IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

CONSTANTIA HEIGHTS (PTY) LTD. APPELLANT

and

THE SECRETARY FOR INLAND REVENUE RESPONDENT

Coram: Wessels, Muller, Corbett, Trengove, JJA
et Galgut, AJA

Heard: 2 March 1979

Delivered: 8 May 1979

J U D G M E N T

TRENGOVE, JA:

This is an appeal, under section 86A of the Income Tax Act, No 58 of 1962, as amended, against a decision of the Cape Income Tax Special Court, concerning the tax-

ability ...../2

ability of an amount of R278 562, which represents the profit realised by appellant company on the sale of certain farm land described as "Portion 23 (Portion of Lot A of the farm Klaassenbosch) situate in the local area of Constantia, Division of the Cape", measuring 17,5848 morgen. Appellant purchased this property (hereinafter referred to as Portion 23) on 9 April 1965 for the sum of R20 000 and resold it in May 1969, for a sum of R300 000. In determing appellant's liability for normal tax for the year of assessment ended 28 February 1970, respondent included the proceeds of this sale in appellant's gross income, and on that basis he issued an assessment in respect of a taxable income of R277 367. In addition, respondent issued an assessment in respect of undistributed profits, based on a taxable income of R277 367, on appellant. Appellant unsuccessfully objected to these assessments on the ground that the profit on the sale of Portion 23 was a

receipt, .../3

receipt, or an accrual, of a capital nature and that it was, therefore, not subject to tax under the Act. On appeal, the Cape Income Tax Special Court (VAN WINSEN, J., presiding) held in favour of respondent. By leave of VAN WINSEN, J., appellant has now appealed directly to this Court.

The fundamental issue in this appeal is whether the profit on the sale of Portion 23 represents income or capital appreciation. The court a quo came to the conclusion that appellant had failed to discharge the burden of proving that the profit was an accrual of a capital nature. The court found, on the evidence, that appellant had sold the property pursuant to a profit-making scheme, and that the proceeds of the sale had, therefore, been correctly included in appellant's gross income. Counsel for appellant submitted that the evidence before the court a quo did not support these findings. I shall at a later stage in this judgment revert to counsel's submission.

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The guide-lines for determining whether a taxpayer, in selling fixed property, is engaged in a profit-making scheme, or is simply realising a capital asset, are well-known, and for present purposes it suffices to refer to what was said on this subject by HOLMES, JA., in Natal Estates Ltd. v. Secretary for Inland Revenue, 1975 (4) SA 177 (AD) at 202G - 203A:

> "In deciding whether a case is one of realising 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 of the particular facts of each case. Important considerations include, inter alia, the intention of the owner, both at the time of buying the land and when selling it (for his intention may have changed in the interim); the objects of the owner, if a company; the activities of the owner in relation to his land up to the time of deciding to sell it in whole or in part; the light which such activities throw on the owner's ipse dixit as to intention; where the owner sub-divides the land,

the ...../5

> the planning, extent, duration, nature, degree, organisation and marketing operations of the enterprise; and the relationship of all this to the ordinary commercial concept of carrying on a business or embarking on a scheme for profit. Those considerations are not individually decisive and the list is not exhaustive.
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> From the totality of the facts one enquires whether it can be said that the owner had crossed the Rubicon and gone over to the business, or embarked upon a scheme, of selling such land for profit, using the land as his stock-in-trade".

I turn now to the factual background of this case. Appellant was incorporated as a private company on 10 March 1965, with a share capital of R100 divided into 100 shares of R1 each. At all relevant times the shareholders of appellant were a Mrs Turner, her minor daughter, and a Mr and Mrs Amos; they each held 25 shares; Mrs Turner and a Mr Swanepoel, her erstwhile attorney, were the directors of appellant; Mr Amos may also at some stage have been a director, but it is not

at ...../6

at all clear from the evidence whether, in fact, he was. Mrs Turner and Mr Amos testified on behalf of appellant. Mrs Turner was the principal witness, and her evidence covers a period of approximately ten years, i.e. from 1960 to 1970. Mrs Turner was formerly married to a Mr Townsend but he died in November 1963, and some four years later she married a Mr Turner; in what follows, I shall, for convenience, refer to her as Mrs Townsend. No evidence was adduced on behalf of respondent.

In the judgment of the court a quo VAN WINSEN, J., deals fully with the sequence of events that led to the formation of appellant company and the purchase and resale of Portion 23, and in the following summary I have borrowed freely from the judgment.

(1) In 1960 a Mrs Rudaizky was the registered owner of a farm consisting of Portions 23, 24, 25, 26, 27 and 28 of the aforementioned farm Klaassenbosch,

measuring ...../7

measuring approximately 157 morgen in all. On 20 September 1960, Mrs Townsend's husband, Mr. T.W. Townsend, entered into a written agreement of lease with Mrs Rudaizky, in terms of which he hired Portions 23 to 28 from her for a period of five years, renewable for a further period of four years and eleven months. A winery, as well as certain cottages, and a portion of the main homestead, which were situate on Portion 27, were excluded from the lease. The purpose of the lease was to enable the lessee to conduct farming operations on the leased property. The lessor reserved the right to sell the farm on giving the lessee six months written notice to that effect, and the lessee in such event had a right of first refusal to purchase the property.

(2) Mr and Mrs Townsend moved into the homestead on Portion 27, and commenced farming on the leased property, in October 1960. Mrs Townsend went in for flower and

vegetable ...../8

vegetable farming on quite an extensive scale, while her husband took charge of the vineyards and the wine farming operations. They immediately set about making improvements to the homestead, the vineyards and the farm land generally. Although Mrs Rudaizky had agreed to lease the farm to the Townsends, she still wanted to sell it, if possible, and she used to bring prospective purchasers to see the farm. This disturbed the Townsends, as one can well understand, for they were busy spending money on improving the property and under their agreement they had no real security of tenure. After a while they approached Mrs Rudaizky and suggested that they be allowed to purchase Portions 23, 27 and 28 of the farm as separate entities. They were interested in these particular portions because some of the better farming land was on Portion 23, the homestead, pumping station and dam were on Portion 27, and all the cottages housing the farm labour were on

Portion ...../9

Portion 28. Mrs Rudaizky's reaction to this proposal was that the Townsends wanted the "cream" of the farm, and she would be left with the "rubbish". She indicated, however, that she was prepared to amend the terms of the lease so as to provide for an option in favour of Mr Townsend and his wife, jointly, enabling them to acquire the various portions of the farm in a certain sequence.

(3) As a result of the further negotiations, the parties entered into an agreement on 26 April 1962 in terms of which Mr and Mrs Townsend obtained the sole and exclusive option to purchase Portions 23, 24, 25 and 26 of the farm for R70 000, such option to expire on 31 May 1963. As a consideration for the option the Townsends were obliged to pay Mrs Rudaizky the sum of R1 000 in cash. Provision was also made in the agreement for the extension of this option on payment of an additional amount of R5 000 for each period of 12

months ...../10

months for which the Townsends required such extension. The terms of the agreement further provided that after exercising the option to purchase the aforementioned portions, the Townsends would have the right to purchase Portion 27 (except approximately 5 to 6 acres thereof on which the wholesale winery business and certain adjoining buildings were situate) for the sum of R60 000, and the whole of Portion 28 for the sum of R30 000. These options had to be exercised within two years of the date on which the option to purchase Portions 23 to 26 had been exercised. Mrs Townsend explained that the object of these extended options was to allow her and her husband some time to make the necessary arrangements to finance the various purchases. Mrs Rudaizky's reason for requiring them to exercise the options in the sequence set out above was that the main homestead and most of the improvements were on Portion 27, and

she ...../11

she was not prepared to sell that portion unless the Townsends also took the balance of the farm, for she might otherwise be left with some relatively unimproved portions of the farm which would be difficult to sell as separate entities. The option price of R1 000 was duly paid, and in due course two payments of R5 000 each were made in respect of further extensions.

(4) Mrs Townsend stated that when these options were acquired neither she nor her husband contemplated selling the farm or any portion thereof. They were particularly keen to obtain Portion 27, on which, as I have mentioned, the homestead was established and they realised that this could not be achieved until the options to purchase Portions 23 to 26, inclusive, had been exercised. After they had obtained the options they continued working the farm intensively. They produced grapes, vegetables and flowers. In 1962

Mrs ...../12

Mrs Townsend bought a florist shop, the first of three retail outlets for flowers grown on the farm; she acquired a second shop in 1963; in that year they also imported various varieties of bulbs direct from Holland at a cost of about R15 000; and in May 1963 they paid the first amount of R5 000 for the extension of the options for a further period of 12 months as from 31 May 1963. At that stage Mr Townsend had already started a vine nursery and had planted young vines on the top part of Portion 23.

(5) Towards the end of 1963 misfortune befell Mrs Townsend. Her husband died on 5 November 1963, after a brief illness, at the relatively young age of 31 years. As a result of her husband's death Mrs Townsend suddenly found herself in grave financial circumstances; she and her husband had invested all their capital in the farm, and none of the options had yet been exercised; the options were due to expire in May 1964 and she required ..../13

quired R5 000 to obtain a further extension of twelve months; the farm was her only source of income, she was not qualified for any particular type of work, and she had to support not only herself but also her young daughter who needed expensive medical treatment. She was, as a result, virtually obliged to carry on with the farming operations in order to keep her head above water.

(6) After her husband's death, Mrs Townsend decided to continue with the farming operations on the whole of the farm under lease, but she soon realised that that was beyond her capabilities, particularly as far as the viticultural side of the farming operations was concerned. Moreover, her health was seriously affected by the shock of her husband's death and she was suffering from severe back trouble as a result of a horse-riding accident. She was very keen, however, to retain the portions of the farm which they originally wanted to

buy ...../14

buy from Mrs Rudaizky, namely Portions 23, 27 and 28, but she realised that in order to do so she would still have to go through the whole process of exercising the various options in the sequence set out in the agreement. This was early in 1964 and it was at this stage that Mr and Mrs Amos came into the picture. They were long-standing friends of her late husband's parents, and she turned to them for assistance. Mrs Townsend showed Mr and Mrs Amos the farm and they were immediately attracted by it. Mr Amos, who was a jockey, was particularly interested in the low-lying part of Portion 23, which he considered he might use, on his retirement from racing, to establish a small stud, a pre-training school and a camp for resting horses that were out of racing. According to Mr Amos this portion of the farm was eminently suitable for this purpose. As he was only interested in acquiring the lower part of Portion 23, he suggested to Mrs Townsend

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that she might be able to arrange for a sub-division of Portion 23, and she could then sell him the one half and retain the other half for herself. This Mrs Townsend was quite agreeable to do. The upper portion, which Mrs Townsend was to retain, was very suitable for vine-growing, new vines having been planted there in 1963. The lower portion, in which Mr Amos was interested, was not suitable for vines; the vines on that portion of the farm were either very old or shy-bearing. However, as a result of her discussions with Mr Amos, Mrs Townsend's attorney lodged an application, accompanied by a sketch plan, with the Divisional Council, on 5 May 1964, for permission to sub-divide Portion 23 into four portions, as depicted on the diagram. The idea was that Mrs Townsend, her minor daughter, and Mr and Mrs Amos would eventually each take transfer of a sub-divided quarter share of Portion 23. On 8 July

1964, .../16

1964, Mrs Townsend's attorney was advised by the Secretary of the Divisional Council that the proposed sub-division had been approved in principle but that a formal application had to be submitted. At that stage Mr Amos was in Natal for the winter racing season and Mrs Townsend did not make contact with him again until he returned to the Cape in August of that year.

(7) During the first half of 1964, while she was negotiating with Mr Amos about the purchase of Portion 23, Mrs Townsend received an offer of R70 000 for that portion from an undisclosed purchaser, through her attorney. After discussing this offer with Mr Amos, she decided to turn it down. During this period she also received unsolicited offers for the purchase of Portions 25 and 26. A Mr Pearce made an offer of R30 000 for Portion 25 in June 1964; Mrs Townsend accepted this offer on 18 June 1964, and the parties entered into a formal deed of sale on 18 July 1964. Earlier in the year, a Mr

Marais ...../17

Marais offered to buy Portion 26 for R48 000. He was farming on a farm adjoining Portion 26. Mrs Townsend also accepted this offer, and this property was then sold to Mr Marais and a Dr Madden for R48 000 on 24 June 1964. This meant that Mrs Townsend was now in a position to take up the options over Portions 23, 24, 25 and 26, in terms of the agreement of 26 April 1962 (see sub-paragraph (3) above), and, on 19 June 1964, her attorney advised Mrs Rudaizky that she had decided to do so. Mrs Townsend stated, in evidence, that all these property deals were undertaken with the object of eventually acquiring Portion 27, for until these options and the option in respect of Portion 28 had been exercised she could not do so.

(8) To continue with the sequence of events. Having been assured that the Divisional Council had approved of the sub-division of Portion 23 in principle, Mrs Townsend entered into an agreement with Mr and Mrs Amos in September

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tember 1974, to form a company in which she, her daughter, and Mr and Mrs Amos, would each hold a 25% interest. It was agreed that Mr Amos and his wife would pay R36 700 for their 50% shareholding in the proposed company. The company, Constantia Heights (Pty) Ltd. was formed in January 1965. This company is the present appellant. Mrs Townsend sold Portion 23 to the appellant for R20 000 on 9 April 1965, and transfer was passed in May 1965. During January 1965, when Mrs Townsend again approached the Divisional Council in connection with the sub-division of Portion 23, she was informed that the Council was preparing a town-planning scheme for the whole of the Constantia area, and that, pending the approval of the scheme, no application for the sub-division of land in that area could be granted. Mrs Townsend then instructed a surveyor to draw a new plan, complying with the proposed town-planning scheme for Constantia, on which the sub-division

of Portion 23 into sixteen erven was shown; and on 22 March 1965, after this plan had been completed, a formal application for permission to establish a township on Portion 23 was lodged with the Divisional Council on behalf of appellant. This application was finally approved in May 1967. However, it appears that no attempt was made by appellant to sell any of the erven in this township. The general plan and diagram of the township were not submitted to the Surveyor-General for approval within the prescribed time, and the grant of the application accordingly lapsed.

(9) The options in respect of Portions 23 to 26 having been exercised, the only remaining options were those relating to Portions 27 and 28. Mrs Townsend said, in evidence, that she realised that she was not in a financial position, at that stage, to exercise the option in respect of Portion 28 and she was very perturbed about it

because ...../20

because she badly needed the upper portion of this property where farm labourers were housed. Towards the end of 1964 she was approached by a Dr Fouche who was interested in buying Portion 28. The deal fell through, however, because Mrs Townsend wanted to retain a servitude of aqueduct enabling her to lead water from the Diep River across this property to Portion 27, and Dr Fouche was not prepared to agree to this. Subsequently Mr Amos came to Mrs Townsend's assistance. The scheme agreed upon was similar to that adopted by them in the case of Portion 23. They formed a company, Klaassenbosch Heights (Pty) Ltd., in which Mrs Townsend, her daughter and Mr and Mrs Amos each held 25% of the equity. By agreement with Mrs Rudaizky Portion 28 was then sold, and transferred, directly to the latter company. The transfer was made subject to a servitude of aqueduct over Portion 28 in favour of Portion 27.

(10) ...../21

(10) Mrs Townsend thereafter exercised the option to purchase Portion 27 on the assurance, she said, from her attorney that she would be able to obtain a loan secured by a bond to enable her to pay the purchase price. There was some delay in relation to the whole matter as Mrs Rudaizky was not selling the whole of Portion 27 but, as explained above, intended to retain an excised part thereof. A plan of subdivision drawn up to give effect to this was rejected by the Divisional Council as not being in conformity with the proposed town-planning scheme for the Constantia area. This raised doubts about the validity of the exercise of the option by Mrs Townsend in respect of Portion 27, but these difficulties were eventually resolved and Mrs Townsend then acquired Portion 27 in her own name. To raise the purchase price of R60 000 she sold Portion 24 for R30 000 and obtained a short term loan of R30 000 from the purchaser of Portion 24,

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on the security of a bond over Portion 27. Eventually she was able to obtain a loan from a building society, on the security of a bond over Portion 27, in substitution of the loan from the purchaser of Portion 24. However, it was a condition of the building society loan that a township plan subdividing Portion 27 into building erven be registered. This was done in February 1967.

(11) During or about February 1967, Mrs Townsend had a nervous breakdown, she spent some time in a nursing home, and then went overseas on medical advice. Save for a short return visit, she was away for about twelve months. During her absence a Mr Steenkamp, who was related by marriage to Mr Amos, was in charge of the farming operations on Portions 23, 27 and 28, but he was very inexperienced and the farming operations suffered somewhat of a set back. Mrs Townsend returned to South Africa in July 1968 and she then decided "to

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go back farming" and "to pick up all the bits and pieces and the disappointments". Prior to her departure for overseas, Mrs Townsend had been living on Portion 27 but on her return, and on the insistance of her mother-in-law, she went to reside at Oak Farm, also in Constantia, in a house which she and her late husband had built at the time of their marriage. At about this time Mrs Townsend received numerous offers from people who were interested in buying various lots on Portion 23, but in most instances she rejected these offers without even discussing them with Mr Amos and his wife, because none of them was interested in selling Portion 23 or any part thereof. In August 1968, Mrs Townsend received a written offer from a Mr Esslinger in the following terms in respect of Lots 1 and 2, Constantia Heights (i.e. Portion 23):

"I would now like to make the following firm offer to you:

(a) ...../23(a)

(a) We would lease the above two lots which adjoin our property from you for a period of five years with an option to renew the lease for another five years. The rental would be equal to the rates and taxes payable on the ground. We would clear the ground and prepare it for paddocks and fence it and these improvements would pass to you at the end of the lease without payment of compensation.

(b) I hereby offer to purchase the two lots for an amount of R32 000 (thirty two thousand rand), with a deposit of 10% being payable on acceptance of my offer and the balance on transfer".

As these lots were on the part of Portion 23 that Mr Amos had earmarked for the erection of paddocks, Mrs Townsend discussed this offer with him, and they rejected it.

(12) In October 1968 Mrs Townsend got married to Mr Turner.

He ...../24

He was not a farmer and does not appear to have been interested in farming. As a result Mrs Townsend decided to sell her florist shops so as to be able to concentrate on the flower farming. Meanwhile, in the case of Portion 28, the Klaassenbosch Heights property, some of the erven on the lower portion, which Mrs Townsend and Mr Amos regarded as inferior land, being partly vlei ground and partly planted with old vines, were sold off. These comprised erven 11 to 20, depicted on a plan marked exhibit Q. The intention was to retain the remaining erven, which were on the upper portion, and to farm them as a whole in conjunction with Portion 23.

(13) At this stage it will be convenient to refer to the evidence relating Mrs Townsend's farming operations since the death of her husband in November 1963. Mrs Townsend had, up to that stage, been in charge of the flower and vegetable farming, while her husband atten-

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ded to cultivation of the vineyards. After his death, Mrs Townsend decided to carry on with both projects. She acquired a third outlet for the flowers grown on the farm in 1964 and she continued cultivating flowers for sale until early in 1970. As a matter of fact, as mentioned in sub-paragraph 12 above, she actually sold her florist shops after her marriage to Mr Turner in October 1968, in order to enable her to give all her attention to flower cultivation. She also continued supplying a well-known group of chain stores with fresh vegetables grown on the farm. During the years 1965 and 1966, Mrs Townsend bought a tractor at a cost of R4 000, a rotary machine at a cost of R700 and she also completed an underground irrigation system at a cost of about R1000. Mrs. Townsend furthermore carried on with the cultivation of the vineyards on Portion 23. Her husband had planted new vines on the upper portion during 1963 and they

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were expected to come into production during 1967 or 1968. After his death Mrs Townsend planted out the remaining young vines that were still in the nursery. The income from the grape crop for the 1963-1964 season was approximately R5 000, and 50% of this crop was produced in the upper portion of Portion 23. In November 1964 Mrs Townsend approached the K.W.V. for a separate wine quota for Portion 23. Up to that stage a quota of 296 leaguers of wine had been allocated to Portions 23, 24, 25 and 26, jointly, but, on 22 December 1964, the K.W.V. allocated a separate quota of 150 leaguers of wine to Portion 23. The 1965-1966 grape crop was a failure, the grapes were delivered to the K.W.V. in the name of appellant, and the income amounted to only R500. Because of the crop failure Mr Amos arranged for a Mr Louw, a very knowledgeable wine farmer from the Stellenbosch area, to inspect the vineyards and to report on their condition. His view

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was that the crop failure was partly due to the fact that many of the vines were old and badly pruned. During 1967-1968 when Steenkamp was managing the farm, he uprooted the old vines on the lower part of Portion 23 and planted cabbages there instead and, on her return from overseas, Mrs Townsend decided that although she would continue reaping what crop she could from the vineyards, she would concentrate on flower farming.

(14) In April 1969 Mrs Townsend was approached by a Mr du Toit who offered to buy the whole of Portion 23 for R300 000. He subsequently put this offer in writing. Mrs Townsend informed Mr Amos and his wife of the offer and they decided to sell the property at this figure. By a resolution of the shareholders of the appellant on 9 May 1969, appellant then resolved to sell the property to a Mr du Toit and a Mr Patterson for R300 000. From what Mrs Townsend stated in evi-

dence ...../28

dence it would appear that apart from the very favourable price offered for the property, she was influenced to sell by the fact that the character of the area was changing from rural to urban, and it was becoming increasingly difficult to carry on farming operations there because of the high cost, and scarcity, of farm labour. Mr Amos stated that he decided to sell the property because of the substantial price that was offered, and because of the fact that it came to his notice, during 1969, that he would not be allowed to keep the number of horses on the farm that he had intended, and that he would not be granted permits to employ black labour there. Out of the proceeds of loans obtained from the appellant after the sale of Portion 23, Mr and Mrs Amos then bought a farm at Franschhoek, which he intends using for the same purpose as Portion 23.

This concludes the summary of the facts and circumstances relating to the purchase, and subsequent sale, of Portion 23.

I turn now to the judgment of the Special Court. In the final analysis the question for decision in the court a quo was whether appellant had discharged the burden of proving on a balance of probabilities that when it sold Portion 23, in May 1969, it was merely realising a capital asset, and was not embarking on a scheme of selling land for profit. The court found, as I have already mentioned, that appellant had not discharged this onus. With reference to the Special Court's approach to this problem, VAN WINSEN, J., said:

> "There is nothing in the evidence from which it appears that appellant Company entertained any 'intention' relative to the various transactions which in any way differed from that of its directors, Mrs Turner and Mr Amos. There are no minutes of directors' meetings before the Court from which it would appear that the Company entertained any corporate intentions in relation to the property. This is therefore an appropriate case in which to deduce the intention of the taxpayer from the actions of its two active directors, Mrs Turner and Mr Amos. (Cf. CIR v. Richmond Estates (Pty) Ltd., 1965(1) SA 602 (AD) at p 606). If the deduction to be made from the evidence as to the actions

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> and stated intentions of Mrs Turner and Mr Amos is that they were merely realising a capital asset in the course of a change of investment when they sold Portion 23 as a whole, then clearly the sum so realised is not income. Per contra if in the light of all the circumstances it is apparent that the sale was in pursuance of a profit-making scheme to sell land, or if this Court is unable, on a balance of probabilities, to say that this was not the case, then the proceeds of the sale would attract income tax.
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> No purpose would be served by a restatement of the considerations to which the Court would advert in determing which of the above deductions is the correct one. These have been amply and cogently set out in such recent judgments as Natal Estates Ltd v. Secretary for Inland Revenue, 1975 (4) SA 177 (AD) and in John Bell & Co. (Pty) Ltd. v. Secretary for Inland Revenue, 1976 (4) SA 415 (AD)".

The reference, in the foregoing passage, and also in other passages in the judgment, to Mr Amos as a director is not quite correct for, as I have already pointed out, it is not at all clear from the evidence that he, in fact, was a director of appellant. Mrs Townsend, certainly, was a direc-

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tor. She and Mr Amos were actually the real shareholders and the main participants in appellant company. On the evidence the de facto control of the affairs of the appellant appears to have been in their hands, and on that account the learned judge was fully justified, in my view, in identifying them with appellant for the purpose of establishing what the latter's intention was when it bought Portion 23 (cf. Secretary for Inland Revenue v. Trust Bank of Africa Ltd., 1975 (2) SA 652 (AD) at 669; and, Secretary for Inland Revenue v. Rile Investments (Pty) Ltd., 1978 (3) SA 732 (AD) at 737).

Then, having referred in some detail to Mrs Townsend's activities in relation to Portion 23, the learned judge concluded as follows:-

> "On a review of all the evidence, it would seem that in the initial stages when Mrs Turner was considering whether to exercise the option to purchase, her intention was to dispose of a part of Portion 23 to enable her

to ...../32

to finance the purchase of the other portions under option. Even at that stage, therefore, she did not contemplate holding the whole of 23. Conceded that her intention initially was to farm on the retained part of 23, but as time went on, it became increasingly obvious that because of the difficulties mentioned above, it would be impracticable for her to do so, and her action in leaving the country for a year is some indication that even at that stage the original intention had faltered and on her return the evidence discloses that little or nothing of that intention remained alive. I am unpersuaded that Mrs Turner has discharged the onus of establishing that her intentions in relation to Portion 23 were anything other than those entertained by her co-director, Mr Amos, viz that, having given up her notion of farming on the land, she hoped to recoup the money invested in the acquisition by indulging in a profit-making scheme by the sale of the land in erven or as a whole".

And in connection with Mr Amos's participation in the venture the learned judge said:-

"Mr Amos who had paid a sum of R37 500 to enable him to acquire his shares

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> in the Company, was prepared to allow the amount so paid, to lie idle without getting any return on it. It would appear that he had no immediate intention of retiring as a jockey and it is difficult to resist the conclusion that he contemplated that he would be compensated for the lack of interest by the profit on the re-sale by the Company of the land as a whole or in erven".

To revert to the argument advanced on behalf of appellant. Appellant's counsel submitted, in his heads of argument: (a) that in coming to the above conclusion on the facts before it, the court a quo erred; and (b) that having regard to the evidence before it, the court erred in its findings of fact upon which the aforesaid conclusion was based. Before turning to the evidence and the facts found by the Special Court, it is necessary to point out that the learned judge made no specific finding as to the credibility of either Mrs Townsend or Mr Amos. There is no direct criticism in the judgment of their evidence or of their demeanour; the evidence reads

well, .../34

well, and, on the face of it, they appear to have given their evidence in a reasonably satisfactory manner. It nevertheless seems to me to be implicit in the learned judge's finding that Mrs Townsend and Mr Amos had both indulged "in a profit-making scheme", that he was of the view that their evidence, as to their subjective intention in regard to Portion 23, was not fully borne out, or supported, by the extrinsic facts; it must therefore be accepted that to this extent the learned judge probably had reservations as to their credibility, and more particularly that of Mr Amos.

I proceed now to examine the basis for the Special Court's finding that appellant had not discharged the onus resting on it. In an enquiry such as the present the intention with which a property is bought is - as has frequently been emphasised - a very important consideration. It is therefore significant to note, at the outset, that in the present instance the court found that Mrs Townsend's "inten-

tion ...../35

tion initially was to farm on the retained part of 23". The court accepted her evidence that the acquisition by appellant of Portion 23 was, in the words of VAN WINSEN, J., "part of a general scheme directed towards acquiring - at any rate at one stage for the purpose of farming - of parts of various portions of land over which options of purchase were held. Substantially it was on a certain part of Portion 23 (the upper part), on Portion 28 (on which the cottages and water supply were situate), and Portion 27 (on which the homestead was situate) that she hoped to farm". It goes without saying that counsel for appellant relied very strongly on this finding. On the evidence, there can be no doubt whatever that this was indeed Mrs Townsend's intention and purpose. This appears clearly from the evidence of her negotiations with Mr and Mrs Amos, which culminated in the formation of appellant company, and its acquisition of Portion 23, in April 1965 (see sub-paragraphs (6) to (8) above).

Now ...../36

Now what was the court's finding in relation to Mr Amos? Except for the above-quoted passages in which some reference is made to his attitude, the learned judge made no specific finding as to what his intention or purpose was in participating, with Mrs Townsend, in the scheme for the incorporation of appellant company, and the acquisition of Portion 23. The court a quo appears to have found that Mr Amos did so for purely speculative purposes. Such a finding, does not accord with Mr Amos's evidence, and it is quite clear from Mrs Townsend's evidence that, if Mr Amos, in fact, had any such subjective intention, he never revealed it to her. Referring to the first occasion when she took Mr and Mrs Amos out to see Klaassenbosch Mrs Townsend said:

> "I actually just took them up Rhodes Drive which adjoins the Portion 23 and I stood on top there and I told them from the top where the farm was lying and I pointed out the various pieces to them ... He (Mr Amos) was

terribly ...../37

> terribly impressed with the hill; he absolutely adored it because as it was, it wasn't too low-lying for what he had in mind because he said that he was getting on and he was thinking of his retirement ... He is a jockey .... He wanted to go in on small scale breeding and possibly going into training with his brother, but what he foresaw then when I pointed out Lord Milner's paddocks at the bottom, he said that is what he would like to do is to have paddocks put up and horses that are either too young for training which haven't came right yet, which haven't come up to the training point yet or horses that had had training and should be put into a rest camp for a while. He thought that the ground was absolutely suited for that" (see also sub-paragraph (6) above).

On this particular aspect Mrs Townsend's evidence was not challenged in cross-examination, and it was not even suggested that this was not what Mr Amos had told her at the time. In my view the court erred in not drawing a clear distinction between whatever Mr Amos's subjective state of mind might have been, and his intention as mani-

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fested during his negotiations with Mrs Townsend in regard to the formation of appellant company, and the purchase of Portion 23. In my view, Mr Amos's subjective state of mind cannot, in the circumstances of this case, operate as the intention of appellant. What must be imputed to appellant, is the common or collective intention of Mrs Townsend and Mr Amos in regard to Portion 23 and whatever doubts the learned judge may have had as to Mr Amos's evidence, he appears to have accepted Mrs Townsend's testimony on this issue. While on this point, I mention, in passing, that Mrs Townsend's evidence, as well as that of Mr Amos, is supported to some extent by what was clearly the principal object of appellant company, as formulated in paragraph 2(a) of its memorandum of association, namely:

"(a) to carry on business as farmers, fruit growers and cultivators; producers of and dealers in fruit, fruit trees, wines, fruit

juices ...../39

juices, syrups and other preparations, derivatives and products of and from grapes and other fruits, fruit canners, and preservers; dealers in livestock; producers of and dealers in dairy produce and fresh produce of all kinds".

On the evidence of both Mrs Townsend and Mr Amos the appellant company was formed, and Portion 23 was acquired, because Mrs Townsend wished to continue farming on the upper portion thereof, and Mr Amos wanted to establish a small stud, a pre-training school, and a rest camp for racehorses, on the lower portion, when he retired. This was the common intention of Mrs Townsend and Mr Amos, who were admittedly the main participants in the company, and it is this intention that must, in my opinion, be ascribed to appellant when it acquired Portion 23. This means that at the time appellant acquired the property its intention, as expressed by Mrs Townsend and Mr Amos, was to hold it as a capital asset.

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The next question is whether appellant subsequently changed its intention to one of holding Portion 23 for the purpose of selling it in pursuance of a profit-making scheme. The court a quo did not, in as many words, find that appellant had deviated from its original intention, but that seems to me to be implicit in the conclusion at which the court arrived. It will be recalled that the court found that in selling Portion 23, on appellant's behalf, Mrs Townsend and Mr Amos "were indulging in a profit-making scheme". This finding is not based on any direct evidence that appellant had changed its initial intention, but upon an inference from the evidence relating to Mrs Townsend's farming activities on Klaassenbosch, after the death of her former husband, in November 1963. It was contended on behalf of appellant that there was no evidence on which the court a quo could reasonably have come to the conclusion that appellant had changed its initial intention and had embarked upon a scheme of selling Portion 23 for profit. I proceed immediately to enquire whether or not the evidence

supports ...../41

supports the finding of the court a quo on this issue. In order to arrive at a proper conclusion it is, of course, necessary to have regard to the cumulative effect of all the relevant facts and circumstances.

The fact that appellant acquired the property as a capital asset is a convenient starting point for, as WESSELS, JA., remarked in the well-known passage in Commissioner for Inland Revenue v. Stott, 1928 AD at 264:

> "It is unnecessary to go so far as to say that the intention with which an article or land is bought is conclusive as to whether the proceeds derived from a sale are taxable or not. It is sufficient to say that the intention is an important factor and unless some other factor intervenes to show that when the article was sold it was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income".

It is also a well-established principle that a change of intention on the part of a taxpayer does not by itself change the character of the asset in question. In this connection I

need ..../42

need only refer to the dictum of WESSELS, JA., in John Bell & Co. (Pty) Ltd. v. Secretary for Inland Revenue, 1976(4) SA 415 (AD) at 429 C-D:

> "... the mere change of intention to dispose of an asset hitherto held as capital does not per se subject the resultant profit to tax. Something more is required in order to metamorphose the character of the asset and so render its proceeds gross income. For example, the taxpayer must already be trading in the same or similar kinds of assets, or 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 taken into or used as his stock-in-trade".

A second factor, and a very significant one, is the fact that the sale of Portion 23 was the result of an entirely unsolicited and fortuitous offer by a Mr du Toit to acquire the whole of Portion 23 for the substantial sum of R300 000 (see sub-paragraph 14 above). According to the evidence of Mrs Townsend and Mr Amos this sale took

place ...../43

place without any initiative on their part. This evidence was not challenged in the court a quo, and there seems to me no valid reason why it should not be accepted. Mrs Townsend and Mr Amos also explained why they decided to sell the property at that stage, and their reasons for doing so appear to me to be quite acceptable. I also refer, in this connection, to the fact that after the sale of Portion 23 Mr and Mrs Amos bought the farm at Franschhoek out of the proceeds of a loan from appellant (see sub-paragraph 14 above).

Then there is the fact that Mrs Townsend and Mr Amos turned down numerous offers to purchase lots of Portion 23 during the latter half of 1968. Moreover, it will be recalled that in August 1968 they rejected an offer by a Mr Esslinger to lease or to purchase Lots 1 and 2 of Portion 23 (see sub-paragraph 11 above). These lots were on the section of Portion 23 that had been allocated to Mr and Mrs Amos, and the fact that Mr Esslinger undertook, as lessee, to erect paddocks on these lots, which would pass to the owner at the end of

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the lease, tends to confirm that even at that late stage Mr Amos had not given up his original intention of keeping horses on the property and that Mr Esslinger was aware that that was his intention.

The court a quo does not appear to have given any consideration to the foregoing factors. I come next to certain other factors on which the court a quo relied in coming to the conclusion that Mrs Townsend was involved in a scheme of selling land for profit. The first refers to Mrs Townsend's financial position and the fact that she sold certain portions of Klaassenbosch to raise money to buy the rest. The learned judge says, in this connection, that "it was only by the sale of certain of these portions as a whole, e.g. 24, 25, 26, by involving the Amoses in the sub-division of Portion 23 and 28 and the disposal of the sub-divided erven on Portion 28 that she (i.e. Mrs Townsend) was able to acquire all the land under option". The fact that Mrs Townsend sold these properties was apparently regarded as being indicative of an intention of selling land for profit. However ..../45

ever, according to Mrs Townsend's evidence, which the learned judge accepted, she intended farming only on certain portions of Portions 23 and 28, and on Portion 27. That being the case, it would not, in my view, be correct to draw any inference, adverse to appellant, from the fact that in pursuing her options under the agreement with Mrs Rudaizky, Mrs Townsend had sold off Portions 24, 25, 26 and certain of the sub-divided erven on Portion 28 (see sub-paragraphs 8 and 9 above). In order to acquire Portions 27 and 28, Mrs Townsend was obliged, under her contract, first to exercise the options in respect of Portions 23, 24, 25 and 26, and in selling Portions 24, 25, 26, and the erven on the lower part of Portion 28, she (and not appellant) was, in effect, disposing of surplus land. (Commissioner for Inland Revenue v. Paul, 1956(2) SA 335 (AD) at 337). In any event, as counsel for appellant pointed out, even if one were to regard the sale by Mrs Townsend of the aforementioned portions of Klaassenbosch, for the purpose of generating funds with which to exercise the remaining options, as a profit-making scheme (a matter on which

I need express no opinion) it would not affect the capital nature of the remaining portions which she bought for farming purposes.

The learned judge a quo also found, on the evidence, that after her husband's death, Mrs Townsend's farming operations "never really got off the ground" and that by 1969 she had "given up her notion of farming". The court a quo appears to have attached considerable weight to this factor. In my view it erred in doing so. According to the evidence Mrs Townsend was determined to carry on with the farming operations after her former husband had died and she, in fact, did so (see sub-paragraph 13). With reference to Mrs Townsend's visit overseas, during 1967 and 1968, the learned judge says "her action in leaving the country for a year is some indication that even at that stage the original intention had faltered and on her return the evidence discloses that little or nothing of that intention remained alive". This is not correct. Mrs Townsend went overseas, on medical advice, after a serious nervous

breakdown, and not because she had become disenchanted with farming. She appointed Mr Swanepoel to manage the farm during her absence, and upon her return in July 1968, she continued farming on the property. It was during the latter half of 1968 that she received, and rejected, the various offers to purchase lots of Portion 23, to which reference has already been made.

I refer, finally, to a point that was not dealt with in the judgment of the court a quo, but which was raised on behalf of the respondent in this Court. Counsel for respondent contended that the fact that appellant had applied for the establishment of a township on Portion 23 was indicative of a change of policy on its part. Counsel referred, in this connection, to the fact that Mrs Townsend and Mr Amos, who were also the major participants in Klaassenbosch Heights (Pty) Ltd., had made a similar application, at more or less the same time, in respect of Portion 28, and that according to the evidence the latter company had, by 1967, clearly gone over to the business of township development. He ar-

gued that, on the probabilities, appellant would, in due course, also have developed Portion 23 as a township. I cannot agree. In my view the two cases are clearly distinguishable and the actual facts are contradictory to counsel's contention. In the case of Portion 23, the application was made to enable the shareholders to take transfer of the portions that had been allocated to them. In that case the general plan and diagram were not submitted to the Surveyor-General for approval, and none of the lots was ever put on the market for sale. It is true that the shareholders never took transfer of their respective portions, but there was no urgency to implement that scheme as Mr Amos had not yet retired. On the other hand, in the case of Portion 28, both Mrs Townsend and Mr Amos were only interested in retaining the upper portion of the property and they accordingly applied for the establishment of a township to enable them to sell the surplus land, which they proceeded to do after the township had been proclaimed.

To sum up. On the evidence as a whole, and having regard to the cumulative effect of all the relevant factors, I am of the view that there is a very definite preponderance of probability in favour of appellant. Appellant has, in my

judgment, discharged the onus of proving that Portion 23 was bought and sold as a capital asset, and not in pursuance of any scheme of selling property for profit. That being so, the profit on the sale of Portion 23 was a receipt or accrual of a capital nature, and was not subject to tax under the Act.

In the result:

(a) The appeal is allowed with costs, including the costs occasioned by the employment of two counsel;

(b) The order of the court a quo is altered to read as follows:

> The appeal is allowed, the assessments are set aside, and the matter is remitted to the respondent for the purpose of issuing fresh assessments which shall exclude from the taxable income the profits on the sale of Portion 23.

TRENGOVE, JA

Wessels, JA)
Muller, JA)
Corbett, JA) Concur
Galgut, AJA)