

198/1958

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In the Supreme Court of South Africa
In die Hooggeregshof van Suid-Afrika

{ APPELLATE ~~Division~~ (Division.)
Afdeling).

Appeal in Civil Case.
Appèl in Siviele Saak.

STRATHMORE HOLDINGS (PTY) LTD. Appellant,

versus
COMMISSIONER FOR INLAND REVENUE Respondent.

Appellant's Attorney ~~Godrick M. Nkomo & Nkomo~~ Respondent's Attorney ~~Godrick M. Nkomo & Nkomo~~
Prokureur vir Appellant Prokureur vir Respondent

Appellant's Advocate ~~A.A. Effinger~~ Respondent's Advocate ~~A. S. S. S. S.~~
Advokaat vir Appellant Advokaat vir Respondent

Set down for hearing on
Op die rol geplaas vir verhoor op Monday 24th Nov, 1958

(1.3.5.8.11) (A) { 9.45 - 12.50 }
{ 2.15 - 4.35 } CAV

JUDGMENT: WEDNESDAY, 10th DECEMBER, 1958.

Appeal dismissed with costs.

Coram: Schreiner J., Steyn, Beyers, Ogilvie Thompson & Smut JJ.

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Record

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter of:

STRATHMORE HOLDINGS (PROPRIETARY) LIMITED Appellant

versus

THE COMMISSIONER FOR INLAND REVENUE Respondent.

Coram: Schreiner A.C.J., Steyn, Beyers, Ogilvie Thompson JJ.A.
et Smit A.J.A.

Heard: 24th November, 1958. Delivered: 10. 12. 58

J U D G M E N T

BEYERS J.A.:

This is a case stated under the provisions of sec. 81 of the Income Tax Act, 1941, by a Special Court for hearing income tax appeals, which sat in Johannesburg to hear an appeal by the appellant against an assessment for normal tax made upon it by the respondent for the year ended 30th June, 1953.

The appellant is a private company which was incorporated in 1946. After its incorporation it acquired, in circumstances which will be set out later, substantial shareholdings in The New Pioneer Central Rand Gold Mining Company Limited and the Stilfontein Gold Mining Company

Limited/2

Limited. During the year ended 30th June, 1953, it sold 25,000 of its Stilfontein shares for the sum of £29,375, which represented a profit of £23,125 over the cost of their acquisition, which, at 5/- per share, was an amount of £6,250. The Commissioner for Inland Revenue included this profit in the appellant's taxable income for that year and issued an assessment accordingly. The appellant objected against this assessment and, the objection having been overruled by the Commissioner, appealed to the Special Court on the grounds:-

(a) that it was an investment company;

(b) that the realisation of the shares from

which the aforesaid profit of £23,125 resulted, was the realisation of a capital asset, the proceeds whereof were placed in other investments; that such proceeds and the profit that resulted from such realisation were accruals of capital and did not constitute income within the definition or meaning of the Income Tax Act and that the realisation was not in the nature of a dealing

3.

in shares nor a gain made by an operation of business in carrying out a scheme of profit making.

It was contended on behalf of the Commissioner:-

(a) that from the nature of its constitution as contained in its Memorandum of Association the Holdings Company was not formed as an investment holdings company;

(b) that, on the evidence, the company had not discharged the onus of establishing that its business was that of an investment holding company;

(c) that, whatever the nature of the company, the profit of £23,125 in dispute was made in pursuance of a profit making scheme which commenced with the acquisition of the New Pioneer shares and options.

The Special Court, for reasons which will appear later, ~~was~~ found against the appellant and held that the profit of £23,125 represented taxable income.

The matter is now before ~~the~~ us, at the instance

of the appellant, in the form of a stated case, the parties having lodged their written consent to an appeal direct to this Court.

It is necessary to give a brief history of the appellant company. It was incorporated on the 13th August, 1946, as a private company with an authorised capital of £1,250, divided into 1,250 shares of £1 each, all of which were duly issued. From its incorporation and at all material times there were three shareholders only, namely, J. Scott, who held 84% of the shares, and J.C. McIntyre and C.W. Roper, who held 12% and 4% of the shares respectively. Scott, as chairman, was in control of the company throughout. The same three shareholders were also, in the same proportions, the sole shareholders in a company called Strathmore Investments Limited. It will be ~~convenient~~ convenient from this point onwards to refer to the appellant as "the Holdings Company" and to this other company as "the Investments Company". The Investments Company had been incorporated in 1936 and started with a capital of £2,500, divided into 1,250 ordinary shares of £1 each and 1,250 preference shares of like value. The Investments Company

was avowedly a company dealing in shares and throughout its existence the greater part of its income was derived from sharedealings, in respect of which it was duly taxed.

According to its Memorandum of Association the objects for which the Holdings Company was formed were, inter alia:-

- (1) To purchase or otherwise acquire or procure and to hold for the purposes of investment with the purpose and intent of immediately or eventually deriving income therefrom, securities and investments of every kind consisting of shares, scrip and stock in any company or corporation and generally to employ the moneys or funds of the Company in such securities or investments as ~~are~~ aforesaid, and to undertake any liability or obligation arising thereout but so that the Company shall not traffic in any such securities or investments as aforesaid and shall not sell or realise the same otherwise than for the purpose of re-investing the proceeds in the same or similar securities or investments or in landed or immovable property with the purpose and intent of deriving income therefrom.
- (2) To acquire any such securities or investments aforesaid either by purchase, transfer, cession or exchange, original subscription, application, tender, participation or otherwise
- (14) To borrow or raise moneys either on security or unsecured
- (17) To distribute by way of dividend or bonus amongst the members of the Company such specific assets belonging to the Company as may be determined by

the Company and in particular shares, stock, debentures or securities of any other Company held by or otherwise belonging to the Company.

According to the minutes of the first meeting of directors of the Holdings Company, the purpose of the Company was to "provide a counterpart to the Investments Company and to handle matters which were essentially investments". Mr. Roper, one of the directors, gave evidence to the same effect. In this regard the President of the Special Court observes in his judgment that -

" Mr. Roper, in the course of his evidence, stated that the purpose of the appellant company was to act as the investment company of the three shareholders, and it was to be the counterpart of Strathmore Investments. All the speculative transactions and businesses were to be operated through Strathmore Investments and all the assets which the shareholders intended should be held as investments were to be acquired by the appellant company".

At the time of the formation of the Holdings Company Scott owned shares in a number of commercial and industrial companies which had recently been established by him. During the first year of its ~~existence~~ existence the Holdings Company acquired the total shareholding in ten of these companies. The book-value of these shares amounted to

£10,695. The Holdings Company also provided these companies with working capital by way of advances amounting to £93,894. As the Holdings Company itself had virtually no working capital, the money for the acquisition of these shares and for the advances made to these companies was provided by Scott, who lent the Holdings Company £115,249 for this purpose. He accomplished this by withdrawing the money from the Investments Company, which in turn provided the funds by raising a bank overdraft and borrowing other moneys. It was hoped that the Holdings Company would in due course receive dividends from these companies. As the companies in question were all private companies there was no prospect of dealing in their shares. During the year ended 30th June, 1947, the Holdings Company incurred a trading loss of £8,471.

It will be convenient at this point to say something about The New Pioneer Central Rand Gold Mining Company Limited, which from this stage onwards features prominently in the affairs of the Holdings Company.

Among the main assets of the Investment Company at this time were the shares held by it in a private company

named /8

named Strathmore Development Company (Pty) Limited, a company which possessed ^{ess} certain mining rights. During 1946 Scott acquired certain options and prospecting contracts over portion of the farm "Stilfontein No. 39" in the Klerksdorp district. In March, 1947, he ceded these contracts to the Development Company, which almost immediately afterwards commenced drilling operations on the farm "Stilfontein". In September, 1947, the Investments Company sold all the shares which it held in the Development Company to ~~a company~~ ~~named The New Pioneer Central Rand Gold Mining Company.~~ ~~Limited.~~ It was a condition of this sale that the entire purchase price was to be applied in taking up shares in the New Pioneer Company at the nominal value of such shares, viz. 5/- each, and it was a further term of the sale that the Investments Company was to receive an option, operative to the 30th June, 1949, to take up a further 400,000 shares in ^{the} New Pioneer Company at 10/- per share. Prior to the said sale the Investments Company had obtained de facto control of the New Pioneer Company by virtue of acquiring shares therein and becoming secretaries and technical advisers to that company. At all material times ^{since the} acquisition of these shares by the Investments Company, Scott had been chairman,

and McIntyre and Roper had been directors, of the New Pioneer Company. At the stage when the Investments Company obtained control of it, the New Pioneer Company was an old gold mining company with no funds but with a stock exchange quotation for its shares, and was in possession of a gold mine which had reached the limit of ~~200~~ its payable life. In order to implement the provisions relating to the said sale and to provide funds for the investigation and development of the interests acquired thereunder the New Pioneer Company increased its share capital from £55,500 to £600,000 by the creation of 2,178,000 new shares of 5/- each.

In the result the Investments Company obtained 200,000 shares in the New Pioneer Company and options to take up an additional 400,000 shares therein. This now represented its main asset. It was, however, in urgent need of funds, which it required for the development of Stilfontein and other mining areas. It was in a difficult financial position because too much money had been taken out of it and put into the Holdings Company, with the result that it was left with an overdraft, which the bank would not increase, of £100,000. Towards the end of 1947 Scott accordingly

approached/10

approached certain financial firms in London with a view to obtaining financial assistance for the Investments Company. He succeeded in interesting three such firms, which were associated with one another, and were represented in the negotiations which followed by a Mr. Drayton. In the course of these negotiations draft balance-sheets of the Investments Company and the Holdings Company, as at the 31st October, 1947, were produced for Mr. Drayton's consideration. Mr. Drayton explained that the three financial firms which he represented were experienced in financial and industrial ventures but not in prospecting and mining propositions and that they preferred to have their money in companies of the former class. He indicated that the Investments Company's holding of New Pioneer shares (200,000) and options (400,000) was too large from his point of view, and that ^{if} ~~in~~ half of these shares and options were taken out and replaced by shares held by the Holdings Company, he and his associates would be prepared to put £200,000 into the Investments Company. This offer was accepted.

In pursuance of the above agreement approximately half of the New Pioneer shares and options were taken out

of the Investments Company and were transferred, via the shareholders, to the Holdings Company. At the time of these negotiations the Investments Company's appropriation account reflected a considerable credit balance made up of the undistributed profits of the company accumulated since its inception in 1936. The whole of these profits was declared as dividends in favour of the three ordinary share-holders, viz. Scott, McIntyre and Roper.. The first dividend, amounting to £46,500, was declared in November, 1947. It took the form of an award of 93,000 New Pioneer shares and 186,000 New Pioneer options to the ~~said~~ said share-holders. These shares and options were reflected in the books of the Investments Company at the cost price thereof, namely £46,500. Simultaneously with the declaration of this dividend, the books of the Holdings Company recorded that these shares and options were purchased by the Holdings Company from Messrs. Scott, McIntyre and Roper for £46,500, and that the Holdings Company owed that amount to these persons.

In order to meet the new situation, in December, 1947, the ordinary share capital of the Investments Company was increased to £301,250 by the creation and issue of

300,000 additional ordinary shares of £1 each.

The requirements of Mr. Drayton were finally satisfied when the Holdings Company sold and transferred to the Investments Company the shares in seven of its subsidiary industrial companies.

As a result of the re-arrangement of the assets between the Holdings Company and the Investments Company the former owed the latter about £50,000. This amount remained owing up to the 29th June, 1948. On that date the Holdings Company sold 100,000 of the 186,000 New Pioneer options for £52,991 and out of ~~these~~ these proceeds paid the Investments Company what was owing to it. Attached to the returns of income made by the two companies on the 17th February, 1949, for the year of assessment ended 30th June, 1948, was a memorandum, in which the reason for this sale is recorded in the following terms:

" Strathmore Holdings (Pty) Limited in terms of its Memorandum of Association can only sell shares to obtain funds for re-investment or to repay its debts. Towards the end of June, 1948, it was called upon to meet a heavy liability for money borrowed. (N.B. It started with a capital of only £1,250 and had to borrow money to keep going). To meet this liability it had to realise some of its assets. Included

" amongst its assets were New Pioneer options which were due to be exercised by June, 1949. To exercise 186,000 options would need £93,000 and as it was doubtful whether the Company would have the necessary funds for this purpose it was decided that if any of its investment shares had to be realised it would be in the best interests of the Company to realise New Pioneer options. Therefore a block of 100,000 was sold in one transaction thus providing the cash to meet the pressing liability for money previously borrowed."

The Commissioner was apparently not entirely satisfied with the reason given in this memorandum, and asked for further particulars. In a letter dated the 24th August, 1949, the Public Officer of the Investments Company (as secretary of the Holdings Company) gave the following explanation:

" Strathmore Holdings (Pty) Limited in terms of its memorandum can only sell shares to obtain funds for re-investment or to pay its debts. To exercise the 186,000 options at 10/- each, the Company would require £93,000 and the Company did not have this amount available. It was therefore decided to sell sufficient options to provide funds to enable the Company to exercise the remaining options. 100,000 options were sold for £52,991 leaving a balance of 86,000 options. The cost to exercise these at 10/- each amounting to £43,000 was thus available."

The Commissioner in his determination of the liability to tax of the Holdings Company for the year of assessment

ended 30th June, 1948, originally included the proceeds of the realisation of the said 100,000 options, viz. £52,991, in the Company's taxable income. The Company lodged an objection to the inclusion of this and the Commissioner thereafter allowed the objection and withdrew the assessment. At the stage when he withdrew the assessment he had before him the two explanations set out above.

The Holdings Company in fact utilized the money to repay its debt of £50,000 to the Investments Company.

During the year ended 30th June, 1949, the Holdings Company sold 29,000 of the remaining 86,000 New Pioneer options for £40,600, which amount was ~~£28,500~~ transferred to Capital Reserve Account and, incidentally, was not taxed.

The balance of the New Pioneer options held by the Holdings Company, namely 57,000 (i.e. 86,000 less 29,000) were converted into shares. At 10/- per share the amount involved was £28,500. In this manner the Holdings Company increased its holding of New Pioneer shares from its original holding of 93,000 (costing £46,500) to 150,000, i.e. 93,000 plus 57,000 (costing £75,000), and was left with no further options.

In the same year the Holdings Company borrowed £150,604 from Philip Hill Securities Corporation (one of the three firms from whom the Investments Company had obtained a loan during the previous year) and as security for the loan pledged, inter alia, the 150,000 New Pioneer shares. The money loaned was utilized to settle the claims of creditors and to repay advances made to the company by its shareholders, who required the cash in connection with the flotation of the Stilfontein Gold Mining Company Limited.

As at the 9th September, 1949, the Holdings Company held 150,000 New Pioneer shares and 1,750 shares in East Rand Extensions Limited. By virtue of these holdings it acquired the right to take up 301,750 Stilfontein shares (i. e. two for one in respect of the 150,000 New Pioneer shares, and one for one ^{in respect} of the 1,750 East Rand Extension shares) at 5/- per share. In October, 1949, the Holdings Company took up the 301,750 Stilfontein shares for £75,437. 10. 0.

In November 1949 the Holdings Company borrowed from International Enterprises Limited, of Paris, an amount of £200,000 for a term of 15 years, at ~~4~~ 4% per annum. As

security for this loan the company pledged its 150,000 New Pioneer shares and its 301,750 Stilfontein shares. The proceeds of the loan were utilized to repay the £150,000 previously borrowed from Philip Hill Securities Corporation, as a result of which the pledge of the New Pioneer shares was redeemed, and to pay, in part, the cost of the Stilfontein shares (£75,437. 10. 0).

During the year ended 30th June, 1953, the Holdings Company, by virtue of its holding of 301,750 Stilfontein shares, acquired the right to take up a further 30,175 Stilfontein shares of 5/- each at 18/- per share (i.e. one share for every ten shares held by it as at the 11th November, 1952). The Holdings Company did not have the funds for taking up the 30,175 shares so offered. To enable it to take up a reduced number of the shares it sold 25,000 Stilfontein shares (cum rights) for £29,375, i.e. at 23/6 per share, making a profit of £23,125.

It is this transaction which is in issue in these proceedings.

After selling the 25,000 shares, the Holdings Company was left with 276,750 Stilfontein shares. In December,

1952, it duly exercised its right to take up the reduced number of ~~27,675~~ 27,675 Stilfontein shares at 18/- per share, for £24,907. 10. 0. Its total shareholding was thereby increased to 304,425.

In November 1953 the Holdings Company exercised its right to take up a further 13,837 Stilfontein shares at 22/6 per share (i.e. one new share for every two of the 27,675 shares previously taken up at 18/- per share) at a cost of £15,566. 12. 6. It now held 318,262 Stilfontein shares.

During the year ended 30th June, 1954, the Holdings Company sold all its Stilfontein shares, 318,262, for £371,659, and all its New Pioneer shares, 150,000 for £114,375. The proceeds of these sales, £486,034, were applied, as to £200,000, in repayment of the loan of £200,000, and as to the balance of £286,034, in purchasing from Messrs. Scott, McIntyre and Roper, 190,696 shares in a company called the Strathmore Consolidated Investments Limited.

After considering the object^s~~ion~~ clause of the Holdings Company - I shall revert to calling it the appellant - and observing that

" although the objects reflect an intention on the part of the company to hold investments, it does not follow that the company cannot be an investment dealing company in the sense in which that term is used in L.H.C. Corporation of S.A. (Pty) Ltd. v. C.I.R. 1950(4) S.A. 640 (A)",

the Special Court went on to say:

" The crucial question is one of fact and for the reasons which follow we have come to the conclusion that the appellant is an investment dealing company and that therefore the profit earned on the sale of the Stilfontein shares did attract tax on the basis of the assessment by the Commissioner:

(a) The issued capital of the appellant is £1,250. With this sum of money it is not possible for the appellant to embark on any investments of a substantial nature. The appellant was only able to invest the money because it borrowed very large sums of money. If this money had been advanced by the shareholders on a permanent or semi-permanent basis, it might be said that the true capital of the company was in the neighbourhood of the £100,000 which appellant originally owed Scott. It was, however, never intended that Scott should remain a creditor of the company, and monies were borrowed from other sources to liquidate the debt. As at the 1st July, 1952, the appellant had borrowed the sum of £200,000 carrying interest at the rate of 4% per annum, the debt ~~maturing~~ maturing on the expiration of 15 years. The appellant company had no revenue producing assets of any importance and we do not think that there can be any doubt but that the company intended to liquidate this indebtedness

" not only by the hoped for dividends, but also by means of the sale of one or more of its investments at a profit. The appellant company was not investing its own money - in the sense of its own capital, but was living on borrowed capital which could in truth only be repaid by the sale of all or portion of its assets.

- (b) The appellant did not invest its money in established concerns. The original acquisition of shares from Scott represented in truth a speculation and not an investment Normally an investment occurs when money put into a business or company yields returns, either immediately or within the foreseeable future. Here the money invested could be, and in several instances was, entirely lost. By way of revenue (for the year ended 30th June, 1953) the company earned £290 interest and £105 dividends, and by way of expenditure it paid interest in the sum of £8,000 on its loan of £200,000.....
- (d) When the appellant company received the shares and options in New Pioneer from Strathmore Investments, it paid only the book-value of the shares i.e. the face value, although the market value of the shares was much higher. It was due mainly to this fact that the appellant was able to borrow large sums of money mainly on the security of the New Pioneer shares. It is obvious that the directors of the appellant were aware of their ability to sell the shares at a large profit and so pay the debts of the company. The shares were quoted on the Stock Exchange and were highly speculative, and any reduction of price would have resulted in pressure by the creditor to sell the shares. At the

" same time the shares were yielding no dividend and in order to pay the interest on the money borrowed, assets would have to be sold. The directors must have believed, as we find, that the only possibility the appellant had of paying the interest was the sale of assets at a profit, and not the holding of the assets in a permanent form.

We have come to the conclusion that the appellant is probably a company dealing in speculations or at the best an investment dealing company. "

Mr. Ettlinger, who appeared on behalf of the appellant, admitted that as far as the primary or basic facts were concerned there was no room for dispute or difference of opinion. And I did not understand him to dispute that the ultimate conclusion from these facts was itself a conclusion of fact. In my opinion it is undoubtedly a question of fact. Questions such as whether certain stands were held for the purpose of a profitable re-sale (Yates Investments Pty. Ltd. v Commissioner for Inland Revenue, 1956 (1) S.A. 612(A)), whether a company's stock-in-trade of land had been converted by a change of policy and intention into a fixed capital asset (Commissioner for Inland Revenue v Richmond Estates (Pty.) Ltd., 1956 (1) S.A. 602(A)), whether shares had been bought for a particular purpose (L.H.C. Corporation of S.A.

Pty. Ltd. v Commissioner for Inland Revenue, 1950 (4) S.A. 640(A)), whether the taxpayer intended, in the process of obtaining a controlling interest, to acquire and sell shares so as to make a profit (Marshall Industrials Ltd. v Commissioner for Inland Revenue, 1951 (3) S.A. 581(A)), have in the past all been treated as questions of fact. "All these cases in which the facts warrant a determination either way can be described as questions of degree and, therefore, as questions of fact" - per Lord Radcliffe, in Edwards v Bairstow 1955 3 All E.R. (H.L.) 48 at p. 56. See also Durban North Traders v Commissioner for Inland Revenue, 1956 (4) S.A. 594 at p. 605.

In the circumstances this Court is entitled to interfere with the finding of the Special Court only if it can be shown to be erroneous in law in the sense that there is no evidence to support it, or, as it is also put, if it is one which could not reasonably have been reached (See Commissioner for Inland Revenue v Richmond Estates (supra) at pp. 606, 607 ; Yates Investments v Commissioner for Inland Revenue (supra) at p. 615 ; Marshall Industrials v Commissioner for Inland Revenue (supra) at p. 587).

In Edwards v Bairstow (supra), which is referred to in Durban North Traders v Commissioner for Inland Revenue (supra) Lord Radcliffe uses the following language :-

" I do not think that it much matters whether this state of affairs is described as one in which there is no evidence to support the determination, or as one in which the evidence is inconsistent with, and contradictory of, the determination, or as one in which the true and only reasonable conclusion contradicts the determination. Rightly understood, each phrase propounds the same test. For my part, I prefer the last of the three..... "

Mr. Wittlinger submitted that the reasons given by the Special Court do not warrant the conclusion arrived at. He contends^{ed} that if upon examination these reasons appear to this Court to be unsatisfactory, this Court is entitled to say, upon a consideration of all the material at its disposal, that the inference drawn by the Special Court was not the one which it was reasonable in the circumstances to have drawn, and is therefore erroneous in law.

It is, however, not enough to say that the inference was not the reasonable one to draw : he must go further and show that it is not a reasonable inference which has been drawn. And this, in my opinion, he has not been able to do. As I see it, there is ample evidence to support the Special Court's finding. The appellant was handicapped by a lack of capital from the outset. The fact that it had to resort to large-scale borrowing of money might not have been a vital consideration if the appellant had possessed revenue-producing assets out of

which to pay the interest on its loans. The fact that it had no revenue-producing assets might not have been important either, if it had not had to pay a substantial amount of interest ^{an}anually. Taken in conjunction, however, these two factors alone are sufficient to warrant the inference that the appellant acquired the New Pioneer and Stilfontein shares with a view to a profitable re-sale and not with the object of holding them as an investment.

Suzman,
Mr. ~~Kikinger~~ who appeared for the respondent, submitted that there were additional grounds upon which the finding of the Special Court might be supported. For example, an analysis of the appellant's share transactions reveals ^{that}/only a very insignificant proportion of the shares acquired could properly be regarded as income-producing investments : the vast bulk of the shares which it acquired from time to time were of a speculative nature. It is, however, not necessary to pursue the subject further. It is sufficient for the purposes of the present case to say that the grounds relied upon by the Special Court were adequate.

The appeal is dismissed with costs.

Schuman ACJ

2 Keyn JA

Ogilvie Thompson JA

Smit afa.

concur

D.O.K. Beyers