchased land for a company to be formed. The company was duly incorporated with the taxpayer and his wife as sole shareholders. The taxpayer advanced an interest free loan to the company to enable it to purchase the property, his intention being to derive an income therefrom in respect of dividends and directors fees. The taxpayer sold his and his wife's share of the entity to prospective

[50] Page 128 *ITC 1185* 35 SATC 122.

purchasers of the property to avoid paying transfer fees. The profits were taxed as revenue.

The object of the company was to develop the land and sell plots at a profit. The profit generated would be in the form of dividends and directors fees intended to support the taxpayer in his later year as a form of pension. However, the sale of shares brought about a profit in a far shorter time and in a lump-sum. This was brought on by the tax payer's deteriorating health.

The Court found that the profit received in a lump-sum was no different in character than the profit the taxpayer foresaw in terms of dividends and directors fees. It was therefore difficult to avoid the conclusion that the taxpayer's intention was to make a profit out of the money expended on the purchase of the property by either means.

Bloch v SIR 1980 (2) SA 401 (C)

A group of people, including the taxpayer, formed a private company in 1966 to buy land for the purpose of establishing a township and selling plots. Having acquired the land they obtained approval to establish a township and entered into contracts for the provision of services. By year end the price of land had risen substantially and the shareholders were made an offer for the purchase of the township far higher that what would have been realized had the plans for development and sale gone ahead. The entire shareholding of the company was sold and the resultant profits were distributed.

The Court found that the only reasonable inference to be drawn was that the taxpayer and shareholders had embarked on the project with the object of investing capital and had sold their share as realization of this investment. The profits were therefore of a capital nature.

Grosskopf J stated that the question to be answered was “Did the profit on the sale of the shares fall within the expression ‘receipts or accruals of a capital nature’ as used in the ‘gross income’ definition in S 1 (1)”. To prove this it had to be shown that the shares were an item of fixed capital in their hands. This turns on the purpose with which the taxpayers acquired and held the shares. The purpose with which a taxpayer acquires or holds an asset is a question of fact which is to be determined from the surrounding facts and circumstances with no one factor more decisive than the other, rather being assessed in totality.

The facts that supported the determination of the assets as those of a capital nature were the following: the money invested in the company was that of the shareholders and supported by an overdraft facility; there were 17 shareholders and no single shareholder could determine the direction of the development; the shares were not readily saleable; the conduct of the shareholders displayed an intent to develop the property as a township and earn income from the company per dividends declared; the conduct commenced with the drawing of a feasibility study and active steps to promote the proclamation and development of the township. Thereafter the market changed and this prompted the sale of shares.

The offer made to purchase the land/shares of the company was considered to be a fantastic offer and “so high in comparison with what the shareholders would have received had the land been developed…that it was felt by all the shareholders that they could not refuse the offer.”.

African Life Investment Corporation (Pty) Ltd v SIR 1969 (4) SA 259 (A)

The taxpayer was a subsidiary which was specifically formed to take over the share portfolio of the parent company and act as its share investment vehicle. The taxpayer was financed by loans and share capital provided by the parent company.

The objects clause of the taxpayer stated that it was formed to operate as an investment company, to hold and administer *inter alia* shares, debentures and stocks with a reservation of powers in respect of the dealing in shares etc. and may acquire same for investment only to generate an income therefrom and that the investments shall not constitute trading stock.

The Court held that the taxpayer had two distinct purposes in acquiring shares, to obtain a dividend income and to achieve an overall profit. The regular dealing in shares was not merely incidental, but a secondary party of its business. Accordingly the profits made from the sale of shares were of a revenue nature and taxable.

Natal Estates Ltd v SIR 1975 (4) SA 177 (A)

The taxpayer was formed in 1920. It acquired as a going concern all the assets of another company which carried on business as a grower and miller of sugar. The

land acquired was some 21000 acres north of Durban. It acquired 7000 further acres which were deemed as investments of capital.
The taxpayer was aware of the demand for residential land in the area.

In 1957 it was granted a certificate in respect of the Town Planning Ordinance for coastal land at La Lucia. The directors considered draft conditions and a report by surveyors but did not proceed until demand for the land was greater.

In 1962 following a change of directors the taxpayer instructed town planners to proceed for development of portions of La Lucia. Engineers and architects were commissioned for the purpose of development. In 1964 and 65 various companies were formed in connection with the development of the taxpayer's property at La Lucia, Umhlanga and Effingham. In 1968 Anglo American joined in formation of a new company which acquired portions of land from the taxpayer.

Throughout the reorganization period the taxpayer had been selling lots in Umhlanga Rocks and La Lucia at first direct to the public and then in bulk to associated companies.

At first the taxpayer had developed the land and built dwellings. It now sold in bulk to associated companies who would take over the development and construction and re-sell to the public. The taxpayer also sold land in other areas.

The taxpayer was taxed on the profit of the sales. On appeal to the Tax Court it was held that the taxpayer had changed its intention to hold land as capital and to embark on a business of selling land to individuals and in bulk sales.

The Court stated, via Holmes JA, that the original intention to hold the land a capital was not decisive so as to preclude a change of intention. It was not only when a taxpayer carried on a business of buying land for resale and then sold that land originally intended as capital that the land could become stock in trade. The fact that the taxpayer was engaged in land-jobbing was of mere evidential value.

It is correct to find that the taxpayer was not merely realizing his capital to best advantage, but having regard to the scale of its township development activities it was carrying on the business of selling land for profit, using the land as stock in trade.

There were two issues: The first, was the land sold being held as an investment of capital which was converted into cash; and second, in respect of such land had the appellant changed its original intention and had gone over to the business of developing and selling such land for profit, using it as trade in stock.[51]

The appellant argued that due to the fact that the taxpayers did not buy in further land that it was not trading in land or carrying on the business of land jobbing.[52]

[51] Page 196, *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A).
[52] Page 201, *ibid.*

The Judge pointed out that when the taxpayer is selling land it may establish that he is not merely realizing a capital asset to the best advantage, but that on the contrary, he is engaged in the business of selling land for profit with the land as stock- in-trade. However, it does not necessarily follow that proof of land jobbing is the only way of establishing that a taxpayer is engaged in the business of selling land for profit using it as his stock-in-trade. It is possible for the nature of land to change from capital to stock in trade by a change of policy whereby the land is merged with the stock-in-trade of an existing trading concern. The buying in of land is not a necessary element of land jobbing as the taxpayer may merely realize the property already in his possession. The Judge cited *The Hudson Bay Co Ltd v Stevens*[53] which highlighted that a taxpayer who embarks on a trade in which he uses that property for the purposes of trade will be liable for tax on the profits accrued or received. Hence the buying in process is not necessary when finding that a taxpayer holding a capital asset has entered into a trade.[54]

Holmes JA states that in deciding whether a case is one of realizing a capital asset or of carrying on a business or embarking upon a scheme of selling land for profit, one must think one's way through all the particular facts of each case. Important considerations are *inter alia*: the intention of the owner at the time of acquiring the asset and on disposal; the objects of the owner; the activities of the owner in relation to this land up to the time of deciding to sell; the light which such activities throw on the owner's *ipse dixit* as to intention; where subdivision occurs the planning, extent, duration, nature, degree, organization and marketing operations of the enterprise;

[53] (Surveyor of Taxes) (1909) 5 Tax Cases 424.
[54] Page 202, *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A).

and the relationship of this to the ordinary commercial concept of carrying on a business or embarking on a scheme of profit making. The factors are not individually decisive and the list is not exhaustive. From the totality of facts one enquires whether it can be said that the owner has crossed the Rubicon and gone over to a business, or embarked upon a scheme of selling such land for profit using the land as trade in stock.[55]

Important factors present in this case were: the vast scale of the development; an initial motivation to trade in land in other areas; and a clear statement of purpose and intent.

The taxpayer was doing much more than merely realizing a capital asset to the best advantage in a business-like manner and that by any cannons of commerce it had gone beyond that field. It had crossed the Rubicon and committed itself on a grand scale to the course and business of selling land for profit using the land as its stock in trade.[56]

The Possible Influence of *NWK*

In the case of *SARS v NWK Ltd* 73 SATC 55 ("NWK") a financing arrangement between First National Bank ("FNB") and NWK was attacked on the basis that the transaction simulated a commercial dealing at arm's length, however lacked any true commercial substance.

[55] Page 202 - 203, *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A).
[56] Page 204, ibid.

Judgment in NWK was handed down by Lewis JA prior to Founders Hill and, in my opinion, there is evidence that a similar theme or policy that was applied in NWK was forced on Founders Hill.

The NWK decision related to a structured finance transaction where FNB, through several subsidiaries, cession of rights and delivery of future products, lent funds to NWK, which were artificially inflated to allow NWK to claim larger interest deductions than were truly incurred.

In assessing the transaction Lewis JA recalibrated the test for simulated transactions whereby the test was extended and required the examination of the commercial sense of the transaction, of its real substance and purpose. If the purpose of the transaction was only to achieve an object other than at face value then it would be regarded as simulated.[57]

Lewis JA stated:

"*The test should…go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose.*"

The judgment by Lewis JA has redirected the precedent confirmed by *Zandberg*[58] and *Randles*[59] where in the latter Watermeyer JA stated that:

[57] Page 3, *SARS v NWK Ltd – a tax planning sham(e)?*, Fareed Moosa.
[58] *v Van Zyl* 1910 AD 302.
[59] *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at 395-6.

“A transaction devised for that purpose, [solely for the purpose of avoiding tax] if the parties honestly intend it to have effect according to its tenor, is interpreted by the Court according to its tenor, and then falls within or without the prohibition of tax”. This shifting of the common law test, from subjective to objective has resulted in a significant change in established precedent and the principle that taxpayers may minimize tax liability by genuinely arranging their affairs in a manner which falls outside the Act.

The theme imported into South African jurisprudence by Lewis JA in NWK has resonated in Founders Hill in her treatment of realisation companies. I believe that the dictum in Founders Hill whereby an interposed company now holds, as a starting point, an asset as trading stock, is an attempt at judicial activism by Lewis JA. The lengths to which the Judge went to illustrate her point is exhibited by the anomalous request to Counsel for the parties to lead evidence from the bar with regard to decision to interpose Founders Hill.

There is, indirectly, an attempt to pierce the veil that is perceived by Lewis JA, by looking through what is deemed by the Judge, as in NWK, as being an artificial transaction with, on her assessment, no commercial reason.

Conclusion

Lewis JA elevates one aspect, in what has been deemed a *numerus clausa* with no one decisive factor, as being decisive: that once a company is interposed as a realisation company with the intention to realise property, the property is held as

stock-in-trade and that company is then carrying on trade and a scheme of profit making.

With respect, the contention by the SCA in Founders Hill could not be more incorrect, if due regard is given to the common law and the principle of *stare decisis*.

The facts in Founders Hill are that of the classical realisation company case. A trading entity, acquired property and it came to be that, in this case, due to an unforeseen event, the landscape and commerce in respect of property changed, and the decision was taken to dispose of the capital asset, held for decades, to the owner's best advantage and adjusting to the demands of the market.

The change in technology and urban growth, a possible *novus actus interveniens,* initiated the desire to sell, and if it were, for argument sake, accepted that the land was in fact stock-in-trade and AECI was trading in property, I believe that the change in demand for the property would constitute an intervening factor that changed the intention to sell the land in plots, as a landjobber, but rather en masse, and therefore accrue the proceeds as capital.

The embarking of a trade and having sought profits from such trade are essential elements in determining whether a taxpayer has engaged in the aforementioned scheme. This element is ignored by Lewis JA. As mentioned above the element of trading is essential and where no trade is conducted there cannot be floating capital or trading stock and there cannot be revenue. To generate revenue without trading stock or trading is a nonsensical deduction.

Furthermore, as per *SIR v Trust Bank of Africa*, the intention of a company should be determined by the "state of mind or intention of the persons in effective control of the company" hence the directors sitting as a board. Lewis JA uses the intention of the parent company as determinant of the intention of the realisation company and therefore finds support for her claim that the property was acquired as stock-in-trade as the intention of AECI was to dispose of the property for a profit, hence Founders Hill sought the same goal and held the property as trading stock.

In past decisions the Court has noted that despite the fact that the taxpayer sub-divided the land and sold the plots at profit, that there was no case where a taxpayer has been held on that account alone to be taxable on such profit.

Furthermore, where subdivision occurs the planning, extent, duration, nature, degree, organization and marketing operations of the enterprise and the relationship of this to the ordinary commercial concept of carrying on a business or embarking on a scheme of profit making is to be considered when deciding whether a trade or scheme is carried out. A yardstick for this, relevant to Founders Hill would be *Natal Estates* and *Berea West*, and to this end, Founders Hill was not trading in land. *Berea West* dictates that it is competent to sell off plots and then develop further plots for sale and that this does not have the effect of crossing the Rubicon.

On Lewis JA logic, if the taxpayer did in fact hold the property as stock-in-trade, the Rubicon would have been crossed, in reverse, due to the fact that the taxpayer was not trading in land, as on the facts of Founders Hill tested against the elements

exhibiting a trade or carrying on of a scheme such as in *Natal Estates*. No trade of selling land was conducted by Founders Hill.

Having regard to the judgment of NWK it is hard not to notice the crusade that Lewis JA is on, attempting to strike down allegedly falsely contrived legal arrangements, which, to the Learned Judge's eye, are not based on commercial expediency, supported by practice and tested precedent, and should be struck down. In attempting to achieve this goal, and seeking to augment the settled law with a further requirement of commerciality, Lewis JA has struck a blow against a windmill in her quixotic quest to render non-commercial dealings null.

In arriving at the conclusion the Court has failed to provide suitable support for the new position as elucidated in Founders Hill and for this reason the judgment will probably be largely ignored or differentiated by judicial officers in future decisions and steps to realise property via the realisation companies will continue unhindered.

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