LL Case No 301/1989

IN THE SUPREME COURT OF SOUTH AFRICA

APPELLATE DIVISION

In the matter between:

COMMISSIONER FOR INLAND REVENUE Appellant

and

GUARDIAN ASSURANCE COMPANY

SOUTH AFRICA LIMITED Respondent

CORAM: CORBETT CJ, NESTADT, KUMLEBEN JJA, PREISS et KRIEGLER AJJA

HEARD: 15 FEBRUARY 1991

DELIVERED: 26 MARCH 1991

JUDGMENT

KRIEGLER AJA:

This income tax appeal is brought direct to this court pursuant to leave granted by the President of the Transvaal Income Tax Special Court in terms of section 86A(5) of the Income Tax Act No 58 of 1962 ("the Act"). The point in issue is whether profits derived by the respondent, Guardian Assurance Company South Africa Limited ("GASA"), from the sale by it during 1982, 1983 and 1984 of shares it held in a number of companies listed on the Johannesburg Stock Exchange formed part of its taxable income. In its returns of income and supporting accounts for the years of assessment ended 31 December 1982, 1983 and 1984 respectively GASA reflected the income thus derived as having been of a capital nature. The appellant, the Commissioner for Inland Revenue ("the Commissioner"), however, included such profits in GASA's taxable income in each of the three years. Its formal objections having been disallowed, GASA appealed to the Transvaal Income Tax Special Court in terms of section 83 of the

Act. Initially the appeal was to have been directed at the assessment for the 1982 year only but by consent it was belatedly expanded to encompass the assessments for the succeeding two years as well. The Special Court ruled in favour of GASA and remitted each of the three assessments to the Commissioner for reassessment on the basis that the profits in question did not form part of GASA's taxable income. Hence this appeal.

The Special Court had before it a dossier prepared by the Commissioner in terms of regulation B(3) of the regulations promulgated under section 107 of the Act, and two supplements thereto. In addition counsel for GASA, shortly after the commencement of the evidence of the first witness, handed in two exhibits. The first, identified as exhibit "A", was described by GASA's counsel as "a summary of all the various transactions in issue in this case." The second, exhibit "B", was described by GASA's counsel as GASA's "bundle of documents", to which he added "... there will be a certain amount of overlapping in the third dossier and the appellant's bundle. Of course this bundle is not handed in as evidence of all the documents in it, except to the extent that they are referred to from time to time by the witnesses and identified." Unfortunately no particular care was taken by counsel on either side in the course of the <u>viva voce</u> evidence to identify documents being referred to. Thus the confusion, inherent in the multiplicity of dossiers, the (unspecified) degree of overlapping and the apparent lack of any index, was compounded. Moreover, when the record on appeal came to be prepared in the Commissioner's office, the officials concerned, unfamiliar with the case, were unable to do so satisfactorily. In particular GASA's "bundle of documents", exhibit "B", which, judging by counsel's introductory remarks, must have comprised a considerable number of documents, is reflected in the record as consisting of a single four page letter.

Furthermore a highly pertinent schedule reflecting movements of equity shares held by GASA, exhibit "B" 108 to 110, and which had been referred to in the evidence in the court a quo, was omitted from the record and had to be handed in from the bar at the hearing of the appeal. Notwithstanding the unsatisfactory state of the record, however, a clear picture of the relevant circumstances can be gleaned from the documentary and oral evidence presented to the Special Court.

Three witnesses were called, all on behalf of GASA. The first was Mr Richard Morris who retired in mid-1987 after forty years with the firm Coopers and Lybrand, public accountants and auditors. He had for many years been the audit partner for GASA and from approximately 1975 he was the review partner involved in important matters of accounting principle relating to GASA's affairs. He was also the specialist tax partner in the firm. Although he had never been involved in the day to day affairs of GASA he was familiar with its history and investment policy. He had moreover been involved in the representations on behalf of GASA to the revenue authorities relating to the taxability of profits derived from the sale of shares in its investment portfolio.

The next witness to be called was Mr Michael Newman, the managing director of GASA as also of its holding company, Guardian National Insurance Company Limited ("GNIC"). He started his career in the insurance industry in 1954, later became the general manager of GASA and in 1973 attained a seat on its board of directors. Mr Newman was able to flesh out Morris's general description of the history of GASA and of its investment policy over the years. He also described in detail the nature of GASA's business, its position in the group of companies of which it was a member and how and when it underwent certain fundamental changes. He too had been involved in the debate with the revenue authorities concerning the taxability of the profits derived by GASA from the disposal of shares held in its investment portfolio. Although he had knowledge of and was able to deal in evidence with a number of the more salient of such disposals, he had not been involved in the day to day administration of the portfolio and traversed the terrain in more general terms.

The detailed information was furnished in evidence by Mr J R McAlpine, a specialist in the field of share portfolio management. He was the managing director of Liberty Asset Management Company Limited ("LIBAM"), a member of the Liberty group of companies, which administered some 80 to 85 share investment portfolios for a variety of principals. Each portfolio was administered in accordance with the specific objectives of the client concerned. Thus the portfolio of a pension fund or of a unit trust is sensitive to fluctuations in share market prices and requires frequent adjustments. Others, like investment trusts, call for a much more conservative approach, the objective being a steady income in the long term with disposals of counters taking place only when necessitated by some extraordinary circumstance. Irrespective of the specific objectives of the client concerned, however, McAlpine, who was the person in LIBAM essentially concerned with the investigation and recommendation of investments, followed the same fixed and conservative policy: one never buys on tips nor for quick profit or speculatively. The witness detailed a series of investigative steps taken and criteria considered before any investment was recommended. He also described in detail how GASA's share investment portfolio had been administered from the mid 1970's to 1987 and explained the circumstances giving rise to each of the transactions which generated profits giving rise to disputes as to their taxability.

The court a quo, "fully cognizant of the fact that the _ipse dixit_ of witnesses in a case such as the present must not be accepted uncritically", accepted the evidence of Messrs Newman and McAlpine as truthful and reliable. There is no reason to differ. Nor can any criticism be levelled at the evidence of Mr Morris, although in his case there was no express endorsement by the court _a quo_. Indeed the Commissioner did not seriously challenge their veracity or accuracy in either court, the main thrust of his case being directed at the surrounding circumstances. Consequently a composite factual summary derived from the evidence of all three witnesses read with the documents to which they referred will suffice.

Although empowered by its memorandum of association to conduct many types of insurance business, GASA at all times material prior to 1 January 1981 carried on business as a casualty, or short-term, insurer. It also built up a substantial share investment portfolio, financed solely from shareholders' funds. Requirements laid down by the Registrar of Insurance prescribed a certain ratio to be maintained between GASA's premium income and the investments it held as also between its liabilities and investments of a prescribed kind. Apart from maintaining such ratios GASA's insurance business and the investment portfolio were managed as separate entities. The necessity to dispose of any part of the investment portfolio in order to finance shortfalls in the insurance business never arose.

In 1974 McAlpine became entrusted with the administration of the portfolio. Previously various staff members of LIBAM had been responsible for the portfolio and had allowed it to become, as McAlpine put it, "cluttered up" with a variety of counters, many of which he regarded as unsuitable having regard to GASA's investment objectives. Over a period of several years thereafter, more especially in 1978, the portfolio was "cleaned up". This entailed the disposal of a number of counters which did not fit in with the conservative investment policy recommended by LIBAM and espoused by the chairman of the Liberty Life group, Mr Donald Gordon. Thus in the year of account ended 31 December 1976 fifteen counters were shed of which six were relatively minor ordinary shareholdings and the balance preferent shares, debenture stock and nil paid letters. The upshot in that year was a surplus of but R1 684. The sale of ordinary shares in the year of account ended 31 December 1977 produced a small surplus of R4 074 on a total selling price of R303 662. In the following year of account sales totalling R2 420 039 took place with a surplus of R41 860. There were only two sales of equity shares during that year, the first resulting in a loss of R22 298. The second, the sale of ordinary shares in Clydesdale Collieries Limited, resulted in a profit of R131 781. Messrs Newman and McAlpine testified that the latter transaction was an extraordinary and "strategic" one in that the Liberty group severed a long-standing relationship with Clydesdale Collieries Limited and GASA merely followed suit. The disposal was in no way motivated by an intention to reap a profit. The balance of the disposals during 1978 constituted "cleaning up", the counters sold being regarded as inappropriate in a stable and long-term investment portfolio aimed at dividend income.

In the year of account ended 31 December 1979 only four equity counters were sold - for a total selling price of R59 786 and resulting in a loss of R6 441. The balance of the disposals during 1979, as in 1978, comprised holdings in preferent shares, debentures, government stock and the like, which were regarded as unsuitable for such a portfolio. In 1980 there was only one sale of equity shares, which produced a profit of R2 542 028 on sale proceeds of R4 719 942. That, too, was a strategic sale and was accepted by the revenue authorities as being of a capital nature and the proceeds were excluded from

GASA's taxable income.

Objectively viewed, the sales data for the years of account from 1976 up to and including 1980 give little or any indication that the sales of counters that took place were steps in a scheme of profit making. On the contrary, they tend to bear out the evidence of the witnesses, more especially that of Mr McAlpine, that the portfolio was administered predominantly as a long-term income-producing capital asset, disposals having been necessitated by extraordinary circumstances or, by "cleaning up", to render the portfolio more suitable for the predominant purpose. If one then has regard to the available data regarding purchases of equity counters during the five year period in question the impression created by the oral evidence and the sales data is confirmed. During the three years of account 1978, 1979 and 1980 more than R10 million was expended in major acquisitions of largely "blue chip" equities (e g Stanbic at a cost of

R534 529, Sasol at R500 000 and Barlow Rand at R2 728 707). The composite picture of purchases and sales reaffirms that the portfolio was intended to be and was managed as a dividend-producing capital asset.

In 1980 there was a fundamental change in the affairs of GASA. Pursuant to a reverse take-over dated 7 August 1980 and effective from 1 July 1980, GASA became a wholly-owned subsidiary of Union National South British Insurance Company Limited, which latter company later changed its name to GNIC. GASA's short-term insurance business was merged with that of GNIC and from 1 January 1981 GASA wrote no new business. During that year all the policies of insurance it had issued in previous years expired and its liabilities in respect of outstanding insurance claims as at the end of that year were assumed by GNIC with effect from 1 January 1982. In the result GASA was left with an insurance licence, on which it at no stage thereafter operated, and its share portfolio containing 4 982 095 equity shares acquired at a cost of R11 225 436.

At a meeting of the board of directors of GNIC held on 8 November 1980 it was resolved to reduce the board of GASA to four members "as only business of a formal nature would be undertaken in future with all policy decisions being handled by the full board of Guardian National." The chairman, Mr Gordon, mentioned "the possibility of retaining GASA as an investment holding company." GASA having become a non-trading wholly-owned subsidiary, an investment shell, its investment portfolio ought rationally to have been transferred to GNIC in order to perfect the merger. Ways and means of attaining such objective without incurring fiscal liabilities were investigated, but to no avail. In the result it was decided to transfer GASA's fixed interest investments to GNIC but to retain the balance of the portfolio in GASA's hands. Subsequently, at a meeting of the board of GNIC held on 27 August 1981 <u>inter alia</u> the following was resolved under the heading "Taxation of capital gains":

> "It was agreed that certain fixed interest securities be transferred to the holding company at book value and that the remaining investments held by GASA, consisting mainly of equities, be retained in that company which would operate as an Investment Trust."

At subsequent meetings of the board of GNIC the matter was raised again from time to time. The minutes of the meeting held on 19 November 1982 contain the following:

> "TRANSFER OF ASSETS FROM GUARDIAN ASSURANCE COMPANY SOUTH AFRICA LIMITED ("GASA") TO GUARDIAN NATIONAL INSURANCE COMPANY LIMITED
>
> Mr Gordon advised the Board that detailed discussions had been held with the company's auditors regarding the transfer of equities from GASA to Guardian National Insurance Company Limited. Mr Gordon said that after these discussions it was felt that GASA should, for the time being operate as an investment trust, and where necessary to sell investments which were not suitable for that company's investment objectives. Should the Receiver of Revenue decide to tax any profit arising from the sale of these investments the matter would be contested in the taxation court on the basis of being a test case."

On 11 May 1983 the board of directors of GASA adopted the following resolution:

"<u>CESSATION OF INSURANCE ACTIVITIES</u>

IT WAS NOTED THAT with effect from 1 July 1980 Guardian National Insurance Company Limited (formerly Union National South British Insurance Company Limited) ('Guardian National') had acquired the company's entire issued equity share capital and that in terms of the arrangements concluded at that time Guardian Assurance Company South Africa Limited would cease trading as an Insurance company.

IT WAS FURTHER NOTED THAT the company would not underwrite any further insurance business from 1 January 1981 and that an adequate reserve be created within the company's accounts for the provision of all liabilities incurred prior to that date.

IT WAS FURTHER NOTED THAT the company would retain its investment portfolio as a long term investment and for the purpose of deriving investment income for the benefit of the company.

IT WAS RESOLVED THAT the aforegoing matter in regard to the cessation of activities as an insurance company is a true and accurate record of the intentions of the company at 1 July 1980."

The board of directors of GNIC discussed the GASA investment portfolio at a meeting held on 17 May 1984, the relevant minute reading as follows:

> "<u>GUARDIAN ASSURANCE COMPANY SOUTH AFRICA LIMITED</u>
>
> The investment portfolio of Guardian Assurance Company South Africa Limited ('GASA') was submitted to the meeting and reviewed by the Board. Mr Gordon said that the uncertainty in regard to the taxation of any surpluses arising from the disposal of investments of GASA was adversely affecting investment decision making by the investment managers and he felt it necessary to consult outside advisers with a view to obtaining clarity from the Revenue authorities in this regard.
>
> It was further agreed that the portfolio remain unchanged unless any profits could be off-set against any losses arising from the sale of any investments."

In the interim the administration of the GASA portfolio under the aegis of LIBAM continued. In the year of account ended 31 December 1981 three equity counters were sold, yielding an overall profit of R384 929. One of these, Fidelity Bank and Trust Company Limited, was an extraordinary or strategic sale which was explained in evidence by Messrs Newman and

McAlpine. The Liberty Life group had enjoyed a business relationship with the purchaser and when the latter exerted pressure GASA deemed it expedient in the interests of the group to accede, realising a profit of R281 250.

In 1982 two of the 35 equity counters in GASA's portfolio were sold, namely, Sappi and De Beers, producing a surplus of R358 132. The proceeds represented 4,7% of the balance sheet value of the shares held by GASA as at 31 December 1982. The Sappi shares had been bought from 1969 to 1979 at a total price of R220 776 and were sold in November 1982 for R714 123. The De Beers shares had been bought in 1979 and 1980 at R570 616 and were sold in 1982 at R435 400. With regard to the first counter sold, McAlpine testified as follows:

> "...Sappi was a share that we were holding for the reasons which I've already outlined to the Court and early 1980's it announced a massive expansion project, the capital cost of which was two or three times its current

> market capitalization. We're always very wary of those types of massive expansions and because of that we thought that the dividend growth prospects could be impaired and after investigation we decided that that holding no longer fulfilled the role which we originally meant it to do and we disposed of it."

With regard to the sale of the De Beers shares McAlpine's evidence was as follows:

> "De Beers shares, here the industry itself, the diamond industry itself went through a fundamental restructure in the early 1980's, in fact there was a stage when the very viability of the diamond industry was, you know, was open to question, this after De Beers had been regarded as the deepest of blue chip counters. I think it was about the entire 1960's and the entire 1970's. Fundamental change in the industry cut its dividend and we thought it no longer fulfils the requirements, so it was sold."

Representations notwithstanding, the Commissioner assessed the nett profit of R358 132 to tax and such assessment formed the first issue in the appeal to the court a quo.

In the succeeding accounting year GASA sold three of its 33 equity counters (representing less than

2,5% of the balance sheet value of its total portfolio as at the end of that year) for a total price of R765 046 and producing a profit of R332 007. In the course of his evidence Mr McAlpine dealt with the circumstances motivating each of the disposals in the 1983 year. In the one instance there was concern about the continued viability of the company concerned, in another there was a fundamental change in the business and management of the company while in the third instance, Anamint, the reason for the disposal was the same as that regarding the De Beers shares. During the same year there were two major share exchanges resulting in profits. In the first 250 000 S A Breweries shares were exchanged for 88 500 shares in the Premier group as a result of a public offer pursuant to a major corporate reconstruction. In the second case, too, the change in shareholding was occasioned by a corporate reconstruction and a consequent offer to shareholders. The overall result was a profit during the financial year ended 31 December 1983 amounting to R2 294 858, the whole of which the Commissioner assessed to income tax. Such assessment was the second issue in the court below.

During the year of account ended 31 December 1984 there was one transaction only. In October of that year GASA sold a parcel of 31 600 Edgars participating preference shares (which it had acquired in April 1977) at a profit of R463 855. Once again the precipitating factor was not a decision to sell with a view to profit. Although GASA would have preferred to retain the counter it responded to what it regarded as a strategically important offer to minority shareholders emanating from a company with which the Liberty group had a close relationship. Representations and a formal objection notwithstanding, the Commissioner adhered to the view that the resultant profit of R463 855 was liable to income tax. Such assessment then formed the third issue before the court *a quo*.

The case presented to that court on behalf of GASA was somewhat ambivalent. Although the main thrust of the evidence presented was to the effect that the merger in 1980 and the consequent cessation of short-term insurance business precipitated a change of intention regarding the investment portfolio, each of the three witnesses nevertheless emphasised that, even prior to the merger, the portfolio had been regarded and administered as a capital asset. Thus Mr Morris, in dealing with GASA's pre-merger intention with regard to the portfolio, said the following:

> "... it was my understanding from what was said to me and what I could observe for myself that the investment policy was to hold their equity portfolio, long-term for income ... Income in the form of dividends."

Mr Newman's evidence regarding GASA's pre-merger investment policy was, albeit of a more general nature, substantially to the same effect as that of Mr Morris. In his evidence-in-chief he confirmed a statement put to him that GASA's "overriding and dominating intention in relation to the portfolio was to retain the portfolio as a permanent investment showing an ever rising dividend yield". He added that GASA had "never been what I would describe as traders in equity investment". Later, in the course of cross-examination, he described the purpose with which the share portfolio had been held prior to the merger in the following terms:

> "My lord, prior to 1981 for some years, the company had a very close association with the Liberty Life group and Donald Gordon was the chairman of the company. Donald Gordon is a very selective investor and the investments that we developed in GASA, to my certain knowledge, are essentially blue chip investments and they were, I am talking of equity investments, purchased for long-term for income producing purposes.
>
> ...
>
> My lord, I will first say that prior to 1981 GASA was a short-term insurer with a share portfolio largely comprised of investments that were effected for long-term investment purposes."

Mr McAlpine, although not a member of the board of GASA nor even an employee of that company, was well qualified to express a view on the intention with which the portfolio had been held and administered from 1974 onwards. He was intimately involved with the day to day management of its investment portfolio in accordance with the policy directives of its board of directors, whose meetings he regularly attended. He understood LIBAM's mandate at all times, i e even pre-merger, to have been to administer GASA's investment portfolio as an investment trust where:

> "... the board of directors laid down a mandate that the brief was to look for steady income, at the income growth over a long period of time. In an investment trust, even if I thought a counter was overpriced relative to others, we would not sell it, we would hold on to it on the basis that it's been a long-term investment. The only circumstances under which we would contemplate making a disposal in an investment trust would be if something fundamental happened to change our company's view on the likelihood or otherwise, of that company continuing to grow its earnings as it has in the past and of course that could be for various reasons. The first one possibly the very industry in

> which it's operating, the outlook for that industry might change drastically. The company might sell off a very large part of its undertaking and it may totally change its nature. The management might totally leave the company and leave the company in what we deem to be incompetent managements. So those would be the sort of things that might cause us to re-appraise and therefore adjust the structure of an investment trust. A casualty insurance company would be something similar to an investment trust. Well, basically the longer term objectives there are steadily increasing income."

Notwithstanding their evidence regarding the capital nature of the investment portfolio prior to the merger, each of the witnesses was at pains to underscore that there had been a change of intention subsequent to and as a result of the merger. Mr Morris described it as "a very, very fundamental change of circumstances ... a totally new ball-park." When pressed in cross-examination by the Commissioner's representative to identify the change the witness, predictably, was in some difficulties and eventually said the following:

> "We simply retained an investment portfolio in the place it was already in. We created

no new structure whatsoever. We left the portfolio exactly where it was. I've admitted it was left there because the directors who were responsible in the stewardship manner for the funds of the shareholders were not prepared to accept a course of action which would entail either immediate or long-term tax implications when the safest course appeared to be to leave the portfolio exactly where it was and to make it clear that there would be a long-term investment policy, which is what they have carried out. "

To this he added a little later:

"... from the time of the change of this decision, the policy with regard to GASA's investments was to be stringent and that sales would only be contemplated if there were the most compelling reasons. In other words, they wanted and decided to cut their transactions to a minimum ... The instruction went out: this is now an investment trust, investment transactions are to be cut to a minimum and only for the most compelling reasons."

When Mr Newman was pressed in cross-examination to identify the change he too was in some difficulty. Eventually, in response to a question by the President, he said:

"There was a change in philosophy in post

1981 certainly, but pre-1981, if we look at the year 1980 when the merger with Unsbic was contemplated, we had a portfolio with Equity Investments that had always been seen as an investment portfolio with stable nature. We may have traded in certain counters but certainly not extensively, but then post the merger with Unsbic there was a definite change in intention towards that portfolio, and it was regarded as an investment trust."

McAlpine, when obliged to describe the alleged change of intention brought about by the merger, was eventually constrained to answer:

"Well, as far as the portfolio is concerned here I'll say that we've gone from probably passive to extremely passive and by extremely passive I mean we've got to a stage here where over the last three years we haven't done one single transaction."

In fairness to the witnesses it should be said that the difficulty they encountered in trying to define the change of intention brought about by the merger was not really of their making. It was inherent in the ambivalence of GASA's case. Nor is the ambivalence fairly to be laid at GASA's door. Its root cause is that, while it was still conducting business as a short-term insurer, it fell foul of a policy adopted by the revenue authorities with regard to such taxpayers. Mr Morris described the policy in the following terms:

> "... there has been applied to short-term insurers, a concept of an all-in company i.e. that its investments are trading stock willy nilly. This has been of great convenience to the Revenue Department, I think, because under this approach, they were always entitled to assume taxability. However, in fairness to the Department, they did not apply it absolutely rigidly and on at least three occasions we successfully, in GASA, put up submissions that certain investments were strategic and not ordinary investments and on each of those occasions we got acceptance from the Revenue Department that they were of a capital nature."

Mr Morris testified that, although he had "always had some reservations about the validity of the all-in concept" he did not regard it as worthwhile to force the issue with the revenue authorities and that GASA "didn't want to be sort of guinea-pigs to take the all-in concept on appeal because it could be a costly and protracted business."

Mr Newman, when confronted with the paradox that GASA, prior to the merger, had purportedly held its investment portfolio as fixed capital but had at the same time generally reflected its surpluses and losses on disposals of counters from the portfolio as revenue, replied:

> "My lord, I think I should say there has always been a debate at GASA board meetings as to the merits of the 'all in' classification definition for a short-term insurance company. It was with a measure of reluctance or a feeling of reluctance that the company accepted the ruling of 'all in' rather than to the extent of appealing the revenue's decisions. ...
>
> ... we were a short-term insurer, there seemed to be little evidence of a prospect of success, the matter had been considered by numerous insurance companies to my knowledge and whilst there was a general feeling that 'all in' classification was not necessarily fair to a short-term insurer, nonetheless it was agreed to allow it to continue. ... To remove that unhappiness would be extremely costly and might not succeed in the end anyway."

Mr McAlpine was even more explicit. From the outset he had regarded his mandate from GASA regarding its equity investment portfolio that it should be managed like an investment trust. That is why he shed the unsuitable counters and, apart from the prescribed holdings for liquidity ratio purposes, administered the portfolio precisely as he did the pure investment trusts under his control. In the case of the latter he was mindful of the risk that undue frequency or volume of transactions might expose the trust to taxability on gains but in the case of GASA, a "casualty insurance company it was always operated under the so-called 'all embracing' situation which, although we didn't agree with it at that stage, we had to admit it was the practice." When asked whether GASA in his opinion had been a sharedealer prior to 1980 he answered unequivocally:

> "No, no, although I can see that the revenue, in the revenue's opinion all casualty insurers were classified as share-dealers here but in my personal opinion here we were not share-dealers because share-dealers is a connotation that you are buying and selling shares with the objective of making profits and that never was and never has been part of the investment objectives in the appellant

company."

The court *a quo*, having analysed the *viva voce* and documentary evidence in the light of the applicable legal principles, found in favour of GASA on the basis that both before and after the merger the investment portfolio had been held as a capital asset. Although the question whether there had been a change of intention consequently did not arise, the Special Court observed that no such change pursuant to the merger had been established. On appeal to this Court the observation as to the absence of adequate proof of a change of intention was supported on behalf of the Commissioner while the finding as to the intention with which the portfolio had been held throughout was challenged. The substance of the Commissioner's case was that, while GASA's primary intention had admittedly been the acquisition of a permanent investment with a view to long-term dividend yields, a secondary and integral part of its investment holding had been the business of dealing in shares. The argument in support rested on four main contentions. The first was that GASA, prior to the merger, had accepted that it was a sharedealer in relation to the management of the investment portfolio, recognising that of necessity it would have to deal in counters as and when its investment policy so dictated. On the basis of that proposition it was then submitted in the second instance that the merger had brought about no real change in either the intention with which the portfolio was held nor in the manner in which it was administered. The third main submission was founded on the use of the phrase "for the time being" in the above quoted minutes of the meeting of the board of directors of GNIC of 19 November 1982. There, it will be recalled, the chairman, Mr Gordon, was recorded as having opined "that GASA should, for the time being operate as an investment trust". It was contended that the use of the particular phrase evidenced some reservation on the part of GASA concerning the intentions with which the portfolio was to be held. The fourth main contention was based on an analysis of the disposals of counters during the years of assessment ended 31 December 1982, 1983 and 1984 respectively. Those transactions, so it was argued, demonstrated that GASA had recognised at all times that the management of a share portfolio such as the one in question necessarily entailed some dealing in shares. In the result, so it was argued, although GASA's primary intention had been the acquisition and holding of a permanent investment with a view to long-term dividend yields, it had not discharged the onus resting upon it under s 82 of the Act of establishing that some dealing in shares for profit had not been a secondary yet integral part of its business.

It is convenient to deal with the submissions on behalf of the Commissioner in the order in which they were advanced. The first was that GASA had accepted the correctness of its categorisation as a dealer prior to the merger. It can be accepted for purposes of argument that, generally speaking, acceptance by a taxpayer over a protracted period of a particular basis of taxation and the arrangement of his affairs accordingly can give rise to the inference that such basis is well-founded. Such inferential reasoning founders on the facts of the present case however. GASA at no stage accepted that it had been correctly assessed to income tax on the profits derived from the disposal of counters held in its investment portfolio, nor did it arrange its affairs on the basis that it was a sharedealer in respect of such transactions. Each of the three witnesses made it plain that the portfolio was regarded by GASA as an income-producing capital asset, administered as such separately from the insurance side of its business: The counters held during the relevant period had been acquired wholly with shareholders' funds, were surplus to any money required to meet insurance claims and the equity share component of the portfolio was not affected by the liquidity ratio requirements of the Registrar of Insurance. According to Messrs Morris, Newman and McAlpine the portfolio was managed conservatively in the belief that it was akin to an investment trust. Such disposals as there were during the period from 1976 to the end of 1980 constituted (i) "cleaning up" of counters considered unsuitable for an investment portfolio, (ii) strategic disposals where profit-taking had played no part and (iii) isolated sales, more often than not at a loss, of relatively small parcels of shares whose dividend yield had been or was anticipated to become inadequate. The acquisitions during that five year period were made with a view to compiling a portfolio which would yield a long-term and ever-increasing dividend income. The evidence, far from establishing acceptance on the part of GASA that it was a sharedealer and conducted its affairs in accordance with such acceptance, manifested a reluctant acquiescence in the "all-in" approach adopted by the revenue authorities, believing it to be wrong but not considering it worth the candle to make it an issue. In this regard Mr Morris pointed out that the profits assessed to tax prior to the merger (and in respect of which the revenue could not be persuaded that the disposals in question had been strategic) were relatively minor and largely off-set by losses sustained on other disposals. On the evidence, therefore, the first point argued on behalf of the Commissioner cannot prevail. GASA neither accepted that it was a sharedealer nor did it manage the portfolio accordingly.

The second point, i e that no real change of intention nor of manner of administration was brought about by the merger, can be accepted as substantially valid. Once it is accepted that GASA's intention prior to the merger had been to hold and administer the portfolio as a capital base, the change in its circumstances consequent upon the merger, however fundamental it may have been, could not have motivated a crucial change of intention with regard to its investment portfolio. That was the dilemma faced by each of the three witnesses in their testimony. Upon a proper analysis of the history of the portfolio and giving due weight to the board resolutions quoted above, it becomes clear though that the dilemma was more apparent than real. Although there was no true change of intention, the changed circumstances of GASA brought about by the merger, whereby it was reduced to the status of a shareholding conduit for its parent company, GNIC, <u>did</u> result in some change vis-à-vis the investment portfolio. Once the insurance business had been shed, the "all-in" approach of the revenue authorities could be resisted with greater justification than before. The board of directors of GNIC could then decide, as it did on 19 November 1982, that GASA should operate as an investment trust and the latter's board could adopt the formal resolution of 11 May 1983 putting on record its intention to "retain its investment portfolio as a long-term investment and for the purpose of deriving investment income for the benefit of the company."

Pursuant to the change in GASA's status and business LIBAM could be instructed, as indeed it was, to adopt the self same cautious and conservative policy with regard to GASA's portfolio as was applied to the other investment trust portfolios it managed. The result of the change brought about by the merger was therefore not so much a change of intention but rather a strengthening of the resolve of the directors, backed by the changed circumstances which lent force to their resolve. Concomitantly the administration of the portfolio, as Mr McAlpine put it, went "from probably passive to extremely passive". Although the portfolio had at all times been administered as a capital base with a view to the production of dividend income, great care was taken after the merger to restrict disposals of counters to the minimum so as to avoid any suggestion of sharedealing. Whereas pre-merger the portfolio had been managed as a capital base, the post-merger administration was directed at ensuring that it was manifestly seen to be such.

The argument based on the use of the phrase "for the time being" by Mr Gordon at the GNIC directors' meeting on 19 November 1982, should be viewed in its contextual matrix. At that stage GASA had for more than two years been a wholly owned subsidiary of GNIC, it had withdrawn from the short-term insurance business from the beginning of 1981 and all of its outstanding obligations had been discharged by GNIC early in 1982. The fixed interest securities in the GASA portfolio had been transferred to GNIC at book value and, had it not been for fiscal impediments, the rest of the portfolio would have been transferred likewise. A tax expert had been consulted about ways of overcoming such impediments and had furnished a gloomy prognosis. LIBAM had been instructed to manage the GASA equity portfolio manifestly as a long-term investment for the deriving of dividend income and had acted in accordance with such mandate. Nevertheless the board members of GNIC and GASA were left in the quandary that the transfer of the portfolio from the one company to the other, which they had desired to effect from the outset as part and parcel of the merger, could not be undertaken without incurring the risk of a heavy tax burden. In those circumstances the use of the phrase in question was probably intended to convey, as the court a quo held, an intention to mark time. In other words, pending a satisfactory way out of the quandary, the GASA equity portfolio was to be held and administered as a dividend-producing capital base. In that context the words used were apposite. They aptly describe the state of mind of Mr Gordon: if and when the fiscal impediments to transfer of the portfolio could be overcome GASA would be divested of the portfolio. During the indefinite intervening period the portfolio would be held in GASA. Upon a proper interpretation, therefore, the phrase does not denote any uncertainty or mixed intentions regarding the purpose for which the portfolio would be held and administered but accurately reflected the uncertainty as to the identity of the holder of the portfolio in the future.

The contention that the sales of shares during 1982, 1983 and 1984 evidence an appreciation on the part of GASA that the management of its portfolio of necessity involved some sharedealing, finds no support in the proven facts. On the contrary, the very paucity of disposals during the years under review lends support to the evidence of Messrs Newman and McAlpine that, not only had there been no contemplation of sales with a view to profit-taking, but that there had been an acute awareness that any suspicion of such contemplation should be avoided. Indeed the evidence establishes that there were occasions when counters could have been sold profitably and where such disposals were in accordance with the sound administration of a long-term dividend yielding investment portfolio but where the opportunity was foregone in order to avoid any semblance of sharedealing.

Faced with such cogent evidence of the intention of the particular taxpayer in question, counsel for the Commissioner submitted as a general proposition that it was inherent in the management of any share portfolio that a measure of sharedealing for profit would be involved. Shares, so the argument ran, are, by their very nature, risk investments which have to be reviewed from time to time. A portfolio comprising a number and variety of counters will therefore necessitate continuous review and adjustment as and when required. Consequently an investor in shares has of necessity to deal in such shares and a simple intention to hold such shares indefinitely or for a long time can make no difference. Unless and until the shares are made part of the permanent structure of the investor on which its business rests and the shares are in effect taken out of its business they remain part of its floating capital. The argument rested principally on the well-known passage in the judgment of Schreiner JA in Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd 1956 (1) SA 602A at 610C to 611B. That passage reads as follows:

> "One must not lose sight of the true nature of the inquiry in cases of this kind. There is no legislative provision that makes the intention of the taxpayer decisive of whether the receipt or accrual was of a capital nature or not. The decisions of this Court have recognised the importance of the intention with which property was acquired and have taken account of the possibility that a change of intention or policy may also affect the result. But they have not laid down that a change of policy or intention by itself effects a change in the character of the assets. The test has been variously expressed but it is enough to say that the

profits of a company's business activities are generally speaking part of its income. Where, as here, a company is formed to carry on land-jobbing and land-letting, these are simply alternative methods of using the company's money to make a business profit, each method having advantages over the other according to circumstances. This was pointed out in L.H.C. Corporation of S.A. (Pty.) Ltd. v. Commissioner for Inland Revenue, 1950 (4) S.A. 640 (A.D.) at p. 646. There the company's money was used to buy shares, but for present purposes there is no difference between shares and land. The case was decided on the principle that where a company is a share-dealing or land-dealing company and has among its objects both dealing and holding, a profit made on the realisation of shares or land acquired for its business will ordinarily be income profit. It was assumed at p. 646 E that in exceptional cases, this might not be so. But the exceptional cases, assuming them to exist, are not brought into existence simply by an intention to hold the asset indefinitely or for a long time; they would be cases where property has been made part of the permanent structure of the company, on which its business rests; such property would in effect be taken out of the field of the company's business, where decisions are made from time to time on how best to make a profit. In contrast with such properties, which might be said to be truly fixed capital, is property which the company would use in its business operations, which it would deal with or hold as the prospects of profitable user dictated that would be its

> floating capital.
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> In the case of a company having objects like those of the respondent company it would seem natural to review the policy in regard to the company's property as a whole, or as to sections of it, or as to individual lots, at reasonable intervals, in order to decide whether to sell or to hold. Changes of policy might be frequent or rare according to circumstances, and might affect few, many or all of the properties. It seems to me to be wrong and, indeed, practically impossible to treat such changes of policy as operating alterations in the character as capital of the properties affected."

It is clear from the passage quoted that the taxpayer under discussion was a company which had been formed to carry on both land-jobbing and land-letting as alternative methods of employing its funds to make a business profit as circumstances dictated. In the L H C Corporation case referred to the taxpayer was a company which had among its objects both sharedealing and shareholding in respect of which there can be no doubt that its profits derived from sharedealing would be taxable as income. Neither case is authority for the proposition that a genuine investor in long-term dividend-producing shares is obliged to hold on to each and every counter in his portfolio irrespective of the fortunes - or possible demise - of the companies concerned or run the risk of being taxed as a sharedealer. Indeed both cases are based on the hypothesis that there is a distinction between a share investor and a sharedealer and both taxpayers were found to have been an amalgam, using their investments as both an income-producing capital base and at the same time as stock-in-trade for sale at a profit. Therefore, as Schreiner JA made clear, as the profits made by a company are generally speaking part of its income, profits derived from the sale of assets held as both capital and stock-in-trade are taxable. But nothing in the reasoning of the learned judge can be regarded as authority for the broad proposition that the management of a wide and varied share investment portfolio, irrespective of the care and long-term investment intention with which it had been compiled, causes it to be regarded as floating capital. In the instant case the evidence is clear. Proposed investments were painstakingly investigated with a view to ascertaining their long-term yield potential and the likelihood of growth in such yield. Counters were not acquired with a view to disposal at a profit and several profitable opportunities that did present themselves were declined. The investment portfolio, or at least the equity share component thereof, was not acquired with a view to possible sharedealing as an alternative to holding for dividend earnings. There was a meticulous and protracted investigation procedure, which on the evidence was invariably followed, whereby GASA endeavoured to ensure a stable investment in counters which would produce satisfactory and increasing dividend yields indefinitely and would not be sold. The mere fact that such investments were made in the share capital of trading companies whose fortunes could not be predicted with absolute certitude did not render them risk investments. Likewise continuous monitoring of the portfolio by LIBAM in the performance of its stewardship mandate on behalf of the GASA shareholders did not serve to convert what had been compiled as a capital base for the production of fruits into a pool of floating capital. Neither in law nor in logic can dogged adherence to a counter or carelessness in the management of a share portfolio be posited as pre-requisites for qualification as a capital investor. Prudence and foresight cannot be equated with an intention to speculate.

The last proposition advanced on behalf of the Commissioner sought to find support in the judgment of Steyn CJ in the case of African Life Investment Corporation (Proprietary) Limited v Secretary for Inland Revenue 1969 (4) SA 259 (A), more especially at 269G to 270A and 271C-F. Indeed the very language used by counsel echoes the words of the learned Chief Justice in the passages cited. The first passage reads as follows:

> "As far back as in <u>Commissioner of Taxes v. Booysen's Estates Ltd.</u>, 1918 A.D. 576 at p. 602 and 604, it was pointed out that, whatever the primary objects of a company may be, it is quite possible that it may derive income in the ordinary course of business from carrying out its secondary objects. Where the sale of shares held as an investment is in fact contemplated as an alternative method of dealing with them for the purpose of making a profit out of them, or, in the case of a company, where it is one of the 'appointed means of the company's gains' (cf. <u>Overseas Trust Corporation Ltd. v. Commissioner for Inland Revenue</u>, 1926 A.D. 444 at p. 456 i.f.; <u>L.H.C. Corporation of S.A. (Pty.) Ltd. v. Commissioner for Inland Revenue</u>, 1950 (4) S.A. 640 (A.D.) at p. 646), it can make no difference, I consider, that it is a secondary or subsidiary purpose of their acquisition. It would nevertheless be part of the business operations contemplated for the production of income, and the profit gained would be 'revenue derived from capital productively employed'. In such a case it could not be said that the pursuit of an overriding main objective of securing a dividend income merely provides the occasion for what is no more than a purely incidental change of investment, even though it be a profitable one. There would be no absolving dominant purpose."

In the second passage cited the learned Chief Justice, in response to an argument "that the manner in which purchases and sales were conducted is fully accounted for by the requirements of an active investment policy directed at ensuring and preserving a durable yield of dividends at the best general level", made the following observations:

> "It must be conceded, I think, that, whether or not the appellant set out to deal in shares for profit, the varying of its many risk investments would be an inherent feature of its activities. It may be that such variations, however gainful, need not in themselves, in the case of an investment company, necessarily lead to the conclusion that resultant profits are to be regarded as income. On the other hand it might also be said that, because an investment company has of necessity, as dictated by the nature of its assets, to deal in shares, and knows in advance that it will have to do so, such variations are an essential feature of its business, that the profits therefrom arise in the ordinary course thereof, and that they should accordingly be regarded as part of its contemplated income. On that approach, the shares might not inappropriately be described as property
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> > 'which the company would use in its business operations, which it would deal with or hold as the prospects of profitable user dictated; that would be

> its floating capital'.
> (<u>Commissioner for Inland Revenue v. Richmond Estates (Pty.) Ltd</u>., 1956 (1) S.A. 602 (A.D.) at p. 610 i.f.)."

The argument advanced on behalf of the Commissioner is unsound and the authority sought to be invoked in support thereof does not avail. The essential question in a case like this is a factual one:

> "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 upon the facts of each case."

(Per Botha JA in <u>Secretary for Inland Revenue v Trust Bank of Africa Ltd</u> 1975 (2) SA 652 (A) at 671B.) A variety of circumstances come into play, e g the nature of the investment asset, the character of the investor, the intention with which the asset had been acquired, any change in such intention and the circumstances surrounding disposals. And it is inherent in the very nature of the exercise that no single circumstance can be elevated to decisive pre-eminence. Thus Schreiner

JA pointed out in the <u>Richmond Estates</u> case, <u>supra</u>, that although the intention with which property was acquired and a subsequent change in such intention are important criteria, they cannot by themselves change the character of the assets and the nature of the profits derived from any sale thereof. What Steyn CJ was at pains to explain in the <u>African Life</u> case <u>supra</u>, was that not even a main purpose would necessarily be decisive. It was in this context that the learned Chief Justice, in the second passage cited above, distinguished between a dominant intention where incidental profits would not attract liability for tax and a main purpose aimed at dividend income but accompanied by an additional, albeit subsidiary, purpose intended to yield a profit. The distinction is a subtle one and is to be made upon a conspectus of the relevant facts. There is no simple and universally valid litmus test, the decision whether particular income falls on the one side of the ill-defined borderline between capital and revenue or on the other being "a matter of degree depending on the circumstances of the case".

When the circumstances of the instant case are evaluated in accordance with the principles thus enunciated, the conclusion is readily apparent. GASA did not set out to establish its portfolio with mixed intentions. Acquisitions were made solely from shareholders' funds; no need was envisaged to draw on such funds to supplement the business requirements of the short-term insurance activities, nor did any eventuate; the portfolio was intended to be a nest-egg consisting of sound investments to be held indefinitely with a view to the production of a steady and ever-increasing dividend income; from 1974 to 1978 McAlpine saw to it that the portfolio was suitably composed to meet such objectives; thereafter and more especially once GASA had ceased any insurance business activities the portfolio was managed predominantly if not solely as a capital investment for the production of dividend income; such purpose was in accordance with the interests and long-term plans of the holding company, GNIC, which were recorded in the minutes of the board of directors of GNIC and formally minuted by GASA's board. Lastly and most significantly the intention was made manifest by the way in which the portfolio was actually managed over a period of many years. Indeed the only circumstance that could possibly be said to support the argument on behalf of the Commissioner that there had been a concomitant intention to deal in shares for profit is the fact that the assets acquired were shares in trading companies. As pointed out above, that circumstance, seen in isolation, could hardly warrant the inference sought to be advanced. When it is evaluated in the context of the numerous and weighty considerations pointing in the opposite direction, it pales into insignificance. The assets comprising the portfolio constituted capital and the profits derived from disposals thereof constituted receipts of a capital nature within the definition of "gross income" in s 1 of the Act. It follows that the court a quo correctly set aside the assessments of GASA to normal tax for the years of assessment ended 31 December 1982, 31 December 1983 and 31 December 1984 and ordered re-assessment on the basis that the amounts of R358 132, R2 294 858 and R463 855 respectively were to be excluded from GASA's income for the relevant years of assessment.

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

KRIEGLER AJA

CORBETT CJ
NESTADT JA
KUMLEBEN JA
PREISS AJA

CONCUR