B4/86

IN THE SUPREME COURT OF SOUTH AFRICA
(APPELLATE DIVISION)

In the matter between:

THE COMMISSIONER FOR INLAND REVENUE .... appellant

and

NEDBANK LIMITED ..... respondent

Coram: CORBETT, VAN HEERDEN, HEFER JJA, GALGUT et NESTADT AJJA.

Date of Hearing: 6 May 1986

Date of Judgment: 29 May 1986

J U D G M E N T

CORBETT JA:

The respondent, Nedbank Limited ("Nedbank"), operates as a registered commercial bank. Nedbank's financial year (and year of assessment for income tax purposes) ends on 30 September. During the year of assessment ended 30 September 1981 Nedbank sold 9,300,000 ordinary shares held by it in Sasol Ltd ("Sasol"). The sale realized

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a profit of R19 300 041. In assessing Nedbank to income tax for this year of assessment, appellant, the Commissioner for Inland Revenue ("the Commissioner"), included in Nedbank's taxable income the profit which thus accrued to Nedbank on the sale of these Sasol shares. On appeal to it in terms of sec. 83 of the Income Tax Act 58 of 1962 ("the Act"), the Transvaal Income Tax Special Court ruled that the proceeds of the shares in question constituted a receipt of a capital nature in the hands of Nedbank and allowed the appeal. The assessment was remitted to the Commissioner for reassessment. The Commissioner appealed in terms of sec. 86A of the Act to the Transvaal Provincial Division, which upheld the decision of the Special Court and dismissed the appeal with costs, including the costs of two counsel. The Transvaal Provincial Division furthermore refused leave to appeal to this Court. Such leave was, however, subsequently granted by this Court.

The circumstances surrounding the acquisition

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and disposal of these shares by Nedbank appear from the evidence given before the Special Court by Mr R J N Abrahamsen, who at all material times held the position of managing director and chief executive of Nedbank. He was called by Nedbank and was the only witness to give evidence.

Abrahamsen explained that in the day-to-day management of Nedbank the powers and duties of the bank were delegated by the board of directors to a management committee, of which he, as chief executive, was chairman. In February 1979 it was announced by the Minister of Finance of South Africa that Sasol, which until then had been a state-owned corporation, would be "opened up" for private investment. Abrahamsen consulted his colleagues on the management committee and it was agreed that Nedbank would offer to Sasol an amount of R100m by way of investment. This offer was communicated to the management of Sasol and

/ Abrahamsen.....

Abrahamsen made it clear that the investment would have to be by way of preference shares. Abrahamsen explained in evidence that the bank frequently made finance available to the most creditworthy corporate customers (described as "triple A customers") by subscribing for preference shares in such corporations. He described the reasons for Nedbank wishing to make this investment in Sasol as being the desire "to obtain commercial banking business, and specifically in this particular case, to make a breakthrough in the Afrikaner business community".

Eventually it transpired that Sasol would not be offering preference shares, but only ordinary shares to would-be investors. Although it was not the policy of Nedbank to invest in ordinary shares, it decided to do so in this instance. The management of Sasol indicated that the Nedbank offer of R100m would ensure the success of the issue and that they were keen to have this commitment on Nedbank's

part. In the end there were (i) a private placement of ordinary shares amongst a number of financial institutions, in terms of which Nedbank was allotted 12½m shares at R2 per share, and (ii) a public issue via the Johannesburg Stock Exchange. Nedbank took up its private allotment at a cost of R25m, but did not participate in the public issue. Sasol decided to phase in the inflow of investment moneys and Nedbank was asked as a condition of the placement to subscribe for specified numbers of shares on specified dates. The first parcel of 5m shares was taken up on 5 September 1979 and the last parcel on 2 January 1981. Abrahamsen stated that if the management of Sasol had invited Nedbank to take a greater part in the placement it would have done so because it was initially prepared to invest R100m. It was entirely Sasol's choice that the value of Nedbank's placement was limited to R25m.

On 5 December 1979 Abrahamsen and a colleague

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held a meeting with two executives from Sasol. The object of the meeting was to obtain "some normal banking business" from Sasol. They were informed that Sasol was traditionally a "one-bank-concern" and that it would not at that stage contemplate any splitting up of current account business. It was arranged, however, that Nedbank would be given an opportunity to quote for "forex" business and for "large/special" transactions. This was regarded from the Nedbank side as a "potentially fruitful visit". The gist of what was agreed to at this meeting was confirmed in a letter from Abrahamsen to the managing director of Sasol on 7 December 1979. The tone of this letter is one of hopeful anticipation that banking business would accrue to Nedbank from Sasol. Ultimately these hopes came to nothing. No current account business came from Sasol, nor did Nedbank receive any foreign exchange transactions or other special business from Sasol. As Abrahamsen put it —

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"... the hopeful anticipation came
to disillusionment".

In September 1980 the management committee of Nedbank decided to sell the Sasol shares. The reasons for the decision were twofold. At that stage it was felt that it was no longer likely that Nedbank would derive from the investment the benefit for which it had originally hoped. And at the same time the market value of the Sasol shares had risen considerably with the result that the yield of 7 per cent on the original cost of the shares had been reduced to an unattractive $3\frac{1}{2}$ per cent or less. In the circumstances it made sense to sell the shares and employ the capital thus released on a "substantially better yield basis". In pursuance of this decision Nedbank's brokers were instructed to sell the shares in "an orderly manner" so as not to disrupt the market. This was done and by 30 September 1981 9,3m of the 12,5m shares had been sold, with the profitable results already mentioned. The remainder of the shares were disposed of during the next

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ensuing financial year.

Abrahamsen declared that the original intention of Nedbank in acquiring these Sasol shares was not with a view to profitable resale at a later date, but in order to make "an investment of a long-term permanent nature". Originally it was anticipated that the preference shares would have a duration of approximately 10 to 15 years and, in accordance with normal practice, would at the end of that period be redeemed at par. On 19 June 1979 (by which time Nedbank knew that its participation would be by way of ordinary shares) a discussion took place between executives of Nedbank (including Abrahamsen) and members of one of the firms of auditors appointed by Nedbank, during which it was agreed (according to a letter dated 21 June 1979 confirming the discussion) —

> ".... that the above equity participation (in Sasol) is a long term investment, held for its dividend yield and that any fluc-

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tuations other than a permanent diminution in value need not be provided for in the annual accounts of the bank".

After the sale of the Sasol shares the profits realized were not transferred to the profit and loss account of the bank, but to an internal reserve account in the books of the bank and there they still remained at the time of the hearing. This was because the profits in question were of an extraordinary nature.

Abrahamsen further declared that it was not the policy of Nedbank to deal in equity shares. He gave individual explanations for various instances where during the financial year in question Nedbank had held and, in some instances, sold shares in other corporations. On a few occasions the bank had in the past been taxed on share transactions, but the amounts were small and the bank decided in each case not to pursue the matter.

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In his judgment the President of the Special Court (MELAMET J) said of Abrahamsen that he —

> "..... made a very good impression on the Court and there is nothing in his demeanour, when giving evidence, which would entitle us to question his evidence on that account. We formed the opinion that he was a frank and honest witness."

The Court further held that his evidence reflected the intention of Nedbank at the time of the acquisition of the Sasol shares, during the time when the shares were held by Nedbank and at the time of the sale thereof. The Court, though conscious of the rule that the ipse dixit of a taxpayer is not conclusive and that his evidence must be considered and tested in the light of all the surrounding circumstances, came to the conclusion that:

> "The decision of the appellant to subscribe to the shares of SASOL was predominantly motivated by a desire to obtain a collateral benefit, namely the

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banking of SASOL, and a foot in the business of the Afrikaans business community. It was a logical progression from the initial intention to offer finance to SASOL by means of preference shares. There can be no doubt that this was the intention of the appellant. It was to make available to SASOL a large sum of money in redeemable preference shares over a period of 8 to 15 years. The benefit to the appellant would have been a dividend from the preference shares and the collateral advantage of obtaining a share of the banking business of SASOL and thereby hopefully an entrée into Afrikaans business circles. The evidence of the witness in this regard is supported by documentary evidence - there was no suggestion that the memorandum was not made contemporaneously with the meeting or that the minutes did not accurately reflect what had taken place at the meeting.

Through no choice of the appellant the form of the investment and the amount of such investment was altered."

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"The appellant had committed itself to making an investment and continued on this line, leaving it to SASOL, for the reasons stated, to determine the nature and extent of the investment, and the appellant was satisfied with the return which would be produced from the investment. The witness testified, and the objective facts and the probabilities support him, that the appellant was not primarily, if at all, influenced by the possible profits from dealing in the shares. The shares came on to the market but the appellant did not attempt to stag the issue, and in fact, did not start selling the shares until almost a year after these had been issued to it.

The fact that the appellant sold the shares at a profit does not make the appellant a sharedealer. The appellant is entitled to realise a capital asset to its best advantage and in the most advantageous manner."

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"It was contended that the appellant had mixed motives when buying the shares. We are of the opinion that even if there

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> were mixed motives, which we do not find, the appellant has established that its dominant motive was to make an investment with a view to obtaining a part of the banking business of SASOL. The final letter from the witness, Mr Stegmann and the memorandum of the meeting of 5th December 1979, reflects the good and close relationship between the two persons, and refutes any argument that there was no reasonable prospect of getting a foot into the banking business of SASOL."

The Court, therefore, concluded that Nedbank had discharged the onus of proving that the shares were acquired as a capital investment and that the sale thereof was effected as a realization of capital assets on the basis most advantageous to Nedbank.

The Full Bench (PREISS, GROSSKOPF and SCHABORT JJ) endorsed the findings of the Special Court and concluded that —

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> ".....the respondent Bank clearly established that its share transaction was, and was intended to be, in the nature of an extension of or addition to the permanent structure upon which its business rested and not an acquisition of shares for resale or as part of a profit making scheme."

Both Courts referred to and relied upon the decision of this Court in the case of Secretary for Inland Revenue v Trust Bank of Africa Ltd 1975 (2) SA 652 (A).

On appeal in this Court counsel for the Commissioner submitted that the Special Court and the Court a quo had erred in failing to have regard to the true character of the transaction relating to the Sasol shares. This was, according to counsel, the furnishing of finance to Sasol in the course of Nedbank's banking business, "which renders the transaction a revenue one". The fact that in doing so Nedbank also hoped or intended to derive

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banking business from Sasol and to make a breakthrough into the Afrikaans business community was, it was argued, legally irrelevant. Counsel further submitted that had the finance been provided by way of preference shares as originally envisaged, the transaction would have been of a revenue character; and the decision to acquire ordinary shares instead was not as a result of a change of intention, but merely a necessary change in the vehicle for providing finance. The Trust Bank case, supra, was, according to counsel, distinguishable from the present one.

Though there may be certain factual differences between the Trust Bank case and the present one, certain principles applied therein are, in my opinion, relevant here. In that case the taxpayer, also a commercial bank, acquired a substantial shareholding ("the NFH shares") in the management company of a growth fund established in terms of the Unit Trusts Control Act 18 of

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1947, as amended. The bank disposed of this shareholding about $3\frac{1}{2}$ years later at a considerable profit. From its inception the bank had used certain of its surplus funds to deal in, ie buy and sell, quoted equities and Government and municipal stock. It was taxed from time to time on the overall profits made on the realization of such stocks and shares. The issue in the case was whether the profit which had accrued from the sale of the NFH shares was similarly taxable. It was accepted by the Special Court and, on appeal, by this Court —

(a) that the acquisition of the NFH shares by the bank was motivated predominantly by the prospect of obtaining certain "collateral advantages", such as new current banking accounts, the short-term investment of funds in the bank, a close association with prominent financial institutions in the growth fund, the acquisition of a priority

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agency for the sale of growth fund units, and the ability thus obtained to provide a further investment facility for the bank's clients;

(b) that the collateral advantages actually accrued to the bank by reason of its NFH shareholding;

(c) that the obtaining of this interest in the growth fund was, and was intended to be, in the nature of an extension of, or addition to, the permanent structure upon which the bank's business rested;

(d) that the acquisition of the NFH shares was quite distinct and different from the bank's normal share-dealing operations;

(e) that although the re-sale of the NFH shares as a future possibility could not be ruled out, given a sufficiently tempting offer, the shares were not acquired with a view to a profitable re-sale; and

/ (f) that.....

(f) that the bank eventually sold the shares, as a result of considerable persuasion and pressure from the board of NFH, to two other banks who were members of NFH and wished to increase their participation therein.

Both Courts accordingly concluded that the sale of the shares constituted the realization of a capital asset and was not the final step in a profit-making scheme. The proceeds of the realization were, therefore, a capital accrual and not subject to income tax.

In the course of his judgment BOTHA JA, who delivered the judgment of the Court, stated with reference to the factor of intention the following (at pp 667F to 668C):

> "It may be that in the case of an investment-dealing company whose business it is 'to deal in shares at a profit', or, which means the same thing, whose 'appointed means of the company's gains'

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'the gaining of profit by selling shares at higher prices than was paid for them'

(L.H.C. Corporation of S.A. (Pty.) Ltd. v Commissioner for Inland Revenue, 1950 (4) S.A. 640 (A.D.) at pp. 645-6, and cf Durban North Traders Ltd. v. Commissioner for Inland Revenue, 1956 (4) S.A. 594 (A.D.) at p. 604), the objective factors, such as the objects of the company as set out in its memorandum of association, the actual nature of the company's business, the normal business carried on by companies of that type, and the nature of the transaction, may, in an enquiry as to the purpose for which specific shares were acquired by such a company, assume greater significance than the intention with which those shares were acquired. (L.H.C. Corporation case, supra at pp. 645-7; Commissioner for Inland Revenue v Strathmore Consolidated Investments Ltd., 1959 (1) S.A. 469 (A.D.) at pp 477-8). The business of such an investment-dealing company is to make a profit on shares either by holding or selling them.

'These are merely alternative methods of dealing with the shares for the purpose of making a profit out of them. In either event there would be "a productive use of the capital employed to earn profits" '

(per SOLOMON, J.A., in Overseas Trust Corporation Ltd. v. Commissioner for Inland Revenue, 1926 A.D. 444 at p. 457). In such a case it would be extremely difficult for the company to show that a particular

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> share transaction nevertheless falls outside its normal trading activities in the sense that the shares were not acquired for a profitable re-sale but to be held purely as an investment. (Commissioner for Inland Revenue v Richmond Estates (Pty.) Ltd., 1956 (1) S.A. 602 (A.D.) at p. 607). Where, however, as in the present case, share dealing is carried on by a banker ancillary to its banking business the question whether a particular share transaction falls within its ordinary share dealing operations, or was intended as an extension of or addition to its banking business and not as a dealing in shares, is a question of an entirely different kind in the determination of which the intention with which the share transaction was entered into must necessarily be fundamental, even though it may not be decisive."

It seems to me that the Trust Bank case and the present case have much in common. In both cases it was found, as a fact, that the dominant motive of the bank in originally acquiring the shares in question was not in order to re-sell them at a profit, but in order to hold them so as to obtain collateral advantages in the form of additional banking business. It is true that in the Trust Bank case

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these collateral advantages in fact materialized, whereas in Nedbank's case they did not. But the significance of this is, in my view, merely evidential. The real issue is whether the obtaining of such advantages was the purpose of the acquisition of the shares: not whether this purpose was achieved or not. Of course the actual obtaining of such advantages would tend to be a positive factor substantiating the averment that that was the purpose of the acquisition; and failure to obtain the advantages might tend to be a negative factor. But where, as in the present case, there is other acceptable evidence to establish that the obtaining of collateral advantages was the purpose of the transaction, then the failure to achieve that purpose becomes legally irrelevant.

Another difference between the two cases is that Trust Bank was a dealer in shares, whereas Nedbank is not. This factor can only enure to the benefit of Nedbank in that it indicates that the acquisition of the Sasol

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shares was an extraordinary transaction.

Taking an overall view, however, and in principle, I consider that the Trust Bank case and the present case are in pari materia and that the Trust Bank decision is relevant authority for the conclusion reached by the Special Court and the Court a quo. As in the Trust Bank case, Nedbank acquired the shares not as part of a profit-making scheme, but as a long-term investment designed to produce collateral benefits in the form of additional banking business.

Counsel for the Commissioner, while apparently conceding that in fact the Sasol shares were not acquired by Nedbank for re-sale at a profit, nevertheless contended that the acquisition was in pursuance of an intention to provide finance in the ordinary course of the business of the bank and that the proceeds of the shares on disposal therefore constituted receipts of a revenue character. In this connection counsel made reference to the following cases:

African Life Investment Corporation (Pty) Ltd v Secretary for Inland Revenue 1969 (4) SA 259 (A); Income Tax Case No 836 21 SATC 330; Punjab Co-operative Bank, Ltd, Amritsar v Income Tax Commissioner Lahore [1940] 4 All ER 87; Commercial Banking Co of Sydney Ltd v Federal Commissioner of Taxation (1950) 4 AITR 406; Inland Revenue Commissioner (NZ) v Auckland Savings Bank (1970) 2 ATR 51; Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation (1946) 3 AITR 450; Frasers (Glasgow) Bank Ltd v Commissioners of Inland Revenue 40 TC 698.

In my opinion, these cases do not assist the Commissioner. In the African Life case, supra, the taxpayer bought and sold shares as part of its insurance business. In pursuit of a "composite purpose" it sold shares which it had bought in order to improve investments, ie by securing better dividends, and also to make profits on sales (see p 272 C-D); and it was held to be taxable on the profits derived from such sales. In Income Tax Case No 836,

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supra, the taxpayer, a commercial bank, realized at a profit certain government stock in which part of its banking funds were invested. The Court held that the transaction was not the realization of a fixed asset, but a normal banking transaction within the limits of the taxpayer's objects and for the purpose of carrying out its objects (see p 333). The Punjab Co-operative Bank case, supra, (relied upon in Income Tax Case No 836) dealt with a similar situation, viz, the sale of certain securities held by a bank in order to meet withdrawals of deposits. It was held that the profits realized from the sale of the securities were taxable. In the Privy Council Viscount MAUGHAM said (at p 95 F-H):

> "In the ordinary case of a bank, the business consists, in its essence, of dealing with money and credit. Numerous depositors place their money with the bank, often receiving a small rate of interest on it. Numerous borrowers receive loans of a large part of these deposited funds at somewhat higher rates of interest, but the banker has always to keep enough cash or easily

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> realisable securities to meet any probable demand by the depositors. No doubt there will generally be loans to persons of undoubted solvency which can quickly be called in, but it may be very undesirable to use this second line of defence. If, as in the present case, some of the securities of the bank are realised in order to meet withdrawals by depositors, it seems to their Lordships to be quite clear that this is a normal step in carrying on the banking business, or, in other words, that it is an act done in 'what is truly the carrying on' of the banking business."

Of the Australian cases cited by counsel the Commercial Banking Co of Sydney case does not appear to be relevant; and in the other two cases, the Auckland Savings Bank case and the Colonial Mutual case, the taxability of profits made on the realization of securities was founded generally on the finding that the buying and selling of such securities was part of the business of, in the one case, the bank and, in the other case, the insurance company concerned. Both decisions relied upon the Punjab Co-operative Bank case. The Frasers (Glasgow) Bank case, supra, was decided on the same principle.

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The facts in these cases are very different from those in the present case. And, as was emphasized in the Trust Bank case, supra, at p 671 B —

> "The question whether any amount received by a taxpayer is a capital or revenue accrual for the purpose of the definition of 'gross income' in the Income Tax Act is essentially a question to be decided on the facts of each case".

In Nedbank's case it was not part of the ordinary business of the bank to deal in equities. It did not invest its funds in such securities. These are indisputable facts. Moreover, the Sasol investment was an extraordinary transaction, originally conceived as a long-term investment in order to bring collateral benefits in the form of additional banking business. If Australian decisions are to be referred to, then it seems to me that a closer analogy is to be found in the case of National Bank of Australasia Ltd v Federal Commissioner of Taxation (1968) 1 ATR 53.

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The argument based upon the submission that, had the original scheme relating to preference shares been implemented, the transaction would have been of a revenue character is, in my view, a sterile one. It is by no means clear to me that on the facts of this case this submission is sound in law; and in any event this original scheme was never implemented.

In the course of his argument counsel for the Commissioner, as I understood him, submitted that the purchase of shares by a bank out of banking funds (ie, circulating capital) inevitably partakes of a revenue character, with the result that a profit made on the sale of those shares by the bank is income in its hands. The unsoundness of this proposition as a generalization is, I think, demonstrated by the decision in the Trust Bank case, supra.

To sum up, having regard to the factual findings, particularly the findings as to intention, made by the Special Court in this case, I am not persuaded that it

reached the wrong conclusion when it held that the realization of the Sasol shares resulted in capital accruals to Nedbank.

The appeal is dismissed with costs, including the costs of two counsel.

M M CORBETT

VAN HEERDEN JA)
HEFER, JA)
GALGUT, AJA) CONCUR.
NESTADT, AJA)