126/86

Case No 22/85

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the appeal of:

MATLA COAL LIMITED ..... appellant

and

THE COMMISSIONER FOR INLAND REVENUE ... respondent.

Coram: CORBETT, BOTHA, VAN HEERDEN, JJA, GALGUT et NICHOLAS, AJJA.

Date of Hearing: 21 August 1986

Date of Judgment: 30 September 1986

J U D G M E N T

CORBETT JA :

The appellant in this matter is Matla Coal

/ Limited.....

Limited ("Matla"). On 20 February 1980 Matla received from the Electricity Supply Commission ("Escom") a payment by cheque of an amount of R9 365 000. In its accounts attached to its return of income for the 1980 income tax year (its financial year having ended on 30 June 1980) Matla described this amount as a -

> "capital receipt arising from sterilisation of certain coal rights, in terms of an agreement between Escom, the Matla Joint Venture and Matla Coal Limited";

and the amount was transferred to its non-distributable reserve. In assessing Matla to income tax in respect of this return, respondent, the Commissioner for Inland Revenue ("the Commissioner") included this amount of R9 365 000 in Matla's income under the notation "Verkoop van steenkool". Matla objected to this assessment, generally on the ground that the amount in question constituted a receipt of a capital nature and, therefore, did not form part of its gross income. In the alternative it was contended that,

/ if.....

if it should be found that any portion of the amount was of a revenue nature, Matla was entitled to an appropriate deduction in terms of sec. 11(a) of the Income Tax Act 58 of 1962 ("the Act"). Its objection having been disallowed by the Commissioner, Matla appealed to the Transvaal Income Tax Special Court. That Court held that the amount had correctly been included in Matla's taxable income, but ordered that the matter be remitted to the Commissioner to enable him to make a suitable deduction in respect of the costs associated with the transaction. With the leave of the President of the Special Court, granted in terms of sec. 86A(5) of the Act, Matla now appeals to this Court against the portion of the judgment of the Special Court holding that the R9 365 000 constituted a receipt of a revenue nature.

The background facts and the events leading up to the payment of this amount, as revealed by the evidence before the Court a quo, may be summarized as follows.

/ Trans-Natal.....

Trans-Natal Coal Corporation Limited ("Trans-Natal") is a coal-mining company within the General Mining and Finance Corporation Ltd. ("General Mining") group. Normally it operates through subsidiary companies, each company controlling an individual mine. At the time of the hearing in the Court below Trans-Natal's output from the mining operations thus conducted by it amounted to about 30m. tons per annum.

The bulk of South Africa's coal reserves are located in the Eastern Transvaal. Trans-Natal had been prospecting in this region for some time and had discovered a large coalfield. For various reasons (which need not be canvassed) Trans-Natal in about 1968/69 entered into an agreement with Clydesdale (Transvaal) Collieries Limited ("Clydesdale") in terms whereof it was arranged that Trans-Natal and Clydesdale would exploit portion of this coalfield (known as "Block IV") on the basis

/ of .....

of an equal partnership. Trans-Natal and Clydesdale further decided that this joint venture would be carried on through the vehicle of Matla, which was then named Alpha Coal Limited ("Alpha Coal") and was a dormant coal-mining company in the Trans-Natal group. Trans-Natal and Clydesdale each acquired 500 shares in Alpha Coal and the mining rights and options held by Trans-Natal over Block IV were ceded and transferred to Alpha Coal. Trans-Natal was to manage both Alpha Coal and Clydesdale.

At about this time Escom announced that it was contemplating the construction of a new coal-fired power station in the Eastern Transvaal and invited tenders for the supply of coal. (Later the scheme was amended to include two power stations.) It was the practice of Escom to establish its power station on the coalfield of the successful tenderer. After some initial hesitation the joint venturers decided to submit a tender in respect of Block IV. This was done on 31

/ August.....

August 1973 by Trans-Natal, acting on behalf of Alpha Coal. In the tender it is explained that Block IV contains three coal seams of economic importance, viz., in descending order, nos. 5, 4 and 2 seams; that the no. 5 seam coal reserves have properties making this coal suitable for future metallurgical use; and that the no. 5 seam is consequently excluded from the tender. Other relevant features of the tender are that in terms thereof —

(1) it is proposed that all mining operations be undertaken by Trans-Natal;

(2) the total capital requirements for a two-mine layout are estimated to amount to R31 123 000;

(3) it appears that the coal reserves in situ are adequate to meet Escom's requirements of approximately 9,6m. tons per annum for a period of full operation of 30 years;

(4) it is proposed that a royalty of 12,5 cents per ton be paid by Escom, subject to various

/ provisions.....

provisions for the escalation thereof; and

(5) a formula is provided for determining the price to be paid for the coal from time to time on a cost-plus basis.

Escom's reaction to the tender was generally a favourable one. It accepted that Block IV would be able to supply the coal required for the two power stations it was intending to establish and it raised no objection to the price formula. It was not, however, favourably disposed to paying a royalty, especially in view of the escalation provisions. It also wished to have control over the mining techniques to be employed in the exploitation of the coalfield. Accordingly, it counter-offered to buy the rights to all coal contained in seams nos. 2 and 4 for the sum of R7 704 000, payable in six equal instalments. The capital cost of establishing the colliery and acquiring the associated assets was to be shared on a certain basis. These pro-

posals were contained in a letter dated 14 November 1973. Later, on 31 January 1974, Escom altered its counter-proposals to include no. 5 seam in its offer to purchase the coal rights, and at the same time it increased the price to R9 365 000. This price was worked out on the basis of the estimated total amount the royalties would have generated over the contract period, reduced to its present value. The attitude of the tenderer was that it really had no alternative but to agree to the counter-offer.

From here on the negotiations appear to have meandered somewhat. On 13 March 1974 Escom wrote stating that it had decided to enter into a contract with Trans-Natal for the supply of coal to the proposed new power station on the basis of its counter-offer —

> "to purchase all rights of Alpha Coal Limited to the coal in Block IV, subject however to your Corporation undertaking to design, establish and work the collieries needed for mining this coalfield....."

/ and.....

and suggesting that the parties prepare heads of agreement

> "which will serve as the basis for starting the investigations and planning which is involved in this joint venture, and for drawing up the final contract in due course."

This was accepted by Trans-Natal and heads of agreement (dated 8 May 1974) were drafted, but apparently not signed. This document provides, under the heading "Coal Rights", as follows:

> "The tendered coal rights per the attached schedule which are at present being held by Alpha Coal Limited will be sold to Escom for the amount of R9 365 000 payable in one amount within 90 days of the date of commissioning the first boiler and turbo-generator set of the first Power Station.
>
> It is envisaged that either the coal rights will be sold from Alpha Coal Limited to Escom or the shares in Alpha Coal Limited will be sold to Escom. In the event of a sale of shares all the coal rights held by Alpha Coal but not included in the tender per the attached map will be transferred to Trans Natal Coal Corporation Limited and Clydesdale (Tvl) Collieries Limited prior to such sale of shares.

/ Either.....

> Either the sale of the rights of Alpha Coal or the sale of Alpha Coal shares will be made conditional to Escom and Trans Natal concluding a contract whereby Trans Natal will undertake and accept full responsibility for the mining operations.
>
> It follows that no Royalty will be payable by Escom on coal delivered to Escom from Block IV."

On 11 April 1975 the name of Alpha Coal was changed to Matla Coal Limited in order to coincide with the recently announced name of Escom's new power station, viz. Matla Power Station.

Thereafter Matla, under the management of Trans-Natal, went ahead with the establishment of the colliery — sinking shafts, installing equipment and so on. Owing to inflation the original estimate of the capital cost of establishing the mine, viz. R31m, proved to be far too low. There was a need for additional capital to be provided. Initially this was to be provided by Escom. Subsequently, however, Escom found difficulty in raising the

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money and approached Matla to increase its capital participation in the colliery. For reasons which need not be elaborated Trans-Natal and Clydesdale did not wish to continue to use Matla as the vehicle for this additional financing and accordingly on 30 June 1978 a series of agreements were entered into with a view to providing for the direct participation of Trans-Natal and Clydesdale in the mining operations. The first such agreement was a joint venture agreement between Trans-Natal, represented by two subsidiaries, and Clydesdale, in terms of which the parties agreed to take over the mining and financing of the colliery as a joint venture in which the parties were to participate equally. The second was an agreement between the joint venturers and Matla whereby for a consideration of R2 479 000 Matla agreed to cede, assign and transfer to the joint venturers "all its right title and interest in and to all mining assets, development assets and property situated on the coalfield", but excluding the rights to coal and options

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to acquire rights to coal held by Matla. In terms of this agreement the joint venturers also assumed all Matla's obligations to Escom in regard to the development and operation of the colliery and the supply of coal to Escom. The third agreement was one foreshadowed in the second agreement, viz. a mineral lease whereby Matla granted to the joint venturers the sole and exclusive right to exploit the coalfield in return for the payment to Matla of a royalty of 12,5 cents per ton in respect of all coal mined, recovered and removed from the coalfield. These new arrangements were acceptable to Escom.

At about this time Mr L S du P van Eeden, who was then commercial manager of the coal division of General Mining, had a discussion with an official of the Inland Revenue Department, in the course of which the latter raised the question as to whether, in the event of the coal rights being alienated to Escom, the companies operating the

colliery would not cease, from the income tax point of view, to be treated as miners and would be regarded merely as contractors. This would be a consequence detrimental to the interests of the companies concerned since a mining company is allowed for income tax purposes to write off its capital expenditure as soon as it comes into production, whereas a contractor is only allowed an annual depreciation allowance on its capital equipment. In the opinion of Van Eeden, who gave evidence before the Court a quo, it was doubtful whether a mining company could exist if it had to rely solely on depreciation allowances: it was "just not economically feasible".

To Van Eeden this presented a real problem. As he put it —

> "We were contractually obliged to sell the mining rights at that stage, to Escom".

He nevertheless approached Escom and explained the difficulty to the Escom officials dealing with the matter.

/ He.....

He suggested that the parties should come to some other arrangement which would still give Escom security of title to the coal reserve. Escom suggested that Van Eeden come back to them with a concrete proposal.

On 14 December 1978 a meeting was held at the offices of General Mining between representatives of Trans-Natal and Escom to —

> "....review the progress with the Matla agreement to date, to record the items on which agreement has been reached and to consider negotiations which are still inconclusive".

The minutes of this meeting contain, under the heading "Payment for coal reserves", the following:

> "Although they are prepared to consider alternative proposals which may assist the Joint Venture, the position at present still stands that they have committed themselves to purchase the coal rights."

(In this passage the word "they" obviously refers to Escom.)

/ At .....

At a meeting on 21 March 1979 attended by executives of Trans-Natal and Clydesdale (it is not clear what the nature of the meeting was) it was agreed that negotiations should commence for the purpose of putting into effect the sale of the coal rights, subject to the existing lease, to Escom; that the joint venture would continue to pay the royalty of 12,5 cents per ton to the lessor which would be Escom; and that the royalty paid would in turn be recovered from Escom "by way of working costs". In a letter dated 3 April 1979 proposals along these lines were conveyed to Escom.

A long correspondence then ensued between the parties. It is not necessary to refer to this in detail. Indeed it is evident that not all the letters exchanged were placed before the Court a quo. I would merely highlight certain features of this correspondence. In a letter of 2 November 1979 Escom reaffirmed its in-

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tention "to acquire all Matla's rights to the coal 'in the Coalfields', subject to the rights of the joint venture"; stated that no royalties would be payable by the joint venture to Escom; and stated that it required a resolution of the shareholders of Matla "authorising the sale of the mineral rights to Escom". On 7 November 1979 a copy of a resolution of the shareholders of Matla agreeing to "the alienation of its main asset, viz. the coal rights" was sent to Escom.

On 28 November 1979 Trans-Natal wrote to Escom proposing that Escom accept that "the pre-payment of royalties in the agreed sum", viz. R9,365m, be "in lieu of an outright purchase of the coal reserve". In this letter reference was made to an earlier letter from Escom, dated 13 June 1978, in which it was stated —

> "..... that the substance of the present agreement is that for the payment of R9 365 million Escom will receive all coal from the Matla field <u>without the</u>

/ <u>payment</u> .....

> payment of royalties. Escom will therefore pay the R9 365 million as previously agreed as a pre-payment in lieu of royalties". (My italics.)

This proposal was repeated in a letter to Escom dated 11 December 1979. Escom replied on 13 December 1979 that it was prepared to accept the proposal subject to certain stated conditions. The letter concludes —

> "Kindly confirm your acceptance of these conditions and inform me of the date you wish payment to be made."

There this particular line of correspondence (which was placed before the Court a quo by the Commissioner's representative during the cross-examination of Van Eeden) appears to come to an end.

On 20 February 1980 Escom sent to Trans-Natal a cheque for R9 365m. under cover of a letter, which reads as follows —

/ " I refer .....

> "I refer to previous correspondence and the numerous discussions between certain Escom staff and members of your staff which have failed to reach any satisfactory conclusion.
>
> In terms of the agreement presently in existence between Escom and the joint venture all the coal rights in respect of the Matla Coal Fields as tendered, plus the coal from the No. 5 seam must be transferred to Escom against payment of the amount of R9,365 million which is now tendered in the attached cheque.
>
> I shall be pleased if immediate arrangements could be made for the transfer of these rights or equivalent agreed protection for Escom is concluded."

Thereafter negotiations and discussions proceeded in regard to the possibility of devising an "equivalent agreed protection". Eventually the parties agreed upon what was termed a "restraint agreement" and a contract in these terms was signed on 29 September 1980. Under this contract Matla and the joint venture agree and undertake that they will not be entitled to extract or dispose of any coal from the coalfield other than for the pur-

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pose of supplying the same to Escom or as Escom may direct, save with the prior written consent of Escom and then on such terms and conditions and at such rate as Escom may prescribe. Escom, on the other hand, is given the right to utilise or dispose of all such coal as it pleases. Clause 4 of the contract provides:

> "In consideration of the restraint imposed herein and the consequent sterilisation of the capital asset of Matla, Escom has agreed to pay to Matla the sum of R9,365m (NINE comma THREE SIX FIVE MILLION RAND), which amount, it is recorded, has already been paid."

Those are the facts. I now turn to the question as to whether the amount of R9 365 000 paid by Escom to Matla constituted income or a receipt of a capital nature in Matla's hands. It seems to me, however, that before this question can be answered it is necessary to characterize this payment. Obviously it was paid by Escom as the consideration for some asset or benefit to be

received by it from Matla and/or the joint venture. The problem is, what asset or benefit?

It was submitted by counsel appearing on behalf of Matla that the amount of R9 365 000 was paid by Escom to Matla as the purchase price of the coal rights relating to Block IV; that mineral and mining rights, like any other property, can be held either as trading stock or as fixed capital assets; that in this instance the coal rights in question had been acquired and held by Matla as capital assets; and that consequently the money paid as the purchase price of these assets constituted a capital receipt in Matla's hands.

Before considering the merits of these submissions it is necessary to deal with a preliminary point raised by counsel for the Commissioner. He referred to Matla's letter of objection. In this letter Matla's

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attorneys state:

> "The grounds of objection are that the amount of R9 365 000 which was received by our client from the Electricity Supply Commission (Escom) was an amount of a capital nature and therefor does not fall into the 'gross income' of the company as defined in s 1 of the Income Tax Act, 58 of 1962. The said amount was received from Escom under cover of a letter of the 20th February 1980, copy of which we enclose herewith. The 'equivalent agreed protection' referred to in the ultimate paragraph of this letter was an arrangement finally entered into and formalised in a written agreement entered into on the 29th September 1980 between Matla Coal Limited (hereafter Matla Coal), Escom and the Matla Joint Venture, a copy of which is enclosed herewith. As will be noted therefrom Matla Coal undertook that it would not be entitled to extract or dispose of any coal from a certain coalfield other than for the purpose of supplying Escom or as Escom might direct and this restrictive covenant was to apply to Matla Coal whether or not the joint venture terminated the mineral lease which it had. The payment made to Matla Coal of R9 365 000 was made in consideration of the restraint imposed on it and the consequent sterilisation of its major asset".

/ The .....

The letter then goes on to sketch in some detail the background to the transaction and the history of events leading up to it and concludes —

> "In summary, the amount of R9 365 000 was paid to Matla Coal in respect of the sterilisation of the coalfield owned by it, and is accordingly a receipt of a capital nature."

Then follow certain alternative submissions. Counsel for the Commissioner contended that in view of the provisions of sec. 83(7)(b) Matla should not be permitted to base its case upon the contention that the payment was consideration for the sale of coal rights: it should be confined to the case made out in its letter of objection, viz. that the payment was consideration for the sterilisation of a capital asset, viz. the coalfield. And here I might point out that Matla's counsel did also present an alternative argument based upon the sterilisation point.

Sec. 81(3) of the Act provides that every objection shall be in writing and shall specify in detail the grounds upon which it is made. And in terms of sec. 83(7)(b) the appellant in an appeal against the disallowance of his objection is limited to the grounds stated in his notice of objection. This limitation is for the benefit of the Commissioner and may be waived by him (see CIR v George Forest Timber Co Ltd 1924 AD 516, at p 521). In this case, however, there is no such waiver. In opening his case before the Court a quo, counsel for Matla referred to both the "sale of coal rights" and the subsequent "restraint agreement" and said that it would be Matla's submission, inter alia, that the transaction was a sale of coal rights on capital account. At the end of counsel's opening address the Commissioner's representative pointed out that this submission was contrary to the grounds of objection which focused upon a sterilisation of the coal reserves. The record of the

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proceedings then continues:

"PRESIDENT: The substance of the objection is that the receipt is one on capital account, whether it arises from sterilization or from the sale of rights?

MR VAN BREDA: That is so, my Lord.

PRESIDENT: Perhaps this is a matter you could canvass further in argument or in cross-examination of the witnesses?

MR VAN BREDA: My Lord, my submission is that because of the reasons set out in his letter of objection appellant is not free at this stage to advance a different reason for regarding it as of a capital nature. He is not free to do so. He is bound by what is stated in his grounds of objection.

PRESIDENT: You raise this now as a preliminary point.

MR SWERSKY: My Lord, we do not intend to go outside the grounds of objection, in our submission. I did say, the disposal or surrender of its rights. It is true that the letter of objection refers to the agreement as being a restrictive covenant, but as I indicated, the essence of the thing is that it constitutes either a disposal or surrender of certain of its rights - its freedom to deal with certain of the coal, or whatever your Lordship considers the nature of the agreement to be."

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That is where matters rested. No ruling was given and the evidence proceeded to canvass fully both the alleged sale of coal rights and the restraint agreement.

It is naturally important that the provisions of sec. 83(7)(b) be adhered to, for otherwise the Commissioner may be prejudiced by an appellant shifting the grounds of his objection to the assessment in issue. At the same time I do not think that in interpreting and applying sec. 83(7)(b) the Court should be unduly technical or rigid in its approach. It should look at the substance of the objection and the issue as to whether it covers the point which the appellant wishes to advance on appeal must be adjudged on the particular facts of the case.

The letter of objection in the present instance is a very full and detailed one. The basic objection taken is that the amount of R9 365 000, included in Matla's income

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by the Commissioner, was a receipt of a capital nature; and that is essentially the case made out in the letter. The facts of the matter are fully canvassed. Letters referring to the sale of coal rights are quoted and a copy of the letter which accompanied the payment of R9 365 000 is enclosed. It is stated that, although in principle Matla Coal had agreed to a sale of coal rights as required by Escom, the final arrangement took a different form, viz. the agreement of 29 September 1980. The sterilisation arrangement was, therefore, an agreement in lieu of the sale of coal rights to Escom.

Throughout, even in this Court, it was a matter of some debate whether in characterizing the payment of R9 365 000 regard should be had to the alleged agreement to sell the coal rights to Escom, which obtained when the payment was made, or to the "equivalent agreed protection" viz. the restraint agreement, which was concluded after

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the end of the 1980 tax year. In its letter of objection Matla did appear to opt for the restraint agreement, but in all the circumstances I do not think that this should preclude Matla from now contending that the appropriate agreement to consider was the sale of coal rights. The preliminary point must, therefore, be decided in Matla's favour.

I come now to the merits of the appeal. The first question to be decided is for what the amount of R9 365 000 was paid as consideration. A study of the evidence as to the course of negotiations between the parties from the earliest beginnings in 1973, when Matla (then Alpha Coal) submitted its original tender, to 20 February 1980, when the payment was made, leaves me in no doubt that as at 20 February there was in existence an agreement between the parties that the coal rights held by Matla would be sold and transferred to Escom

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in consideration of the payment of R9 365 000; and that the payment was made on this basis. I have already recounted this evidence in detail. At this stage I would merely focus attention on Escom's letters of 14 November 1973, 31 January 1974 and 13 March 1974; on the heads of agreement dated 8 May 1974 (the suggested sale of shares in Matla does not appear to have been pursued at all); on the minutes of the meeting between representatives of Trans-Natal and Escom held on 14 December 1978; on the meeting attended by executives of Trans-Natal and Clydesdale on 21 March 1979; and on the resolution of shareholders of Matla taken in November 1979 and authorising the sale of the mineral rights to Escom. In addition, there is the evidence of Van Eeden that Matla became contractually obliged to sell the coal rights to Escom. It is true that as a result of Van Eeden's discussion with the Inland Revenue Department, which probably took place about

/ mid-1978, ...

mid-1978, Matla and the joint venture were anxious, for tax reasons, to explore the possibility of an alternative arrangement with Escom - hence the correspondence speaking of "a pre-payment of royalties" or "a pre-payment in lieu of royalties" — but as at 20 February 1980 nothing concrete seems to have emerged from this. This explains the opening sentence of Escom's letter of 20 February 1980, which refers to discussions which had failed "to reach any satisfactory conclusion". Moreover, the following sentence makes it clear (i) that in Escom's view the agreement then in existence between the parties was one for the sale and transfer of the coal rights to Escom against payment of the purchase price of R9 365 000, and (ii) that the enclosed cheque was tendered in payment of this purchase price. The final sentence demands transfer of the coal rights, but also mentions the possibility of concluding "equivalent agreed protection" for Escom. This last statement ob-

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viously refers to the alternative arrangement which Matla and the joint venture were seeking in order to overcome their tax problems and which until then had been the subject-matter of inconclusive negotiations. Matla and Trans-Natal (its manager) received the letter and the payment without apparently disagreeing with the contents of the letter or the basis upon which the R9 365 000 was being paid. All that happened was that the search for an equivalent agreed protection continued, resulting eventually in the contract of 28 September 1980. This contract was a novation of the original agreement for the sale of coal rights. Obligations of Matla and the joint venture to sell and transfer the coal rights to Escom were replaced by a restraint undertaking in favour of Escom; it was agreed that the consideration to be paid therefor by Escom be an amount of R9 365 000; and it was further agreed in effect that the payment in this amount already

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made by way of the purchase price of the coal rights be treated as payment of the consideration due under the restraint agreement.

In the result, therefore, the payment of R9 365 000 underwent a metamorphosis. At the actual time of payment, viz. 20 February 1980, it was the consideration for the purchase of coal rights; and on 28 September 1980 it became the consideration for the restraint undertakings. How must it be classified from the fiscal point of view in determining Matla's liability for income tax for the tax year which ended on 30 June 1980? Counsel were not able to refer us to any authority directly in point; nor am I aware of any. On principle, however, it seems to me that the payment must be characterized either with reference to the position which obtained at the time of payment (cf. Mooi v SIR 1972 (1) SA 675 (A) at p 684 E-H) or, at the latest, to the position which obtained

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on the last day of the fiscal year (cf. Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A), at pp 675 E - 676 D, 677 G - 678A; and see Silke South African Income Tax 10 ed § 2.17). It is not necessary to choose between these alternatives since in this case the position which obtained as at the time of payment persisted unchanged until the end of the fiscal year.

For these reasons the receipt by Matla of R9 365 000 must, in my view, be characterized as the consideration paid by Escom for the purchase of the coal rights. That being the position, the next question which arises is whether the coal rights were held by Matla as trading stock or as fixed capital assets.

According to the evidence of Mr G Clark, the general manager of Trans-Natal, Trans-Natal never acquired coal rights or options or prospecting rights over coal with the object of disposing of them at a profit. He said —

/ "That.....

> "That would have been a negation of our total function. We are miners not speculators."

Matla, which was managed by Trans-Natal, was run on the same philosophy. Nor had Trans-Natal, or any company in the Trans-Natal group, ever sold coal rights for the purpose of making a profit. Clark explained —

> "I should emphasize here that we started as a very small company, trying to establish ourselves in the mining business, and your ability to become a power in the mining business depends on your reserves. So buying and selling reserves was totally foreign to any concept - a quick small profit is not the way you build up a major annual income."

These averments were not challenged in cross-examination; nor was any rebutting evidence adduced. Clark also stated, with particular reference to Block IV, that the rights in respect thereof were acquired by Alpha Coal in order to exploit the rights themselves, and not with the intention

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of disposing of those rights to outside interested parties.

The Court a quo made no credibility finding in regard to this evidence. It did nevertheless hold that (I quote from the judgment of the President) —

> "The appellant came into the picture as a vehicle in which the coal rights were conveniently placed solely in order to carry into effect the purposes of the joint venture between Clydesdale and Trans-Natal. One must therefore look through the narrow structure of the appellant company to see what was really done, and that was the business of securing and implementing a contract for the sale of coal to Escom to the value of approximately R800 million. .....
>
> In all the circumstances it has not, in our view, been established, on a balance of probabilities, that the appellant acquired the coal rights in question as a fixed capital asset. The amount of R9 365 000 was therefore correctly included by the Commissioner in the taxable income of the appellant."

In my view, there is no reason to reject the evidence of Clark on this issue. His testimony on the

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philosophy and past practices of the Trans-Natal group was not challenged either in cross-examination or by way of rebutting evidence. Nor is there any circumstantial evidence to contradict it. Indeed Matla's initial tender was wholly consistent with this general policy, viz. to exploit coal rights and not to trade in them; and it was only when Escom rejected the idea of paying royalties and insisted on acquiring the coal rights that the transaction assumed the form of a sale of coal rights.

Moreover, I cannot agree that the sale of coal rights can be equated to a sale of all the extractable coal in the coalfield. It seems to me that the coal itself can only be regarded as stock-in-trade and become the subject-matter of a sale in the course of a business once it is separated from the land of which it forms part, ie., is mined. (Cf. remarks of INNES CJ in CIR v George Forest Timber Co Ltd 1924 AD 516, at pp 523-4, 525-6.)

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In support of his general submission that Matla decided to sell the coal rights as part of a scheme of profit-making, counsel for the Commissioner stated that a substantial part of the coal rights was acquired by Matla only after Escom had decided that it wanted the coal rights. This is not strictly correct. According to Clark's evidence, at the time when Escom decided that it wanted to purchase the coal rights, Matla either held these rights or held the option to acquire them. He explained that it was normal practice in the mining industry to obtain mineral rights under prospecting contracts for the exploration of an area with a right to buy. At the time of tender it was indicated to Escom that part of Alpha Coal's title rested on its prospecting contracts. Later the options were exercised in order to make transfer of the relevant coal rights to Escom. I do not think that there is any substance in this point.

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In determining the intention with which the coal rights were acquired by Matla regard must be had, in my view, to the time when the prospecting contracts, containing the options, were first entered into. (Cf. the decision of the Canadian Federal Court, D and K Thom v The Queen (FCTD) [1979] CTC 403, cited to us by counsel for Matla; and see also the decision of the High Court of Australia in the case Western Gold Mines No Liability v Commissioner of Taxation (WA) 1 AITR 248, at pp 251-2.)

There is no doubt that mining and mineral rights, like any other property, may be acquired and held by a taxpayer with a view to exploiting the rights themselves as income-producing capital assets or alternatively with a view to realization as part of a profit-making scheme, in which case they assume the character of trading stock. (See, eg., Commissioner of Taxes v Booysens Estates Ltd 1918 AD 576; SIR v Smit 1965 (3) SA 591 (A);

/ SIR v Struben.....

SIR v Struben Minerals Ltd 1966 (4) SA 582 (A).) When the rights are sold, then in the former case the proceeds constitute a capital receipt in the hands of the taxpayer, in the latter case income. In my view, the evidence in the present case establishes, upon a preponderance of probability, that the coal rights in question were acquired by Alpha Coal (later Matla) as incoming-producing capital assets and so held until it was agreed that they should be sold to Escom; and, with respect, I cannot agree with the contrary finding of the Court a quo. It follows that the proceeds of the sale, amounting to R9 365 000 was a capital receipt in Matla's hands and that the Commissioner erred in including this amount in Matlas's taxable income for the 1980 year of assessment.

The appeal is allowed with costs, including the costs of two counsel, and the order of the Court a quo

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is altered to read:

"Appeal allowed and the assessment set aside. The matter is remitted to the Commissioner for reassessment on the basis that the receipt of R9 365 000 constituted a receipt of a capital nature."

M M CORBETT

BOTHA, JA)
VAN HEERDEN, JA)
GALGUT, AJA) CONCUR.
NICHOLAS AJA)