Case no 624/90

IN THE SUPREME COURT OF SOUTH AFRICA (APPELLATE DIVISION)

In the matter between:

BERBA PARK AVENUE PROPERTIES (PTY)LTD Appellant

and

COMMISSIONER FOR INLAND REVENUE Respondent

CORAM: JOUBERT, VAN HEERDEN, NESTADT,
KUMLEBEN JJA et NICHOLAS AJA

DATE HEARD: 22 SEPTEMBER 1994

DATE DELIVERED: 23 NOVEMBER 1994

J U D G M E N T

NESTADT. JA:

The respondent disallowed an objection by the appellant

to the inclusion in its income for the year of assessment ended 28 February 1982 of a profit of R836 717,00 which accrued to the appellant consequent upon the sale of certain of its fixed property. The objection was based on the contention that the amount was a receipt of a capital nature and thus not subject to tax. The appellant's appeal to the Transvaal Income Tax Special Court against the respondent's decision was dismissed. The Special Court held that the amount had rightly been regarded as income. The appellant's further appeal to the full court of the Transvaal Provincial Division also failed. With the leave of the latter court, the appellant now appeals to this Court.

The basic facts are not in dispute. In summary they are the following. The appellant is a private company which was

incorporated on 2 May 1974. Its main object was to acquire and develop property situated in Pretoria. The property in question, namely a certain vacant consolidated erf, was acquired soon after the appellant's incorporation. On 21 July 1975 Costa Ellinas and Andrea Pashiou purchased the shares and loan accounts of the existing shareholders and were appointed directors of the appellant. Ellinas and Pashiou carried on business in Pretoria as building contractors. This they did through a company called Pace Construction (Pty) Ltd ("Pace"). It had been incorporated in 1973. Here, too, they each owned half the issued shares and were directors of the company. In 1975 the appellant, now under the control of Ellinas and Pashiou, decided to develop the appellant's property. An eight storey block of 45 flats known as Vasella was erected. The

construction work was done by Pace. The building was completed in August 1976. The flats were then let and in this way rental income was earned. On 29 October 1979 the appellant resolved to take the necessary steps for the approval of a sectional title development scheme in respect of Vasella. The sectional plan was registered on 13 March 1980 in terms of sec 8(3) of the Sectional Titles Act 66 of 1971. Some five months later, on 6 August 1980 the appellant sold all the units for the sum of Rl,3m. It is the nature of the resultant profit of R836 717,00 which is in issue in this appeal. The appellant's contention is that the proceeds resulted from the realisation of a capital asset and were therefore not taxable. The respondent's attitude on the other hand has been that the sale was in pursuance of a profit-making scheme so that the gain bore the imprint

of revenue.

Two factors are of decisive importance in deciding the type of problem with which we are faced. They are (i) the intention with which the taxpayer acquired the property and (ii) the circumstances in which the property was sold (Malan vs Kommissaris van Binnelandse Inkomste 1983(3) SA 1 (A) at 10 B). I commence with a consideration of the former. The appellant's intention is to be determined by examining the state of mind of Ellinas and Fashion when they acquired the shares in the appellant and when, shortly afterwards, Vasella was erected. At the time of the hearing before the Special Court, Fashion's health was such that he was unable to testify. However, Ellinas gave evidence on behalf of the appellant. He stated that the project was an investment "for ourselves and our

children"; the intention was "to keep the building for rental." Other witnesses called by the appellant confirmed this. And, as the Special Court pointed out, not only was the evidence in question not seriously disputed, but in argument its veracity was accepted by the Commissioner's representative - an attitude which was quite properly maintained before us by Mr Dunn, on behalf of the respondent.

One proceeds then on the basis that, initially at least, Vasella was a capital asset. But this is not conclusive in favour of the appellant. As has been indicated, the circumstances in which the property was sold must be looked to. In a given case they may reveal that there was a change of intention in the sense not merely of a decision to realise the asset (to best advantage) but by the adoption of a new policy which has the effect of converting the character of

the asset to trading stock in a profit-making scheme or business (Elandsheuwel Farming (Edms) Bpk vs Sekretaris van Binnelandse Inkomste 1978(1) SA 101(A) at 118 F-119 in fin). This, so it was contended on behalf of the respondent, is what happened in the case of the appellant. On grounds to which I shall in due course refer, it was argued that the intention to hold the property as a long-term investment changed in 1979 and the appellant thereafter crossed the Rubicon and used the property in a profit-making scheme. The appellant disputed this. And most of the evidence adduced by it to the Special Court was aimed at discharging the onus which it bore of negativing the alleged change of intention. The Special Court, however, found that the appellant had failed to do this and on this basis dismissed the appeal. The court a quo agreed with the Special

Court's conclusion though, as will be explained, not quite for the same reasons.

Often the reason why a taxpayer sells an asset will be irrelevant. A capital investment may be disposed of for whatever motive. But where the status of the asset at the time of the sale is in issue, the position is different. Here the reason for disposal might provide a good indication that there had been a change of intention and that a profit-making scheme was afoot. It is therefore not surprising that in its evidence the appellant sought in some detail to explain why, contrary to its declared intention to retain Vasella, the property was sold. The reason advanced hinged around Pace and was to the following effect. The financial well-being of this company was all important to Ellinas and Pashiou. According to their

auditor, Pace was "the goose that laid the golden egg"; it was their main source of income. The company had big construction contracts. But by 1978 liquidity problems had developed. The company was short of working capital. Its overdraft facilities were inadequate. Time limits for paying suppliers of building materials could not be kept to. And over the next two years its financial position worsened. The company was "in a very precarious state." Efforts were accordingly made to borrow money which could be injected into Pace. They were unsuccessful. This left two remaining sources of funds. One was a company called Sumaco (Pty) Ltd ("Sumaco"). Though its shareholders were the children of Ellinas and Pashiou (together with the children of a certain Mr Schewitz) the company was effectively controlled by Ellinas, Pashiou

and Schewitz. The main asset of Sumaco was a block of flats which had been erected by Pace early in 1978. On 26 September 1978 Sumaco resolved to apply for a sectional title development scheme. This was approved on 30 November 1978. A few months later it was decided to sell the individual units and pay over the proceeds to Pace (partly in discharge of what Sumaco owed Pace in respect of the cost of erecting the flats and partly by way of a loan). This was done. Pace received an amount of about R660 000. However, Pace's liquidity problems persisted. Additional funds were required. As Ellinas said, there was no option but to sell; he did not want to sell Vasella; he had to sell it to save Pace; had he not done so Pace could have been liquidated. Save that Pashiou was even more reluctant to dispose of the property, this reflected his state of mind

as well. Thus it was that the units comprising Vasella were sold. With the proceeds of the sale the appellant repaid the sum of R160 520 owing to Pace for the construction of Vasella and in addition, lent Pace R638 958. Pace accordingly received from the appellant just under R800 000. In the result, so it would seem, Pace was restored to financial stability; at least its liquidity crisis was overcome.

On this evidence, it is clear, I think, that Vasella remained a capital asset; that there was no change of intention as alleged by the respondent. The Special Court found that Pace, during 1978 and 1979, did have a liquidity problem and that the profits on the sale of Sumaco's units were used to resolve this problem. It held, however, that when in August 1980 Vasella was

sold "the elimination of the illiquidity of (Pace) was not as pressing as suggested in evidence". Indeed, on a reading of the rest of the judgment, it would seem that the appellant's contention that it was compelled to sell Vasella in order to save Pace was rejected. In the court's view there was, commencing with the application for the opening of a sectional title register in October 1979, a change of intention. The property was thereby converted to a more marketable form. Thereafter the appellant's overriding motive was to sell it when it became profitable to do so. Alternatively the property was then held with a dual intention, namely for rental income and for sale at a profit. In either event, so it was concluded, the appellant had failed to discharge the onus of proving that the profit was of a capital nature.

The approach of the court a quo was somewhat different. After an analysis of a number of factors, it concluded that though "on a clinical analysis of the objective facts one may wonder whether Pace's problems were (such that)...there was a real need to sell at that stage...the criticism advanced on behalf of the appellant of the conclusion of the Special Court, that the liquidity problems of Pace had been overstated, is justified" and that "credible evidence supports the submission that Ellinas at least was led to believe that it would be prudent to dispose of the sections in Vasella." This notwithstanding, the full court agreed that there had been a change of intention. Its reasoning was that Ellinas and Pashiou were in substance partners; that all their business activities had to be taken into account; by 1979 these included dealing in fixed property and

making use of sectional title systems; Ellinas and Pashiou were, in other words, land-jobbers; from then on Vasella was earmarked as part of the stock-in-trade of such business; it would be disposed of should this be required or should circumstances be propitious; as it turned out the liquidity problems of Pace made it advisable to sell Vasella so as to provide that company with working capital.

In considering the correctness of both courts' judgments and in particular their finding that there was a change of intention, it will be apparent that there are, broadly speaking, three factors that require analysis. They are (1) Pace's illiquidity; (2) the conversion of Vasella to a sectional title scheme; and (3) the land-jobbing activities of Ellinas and Pashiou. Obviously they are interdependent and must be cumulatively weighed. It will be convenient, however,

to deal with them separately. I proceed to do so.

(1) Pace's illiquiditv.

As has been indicated, it was not the appellant's case that the units in Vasella were sold simply because a good offer was received. I therefore agree with the observation of Eloff DJP (who gave the judgment of the full court) that if "the appellant's contention that the main motive for the sale of the units in Vasella was to enable it to pay Pace its due and thus ameliorate the liquidity problems of the matter" was correctly rejected by the Special Court "it becomes difficult to think of any reason for the sale other than that it had become the business of Ellinas and Pashiou to trade in assets such as the sections in Vasella, and that Vasella was kept as part of that business".

Certainly, and as Mr Dunn during the course of his thorough argument pointed out, there are factors which support the Special Court's conclusion that the sale was not due to Pace's illiquidity. The allegation that it was Pace's illiquidity which was the reason for the sale of Vasella was only belatedly raised by the appellant in its pre-trial communications with its local Receiver of Revenue. Pace did not retain all the monies paid over to it by Sumaco and the appellant (as one might have expected had Pace been short of working capital); instead it repaid directors' and shareholders' loan accounts and also made loans to certain unspecified persons; these repayments and loans totalled R856 203,00. By the time Vasella was sold, Pace had already received a large injection of capital from Sumaco. There was no

evidence that Pace was ever sued; nor was it insolvent. Although the deed of sale was entered into on 6 August 1980, the purchase price of R1.3 m was only payable on 1 March 1981; this is not an indication that funds were urgently required for Pace.

Based mainly on these considerations, it was submitted on behalf of the respondent that the liquidity problems of Pace had been overstated or at least, by mid-1980, alleviated; that they were advanced as an afterthought in order to obscure the true reason for the sale of Vasella; and that the Special Court's conclusion on the issue under discussion was the correct one. I am unable to agree. Clearly Pace had continuing liquidity problems. That Ellinas and Pashiou perceived Pace's position as serious and felt compelled to sell Vasella is also plain. It is a theme that runs throughout the evidence.

I have already referred to the allegations of Ellinas in this regard. They were corroborated by a number of witnesses who testified for the appellant. Mrs Spengler, the bookkeeper and financial manageress of Pace, testified:

> "Now, when the agreement of sale was concluded on the 6th of August 1980, what was the reaction of Mr Ellinas and Mr Pashiou, would you describe them as eager sellers? ... Definitely not.
> Would you tell his lordship why? ... Well, the building had been put up as an investment and it was as far as they were concerned, the last investment and they would have no more and Mr Pashiou was very much against that. They had built
> it for themselves and now they had to dispose of it. . .
> Now, Mrs Spengler, you said to the court that your impression was that Messrs Ellinas and Pashiou, that they sold these properties reluctantly. Is that correct? --- Berea Park and Sumaco.
> Yes, were those your impressions or did they come to you and did they say to you 'Listen we don't want but we have to. — They were quite emphatic about it, particularly Mr Pashiou."

Mr Davis was a partner in the firm of auditors acting for Pace and

the appellant. The following extracts from his evidence are relevant:

> "Are you aware whether the directors of Berea Park Avenue Properties (Pty) Ltd were anxiously desiring to sell this block of flats owned by this company? .... They didn't want to sell this block at all. How would you describe their decision to sell the block? ... It
> was a decision they were forced to take in my opinion. . .
> Mr Davis, I think I've asked you what was the attitude of Mr Ellinas and Mr Pashiou at that stage to the disposal of the property owned by Berea Park Avenue Investments (Pty) Ltd. .... Neither...Mr Ellinas or Mr Pashiou wished to sell. Mr Ellinas said it was necessary to sell in order to save Pace Construction and Mr Pashiou was adamant that that property would not be sold."

Finally there is the evidence of Schewitz (who until 1978 was Ellinas and Pashiou's attorney but in August 1980 was negotiating to buy Vasella on behalf of the eventual purchaser). Having stated that because of Pace's lack of capital the company was in "a difficult financial situation" and that "they [Ellinas and Pashiou] were petrified

that they were going to lose their company", he went on to testify as follows:

> "Can you tell his lordship, did you discuss: what was the attitude of Mr Ellinas and Mr Fashion to the sale of the property at that stage? --- Mr Pashiou was very violent and he
> did not want to sell it. . What did Mr Ellinas do? --- Mr Ellinas wanted to save Pace at all costs. He wasn't happy about it but he felt that he had to sell something in order to inject cash into Pace."

He also explained that Pace "wanted cash...almost immediately". Schewitz therefore arranged for a substantial advance payment on account of the purchase price to be made to Pace prior to 1 March 1981. And the fact that the units were sold not individually but as a whole served to support the inference that the sale was regarded as urgent. The appellant's witnesses made a good impression on the Special Court. Moreover, as the court a quo observed, the evidence

that Pace was thought to be "in a tight spot" and that the sale of Vasella would significantly ease Pace's position was not really challenged. Mr Dunn was also constrained to concede that a number of factors on which he relied in support of his argument were not, as they should have been, put to the witnesses. It might be that they would have been able to provide an acceptable explanation for the criticisms that are now levelled against the appellant's version. This must detract from their cogency. It is clear that genuine efforts were made to avoid selling Vasella. I refer to the unsuccessful attempts by Pace and the appellant to increase their respective overdraft facilities and to raise money by way of second bonds. There was detailed evidence in this regard. Finally, there is the consideration that the rental income produced by Vasella gave what was described

in the evidence as "an excellent return". This is a further indication that the appellant was an unwilling seller. In my opinion therefore, the matter fell to be decided on the basis that it was established that in the perception of Ellinas and Pashiou, Vasella had to be sold to save Pace.

It is, of course, true that the object of paying the proceeds of the sale of Vasella to Pace was to enable Pace to continue with its profit-making activities (and probably to enhance them). But this cannot avail the respondent. It is not inconsistent with the appellant's evidence regarding the reluctance of Ellinas and Pashiou to sell the building. Nor is the fact that the total amount paid by the appellant to Pace was possibly more than what was immediately required to alleviate Pace's liquidity crisis. The court

a quo found it significant that Ellinas and Pashiou did not rather utilise the "surplus funds" to provide a pension for themselves. I cannot agree. As already indicated, Pace was the core of their business operations. They obviously regarded it as a good investment. They were entitled to place the full proceeds of the sale of Vasella there. The court a quo, however, also laid stress on the appellant's indebtedness to Pace (arising from the cost of the construction of Vasella). Its reasoning was that Ellinas and Pashiou must have realised that the appellant would not be able to discharge it out of the appellant's income; that it would have to sell at least part of its interest in Vasella. But this is not borne out by the evidence of Ellinas. He said that in 1976 when Vasella was erected, he did not contemplate that Pace would have any difficulty in

carrying the loan owed by the appellant; it was not foreseen that repayment would be required by Pace at least not until the appellant's bond had been paid; and thereafter the appellant would be able to pay Pace from its rental income. (2) The conversion of Vasella to a sectional title scheme.

It will be apparent from what has been said that this fact played a significant role in the conclusion of both the Special Court and the court a quo that a change of intention occurred. In many cases a sale by sectional title will indicate that a trade for earning profits had been embarked on. But this is not necessarily so (ITC 1348 44 SATC 46 at 49). And I do not think that the opening of a sectional title register in respect of Vasella pointed to a profit-making scheme. The appellant's attorney was a Mr Klagsbrun. He testified

that from about 1978 it was feared that amending legislation would be passed making it more difficult to sell by sectional title unless a register had already been opened; he therefore advised the appellant (and Sumaco) that as a precaution this should be done; it was in these circumstances that Vasella was converted to a sectional title scheme. Both Ellinas and Schewitz confirmed this. Ellinas described sectional title schemes as being "the trend" (during 1979 and 1980).

The Special Court, however, did not think that this evidence "takes the matter any further". Its view was that Ellinas and Pashiou made the application for a sectional title scheme "in the light of their success with the sale under sectional title of Sumaco"; this evidenced the necessary change of intention. I must respectfully

differ. Klagsbrun's evidence refutes this. There is no warrant for not giving full effect to it. This I think is so despite the appellant's delay, until October 1979, in taking steps to apply for the registration of a sectional title scheme. This was more than a year after Sumaco's application and (so one can infer) after Klagsbrun's recommendation that a sectional title register be opened. But this was never put to any of the appellant's witnesses. It should accordingly not be used (as the court a quo did) as indicating that the decision to convert to a sectional title scheme was not motivated by Klagsbrun's advice. (3) Land-jobbing activities of Ellinas and Pashiou.

Besides the appellant and Sumaco, Ellinas and Pashiou were minority shareholders in five other property-owning companies

whose shares or properties (blocks of flats) were (for the most part during 1979 and 1980) sold at a profit. It was, however, not suggested that these sales constituted speculation in fixed property. In each case the proceeds were regarded by the Receiver of Revenue as of a capital nature. What the court a quo mainly relied on as establishing that by the time Vasella was sold Ellinas and Pashiou had become land-jobbers, were the operations of two other private companies. They were Wessels Street Gardens (Pty) Ltd ("Wessels Street") and Cosmian Investments (Pty) Ltd ("Cosmian"). Ellinas and Pashiou were equal shareholders. In 1979 Wessels Street and in 1980 Cosmian erected a block of flats on their respective properties and then within a short period sold the individual units by sectional title. The resultant profits were in each case reflected as

income and taxed as such. In addition there was, of course, the profitable disposal by Sumaco of its units during 1979. It will be recalled that they were sold (also by sectional title) within about a year of their construction.

It is unnecessary to say much about the Sumaco transaction. The respondent sought to tax it. However, Sumaco's appeal against the dismissal of its objection to the assessment was allowed (see ITC 143, 50 SATC 60). This leaves Wessels Street and Cosmian for consideration. The appellant never sought to deny that they were speculative projects. As such they show that Ellinas and Pashiou were at the time engaged in land-jobbing. But this was only to a limited extent. It is clear that Wessels Street and Cosmian were isolated cases of property speculation. In each case Pace was

the contractor. The projects were undertaken to provide temporary work for its employees and to generate a quick profit for the company. They were not repeated. Moreover, Ellinas and Fashion had interests in two other blocks of flats (Devenish Gardens and Monopati) which were held as long-term investments. In the circumstances, I do not think that Wessels Street and Cosmian provide a firm foundation for the respondent's argument that in relation to the appellant as well, Ellinas and Pashiou were trading in land.

There is, in any event, another difficulty with the argument. There was, as the court a quo observed, credible evidence that Ellinas and Pashiou were at pains to keep the speculative ventures apart from what they considered to be

investments; "a clear divide", as it was referred to. This may, of course, be done. A taxpayer who is a land-jobber may have other property as an investment and which is therefore not part of his trading stock (cf Cohen vs CIR 1962(2) SA 367(A) at 376 C-F). So it does not follow that all the business affairs of Ellinas and Pashiou were (in the words of the full court) "interrelated and interdependent". If they continued to regard Vasella as an investment, the building did not become part of the stock-in-trade of their business of dealing in land.

The test whether a taxpayer has embarked on a profit-making scheme is one of degree. Often, therefore, a decision whether this has occurred is a finely-balanced one. The present matter exemplifies this. I have, nevertheless, come to the firm

conclusion that the appellant succeeded in establishing that no change (of the kind that converts a capital asset into stock-in-trade) occurred in its intention to hold Vasella as a long-term investment. The property was kept for five years. The appellant's reluctance to sell (see (1) above) is not easily reconcilable with the voluntary undertaking of a profit-making scheme. The proceeds were not (as one would have expected had the sale of Vasella been part of Ellinas and Fashion's land-jobbing) used to deal in other fixed property. Nor for the reasons stated in (2) can an inference of such dealing be drawn from the opening of a sectional title register. As I have said, this was done on legal advice and as a precautionary measure. It was a prudent step. In any event, the appellant was entitled to adapt its asset to the exigencies of the market and dispose of it to best

advantage. Sumaco's earlier adoption of the same course simply served to emphasise the benefits of this mode of disposal.

therefore cannot agree with the respondent's argument (based on the language of Wessels JA in John Bell and Co (Pty) Ltd vs SIR 1976(4) SA 415(A) at 429 C-D) that the appellant's conversion of Vasella to a sectional title scheme was the "something more" which metamorphosed its character. More especially is this so seeing (as found in (3)) that Ellinas and Fashion's land-jobbing operations were of a restricted nature. In my view Vasella never became part of such operations. The appellant never went over to the business of trading in fixed property. There was a mere change of intention without the intervention of any new or additional factor. The profit on the sale of Vasella was of a capital nature. It was, therefore,

incorrectly included in its taxable income.

The appeal succeeds with costs (save that the costs of an unnecessary application by the appellant to condone the late filing of the record are to be paid by the appellant). The judgment of the court a quo is set aside. The following order is substituted:

> "The appeal is upheld with costs. The order of the Special Court and the assessment for the year ended 28 February 1982 are set aside. The matter is referred back to the Commissioner for Inland Revenue for assessment on the basis that the profit of R836 717.00 on the sale of Vasella should not have been included in the appellant's taxable income."

HH Nestadt Judge of Appeal Joubert, JA) Van Heerden, JA)
Concur Kumleben, JA) Nicholas, AJA)