THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

Case No: 411/08

In the matter between :

ANGLOVAAL MINING LIMITED Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Neutral citation:	*Anglovaal v SARS* (411/08) [2009] ZASCA 109 (22 September 2009)
Coram:	STREICHER, MTHIYANE JJA, HURT, LEACH and BOSIELO AJJA
Heard:	18 AUGUST 2009
Delivered:	22 SEPTEMBER 2009
Summary:	Income Tax Act 58 of 1962 – acquisition of shares – whether acquired as capital investment or trading stock – whether computation of appellant's income tax liability done in accordance with s 22.

ORDER

On appeal from: the Tax Court (Mbha J sitting as court of first instance).

1 The appeal is allowed with costs including the costs of two counsel.

2 The order by the Tax Court is set aside and the matter is referred back to the respondent to revise the appellant's assessment for the 1999 year of assessment on the basis that the appellant is entitled to the deduction of the amount of R159 702 919 from its taxable income.

JUDGMENT

STREICHER JA (MTHIYANE JA, HURT, LEACH and BOSIELO AJJA concurring)

[1] On 1 June 1994 the appellant acquired shares in National Brands Limited ('NBL'). During its 1999 year of assessment it sold these shares at a loss. In its income tax return for that tax year the appellant claimed a deduction equal to this loss but the respondent disallowed the deduction on the ground that the shareholding was of a capital nature and that the loss did not qualify for deduction. An appeal by the appellant to the Tax Court was dismissed but that court granted leave to the appellant to appeal to this court.

[2] In 1994 the appellant, then known as Anglovaal Limited and at the time controlled by two families, had a mining division and an industrial division. The mining division consisted of various subsidiary mining companies whereas the industrial division consisted of a 60% shareholding

in Anglovaal Industries Limited ('AVI'), a company listed on the Johannesburg Stock Exchange ('the JSE'), which in turn had a number of subsidiaries. One of AVI's subsidiaries was NBL in which it had a 97,7% shareholding. NBL was the company in which all the fast moving consumer goods businesses such as Five Roses Tea, Bakers Biscuits and Beaumont's Biscuits were housed. Apart from its mining and industrial interests the appellant, since the formation of the group of companies in 1933, had actively traded in shares, particularly in listed mining shares, which were not regarded as strategic long term assets with the object of making money by speculative investment.

[3] On 21 April 1994, pursuant to a resolution by the appellant, NBL purchased a snack food business carried on by United Tobacco Company under the name 'Willards Foods'. The appellant funded the acquisition by acquiring a 15,6% shareholding in NBL for the amount of R300m. It in turn acquired the funds by issuing N ordinary shares to foreign investors.

[4] In early 1998 Morgan Stanley, an investment bank, advised the appellant to separate the mining from the industrial companies. The appellant implemented the proposal by changing its name to Anglovaal Mining Limited and transferring its shares in AVI to another holding company. At the same time the appellant decided to sell the NBL shares held by it to AVI. The sale took place in the appellant's 1999 tax year at a price of R141 021 605 leaving the appellant as a purely mining investment company. The sale resulted in a loss of R159 702 919.

[5] As stated above the respondent disallowed the deduction of the loss from the appellant's income during its 1999 year of assessment. In its objection to the disallowance the appellant stated that under normal circumstances the shares issued by NBL to fund the Willards acquisition

would have been issued to the holding company of NBL, namely AVI, and that the shares would have become part of AVI's long term portfolio. However, the appellant's merchant bankers advised that funds could be raised in the international market by way of a foreign equity placement of appellant's shares. The appellant followed the advice and raised the funds required to acquire the new equity in NBL. It stated that normally it would not have had a direct holding in a food company but would have had its exposure to NBL via AVI. An exception was made in this case because NBL was earmarked for a listing on the Stock Exchange later in the year and the shares would have been sold by the appellant within a few months. The intention of taking up the shares directly was with a speculative motive and should be distinguished from appellant's long-term strategic investment in NBL which was held indirectly through AVI. Unfortunately, according to the appellant, NBL's profit performance after the Willard's transaction deteriorated sharply with the result that the proposed listing did not materialize. For these reasons, the appellant contended, the loss was tax deductible.

[6] The respondent dismissed the objection whereupon the appellant appealed to the Tax Court on the ground that the loss incurred on the disposal of the shares should be allowed as a deduction from income in the determination of taxable income on the basis that the amount represented a revenue loss actually incurred in the production of income as envisaged in section 11(a) read together with section 23(g) of the Income Tax Act 58 of 1962.

[7] At the time concerned the relevant part of s 11(a) of Act 58 of 1962 read as follows:

'11 For the purpose of determining the taxable income derived by any person from carrying on any trade within the Republic, there shall be allowed as deductions from the income of such person so derived –

(a) expenditure and losses actually incurred in the Republic in the production of the income, provided such expenditure and losses are not of a capital nature; . . .'

Section 23(g) provided:

'23 No deductions shall in any case be made in respect of the following matters, namely-

. . .

(g) any moneys claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade;

. . .'

'Income' was defined in s 1 as meaning 'the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II'.

'Gross income', in terms of s 1, 'in relation to any year or period of assessment, means, in the case of any person, the total amount, in cash or otherwise, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within the Republic, excluding receipts or accruals of a capital nature . . .'

[8] To qualify for deduction the appellant's loss had to be a loss other than a loss of a capital nature. The appellant contended that it was not of a capital nature whereas the respondent submitted that it was. If the shares were acquired as trading stock with the intention of disposing of them at a profit the former is the case. See *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste*[1] where Corbett JA said:

'Where a taxpayer sells property, the question as to whether the profits derived from the sale are taxable in his hands by reason of the proceeds constituting gross income or are

[1] 1978 (1) SA 101 (A) at 118A-D.

not subject to tax because the proceeds constitute receipts or accruals of a capital nature, turns on the further enquiry as to whether the sale amounted to the realisation of a capital asset or whether it was the sale of an asset in the course of carrying on a business or in pursuance of a profit-making scheme. Where a single transaction is involved it is usually more appropriate to limit the enquiry to the simple alternatives of a capital realisation or a profit-making scheme. In its normal and most straightforward form, the latter connotes the acquisition of an asset for the purpose of reselling it at a profit. This profit is then the result of the productive turnover of the capital represented by the asset and consequently falls into the category of income. The asset constitutes in effect the taxpayer's stock-in-trade or floating capital. In contrast to this the sale of an asset acquired with a view to holding it either in a non-productive state or in order to derive income from the productive use thereof, and in fact so held, constitutes a realisation of fixed capital and the proceeds an accrual of a capital nature. In the determination of the question into which of these two classes a particular transaction falls, the intention of the taxpayer, both at the time of acquiring the asset and at the time of its sale, is of great, and sometimes decisive, importance. Other significant factors include, *inter alia*, the actual activities of the taxpayer in relation to the asset in question, the manner of its realisation, the taxpayer's other business operations (if any) and, in the case of a company, its objects as laid down in its memorandum of association.'

[9] At the hearing of the appeal in the Tax Court the appellant tendered the evidence of two witnesses, Peter Menell and David Barber. David Barber became the Group Financial Manager of the Anglo Vaal Group in 1994 and in 1996 he was appointed Group Financial Director. He oversaw the unbundling process in 1998 and left the group when it was completed. At the time of the hearing in the Tax Court he no longer had any financial interest in the group. According to him the appellant often invested in shares with the purpose of reselling them and at every executive committee ('exco') meeting of the appellant there was a slot for reporting on the purchase and sale of shares. He was responsible for the buying and selling of investments and before he became a member of exco he attended that part of the exco meetings relating to the buying and selling of investments.

[10] In respect of the Willards transaction Barber, in a written presentation, suggested to exco that R300m of the funds required by NBL be funded by the appellant purchasing shares in NBL. He testified that the appellant did not normally invest in an industrial subsidiary. There had to be some justification to permit this type of unusual activity. His justification to exco was first that by acquiring the shares the appellant would increase the group holding in NBL from 59% to 65%. Second, the direct holding could be sold at a profit to a potential foreign partner. It was thought, after the first democratic elections, with foreign companies looking at South Africa as a potential new market, that it would be better to have foreign fast moving consumer goods and food companies as a partner than a competitor and so get access to their brands. Third, AVI was an acquisitive company and sometimes acquired companies in exchange for AVI shares thereby diluting the appellant's shareholding in AVI. To counter such dilution the appellant would be able to sell its NBL shares to AVI in exchange for AVI shares so as to maintain its 60% shareholding in AVI which it considered to be the desired holding. Fourth, in the event of a stock exchange listing of NBL being sought, a certain number of shares would have to be sold to the public and the NBL shares could be used for that purpose without reducing AVI's strategic investment. He also stated in his written presentation that the NBL shares would be held in a tax efficient vehicle to minimise tax liability in the event of onward sale. However, no way could be found to 'shelter the tax liability' so the shares were left in the appellant.

[11] The direct holding by the appellant of shares in NBL was according to Barber inconsistent with the group structure but was undertaken for two reasons. First, it allowed the appellant to take advantage of the offshore market. Second, it was felt that it was not a long term holding and that the structure would be restored within a short period of time as the intention

was to dispose of the holding for profit in one of the three ways referred to above. Asked whether AVI shares as opposed to the appellant's shares could have been placed with a foreign investor Barber said that AVI would not have given foreign investors an exposure to mining and would probably not have been that attractive.

[12] Menell joined the appellant in 1992 as Manager, Finance and Administration, Mines. In September/October 1994 he was appointed as a director of the appellant. Exco, which met every Thursday, was the 'main forum' for debating business decisions. He only became a regular participant in these discussions as a member of the committee after October 1994 and was therefore not a party to the actual decision relating to the acquisition by NBL of Willards or the acquisition of a 15,6% shareholding by the appellant in NBL. He did however confirm Barber's evidence that the acquisition by the appellant of the 15,6% shareholding in NBL was inconsistent with the structure of the group as AVI was created 'to be the home for all the industrial interests'. To hold some of the NBL shares in the appellant was according to him 'a step backwards to a more complex structure'.

[13] Menell and Barber were two of the senior members of the executive of the appellant who embarked on a marketing trip to North America and Europe to sell its shares in order to raise the R300m required for the acquisition of the NBL shares. The group of executives was led by the managing director of the appellant and he spoke at every meeting of foreign investors. Menell testified that foreign investors were told how the proceeds of the shares were going to be used. It was explained to them that buying a direct stake in NBL was contrary to the appellant's policy of 'streamlining' its industrial holdings through AVI but that it was an efficient mechanism and created various options to make an extra profit

from the transaction. Three options were mentioned. One was to promote a listing of NBL and sell the shares once NBL had been listed. Another one was to sell the shares to an incoming foreign investor. The third one was, in the event of a rights issue by AVI, to take up the shares in AVI against delivery of the NBL shares to AVI in lieu of cash so as to maintain the appellant's 60% shareholding in AVI.

[14] Barber testified that he gave the financial perspective of the Anglo Vaal Group at the presentations to foreign investors. He confirmed Menell's evidence that the appellant's intentions with the NBL shares were mentioned to the foreign investors and stated that if the appellant held on to the NBL shares outside the AVI structure it would have been subject to criticism and that that situation could not have lasted on a long-term basis.

[15] The statement in the appellant's objection to the respondent's 1999 assessment that NBL was earmarked for a listing on the stock exchange later in the 1994 year and that NBL shares would have been sold within a few months was not borne out by the evidence. In the public announcement of the acquisition by NBL of the business of Willards Food Division it was stated:

'Various financing alternatives are presently being evaluated and a further announcement will be published once these are finalised. This is not expected to result in the listing of NBL in the immediate future.'

Although it appears from the papers discovered, such as a draft prospectus, that a listing of NBL shares was on the cards in 1993, and although it is stated in the exco minute dated 10 February 1994 that a listing is being reviewed on an ongoing basis, that option was not proceeded with. Menell testified that as from the end of 1994 signs of a decline in the fortunes of NBL became apparent and that profits dropped dramatically as from 1995 as a result of which the listing of the shares was not proceeded with. But

under cross-examination he had to concede that during 1993, 1994 and 1995 NBL was the star performer in the AVI group, that NBL's profits declined after June 1995, and that the statement in the objection was not correct. A listing was only one of the options.

[16] According to Barber the Willards' transaction did not meet the expectations. As a result it became difficult to achieve the benefits foreseen in the acquisition of the NBL shares. Foreign partners would have required undertakings and warranties relating to the health of the company, AVI would not have paid an amount which would have allowed the appellant to make a profit and for a listing it would have been necessary to show that the Willards transaction was successful.

[17] In 1998 Morgan Stanley advised that the Group was too diversified, that the worldwide trend was back to core business and that the market disliked family controlled structures. As a result it was decided to restructure the group into firstly two and ultimately three separate companies in which, respectively, the focus was on mining, engineering and food activities. The intention was that the appellant should end up being a purely mining investment company. It would have been anomalous for a mining company to retain the 15% shareholding in NBL. For that reason it was decided that, as part of the transaction, the NBL shares should be sold to AVI.

[18] In a document prepared in 1998, at the time of the unbundling, it was stated in respect of the acquisition of the appellant's NBL shares by AVI –

'This splitting of the shareholding was deemed appropriate at the time as the shares acquired by Anglovaal would be those utilised for the introduction of any outside minority in National Brands. (At that time certain global operations were considering returning to South Africa and investing in F.M.C.G.[2] operations in the country.)

[2] Fast-moving consumer goods.

Any outside shareholding introduction did not occur and the proposed restructuring of AVI gives rise to the opportunity to rationalise the National Brands' shareholding.'

[19] The Tax Court held that the essential issue was whether the intention of the appellant in acquiring the NBL shares was to hold them as a capital investment in order to derive income therefrom in the form of dividends. It stated that 'the appellant's 98% shareholding in NBL as at the beginning of 1994, was a strategic long-term investment of a capital nature'. The Barber memorandum, in which it was stated that the Willards acquisition would have a major long-term strategic benefit for NBL's activities, according to the Tax Court 'quite clearly explains the appellant's capital intent regarding the purported acquisition of the 15,6% shareholding in NBL'. The NBL shares acquired by the appellant never became stock in trade.

[20] The Tax Court found support for its finding that the acquisition was of a capital nature in the offering circular in respect of the international placement of N ordinary shares in the appellant, more particularly:

(a) In the passage in which it is said that the directors 'consider the acquisition of Willards to be an important step in Anglovaal's strategy of developing its interests in the branded fast-moving consumer goods market'.

(b) In the fact that there is no mention in the document 'that suggests that they were being invited to put up the R300million (for the Willards acquisition) as a short term speculation on the JSE as Messrs Menell and Barber would like the court to believe'.

The direct holding of NBL shares in the appellant was a by-product of the method of financing of the Willards acquisition and the resulting structure was not created for any speculative reasons, the Tax Court held.

[21] The appellant submitted that it did not acquire the NBL shares as a capital investment but acquired them as trading stock. In terms of s 1 of the Income Tax Act 58 of 1962, as it read at the time, 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 . . ..'

[22] The appellant submitted that the NBL shares were 'purchased . . . for purposes of . . . sale or exchange' and also that 'the proceeds from the disposal of (the shares) forms part of its gross income' ie that on either basis the shares qualified as trading stock as defined.

[23] The Tax Court erred in equating the intention with which NBL shares were held in the appellant with the intention with which NBL shares were held in AVI. This is apparent from the Tax Court's reference to 'the appellant's 98% shareholding in NBL as at the beginning of 1994' whereas it was AVI that held 98% of the NBL shares. The appellant had an indirect interest of approximately 59% in NBL only through its 60% shareholding in AVI. Consequently, the fact that the directors of the appellant considered the acquisition of Willards to be an important step in the appellant's strategy of developing its interests in the branded fast-moving consumer market and the fact that the Willards acquisition would have had a major long-term strategic benefit for NBL's activities indicated that the group had a long-term strategic interest in NBL but it did not necessarily indicate an intention on the part of the appellant to have a direct shareholding in NBL on a long-term basis. None of these facts excluded the possibility that the appellant had no long term intention to hold on to the NBL shares. It clearly had a long-term strategic interest in NBL through AVI but that is not to say that it had a long-term interest in having a direct shareholding in

NBL. The object of the Willards transaction was to strengthen the position of NBL but that is not to say that the method used to finance the transaction was intended to have permanent consequences in so far as the direct holding of shares in NBL was concerned.

[24] The Tax Court also erred in holding that if the intention of the appellant was to dispose, in due course, of the NBL shares acquired by it at a profit and if foreign investors were told that that was the intention it would mean that the foreign investors were invited to put up R300m as a short term speculation on the JSE. It is true that the R300m was required for the purchase of the NBL shares but the foreigners were not invited to invest in NBL; they were invited to invest in the appellant which had mining interests and industrial interests of which NBL constituted only 2%. The foreigners who bought shares in the appellant therefore invested in the appellant. That was not a speculative investment whether or not it was the appellant's intention to dispose of the NBL shares at a profit.

[25] In *Commissioner, South African Revenue Service v Smith* 2002 (6) SA 621 (SCA) at 629C-E this court approved of the following dictum by Miller J in ITC 1185, 35 SATC 122 at 123-124:

'It is often very difficult, however, to discover what [the taxpayer's] true intention was. It is necessary to bear in mind in that regard that the *ipse dixit* of the taxpayer as to his intent and purpose should not lightly be regarded as decisive. It is the function of the court to determine on an objective review of all the relevant facts and circumstances what the motive, purpose and intention of the taxpayer were. Not the least important of the facts will be the course of conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or participation in similar transactions. The facts in regard to those matters will form an important part of the material from which the court will draw its own inferences against the background of the general human and business probabilities. This is not to say that the court will give little or no weight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in

cases of this nature. The taxpayer's evidence under oath and that of his witnesses must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts.'

[26] *Silke on South African Income Tax* 11th Memorial Edition vol 1 para 3.2 says:

'The taxpayer's own evidence about his intention and his credibility will be considered by a court but, because of subjectivity, self-interest, the uncertainties of recollection and the possibility of mere reconstruction, it will test that evidence against the surrounding facts and circumstances in order to establish his true intention.'

[27] Relying on these passages the respondent submitted that the evidence of Barber and Menell that the appellant intended to dispose of the NBL shares at a profit should not be believed. The respondent referred to the fact that they were testifying many years after the event and submitted that their evidence is contradicted by the content of the appellant's objection to the assessment and that of the offering circular.

[28] In the objection to the assessment it is said that the NBL shares were earmarked for a listing on the JSE later in the year and that the shares would have been sold by the appellant within a few months. That statement does not accord with the evidence of Menell and Barber. According to them a listing of the shares was merely one of the possibilities. It is however not contended that any one of them was responsible for the statement. Both of them testified that they no longer had any financial interest in the matter and that evidence of theirs was never challenged. It is nevertheless worrying that the appellant based its objection on a wrong statement of fact, but as to how it came to be made was never explored. In

the circumstances the fact that the statement is wrong does in my view not afford a basis for criticising the evidence of Menell and Barber.

[29] In the circular in terms of which the appellant's N shares were offered to foreigners so as to raise R300m ('the offering circular') it was simply stated that the 'net proceeds of the Offer will be used to expand Anglovaal's interests in the branded fast-moving consumer goods sector through the acquisition of the Willards savoury snacks business'. The respondent submitted that the fact that the offering circular failed to mention that the proceeds of the foreign placement of shares was intended to be utilised for the acquisition of the NBL shares in a speculative venture, justified the Tax Court's rejection of Menell's and Barber's evidence as to such intention. However, the statement in the circular was correct and the fact that it was the intention to dispose, in due course, of the appellant's direct holding of 15.6% of the NBL shares is not inconsistent with that statement or any other statement in the offering circular. Furthermore, in the light of the appellant's vast mining and industrial interests, its intention, in so far as the NBL shares held by it are concerned, did not warrant a mention in the circular.

[30] As stated above the appellant, before the acquisition of Willards, held all its industrial interests through AVI. In the offering circular it is stated:

'Anglovaal's industrial interests are controlled through a 60 per cent holding in AVI, a company which is itself listed on The Johannesburg Stock Exchange. AVI's businesses are, in the main, major participants in the markets which they serve. AVI's principal subsidiaries are Consol, engaged in the manufacture and marketing of packaging and rubber; National Brands, a leading supplier of branded fast-moving consumer goods; AVI Diversified Holdings, a holding company for engineering and textile interests; Irvin & Johnson, which procures, markets and distributes fish and frozen foods; and Grinaker, which is engaged in construction and construction materials and the

manufacture of electronic equipment and acts as a provider of a wide range of communication and information technology services.'

Contrary to this statement the circular included a diagrammatical representation of the group structure which indicated that the appellant, in addition to its 60% shareholding in AVI held 15,6% of the shares in NBL.

[31] The acquisition of a direct shareholding in NBL was clearly contrary to the existing structure as was testified by Barber and Menell. It is furthermore beyond question, in the light of Barber's memorandum, that he explained to exco that the best option was nevertheless to finance the Willards transaction by way of an acquisition of NBL shares, that the immediate effect would be that the appellant increased its interest in NBL which it could in due course sell to AVI, to a foreign investor or to private investors as a float if it were decided to list the NBL shares on the JSE.

[32] In the light of the aforegoing there is in my view no reason to doubt the evidence of Barber and Menell that foreign investors asked questions about the appellant's direct holding of 15,6% of the shares in NBL. One would have expected them to do so. In the light of the incongruous nature of the structure and Barber's memorandum there is also no reason to doubt Barber's and Menell's evidence that such direct shareholding was but a temporary aberration and that that was explained to the foreign investors. It is highly improbable that having structured the industrial holdings the way it did the appellant would have hung on to its direct shareholding in NBL.

[33] The Tax Court rejected the evidence that one of the options open to the appellant was to sell the NBL shares to a foreign investor on the basis, first, that it was not supported by any evidence, documentary or otherwise and, second, that it was never shown that 'there was any foreign investor "waiting in the wings" so to speak'. It may be that there was no foreign

investor waiting in the wings but the evidence that a sale to a foreign investor was one of the options is borne out by the Barber memorandum and supported by the statement in the offering circular that it was 'the objective of the Group to form partnerships with overseas corporations to exploit business opportunities both in South Africa and elsewhere'. At the time of the acquisition of the shares the probabilities were that in the event of a sale to a foreign investor or another third party not occurring, the appellant would in due course sell the NBL shares to AVI at market value which the appellant thought would be higher than the purchase price ie at a profit. In the event, the shares where not sold until the unbundling of the appellant in 1998. Barber testified that the reason for not having sold them before the time was that NBL's performance was such that the shares became worth less than R300m. Again there is no reason not to accept this evidence.

[34] Prof Wainer, a chartered accountant, was the only witness called by the respondent. He testified that it was unusual for a company to hold shares in its subsidiary with a speculative intent. If it was indeed the intention of the appellant to sell the NBL shares at a profit he would have expected disclosure of that intention in the financial statements of the appellant. Absent such a disclosure everything in the financial statements suggests that the holding was long-term. The respondent submitted that this evidence casts grave doubt on the reliability of Menell's and Barber's evidence as to the intention of the appellant. However, the direct holding of shares in NBL in itself was unusual and it cannot be said that the financial statements suggest that the holding was long-term, as it is not disputed that the appellant traded in shares and that such shares were dealt with in the appellant's financial statements in the same way as the NBL shares.

[35] In the light of the evidence of Menell and Barber, the documentary evidence and the probabilities I am of the view that the Tax Court erred in not finding that it had been proved on a balance of probabilities that the NBL shares had been acquired by the appellant with the intention of disposing of them at a profit ie that the shares constituted trading stock in the hands of the appellant.

[36] The Tax Court, held that even if the NBL shares were 'acquired and held as part of a scheme of profit-making and were part of [the appellant's] trading stock, the expense of the purchase of R300 million, incurred in 1994, cannot nevertheless be claimed as a deduction in the 1999 year of assessment'. Its reason for so holding was that the appellant had not, so the Tax Court held, in the 1994 tax year and in the ensuing tax years taken the expense into account, whether as opening stock, purchases or closing stock. Referring to ss 11(a) and 22 of the Act it held that it was of fundamental importance 'that the actual deduction in respect of the cost price (of the shares) must have been made and taken into account in the determination of taxable income in the year of their acquisition (in terms of section 11(a)), and in addition in each year thereafter until disposition there must be appropriate figures for closing and opening (in terms of section 22)'.

[37] The respondent submitted that this finding of the Tax Court was correct as income tax is an annual tax, which entails that deductions are to be claimed in the year of assessment during which the expenditure is actually incurred. It referred in this regard to *Sub-Nigel Ltd v Commissioner for Inland Revenue* 1948 (4) SA 580 (A) and *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A). In the *Caltex Oil* case Botha JA said at 674B-C:

'In determining the taxable income of a person carrying on any trade in any year of assessment there is, in terms of sec.11 (a), deductible from such person's income the

expenditure actually incurred by him in the production of the income during that year of assessment.'

In the *Sub-Nigel* case Centlivres JA said at 589:

'For the whole scheme of the Act shows that, as the taxpayer is assessed for income tax for a period of one year, no expenditure incurred in a year previous to the particular tax year can be deducted.'

[38] At the relevant time s 22 of the Act provided as follows:

'(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 –

(a) in the case of trading stock other than trading stock contemplated in paragraph (b), 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; and

(b) . . .

(1A) . . .

(2) The amounts 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 beginning of any year of assessment, shall –

(a) 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

(b) . . ..'

[39] It follows that in terms of the section, in the determination of taxable income, the amount to be taken into account in respect of the value of shares held and not disposed of at the end of a year of assessment should be the cost price of those shares. That same amount, ie the cost price of the shares, is the amount that should be taken into account in respect of the value of the shares held and not disposed of at the beginning of the immediately following year of assessment. In effect the cost price of shares as trading stock is in terms of the section to be carried forward as opening and closing stock until the shares are disposed of. The legislature clearly intended that the value of opening stock should be deducted and the value of closing stock should be added to the taxpayer's taxable income.[3]

[40] The financial statements of the appellant for the 1994 year of assessment contain a schedule in which the appellant's shareholdings at the beginning of the year, their book value, share purchases during the year, the cost price of the shares, sales of shares during the year, the selling price, the appellant's shareholdings at the end of the year and their book value are listed. The schedule indicates that the NBL shares had been purchased during that year for a purchase consideration of R300m, that the book value of those shares at the end of that year was R300m and that no profit or loss had been made in respect of the shares during that year. The income statement contains an item 'profit on sale of investments' which reflects the profit on the realisation of investments as per a schedule of profit on the sale of 'investments-taxable' and profit on sale of 'investments-non-taxable'.

[41] The financial statements of the appellant for the 1995 year of assessment are similar. Insofar as the NBL shares are concerned their value at the end of the 1994 year is taken as their value at the beginning of the

[3] RC Williams *Income Tax in South Africa - Law and Practice* 1994 p 281 para 24.2.

year; 1 344 shares at a value of R724 524 being a dividend in specie is added as being a purchase during the year; no profit or loss is shown for the year; and the book value at the end of the year is reflected as R300 724 524 ie the cost of acquiring the shares. The same accounting procedure was followed in respect of the 1996 and 1997 years of assessment. In respect of the 1998 year of assessment the NBL shares were dealt with differently because the shares were going to be sold and the price at which they were going to be sold had already been determined. It was therefore considered to be imprudent to carry the shares in the appellant's accounts at R300 724 524 when it was apparent that they were worth R159m less. Provision was consequently made for a loss of R159 068 301 (the amount was wrongly calculated and should have been R159 702 919) and the book value of the shares as at the end of the year was reflected as R141 021 605. However, that loss was added back in order to arrive at the profit on investments for the year. The net result for purposes of calculating the income tax payable was therefore the same as it would have been if the book value of the shares at the end of the year had been taken as being the same as at the beginning of the year namely R300 724 524.

[42] In the financial statements for the 1999 tax year the book value of the NBL shares at the beginning of the year is reflected as R141 021 605 and it is also indicated that they were sold for that price. However, in the computation of normal taxation a loss of R159 702 919 is taken into account. The net result for purposes of calculating the income tax payable was therefore the same as it would have been if the book value of the shares at the beginning of the year had been taken as the cost price of the shares.

[43] Referring to these financial statements Barber testified that, during the 1994, 1995, 1996 and 1997 years of assessment no account was taken

of the appellant's expenditure in respect of the NBL shares in the computation of the appellant's tax liability. Counsel for the respondent argued that as no account of such expenditure was claimed during these years there is 'no basis upon which deduction pertaining to the cost price of [the shares] can suddenly be claimed in the 1999 year of assessment, for expenditure already incurred in the 1994 year of assessment'. In this regard he referred to an editorial in The Taxpayer, October 1967 which concluded:

'While, therefore, the practice of including opening and closing stock in determining taxable income, is well established, its legal foundation remains most uncertain.'

Counsel submitted that 'although the legal basis for adding back closing stock and carrying forward opening stock as a deduction is uncertain, one thing which is certain is that one commences the process by claiming a deduction in the year of assessment when the expenditure is actually incurred'.

[44] In my view there is no merit in the submission. When Barber testified that no account was taken of the appellant's expenditure in respect of the 1994 to 1997 years of assessment in the computation of the appellant's income tax liability he could have meant only that the expenditure had no effect on such computation as it was cancelled out by the book value of the shares at the end of the particular year as required by s 22. For purposes of computing the appellant's income tax liability it acted in accordance with the provisions of s 22.

[45] For these reasons the Tax Court should have found that the appellant discharged the onus of proving that it was entitled to the deduction of the amount of R159 702 919, being the loss suffered on the disposal of the NBL shares, against its taxable income in the 1999 year of assessment.

[46] The following order is made:

1 The appeal is allowed with costs including the costs of two counsel.

2 The order by the Tax Court is set aside and the matter is referred back to the respondent to revise the appellant's assessment for the 1999 year of assessment on the basis that the appellant is entitled to the deduction of the amount of R159 702 919 from its taxable income.

_____

P E STREICHER
JUDGE OF APPEAL

Appearances:

For Appellant:	P A Solomon SC J M A Cane Instructed by Deneys Reitz Attorneys, Johannesburg Webbers, Bloemfontein
For Respondent:	H Z Slomowitz SC R Bhana SC Instructed by The South African Revenue Service, Pretoria The State Attorney, Bloemfontein