CASE NO. 458/93

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

RICHARDS BAY IRON & TITANIUM
(PTY) LTD & TISAND (PTY) LTD APPELLANTS

and

THE COMMISSIONER FOR
INLAND REVENUE RESPONDENT

CORAM: CORBETT CJ, BOTHA, EKSTEEN, HOWIE et
MARAIS JJA

HEARD: 2 MAY 1995 DELIVERED:

24 AUGUST 1995

J U D G M E N T

MARAIS JA/

MARAIS JA/

These are appeals by Richards Bay Iron and Titanium (Pty) Ltd ("REIT") and Tisand (Pty) Ltd ("Tisand") against the dismissal by the Natal Income Tax Special Court of their respective appeals against the Commissioner for Inland Revenue's assessment of the normal tax payable by REIT for the years of assessment ended 31 December 1987,1988, and 1989, and by Tisand for the years of assessment ended 31 December 1987, 1988, 1989 and 1990. The income generating activities of REIT and Tisand are so closely intertwined that the hearings of both appeals were consolidated before the court a quo, as were the appeals to this court. Both appellants were represented by the same counsel and attorneys in the court a quo. On appeal to this court they were represented again by the same

counsel and attorneys.

The questions which fall to be considered will be better understood if their formulation is deferred until after the factual background giving rise to them has been sketched. The coastal dunes in the vicinity of Richards Bay in Zululand are rich in certain minerals. REIT and Tisand join forces to extract and beneficiate those which are valuable. The process, in broad, consists of creating in the dunes self-contained ponds of water into which dune sand is made to slump by undermining the face of the dunes; of removing the resultant slurry by suction with the aid of a floating dredger; of separating the heavy mineral concentrate from the dune sand in a floating concentrator plant by means of a gravity separation process; of separating that heavy mineral concentrate in a mineral separation plant into rutile, zircon, monazite and ilmenite; and of thereafter

beneficiating the ilmenite in a sophisticated smelter complex to yield titania slag and an iron of high purity.

Rutile and zircon are sold as mineral sands. Rutile is used as a raw material in the manufacture of pigment and in the production of titanium metal, as well as a flux coating on welding electrodes. Zircon is used mostly as an opacifier in ceramic glazes, a constituent of refractory materials used in the production of steel and glass, and as a moulding sand in foundries. It is also used in the production of zirconium oxide, metal and chemicals, sanitary ware and tiles.

The titania slag is cooled, crushed and screened into different grades, stored in silos, and sold to customers both here and abroad. It is an essential raw material for the production of titanium dioxide pigment which is a white pigment used in the production of

paints, plastics, paper and printing inks. It is also used in the production of textile fibres and vitreous enamels.

The high purity iron is essentially a raw material used by the ductile iron foundry industry. The iron's low manganese and phosphorus content provides important metallurgical and economic advantages for the industry. The iron is marketed in the form of "pigs" or ingots.

The role of each of the appellants in this process requires explanation. Tisand is owned by a majority of South African shareholders and holds the mineral rights which are being exploited. REIT is owned by a majority of Canadian shareholders. The two companies operate in conjunction with one another under the style Richards Bay Minerals. Tisand conducts the operations which result in the production of the heavy mineral concentrate. It separates them

into three main products, namely, ilmenite, rutile and zircon. Some monazite is also produced. It sells the ilmenite to RBIT and the rutile and zircon to whomsoever will buy them (mainly, purchasers abroad). The monazite was at one time readily saleable but has become less so as a consequence of the discovery of a better product in China. Tisand sells it when it can. RBIT processes and smelts the ilmenite purchased from Tisand to produce titania slag and high purity iron, mainly for export.

In the course of these operations, there are brought into existence at various stages what are described by appellants as "stockpiles" of material. It is the status in tax law of some of those stockpiles, and the extent, if any, to which they are to be taken into account in assessing appellants' taxable income, which require to be considered in this appeal. That necessitates a more detailed

description of some aspects of appellants' operations, and the nature of the relevant stockpiles.

From every 1000 tons of dune sand, Tisand produces some 50-70 tons of heavy mineral concentrate of which about 70 per cent are valuable heavy minerals. The heavy mineral concentrate is pumped to a specially prepared stockpile area and it is that concentrate which is referred to as stockpile 1. Heavy mineral concentrate taken from there may go directly into the mineral separation plant or may go into another stockpile of heavy mineral concentrate maintained at the plant. That stockpile is known as stockpile 2, or the "Sunday" stockpile and it serves as a "stand-by" supply of heavy mineral concentrate to ensure that at all times there will be a supply of concentrate available to keep the plant operating continuously. Temporary shut downs are expensive and restarting complicated.

What is in stockpiles 1 and 2 is mainly a mixture of ilmenite, rutile, zircon, and monazite.

Tisand subjects the heavy mineral concentrate to treatment in a minerals separation plant. What emerges is, on the one hand, ilmenite which goes into stockpile 3, and is referred to as roaster feed and, on the other, a mixture of rutile and zircon which goes into stockpile 4. There is also a residual mixture of ilmenite, monazite, rutile and zircon (described as LSR (low susceptible rejects) concentrates in the documentation and the record) which constitutes stockpile 5. The material in stockpile 5 is subjected by Tisand to a process designed to extract from it, and to separate, any remaining ilmenite. Any ilmenite so recovered is added to stockpile 3. It is the ilmenite in stockpile 3 which is sold by Tisand to REIT. The monazite is also separated from the material in stockpile 5 during this

process, as are the rutile and zircon. The monazite is stored in a silo and referred to as stockpile 9. The rutile and zircon recovered will have not yet have been separated from one another and they will be processed together with the rutile and zircon mixture emanating from stockpile 4. The two minerals are separated from each other by electrostatic techniques. The rutile goes into a silo described as stockpile 6. The zircon is subjected to further treatment which yields two grades of zircon. The standard grade goes to stockpile 7; the prime grade goes to stockpile 8. That describes Tisand's operations sufficiently for present purposes, and accounts for stockpiles 1 to 9. I turn now to the operations of REIT.

REIT subjects the ilmenite in stockpile 3 to a roasting and magnetic process which removes calcium and chrome from it and renders it suitable for smelting. It emerges as pure ilmenite and it is

stored in silos described as stockpile 10. At this stage it is referred to as smelter feed and is a composite of titanium and iron oxide. The smelting process requires anthracite to be used as a reductant. It is heated in a charring plant to reduce its volatile content and to create char and coke stockpiles. The char is conveyed to the smelter where it is blended with the smelter feed (roasted ilmenite) from stockpile 10 and the resultant blend is referred to as furnace charge and constitutes stockpile 10a.

In the furnace the carbon in the char combines with the oxygen in the iron oxide and molten iron is produced. The iron oxide having been removed from the ilmenite, a high grade titania slag (titanium dioxide) is produced. The titania slag is tapped into moulds, cooled, crushed, and sized. The various grades and types of slag are in stockpiles 11, 12,12a, 12b, 12c, 12d, and 12c. They are marketable

as such.

The molten iron is subjected to further treatment at an iron injection plant where chemical additives are injected to obtain grades required by REIT's customers. The molten iron is then cast into "pigs" or ingots and comprises stockpile 13.

In completing their income tax returns for the relevant tax years, and more specifically, when calculating their trading income, appellants failed to take into account the value of certain of the stockpiles. Appellants subtracted from their trading income all the deductible expenses incurred in producing these stockpiles, but failed to add to such income the value to appellants of the stockpiles generated by a good deal of that expenditure. The economic and financial benefit which had accrued to appellants as a result of such expenditure was simply ignored.

The questions which arise in this appeal are the consequence of the Commissioner adding to the profits of appellants for the tax years in issue substantial amounts running into millions of rands and representing what the Commissioner styled "closing stock in respect of work in progress" for the 1987 tax year, and "increase in work in progress stock" in the tax years 1988, 1989, and 1990. In the case of REIT, and for the 1989 tax year, the Commissioner deducted from its taxable income an amount representing what he styled "decrease in work in progress stock". In effecting these adjustments the Commissioner sought to rectify the failure of appellants to reflect the value of the particular stockpiles when calculating their taxable income. Appellants contend that they acted correctly in ignoring the relevant stockpiles. The Commissioner contends that they did not.

The Commissioner's contention is founded upon the

provisions of sec. 22 read with the definition of "trading stock" in sec.

1, of the Income Tax Act No. 58 of 1962 ("the Act") and the

particular character of the stockpiles in issue. Those provisions of sec.

22 of the Act which are directly relevant to the questions (I omit those

which are not) then read:

> "(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being shares held by any company in any other company, has been diminished by reason of damage, deterioration, change in fashion, decrease in the market value or for any other reason satisfactory to the Commissioner.
>
> (2) The amount which shall in the determination of the taxable income derived by any person during the year of

assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the beginning of any year of assessment, shall -

(1) if such trading stock formed part of the trading stock of such person at the end of the immediately preceding year of assessment be the amount which was, in the determination of the taxable income of such person for such preceding year of assessment, taken into account in respect of the value of such trading stock at the end of such preceding year of assessment; or

(2) if such trading stock did not form part of the trading stock of such person at the end of the immediately preceding year of assessment, be the cost price to such person of such trading stock.

(3) (a) For the purposes of this section the cost price at any date of any trading stock in relation to any person shall be the cost incurred by such person, whether in the current or any previous year of assessment in acquiring such trading stock, plus, subject to the provisions of paragraph (b), any further costs incurred by him up to and including the said date in getting such trading stock into its then existing condition and location.

(b) The further costs which in terms of paragraph (a) are required to be included in the cost price

of any trading stock shall be such costs as in terms of any generally accepted accounting practice approved by the Commissioner should be included in the valuation of such trading stock."

"(4) If any trading stock has been acquired by any person for no consideration or for a consideration which is not measurable in terms of money, such person shall for the purposes of sub-section (3) be deemed to have acquired such trading stock at a cost equal to the price which in the opinion of the Commissioner was the current market price of such trading stock on the date on which it was acquired by such person: Provided that any capitalization shares awarded by any company to shareholders of that company on or after 1 July 1957 shall have no value as trading stock in the hands of such shareholders: Provided further that options or any other rights to acquire shares in any company which have been acquired as aforesaid shall have no value."

Legislative alterations of sec 22 have been made since, but without retroactive effect, and the changes made have no bearing upon the questions raised in this appeal.

The definition of "trading stock" in sec. 1 of the Act read

at the relevant times:

> " 'Trading stock' includes anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for purposes of manufacture, sale or exchange by him or on his behalf, or the proceeds from the disposal of which forms or will form part of his gross income".

Subsequent amendments brought about by sec 2 (1) (e) of Act No 101 of 1990 and sec 2 (1) (m) of Act No 113 of 1993 were not operative during the tax years in issue and are consequently not material for present purposes.

The rationale for the existence of these provisions is neither far to seek nor difficult to comprehend. The South African system of taxation of income entails determining what the taxpayer's gross income was, subtracting from it any income which is exempt from tax, subtracting from the resultant income any deductions allowed by the Act, and thereby arriving at the taxable income. It is on the

latter income that tax is levied. The concepts involved are defined in the Act. Commissioner for Inland Revenue v Nemojim (Pty) Ltd 1983(4) SA 935(A) at 946G-H. Where a taxpayer is carrying on a trade, any expenditure incurred by him in the acquisition of trading stock is deductible in terms of sec. 11(a) of the Act because it is expenditure incurred in the production of income, and it is not of a capital nature. Income generated by the sale of such stock is of course part of the trader's gross income. Where in his first year of trading a trader has bought, and thereafter sold, all the stock which he acquired during that year, no problem arises. There will be a perfect correlation between the trading income earned and the expenditure incurred in that particular year in purchasing and selling the stocks sold, and the difference between the two sums will give a true picture of the result of the year's trading. There will be no stock on hand at the close of

the year of which account need be taken. Contrast with that situation, a situation in which the trader, having sold all the stock acquired earlier during that year at a substantial profit, purchases large quantities of stock just prior to the close of his tax and trading year. | If he were permitted to deduct the cost of purchasing that stock from the income generated by his sales, without acknowledging the benefit of the stock acquired, he would be escaping taxation in that year on income which otherwise would have been taxable, by the simple expedient of converting it into trading stock of the same value. That process could be repeated every year ad infinitum. It is true that there would ultimately have to be a day of reckoning when trading finally ceases, but the fact remains that the taxpayer will have been enabled to avoid liability for tax until that point is reached. Where the trader is an individual who is subject to rising marginal tax rates

as his trading profit increases, he would be enabled to so regulate his apparent profit that he immunised himself from them indefinitely.

All this appears to be recognised expressly or implicitly by the writers of text-books on income tax in South Africa. See Meyerowitz and Spiro on Income Tax, para. 538; Silke on South African Income Tax, para. 8.111; Williams, Income Tax in South Africa. Law and Practice. (1994) at page 281; Stack and Cronje, The Taxation of Individuals and Companies. 8th ed. (1994), pages 163 and 342. In Australia, whose system of taxation has much in common with our own in its eschewal of the assessment of tax on the profits or gains of a business in accordance with undiluted accounting principles and practices, and its preference for the assessment of tax upon the excess of assessable income over allowable deductions, the rationale for the existence of provisions broadly similar to sec 22 of the South

African Act has been explained by the High Court in Federal Commissioner of Taxation v St Hubert's Island Pty Ltd (in liquidation) (1978) 78 Australasian Tax Reports 452. The decision is helpful in two respects. Firstly, it explains why it is necessary to take into account the value of trading stock on hand at the beginning and at the close of a tax year. Secondly, it explains why trading stock is now regarded as encompassing more than the stock of goods acquired or ! manufactured by a trader to be sold. Because the report of the case is unlikely to be generally accessible in South Africa I shall quote extensively from it.

Stephen J (at 456) recalled that in C of T (SA)v Executor Trustee & Agency Co of SA Ltd (Garden's case) (1938) 63 CLR 108 at 156, 1 AITR 416 at 443, Dixon J had said: "The basis of a trading account is stock on hand at the beginning and end of the period and

sales and purchases". He went on to say that Dixon J had explained why it is impracticable to estimate income from trade otherwise than by means of a profit and loss account, and had added that the computation of profits from trading "has always been upon the principle that the profit may be contained in stock-in-trade —". Stephen J concluded that only "by taking account of stock-in-trade in the conventional way can a correct reflex of the trader's income for the accounting period be obtained", and that the provisions in sections 28-31 of the Australian legislation were there to ensure "such a correct reflex in the case of stock-in-trade". Reference was also made to a passage from the speech of Lord Reid in Duple Motor Bodies Ltd v

Ostime (1961) 39 TC 537 at 569-70 in which he said ".....long ago it became customary to take account of stock-in-trade, and for a simple reason. If the amount of stock-in-trade has increased materially during

the year then in effect sums which would have gone to swell the year's profits are represented at the end of the year by tangible assets, the extra stock-in-trade which they have been spent to buy; and similar reasoning will apply if the amount of stock-in-trade has decreased. So to omit the stock-in-trade would give a false result". There is no reason to doubt that it was for these reasons that the South African legislation too requires opening and closing trading stock to be taken into account when determining taxable income derived from carrying on any trade in any year of assessment. Certainly, no other reasons have been suggested. See the case of Nemoiim, supra, at 956G -957A.

How it came about that the narrower view of what constituted trading stock or stock-in-trade gave way to the wider view now taken in both Australia and South Africa is also explained. In the

Australian legislation "trading stock" is defined as including "anything

produced, manufactured, acquired or purchased for purposes of

manufacture, sale or exchange, and also includes live stock".

Stephen J said:

> "In deciding this question one notes, at the outset, that the statutory meaning, by including in 'trading stock' things acquired not only for purposes of sale or exchange but also for purposes of manufacture, enlarges the ordinary meaning of the term. Dictionary meanings of 'stock', in the sense of stock-in-trade or trading stock, generally involve the concept of being kept on hand by a trader for sale by him and would not extend so as to include raw materials acquired for purposes of manufacture. The inclusion of live stock effects a further enlargement of the meaning of trading stock, a dairy farmer's milking herd, although 'live stock', would not be trading stock as ordinarily understood". (At 454.)

Mason J said:

> "It has been suggested that the definition contained in s 6(1) of the Act, to the extent to which it refers to anything 'acquired or purchased for the purposes of manufacture', represents an extension of the accepted meaning of the term. No doubt it is correct to say that historically 'trading stock' and 'stock-in-trade' denoted the stock of goods acquired by a trader or dealer and

held for sale. Even today it would be correct to speak of the trading stock or stock-in-trade of Steptoe & Son. But whereas both expressions may have had this limited meaning in times gone by, trading stock has acquired a more extensive denotation in modern times. It is a commercial term, ordinarily employed by accountants and auditors and it is to usage by commercial men that we must look in determining what it signifies, rather than to standard dictionaries which so often fail to reflect current usage and just as frequently fail to reflect modern commercial usage.

As applied to the business of a manufacturer of goods, accountants and commercial men by their use of the expression 'trading stock' denote not only the goods which he has manufactured and holds for sale but his stock of raw materials, components and partly manufactured goods. Whiteman and Wheatcroft on Income Tax, 2nd ed (1976) p 444, under the heading 'Stock-in-Trade and Work in Progress', say:

> 'A manufacturer who buys raw materials, processes them and sells the finished product will normally have on hand some unused raw materials, some partly manufactured goods and some finished goods awaiting sale. The first and last are stock, the partly processed goods being sometimes called stock and sometimes work in progress. In addition, a manufacturer may have on hand goods which he consumes in the course of his manufacture, such as coal; this is also regarded as stock'.

See also Simon's Taxes, 3rd ed, vol B, pp 411 et seq.

The view expressed by Whiteman and Wheatcroft is not a mere outgrowth of the United Kingdom statutory definitions to which I have already referred. It is a reflection of commercial usage arising from the development of accounting principles over a long period of time. The authors refer, in support of the last sentence in the passage quoted, to the decision of Rowlatt J in George Thompson & Co Ltd v IR Comrs (1927) 12 TC 1091 where a shipping company having contracted to purchase a quantity of coal for the purpose of running its ships subsequently transferred the benefit of the contract at a profit - when its ships were requisitioned in 1916, there being no need for the coal. It was held that the coal was bought on revenue account as consumable stores as part of the business and that therefore the profit was taxable. In effect the coal was treated as part of the taxpayer's trading stock.

The recognition by accountants and commercial men that raw material used for the purpose of manufacture in a manufacturing business and partly manufactured goods form part of the trading stock of the business was an almost inevitable development. It enabled the value of raw materials and partly manufactured goods to be included in the value of trading stock at the beginning and end of an accounting period and by this means it led to the making or a more accurate calculation of the profit earned or the loss sustained in that period. It is not easy to see how an accurate calculation of profit or loss could be made

unless the value of raw materials and partly manufactured goods was taken into account. Of course the value might be taken into account, even though by different means. Partly manufactured goods may be dealt with as 'work in progress', as indeed they are sometimes, but this expression is no more than an alternative description except in so far as it is intended to introduce different methods of valuation.

In this respect I agree with Aickin J that the House of Lords in Ostime (Insp of Taxes) v Duple Motor Bodies Ltd (1961) 1 WLR 739 did not treat work in progress as being essentially different from trading stock. Their Lordships used the expression 'work in progress' as an alternative description for partly manufactured goods which, like raw materials and completed goods, form part of the trading stock of a business and which, as that case illustrates, give rise to special problems of valuation. At 751, Lord Reid. with whose judgment Lord Tucker and Lord Hodson agreed, said:

> 'Suppose that the manufacture of an article was completed near the end of an accounting period. If completed the day before that date the article, if not already sold, has become stock-in-trade, if completed the day after that date it was still work in progress on that date'.

In Henderson v FC of T (1969) 119 CLR 612 at 635; 1 ATR 133 at 146, Windeyer J, after referring to this statement, said:

> 'These propositions relate to 'work in progress' as a synonym for tangible things, goods in process of manufacture from raw materials, things which when completed will become stock-in-trade'.

These observations were directed to the question whether the stock of partly manufactured goods is to be treated for taxation ! purposes in the same fashion as completed goods and to this question an affirmative answer was returned. The expression 'work in progress' was used to differentiate goods in the former from those in the latter category. It is, I think, taking too much from what was said to conclude that these statements positively express the view that goods in process of manufacture are excluded from 'trading stock'. If they go so far, I would, with respect, disagree with them. The wide view of the ordinary denotation of 'trading stock' is not something which is peculiar to the United Kingdom and foreign to Australia. In 1 CTBR (NS) Case 120 at 572, the Chairman, Mr Gibson, observed that he had little doubt that raw materials came to be regarded long ago commercially as trading stock.

It has been pointed out previously that, unlike the United Kingdom income tax legislation, the Act does not provide for the assessment of tax on the profits or gains of a business - see Commercial & General Acceptance Ltd v FC of T (1977) 7 ATR 716 at 720-1; 16 ALR 267 at 272-3, and the cases cited; J Rowe & Son (Pty)Ltd v FC of T (1971) 124 CLR 421 at 450-1; 2 ATR 497 at 500-1. One consequence of this

> difference is that some accounting principles and practices which have been held to be appropriate in the ascertainment of a taxpayer's profit may have no application here because our statutory provisions specifically instruct us as to what constitutes assessable income and as to the items that shall be allowed as deductions from that income. The trading stock provisions contained in ss 28 to 36 are a case in point. Accounting principle and practice cannot prevail over them. However, as the definition of 'trading stock' contained in s 6(1) is not an exclusive definition, it requires us to give effect to the ordinary, and in this case that happens to be the commercial, meaning of the expression, notwithstanding that in part at least it is a meaning which may have derived from or may have been influenced by accounting principle or practice.
>
> If trading stock according to its ordinary meaning denotes land as well as goods and commodities, it must follow that land may form part of the trading stock of a business before it has been converted into the condition in which it is intended to be sold. Just as raw materials and partly manufactured goods form part of the trading stock of a manufacturer, so also virgin land which has been acquired by a land developer for the purpose of improvement, subdivision and sale in the form of allotments will i form part of his trading stock". (At 461-462)

Aickin J said nothing inconsistent with the views of Stephen J and Mason J.

I did not understand counsel for appellants to contest during oral argument the rationale for the existence of provisions such as sec 22 read with the extended definition of trading stock in sec 1 of the Act. In the heads of argument filed by appellants it had been contended that the decision of this court in De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue 1986(1) SA 8(A) showed at 32 E-F that the definition of trading stock in sec 1 should be interpreted in such a way that only that which would ordinarily have been regarded as trading stock or stock-in-trade falls within its ambit. However, during oral argument counsel for appellant frankly conceded that in making that submission in the heads of argument, the impact of the use of the word "comprehend" in the following passage in the judgment was not sufficiently taken into account:

> "..... the definition would seem to comprehend what is

ordinarily understood by the term trading stock". (At 33 C.) If the entire sentence (of which the above passage is but a part) in the judgment is read, it is plain that the court did not intend to convey that the meaning to be given to the words "trading stock" had to be so confined. The court was concerned with a different question, namely, whether or not the definition was exhaustive.

While accepting that the definition had the effect of encompassing things which would or might not ordinarily be regarded as trading stock, counsel for appellants submitted that it should not be interpreted as encompassing that which has no separate identity and value as a saleable article, or product, or commodity. He contended that that is especially so in the case of anything manufactured. He emphasised the use of the word "anything" in the definition and contended that that part of the definition which reads "anything……

the proceeds from the disposal of which forms or will form part of his gross income" shows that a saleable product was contemplated. It was suggested that the reference in sec 22(1) of the Act to a possible diminution in the value by reason of a "decrease in the market value" of trading stock held by the taxpayer, and the reference in sec 22 (4) to trading stock being deemed in the circumstances there set out to have been acquired "at a cost equal to the current market price of such trading stock on the date on which it was acquired" strengthened the contention. A "purposive" approach to the interpretation of the definition of trading stock, such as that described in Public Carriers Association and Others v Toll Road Concessionaries (Pty) Ltd and Others 1990(1) SA 925(A) at 943C - 944D, was submitted to be appropriate because of the generality of the language employed in the definition and the need to restrict the meaning to be assigned to it so

as to achieve the purpose of the legislature, without at the same time dubbing as trading stock things which there could be no sensible legislative purpose in treating as trading stock. As I have said, the contention was that the purpose of the legislation was to ensure that only saleable or realisable stock is brought to account. The corollary of the submission was that if something is merely in the process of being "produced, manufactured, purchased or in any other manner acquired" by the taxpayer and it has as yet no realisable value, it cannot be regarded as trading stock within the meaning of the definition. The use of the past tense in the definition ("produced", "manufactured", "purchased" or "acquired") showed, so it was argued, that if what was acquired or manufactured was what counsel called "part of a continuous process of acquisition or manufacture", it could not fall within the definition because the process was incomplete. I

interpolate here en passant that this would result in what is referred to in England and Australia as work-in-progress being largely, if not entirely, excluded from the statutory concept of trading stock.

A further submission made by counsel for appellant was

that it was inherent in the concept in the definition of "anything…… …… the proceeds from the disposal of which forms or will

form part of his gross income" that a saleable or realisable thing was contemplated because there could be no talk of proceeds if that were not so, and "to hold otherwise would mean that a taxpayer would be obliged to pay tax on the deemed value of something which at that stage is not realisable by him".

It was contended that the particular stockpiles in issue did not comply with the interpretation of the relevant provisions postulated by counsel for appellants and that they were therefore rightly

disregarded by appellants in calculating their taxable income. The particular stockpiles disregarded are listed below with a brief accompanying description of what they contained.

Tisand's Stockpiles

Stockpile No 1 - Heavy Mineral Concentrate (HMC) Stockpile

This is situated close to the dredging pond and it consists of heavy mineral concentrate which has been separated from the dredged sand. The heavy mineral concentrate is mainly a mixture of ilmenite, rutile, zircon and monazite.

Stockpile No 2 - "Sunday" Stockpile

This too consists of heavy mineral concentrate and is a reserve supply.

Stockpile No 4 - Zircon/Rutile Stockpile

This consists of a mixture of rutile and zircon derived from the processing of heavy mineral concentrate in a minerals separation plant.

Stockpile No 5 - Low Susceptible Rejects Stockpile

This is a residual mixture of ilmenite, monazite,

rutile and zircon which is subjected thereafter to further processes designed to separate the four minerals from one another. REIT's Stockpiles

Stockpile No 10 - Ilmenite Feedstock Stockpile

This is also described as smelter feed. It is ilmenite from which calcium and chrome have been removed by a roasting and magnetic process. It is a composite of titanium and iron oxide which is destined for the smelter.

Stockpile No 10(a) - Furnace Charge Stockpile

This is a blend of ilmenite feedstock (smelter feed) from Stockpile 10 and char derived from the heating of anthracite. It is this blend which goes to the furnace and yields titania slag (titanium dioxide) and molten iron. Counsel for appellants submitted that these stockpiles

were not realisable or saleable assets in the form in which they were

and had no market value as such, that they represented no more than

particular phases of a continuous process of production or manufacture or "bulges in the pipeline", that they all required to be subjected to yet further processing before anything capable of being sold or realised would emerge, and that it could never have been intended that this continuous process should be notionally halted at the end of a tax year, and that these stockpiles should be assigned a "completely artificial value". He suggested that if the legislature had intended anything which was being used in a process of manufacture to be regarded as trading stock, it would have employed the language which it had used elsewhere in the Act to so describe such things. He pointed out that there are other provisions in the Act in which the legislature has used the expression "used in a process of manufacture" and suggested that its choice of different language in the definition indicated that it did not intend to include anything used in a process of manufacture.

An alternative argument was presented along the following lines. Even if a "strictly literal" interpretation be given to the definition, the stockpiles would still not fall within it because they were not "created" (counsel's word) for the purpose of "manufacture, sale, or exchange" (the relevant words in the definition). None was created for sale or exchange. Stockpiles Nos 1, 2, 4 and 5 were created for the purpose of separating their contents into their constituent parts. That process is not a manufacturing process but a mining process falling within the definition of "mining" in sec 1 of the Act. The same applies to Stockpile 10 which is acquired by REIT from Tisand for beneficiation, namely, conversion of the ilmenite to titania slag and high purity iron. The process entails winning titania slag from ilmenite which is a constituent of the soil. Stockpile 10(a) is (but for the char, which is not in issue) in the same category.

Because none of the stockpiles are disposed of in a way which will result directly in the receipt of any "proceeds", but are disposed of by | being utilised in a further stage of a continuous process, they cannot fall within that part of the definition which relates to "anything

……the proceeds from the disposal of which forms or will form part of his gross income".

In yet another alternative argument, it was contended that respondent had failed to apply his mind to whether or not there had been a reduction in the value of the stockpiles by reason of, inter alia, a "decrease in the market value" thereof. It was submitted that the value had decreased to nil and that the question should be referred back to respondent for consideration in terms of sec 22(1) of the Act.

The court a quo concluded that there was no scope for a purposive interpretation of the relevant provisions because there was

no uncertainty or ambiguity lurking in the language used by the legislature. It rejected the suggestion that it had been held by this court in the De Beers Holdings case supra, that the definition of trading stock encompassed no more than what would ordinarily have been included in that term. It drew attention to the breadth of the definition and concluded that it embraced "considerably more than what would otherwise be understood thereby". The evidence established in its view that the stockpiles in issue were "produced" or "manufactured" by appellants "for purposes of manufacture" within the meaning of the definition.

In considering appellants' contention that the stockpiles had no value for the purposes of sec 22, the court a quo was prepared to assume that the material in the stockpiles was unsaleable in its then condition and that there was no market for it. Even if the stockpiles

could properly be described as "bulges in the pipeline" of production (which it doubted), the court regarded that as irrelevant because they would none the less fall squarely within the first part of the definition. The assumed absence of any market for the stockpiles in the state in which they were was thought to be of no consequence. So was the absence of any intent on the part of appellants to sell them. That they | had a considerable value to appellants seemed to the court to be quite plain, at least for as long as appellants continued their operations and did not terminate them abruptly. The court did not elaborate but I take it that what it had in mind was that appellants had expended time, effort and money in accumulating what was in those stockpiles; they contained materials which after further processing could be profitably marketed; if the stockpiles were for any reason to be lost or destroyed, appellants would have sustained a loss occasioned by the

fact that the money, time and effort spent in establishing the stockpiles would have been spent fruitlessly and the potential profit which they stood to make on the sale of their contents after further processing would also have been lost.

The court a quo went on to say that sub-secs 22(1) and (3) do not refer to the market value of trading stock but to the cost price of such stock. Such cost price is defined in sec 22(3) (a) as being

"the cost incurred……in acquiring such trading stock, plus,

subject to the provisions of paragraph (b), any further costs incurred

…… in getting such trading stock into its then existing condition

and location". The Court pointed out that those were the very costs which had been quantified by appellants when respondent required the value of the stockpiles to be calculated. It concluded that the stockpiles had at least that value for the purposes of sec 22.

The contention that respondent had failed to consider reducing the value of the stockpiles pursuant to the discretion vested in him by sec 22(1) and that the matter should be remitted to him for consideration was rejected. The court a quo said that the question had never been raised until the hearing of argument and that respondent himself had had no opportunity of responding to the allegation that he had failed to consider the question. It queried whether in the absence of any provision enabling appellants to appeal against a failure to exercise such a discretion, it was within the power of the Income Tax Special Court to entertain what amounted to a review of respondent's alleged failure. It thought that what little there was before it suggested that respondent had considered the matter and it added that prima facie there were grounds upon which a refusal to reduce the value could be justified. In the result, the appeals were dismissed and the assessments

confirmed.

Were the stockpiles trading stock?

Some preliminary observations about the scope of the definition seem appropriate. As was observed in the De Beers Holdings case supra, the definition may be notionally and grammatically divided into two parts. The first part lays emphasis upon the purpose for which anything may have been produced, manufactured, purchased or in any other manner acquired by a taxpayer. The specified purposes are manufacture, sale or exchange by the taxpayer or on his behalf. The second part makes no direct reference to any purpose which the taxpayer must have had at the time of acquisition; it postulates an objective assessment, namely, whether, if the thing under consideration was disposed of, the proceeds would form part of his gross income. The first part, in so far as it refers to

the purpose of sale or exchange, envisages that upon disposal of the thing in question something will be received in return, either money or some other quid pro quo. To that extent, the definition is consistent with the general thrust of the argument of counsel for appellants that what is contemplated is anything which has an independent existence and value as a saleable or exchangeable article, product or commodity. But the argument falls foul of other aspects of the definition. The first part of the definition also includes "anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for purposes of manufacture……by him or on his behalf". Those words are quite plain and unambiguous. It is inherent in them that, in order to fall within the definition, what the taxpayer produces, manufactures, purchases or otherwise acquires need not be intended to be disposed of in the state in which it then is. It suffices

that it is intended to be used for the purpose of manufacturing something. Nor does it matter whether or not that which is intended to be used, is capable of realisation or sale in the state in which it then is. Whether it is so realisable or not, there will be no contemplation of receiving any quid pro quo for it in the state in which it then is. The fact that it may be saleable in its then state and have an ascertainable market value is not what brings it into the first part of the definition because it was not produced, manufactured, purchased or in any other manner acquired for sale or exchange. What brings it into the definition notwithstanding that its sale or exchange was not contemplated, is its intended use for purposes of manufacture. To illustrate: a manufacturer of sewing machines may purchase or manufacture screws for the sole purpose of using them in the manufacture of the sewing machines. The screws may have an

ascertainable market value and a functional existence separate from, and independent of, the sewing machines, yet they would not be trading stock for the purposes of the definition, but for their intended use in the manufacture of the sewing machines. The same manufacturer may purchase or produce or manufacture for incorporation in the sewing machines a custom made part which is not capable of use by anyone other than himself, and has no value to anyone other than himself. While it may have a separate physical existence, it has no independent functional utility capable of being turned to account in any other way. It may even have no value as scrap. Yet it falls within the plain and unambiguous language of the definition. Once it is obvious, as I think it is, that the legislature has deliberately chosen to extend the concept of trading stock beyond its colloquial ambit so as to include things which the taxpayer has no

intention of disposing of as separate entities, but intends to use solely for the purpose of manufacturing something else in which he trades, there is little, if any, scope for a purposive interpretation of the provisions. In any event, what, one may ask, is the more restricted purpose which is so apparent that effect should be given to it? In my view, there is none.

The suggested difficulty in identifying and ascribing a value to things in the process of being manufactured on the last day of the tax year does not entitle the court to disregard the plain language of the definition. Moreover, the difficulty strikes me as being more apparent than real. Certainly in other tax jurisdictions the legislators and the courts have not baulked at the concept of valuing work-in-progress and there is no reason to suppose that the South African parliament was daunted by the prospect. As has been noted,

appellants themselves encountered no great difficulty in doing so when required by respondent to do so.

A fundamental weakness in the argument of counsel for appellants, in my view, is that it postulates that something which is plainly trading stock by definition when acquired, purchased, produced or manufactured will cease to be regarded as such the moment it commences being integrated or incorporated in that which is in the process of being manufactured. Once it is clear (as it is) that, for example, raw materials purchased for purpose of manufacture must be regarded as trading stock even although they have not been purchased for the purpose of selling or exchanging them, and once it is clear (as it is) that the rationale for requiring them to be so regarded is to obtain a more accurate calculation of the profit earned or the loss sustained during the year, it would make little sense to ignore the value of the

raw materials utilised in such partly manufactured goods as may be on hand. It would result, not in the true reflection of the taxpayer's trading fortunes which the legislation is designed to produce, but in a distorted reflection of them. In short, it entails ignoring work in progress despite the fact that it may have very great value, and despite the fact that the cost of producing it has not been ignored but, on the contrary, brought to account as an expense incurred. I can find no warrant in the language used by the legislature for attributing any such inconsistency of approach to the legislature:

> I do not consider that the use of the past tense ("produced", "manufactured", "purchased" or "acquired") in the definition can be invested with the significance suggested by counsel for appellants. A thing produced or manufactured for the purposes of manufacture is manifestly something which is intended to be used in

a process of manufacture, yet it plainly falls within the definition. It will continue to be regarded as trading stock until the process of manufacture for use in which it was itself manufactured, is complete. Only then will its classification as trading stock in its own right cease, and that will be simply because it will have become an integral part of the finished product which, in its completed state, represents a newly created item of trading stock in which the value of such trading stock as may have been used in its manufacture is subsumed.

Nor do I consider that the second part of the definition shows that in the first part only a product saleable in its own right is contemplated. The Erst part certainly includes things saleable in their own right. The very fact that it contemplates a thing which has been purchased by the taxpayer carries with it an implication of saleability. But there is no justification for implying the quality of saleability

when it comes to anything produced or manufactured for purposes of manufacture. Such a thing may or may not be saleable in its own right, but nothing in the language used by the legislature would justify the drawing of a distinction between those things which are saleable and those which are not and the regarding of only things saleable in their own right as trading stock. As pointed out earlier, it would also be inimical to the attainment of the object which the legislation is designed to achieve, namely, a true reflection of the taxpayer's trading fortunes.

The references in sec 22(1) to a "decrease in market value" and in sec 22(4) to "current market price" do not appear to me to provide any support for the interpretation contended for by counsel for appellants. A decrease in market value is but one of a number of factors listed in sec 22(1) which may be taken into account by the

Commissioner in deciding whether or not to allow a taxpayer to reduce the value of trading stock held by him at the close of the tax year to below the cost price (as defined) to him of such stock. What requires to be emphasised, is that what the Commissioner is empowered to do is to allow the taxpayer to deduct an amount thought by the Commissioner to be just and reasonable "as representing the

amount by which the value of such trading stock.....has been diminished". The value which must have diminished by reason of any of the listed factors is obviously the pre-existing value. That preexisting value is the cost price (as defined) to the taxpayer of the relevant trading stock. If the factors listed have not caused the trading stock to fall below the cost price of such trading stock to the taxpayer, there would appear to be no warrant for allowing the taxpayer to deduct an amount "representing the amount by which the value of such

trading stock..... has been diminished" because no such diminution would have occurred in fact. Merely because a decrease in the market value of goods which a trader purchased for resale has occurred will not necessarily mean that he is entitled to be allowed to make an equivalent deduction; it is only to the extent that the market price falls below the cost price (as defined) which he paid for the goods that a deduction would be permissible. To grant a deduction to cater for a non-existent diminution of value of goods in the trader's hands, would be to falsify his true financial position. The same would apply to any of the other possible causes of diminution of value listed in sec 22(1).

In any event, the fact that one of the possible causes of a diminution in market value mentioned in sec 22(1) is a decrease in market value, provides no logical basis for the assumption that sec

22(1) is concerned only with saleable things. All the other potential causes of a diminution in value of trading stock (damage, deterioration, change in fashion, any other reason satisfactory to the Commissioner) are potentially quite capable of application to work in progress even although such work in progress may have no market value.

As for the reference to "current market price" in sec 22(4), that too is no indication that trading stock can comprehend only saleable things. It can obviously only be applied if a current market price is ascertainable. This provision is to deal with a case in which trading stock has been acquired for no consideration or for a consideration which is not measurable in terms of money. It will follow that nothing which could be claimed as a deduction by the taxpayer will have been expended on its acquisition and, from the

point of view of the fiscus, there is therefore not the same imperative need to value the corresponding benefit and to take it into account when assessing the taxpayer's liability for tax. If therefore cases should arise in which it is not possible to value certain trading stock, that is a consequence to which the legislature must be taken to have resigned itself.

It is true that the legislature has employed the expression "used in a process of manufacture" in some of the other provisions of the Act and that it did not use it in the definition of "trading stock" but the legislature does not always use exactly the same language to convey the same notion. As long as the words which it has chosen to use convey plainly and unambiguously the same notion, nothing can be made of the point. I consider that the words "for purposes of manufacture……by him or on his behalf in the definition

can only mean "for use in manufacture".

The method of assessment of the value of trading stock as defined which is prescribed in sec 22(1), (2) and (3) also shows, I think, that the legislature contemplated that the trading stock which may have to be valued in a given case may consist of work in progress. Those provisions make the cost price to the taxpayer of the trading stock the basic measure of value but recognise firstly, that "further costs" may have been "incurred" by the taxpayer, inter alia, "in getting such trading stock into its then existing condition" and therefore have to be included, and secondly, that there exist generally accepted accounting practices by reference to which it may be determined whether or not any particular further cost is one which should be included in the valuation of the trading stock in question. It is common cause that there existed at the time, and still exists, a

generally accepted accounting practice approved by respondent and known as AC 108. That provides for the valuation of "work in progress" as a component of "stock". It is described as stock "in the process of production for sale". The historical cost of stock is defined as "the aggregate of cost of purchase, cost of conversion, and other costs incurred in bringing the stock to its present location and condition". The "cost of conversion" is defined as "the cost that relates to bringing the stock to its present location and condition". It is clear from AC 108 that costs such as, for example, materials and labour, are to be taken into account when valuing stock. It is therefore generally accepted in accounting practice that there will be an ascertainable value attaching to things which are still in the process of being manufactured and are not yet saleable.

The contentions which rested upon the proposition that the

stockpiles in question were not "produced" or "manufactured" within the meaning of the definition of trading stock but were "mined" within the meaning of the definition of "mining" in sec 1 were not pressed in oral argument by counsel for appellants. He conceded that save possibly for the initial dredging operation, he could not argue with any conviction that in carrying out any of the ensuing processes which resulted in the existence of the stockpiles, appellants had not "produced" or "manufactured" them "for the purposes of manufacture" within the meaning of the definition of trading stock in sec 1. It is therefore unnecessary to detail the evidence given in regard to those processes; it suffices to say that it establishes that the processes do indeed fall within the definition. It is also unnecessary to consider the contention of counsel for respondent that the point was not made in appellants' grounds of objection, that far from there being any

application to the court a quo to allow an amendment of the notice of objection, appellants' objection had been argued on the basis that the stockpiles in question were indeed produced by manufacturing operations, and that as a consequence appellants are barred by sec 83(7) (c) of the Act from raising the contention that the stockpiles were mining stocks.

I conclude therefore that the court a quo was correct in holding that the relevant stockpiles were trading stock as defined. The alternative claim for remittal of the matter to respondent. What actually happened in this regard is shrouded in obscurity. It is not entirely clear whether respondent did or did not give consideration to the question of whether appellants should be permitted to reduce the value of the relevant stockpiles for any of the reasons set forth in sec 22(1). His reply to the notices of objection is a pro forma rejection

of the objections raised. If he did consider the question and if he concluded that no reduction should be permitted, counsel for appellants concedes that appellants would have no redress in either the court a quo or this court. Had appellants pertinently alleged that respondent had failed to consider their request for a reduction in their notice of objection, or made that allegation in other proceedings designed to compel respondent to consider their request, respondent would have responded to the allegation and what had actually happened would have become known. It is true that in the course of his argument before the court a quo respondent's representative submitted that the respondent had not considered the question but that was merely a submission made without reference to respondent in response to a contention raised for the first time in argument by counsel for appellants that respondent had not considered allowing a reduction in

value. The context in which the submission was made was that a number of tax years had gone by in none of which had appellants reflected the stockpiles in question as trading stock. It followed that appellants had never asked respondent in those tax years to allow the value of the stockpiles to be reduced, and that respondent could obviously not have considered any such request then. It is far from clear that respondent's representative was basing his submissions on anything more than inferences drawn by himself. The only occasion when anything resembling a pertinent request to respondent to consider allowing a reduction in value of the relevant stockpiles was made by appellants, was after the assessments for those tax years had been made. The form which the "request" took was in reality more in the nature of a contention designed to reinforce the primary contention that those stockpiles were not trading stock as defined because they

were not saleable in that state and therefore had no market value. For all I know, respondent considered the contention and rejected it. Prima facie, and without purporting to express any definite opinion upon the question, there are grounds which could justify a rejection of the contention. It was the appellant's contention that the stockpiles had never had any market value, not that since the creation of the stockpiles there had been a diminution in their value by reason of a decrease in market value. It is therefore difficult to see upon what basis a reduction in the defined value of the stockpiles could have been founded. However that may be, I share the view of the court a quo that a complaint of this nature cannot be entertained given the failure of appellants to raise it pertinently in a manner which would have required respondent to respond to it.

In the result, the appeals are dismissed with costs and the

assessments are confirmed. It was common cause that the costs of two counsel should be allowed. It is noted for the benefit of the taxing master that only one counsel was engaged to draft respondent's heads of argument.

R M MARAIS

CORBETT CJ
BOTHA)
EKSTEEN) JJA
HOWIE) Concur