THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 20844/2014

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

CAPSTONE 556 (PTY) LTD **RESPONDENT**

Neutral citation: *CSARS v Capstone 556 (Pty) Ltd* (20844/2014) [2016] ZASCA 2 (9 February 2016).

Coram: Ponnan, Bosielo, Wallis and Mbha JJA and Van der Merwe

AJA

Heard: 13 November 2015

Delivered: 9 February 2016

Summary: Income tax ─ whether proceeds of sale of shares revenue or a receipt of a capital nature ─ dominant purpose of acquisition of shares long term capital investment to rescue a distressed business ─ at time of acquisition sale of shares at a profit contemplated only as one of several possibilities to be explored at the appropriate time in future ─ subsequent sale of shares unsolicited and fortuitous ─ proceeds a receipt of a capital nature ─ cross-appeal ─ calculation of base cost for capital gains tax purposes ─ inclusion of indemnity payment.

ORDER

On appeal from: Western Cape Division of the High Court, Cape Town (Griesel, Yekiso and Baartman JJ sitting as court of appeal):

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

2.1 The cross-appeal is upheld with costs, including the costs of two counsel.

2.2 It is declared that the liability undertaken by the taxpayer during July 2004 to pay the amount of R55 million to Daun et Cie Aktiengesellschaft, formed part of the base cost of the acquisition of the shares in JD Group Ltd.

JUDGMENT

Van der Merwe AJA (Ponnan, Bosielo, Wallis and Mbha concurring):

[1] During April 2004 the respondent, Capstone 556 (Pty) Ltd (Capstone), disposed of approximately 17 million shares in J D Group Ltd (JDG) and made a profit of nearly R400 million. The principal question in this appeal is whether Capstone is liable for tax on the amount of the profit on the basis that it constituted income (as the appellant, the Commissioner for the South African Revenue Service (the Commissioner) contends) or a receipt of a capital nature (as Capstone contends). The Tax Court, Cape Town (Davis J presiding) found for the Commissioner on this issue, but that finding was overturned by the full court of the Western Cape Division of the High Court, Cape Town (Griesel, Yekiso and Baartman JJ) on appeal to it. This court granted leave to the Commissioner to appeal against the order of the full court.

Background

[2] In the tax court, Capstone presented the evidence of several witnesses, whom I shall identify in due course. The Commissioner called no witnesses. The picture that emerged from the evidence was set out in the reported judgments of the tax court (ITC 1867 (2013) 75 SATC 273) and that

of the full court (*Capstone 556 (Pty) Ltd v Commissioner for the South African Revenue Service* 2014 (6) SA 195 (WCC); 77 SATC 1). In the result I will restrict myself to those facts that I consider material and necessary for a proper understanding of this judgment.

[3] By the end of 2001, Profurn Ltd (Profurn), a JSE listed company in the retail furniture industry, had run into serious financial difficulties. It owed FirstRand Bank Ltd (FirstRand) in excess of R900 million. Profurn also owed between R70 and R90 million to Steinhoff International Holdings Ltd (Steinhoff). Steinhoff was then a major manufacturer and supplier of furniture to the retail industry. Its chief executive officer was Mr Markus Jooste, who was also a major shareholder in Steinhoff. Dr Theunie Lategan, head of the corporate division of FirstRand, was responsible for Profurn's account. FirstRand also had exposure to other furniture retailers. Profurn risked imminent liquidation in view of its critical financial position. This represented a serious financial risk to FirstRand and Steinhoff, as well as a major threat to the stability of the retail furniture industry in South Africa as such.

[4] Dr Lategan, who was under immense pressure to come up with a solution to the Profurn problem, discussed it with Mr Jooste. Mr Jooste referred him to Mr Claas Daun, a wealthy German businessman and director and shareholder of Steinhoff. Mr Daun also indirectly held a 13 per cent shareholding in Profurn so stood to suffer financially if Profurn was liquidated. FirstRand had determined that for Profurn to survive, it needed to reduce its debt to FirstRand to some R300 million. Hence Profurn needed a capital injection of approximately R600 million. For this purpose Dr Lategan entered into discussions with Mr Daun early in 2002. Mr Daun was interested but held a firm view that what was required to save Profurn, was both an injection of capital and sound management. He held the managerial skills of Mr David Sussman, executive chairman of JDG, in high regard. He made it clear that he would only be prepared to invest if the management of Profurn was taken over by Mr Sussman. FirstRand therefore approached Mr Sussman. Mr Sussman was agreeable but in turn insisted that the investor should be committed to remain on board as a shareholder for as long as it would take to

turn the business of Profurn around. Mr Sussman discussed the matter with Mr Daun, who gave the required undertaking.

[5] These developments were followed by a series of discussions between mainly Dr Lategan, Mr Jooste, Mr Daun and Mr Sussman. They resulted in a plan to rescue Profurn and stabilise the retail furniture industry. All concerned were ad idem, however, that the attempt to rescue Profurn would be a difficult operation, would involve high risks and would probably require a period of three to five years.

[6] In essence, the solution agreed upon was the following. FirstRand would underwrite a R600 million rights issue by Profurn, thereby converting R600 million of the debt owed to FirstRand into equity. This would be followed by a merger between Profurn and JDG, whereby the Profurn shares would be exchanged for JDG shares. FirstRand would then sell the JDG shares so acquired by it for R600 million to a South African special purpose vehicle, to be created in due course when needed (Capstone). Daun et Cie Aktiengesellschaft (Daun et Cie), a German private holding company controlled by Mr Daun, would invest R300 million in Capstone, which would be used to pay half of the purchase price. R200 million of the purchase price would be settled by the issue by Capstone to FirstRand of redeemable preference shares and the balance by a participating loan by FirstRand to Capstone. In this manner the required capital injection and management would be achieved.

[7] Most of this was reflected in a memorandum of understanding (MOU) signed by Mr Daun on 26 June 2002 at Rastede in Germany. In terms of the MOU it was naturally envisaged that final written agreements would be entered into and that the requisite regulatory approval be obtained. It was nevertheless accepted by all relevant parties that the MOU gave rise to a binding commitment by Mr Daun and his associates via the proposed special purpose vehicle to purchase the JDG shares from FirstRand and that the risk and reward in respect of the shares passed with effect from 26 June 2002, which was the express effective date of the MOU.

[8] Despite some efforts by FirstRand to encourage existing shareholders of Profurn to take up the rights offer, only a handful did so, raising less than R1 million. This was an indication of the desperate position of Profurn, as was the fact that after the MOU was signed, Profurn's share price fell even further. As a consequence FirstRand acquired a 78,8 per cent shareholding in Profurn. Thereafter JDG and Profurn merged and FirstRand acquired approximately 42 million JDG shares.

[9] In the agreements and amended agreements entered into following on the MOU, the rescue plan was varied in two material respects. First, FirstRand determined to retain one-sixth of its JDG shares. In the result five-sixths of the JDG shares would be transferred to Capstone. This translated to approximately 35 million JDG shares and a 20,9 per cent interest in JDG. Second, Mr Daun invited Mr Jooste to participate in the transaction, which required some restructuring of the special purpose vehicle to keep Mr Daun's financial interests separate from those of Mr Jooste. As a result, half of the 35 million shares were sold to Daun et Cie for R250 million and the other half to Capstone for the same purchase price. In terms of these agreements the purchase price of the shares was fixed as at 26 June 2002 and the purchasers had to pay interest on the purchase price calculated from that date. Daun et Cie eventually paid R262 725 131 (R250 million plus interest) to FirstRand in cash. This constituted a significant foreign investment in South Africa. The funding of the purchase price payable by Capstone was of course the responsibility of Mr Jooste. Daun et Cie and Capstone thereby committed themselves to a significant investment of indefinite duration, the ultimate profitability of which depended upon the ability of Mr Sussman to turn around the operations of Profurn and integrate them profitably into those of JDG.

[10] Capstone was incorporated on 2 April 2003. It was wholly owned by another special purpose vehicle, Business Ventures Investments No 687 (Pty) Ltd (BVI). The financial interest in BVI was held by Mr Jooste and his associates. Genbel Securities Ltd (Gensec) advanced the amount of R150 million to BVI on condition that it be utilized to enable Capstone to acquire the JDG shares. BVI thereafter made a shareholder's loan to Capstone in the

amount of R150 million on the same terms and conditions as those contained in the loan agreement between Gensec and BVI. The balance of the purchase price was settled by the issue by Capstone of three year and one day redeemable preference shares to FirstRand. For this reason Capstone was required to comply with FirstRand's standard terms and conditions in respect of preference shares. In the result Capstone took a number of registered special resolutions. One of these inter alia provided that a special condition be inserted in Capstone's memorandum of association that until the date on which the preference shares have been redeemed in full, Capstone shall not:

'. . . be entitled to conduct any business whatsoever, enter into any contract or undertake any obligation whatsoever, other than in respect of the sale and subscription agreement and a voting pool agreement relating to its shares in JD Group Limited, provided however that this shall not prevent the company from acquiring any additional shares in the share capital of the JD Group Limited from time to time . . . without the express prior written consent of FirstRand.'

The effect of this and other terms and conditions was that for the period of three years and a day from 30 May 2003, Capstone was prohibited from disposing of its JDG shares without the consent of FirstRand.

[11] Two additional liabilities were attached to the acquisition of the JDG shares by Capstone. First, a due diligence investigation performed in respect of Profurn at the instance of JDG, revealed contingent liabilities of Profurn in respect of tax. FirstRand indemnified JDG in respect of these liabilities in the amount of R150 million. FirstRand required the purchasers of the shares to carry proportionate shares of its liability in terms of the indemnity to JDG. As a result, as part of the consideration for the shares, Daun et Cie and Capstone each indemnified FirstRand in the amount of R62,5 million. The indemnities were given for a period of five years commencing in early 2003. Second, the loan agreement between Gensec and BVI provided, in addition to interest on the loan, for payment of what was referred to as an 'equity kicker'. The equity kicker was a portion of any gain in the market value of the JDG shares as on date of repayment of the loan, calculated in accordance with an agreed formula. It was payable by BVI to Gensec upon repayment of the loan, irrespective of whether or not the JDG shares had been sold. As the BVI-

Capstone loan duplicated the terms of the Gensec-BVI loan, Capstone in turn was obliged to pay the equity kicker to BVI.

[12] When Mr Daun invited Mr Jooste to participate, he made it clear that he would retain sole control over the 35 million JDG shares, which would at all times be dealt with as one package by Mr Daun. This was understood and accepted by Mr Jooste. He felt honoured by the invitation and was content that Mr Daun would be the 'captain of the boat' in which he would be the 'passenger'. For this reason Mr Daun and the manager of his South African interests, Mr Schouten, were directors of Capstone at all times material to the appeal, whilst Mr Jooste was not. The other directors of Capstone were Dr Lategan and Mr Steve Müller, who represented the interests of FirstRand and Gensec respectively. The shares in BVI were held by Daun et Cie as nominee for companies controlled by Mr Jooste and his associates. Mr Daun was also the only director of BVI and thus at all times relevant hereto also in control of BVI.

[13] In terms of an agreement entered into on 20 June 2002, Profurn was placed under the interim management of JDG pending the final authorisation of the merger application by the Competition Tribunal. However, substantial delays occurred due to the need to obtain approval from the Competition Tribunal and on appeal, the Competition Appeal Court, as well as the South African Reserve Bank. The Tribunal approved the merger on 12 December 2002, subject to conditions which were set aside by the Competition Appeal Court on 28 May 2003. The JDG shares were ultimately paid for and transferred to Daun et Cie and Capstone only on 5 December 2003. By that date, the share price had risen considerably from the levels at which it stood when the transaction was originally devised.

[14] In November 2003, when Steinhoff undertook an international 'book building' exercise with the assistance of Citigroup Global Markets Ltd (Citigroup), Mr Jooste was having coffee with Mr Nicholas Pagden of Citigroup in San Francisco and enquired whether a similar exercise could be done in respect of the JDG shares that Daun et Cie and Capstone were in the

course of acquiring. A book building exercise is a means of determining a price and acquiring institutional investors through either the issue and acquisition of new shares, or the sale of an existing block of shares in circumstances where the disposal of such a large block of shares in the market would detrimentally affect the price of the shares on a stock exchange. The institution undertaking the book building approaches institutional investors to ascertain how many shares they might buy and at what price. Once the price is determined the shares are disposed of other than through the exchange on which they are, or are to be, listed. As a result, in March 2004, Citigroup, represented by Mr Pagden, made a presentation to Mr Daun concerning a book building. The proposed book building entailed disposal of the full block of JDG shares controlled by Mr Daun. Mr Daun accepted the proposal in respect of the approximately 14 million shares held by each of Daun et Cie and Capstone. Each retained approximately 3,5 million shares. The sale by book building by Citigroup took place on 29 April 2004. It realised the price of R42.50 per share. More or less at the same time Capstone sold its remaining 3,5 million JDG shares to Mayfair Speculators (Pty) Ltd, a company holding the interests of Mr Jooste and his family, for R45 per share. The shares had been purchased as at 26 June 2002 for R14.17 per share.

[15] On 30 April 2004 Mr Daun, Mr Schouten and Dr Lategan resigned as directors of Capstone. On the same date Gensec and BVI entered into a further written agreement to settle the loan. In terms of this agreement the liability in respect of the equity kicker amounted to R45 123 050, calculated on the actual proceeds realised. Although BVI (and therefore Capstone) were entitled to temporarily retain a portion of the equity kicker, the liability for the full equity kicker arose on 30 April 2004. Mr Müller resigned as director of Capstone on 5 July 2004 and shortly afterwards Mr Jooste and an associate were appointed as its directors.

[16] What remained was Capstone’s contingent liability in terms of the indemnity to FirstRand. However, during July 2004 Daun et Cie and Capstone, represented by Mr Daun and Mr Jooste respectively, agreed that Daun et Cie would accept the full contingent liability of Capstone towards

FirstRand in return for payment of the amount of R55 million. Capstone thus incurred liability for payment of R55 million to Daun et Cie in the 2005 year of assessment in substitution of its contingent liability towards FirstRand. This debt was settled much later, by operation of set-off.

[17] Capstone calculated and paid capital gains tax on the proceeds of the sale of its JDG shares (the proceeds). The Commissioner, however, issued an additional assessment in respect of the 2005 year in terms of which the proceeds were taxed as revenue. In addition, the Commissioner disallowed deductions from gross income of R45 123 050 in respect of the equity kicker and R55 million in respect of the settlement of the indemnity obligation (the indemnity settlement). Capstone's objection to the additional assessment was dismissed and it appealed to the tax court. As I have said, the tax court held that the proceeds constituted revenue. However, it revised the assessment to allow for the deduction of the equity kicker and the indemnity settlement from gross income in terms of s 11*(a)* read with s 23*(g)* of the Income Tax Act 58 of 1962 (the Act). Because Capstone's contention that the proceeds were of a capital nature was upheld on appeal to the full court, the question arose whether the equity kicker and the indemnity settlement formed part of the base cost of the acquisition of the JDG shares in terms of paragraph 20 of the Eighth Schedule to the Act. The base cost is deducted from the proceeds to determine the taxable capital gain.

[18] Subject to an exception, paragraph 20(2) of the Eighth Schedule provides that the base cost does not include 'borrowing costs, including any interest as contemplated in s 24J or raising fees'. The exception is that one-third of the interest as contemplated in s 24J of the Act on money borrowed to finance the acquisition of listed shares, does form part of the base cost. Section 24J defines 'interest' to inter alia include: 'the gross amount of any interest or related finance charges, discount or premium payable or receivable in terms of or in respect of a financial arrangement'. The full court found that the equity kicker constituted interest as defined. On this basis it concluded that R30 082 033, that is two-thirds of the amount of R45 123 050, fell to be included in the capital gain. Before us the parties were ad idem that this

conclusion was correct. However, the full court found that the indemnity settlement in the amount of R55 million did not constitute part of the base cost. Capstone noted a cross-appeal against this finding. It also noted a conditional cross-appeal in the event of a finding that the proceeds were not of a capital nature.

Test on appeal

[19] Prior to its repeal by the Tax Administration Act 28 of 2011 with effect from 1 October 2012, s 86A of the Act dealt with appeals from a tax court. In *Commissioner for Inland Revenue v Da Costa* [1985] ZASCA 32; 1985 (3) SA 768 (A) at 775B-F, this court characterised the nature of an appeal in terms of s 86A as follows:

'Section 86A now provides for a full right of appeal against any decision of a Special Court on issues of fact or law. As was pointed out by Trollip JA in *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A) at 485, such an appeal

"is therefore a re-hearing of the case in the ordinary well-known way in which this Court, while paying due regard to the findings of the Special Court on the facts and credibility of witnesses, is not necessarily bound by them".

Having pointed out that the section is silent about the powers of this Court in such an appeal, Trollip JA went on to say that it was manifestly the intention of the Legislature that this Court was to have those general powers that are conferred upon it by s 22 of the Supreme Court Act 59 of 1959. In my view it is implicit in these *dicta* that in an appeal from a Special Court those powers should be exercised according to the principles and subject to the restrictions applicable to appeals in general. And, there is indeed no reason to differentiate between an appeal from a Special Court and an appeal from a Local or Provincial Division. Unlike the position obtaining in a Special Court where a decision is given on facts which may not have been considered by the Commissioner, this Court hears an appeal from a Special Court on the record of the proceedings in that Court.'

[20] Capstone lodged an objection to the additional assessment on 17 May 2010 and lodged the appeal to the tax court on 2 August 2010. The parties are nevertheless rightly agreed that the appeal from the tax court was governed by the provisions of Part E of Chapter 9 of the Tax Administration

Act (ss 133-141). This is provided for in s 270 of the Tax Administration Act. Section 270(2)*(d)*, in particular, provides:

'The following actions or proceedings taken or instituted under the provisions of a tax Act repealed by this Act but not completed by the commencement date of the comparable provisions of this Act, must be continued and concluded under the provisions of this Act as if taken or instituted under this Act:

. . .

(d) an objection, appeal to the tax board, tax court or higher court, alternative dispute resolution, settlement discussions or related High Court application; . . .'

[21] The provisions of s 86A of the Act and of Part E of Chapter 9 of the Tax Administration Act are substantially the same. In terms of s 134(2)*(b)* of the Tax Administration Act, a notice of intention to appeal against the decision of a tax court must indicate the findings of fact or rulings of law appealed against. Section 139(3)*(b)* requires the same of a notice of cross-appeal. In my judgment the principles set out in *Da Costa* are equally applicable to appeals from a tax court in terms of the Tax Administration Act. Such appeal is on the same footing as an appeal from a division of the High Court. It follows that the full court was bound by the factual findings of the tax court, unless they were affected by material misdirection or the full court was convinced that they were wrong. And in exercising its powers on appeal in terms of s 19 of the Superior Courts Act 10 of 2013, this court essentially has to consider what order the full court should have made on application of these principles.

Revenue or capital

[22] In terms of s 82 of the Act (now s 102 of the Tax Administration Act) the burden of proving that the decision of the Commissioner subject to appeal was incorrect, rested on Capstone. In line with its predecessors, s 1 of the Act defines 'gross income' in essence as the total amount received by or accrued to a person, excluding receipts or accruals of a capital nature. Our courts have therefore taken the view that any receipt or accrual must be either income or capital, and 'there is no third category or halfway house' (see *Crowe v Commissioner for Inland Revenue* 1930 AD 122 at 129; 22(1) *Lawsa*, 2 ed, para 46). It follows that Capstone could only discharge the onus by

showing, on a balance of probabilities, that the proceeds were capital. That is a question of law to be decided on the particular facts of each case, for which there is no single infallible test. (See *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* [1992] ZASCA 84; 1992 (4) SA 39 (A) at 56G).

[23] In *Overseas Trust Corporation Ltd v Commissioner for Inland Revenue* 1926 AD 444 at 452-3, Innes CJ said the following:

'It was pointed out in *Commissioner of Taxes v Booysen's Estate* (1918, A.D., p. 576) that the profit resulting from the sale of an asset might be either capital or income, according to the circumstances. If the transaction were a mere realisation of capital at an enhanced value, the entire proceeds would remain capital; but if it were an act done in the ordinary cause of the vendor's business, then the resulting gain would be income. The reason for the distinction is clear. Where an asset is realised at a profit as a mere change of investment there is no difference in character between the amount of enhancement and the balance of the proceeds. But where the profit is, in the words of an eminent Scotch Judge, see *Californian Copper Syndicate v Inland Revenue* (41 Sc.L.R, p.684), "a gain made by an operation of business in carrying out a scheme for profit making," then it is revenue derived from capital productively employed, and must be income.'

[24] Whilst recognising that it is not universally valid, our courts have in circumstances such as the present consistently applied the test that a gain made by an operation of a business in carrying out a scheme of profit-making, is income and vice versa. In *Commissioner for Inland Revenue v Stott* 1928 AD 252 at 259-260 the passage from *Overseas Trust* at 452-3 was quoted with approval. Wessels JA added (at 261): 'It is not sufficient that the cutting up of the land and its sale in lots should in its result prove to be a profit-making matter so as to stamp the proceeds as gross income. The gain must be acquired by an operation of business in carrying out a scheme for profit-making'. In *Commissioner for Inland Revenue v Leydenberg Platinum Ltd* 1929 AD 137 at 145, Stratford JA referred to this passage in *Overseas Trust* and said that the principles applicable to the question whether profits are taxable as income or are accruals of a capital nature, 'are now well settled'.

He made clear that the profit in respect of a single transaction of a company may on application of this test constitute income.

[25] It is true that in *Natal Estates Ltd v Secretary for Inland Revenue* 1975 (4) SA 177 (A) at 198F-H, Holmes JA made reference to 'selling an asset in the course of carrying on a business *or* embarking on a scheme of profit' (my emphasis). However, reading the case as a whole, it is clear that Holmes JA was not attempting to propound alternative tests. In my view it is clear that Holmes JA did not intend to deviate from the established principles. The court pointed out that in *Stott* the remarks of Innes CJ in *Overseas Trust* were adopted and said that *Stott* had long been recognised as a leading case. This is also apparent from the result of the application of the principles to the facts in *Natal Estates*. The court found (at 204F-H) that the taxpayer 'had crossed the Rubicon and committed itself on a grand scale to the course and business of selling land for profit, *using the land as its stock-in-trade*'. (See also the majority judgment of Smalberger JA in *Pick 'n Pay* at 56J-57E.)

[26] Hefer AP, in *Samril Investments (Pty) Ltd v Commissioner, South African Revenue Service* [2003] ZASCA 118; 2003 (1) SA 658 (SCA) para 2, confirmed that the 'usual test for determining the true nature of a receipt or accrual for income tax purposes is whether it constituted a gain made by an operation of business in carrying out a scheme for profit-making'. He pointed out that profit-making is also an element of capital accumulation. He said that:

'Every receipt or accrual arising from the sale of a capital asset and designedly sought for with a view to the making of a profit can therefore not be regarded as revenue. Each case must be decided on its own facts . . .'

Thus the mere intention to profit is not conclusive. There must be 'an operation of business in carrying out a scheme for profit-making' for a receipt to be income. That expression refers to the use of the taxpayer's resources and skills to generate profits, usually, but not always, of an on-going nature. In *Pick 'n Pay* at 58B-C, the majority similarly found for the taxpayer on the grounds that it was not carrying on a business by trading in shares and that even if it was, it was not a business carried on as part of a scheme for profit-making.

[27] Where a profit is the result of the sale of an asset, the intention with which the taxpayer had acquired and held the asset is of great importance and may be decisive. In essence, the question is whether the asset was acquired for the purpose of reselling it at a profit and assumed the character of trading stock (see *Matla Coal Ltd v Commissioner for Inland Revenue* 1987 (1) SA 108 (A) at 129B-D).

[28] In this regard Wessels JA said the following in *Stott* at 264:

'It is unnecessary to go so far as to say that the intention with which an article or land is bought is conclusive as to whether the proceeds derived on the sale are taxable or not. It is sufficient to say that the intention is an important factor and unless some other factor intervenes to show that when the article was sold it was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income.'

In determining this intention the court 'is not concerned with that kind of subjective state of mind required for the purposes of the criminal law, but rather with the purpose for which the transaction was entered into'. (See *Secretary for Inland Revenue v Trust Bank of Africa Ltd* 1975 (2) SA 652 (A) at 669E-G.) This was formulated as follows in *Pick 'n Pay* at 58F-G:

'Contemplation is not to be confused with intention in the above sense. In a tax case one is not concerned with what possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose.'

[29] And in *Commissioner of Taxes v Levy* 1952 (2) SA 413 (A) at 421, Schreiner JA said that 'where the purposes of an individual taxpayer are mixed the only course, on principle as well as for practical reasons, is to seek and give effect to the dominant factor operating to induce him to effect the purchase'. (See also *Trust Bank* at 670H-671A). This is a matter of degree depending on the circumstances of the case. (See *African Life Investment Corporation (Pty) Ltd v Secretary for Inland Revenue* 1969 (4) SA 259 (A) at 269E.)

[30] The purpose or dominant purpose of the acquisition of an asset is a question of fact. (See *Trust Bank* at 666B-C.) It must be determined objectively in the same manner that any fact is determined by a court of law. The credibility and reliability of the evidence of the witnesses for the taxpayer must be determined in the light of the objective facts and inferences drawn therefrom, the probabilities and any evidence put up in contradiction thereto. (See *Commissioner, South African Revenue Service v Pretoria East Motors (Pty) Ltd* [2014] ZASCA 91; 2014 (5) SA 231 (SCA) at para 8.)

[31] Apart from the intention of the taxpayer, a number of factors must be considered. First, the nature of the business activities of the taxpayer must be scrutinised. As *Stott* and *Samril Investments* demonstrate the line of demarcation between the realisation of an asset at a capital gain (*Stott*) and turning an existing asset to the purpose of generating revenue (*Samril Investments*) may be a fine one. So close regard must be paid to the nature of the business activities in which the taxpayer is ordinarily engaged. In *Stott* the sale of land acquired with the surplus from the taxpayer’s profession as a land surveyor was reasonably remote from his main business activity. In *Samril Investments* the sale of sand was closely connected to the farming business already conducted on the property.

[32] Second, the period for which the asset is held and the period for which it was anticipated it would be held at the time of acquisition will be relevant. In general the longer that period the more likely it is that the disposal is a realisation of capital rather than a receipt of income. Third, when dealing with an investment, the nature of the risk undertaken has a bearing on whether the exercise is one directed at building up the value of the taxpayer’s capital or directed at generating revenue and profit. Finally, it must be recognised that in many commercial situations there may be no clear intention at the outset and any endeavour to discern one or select one as more prominent than another, rather than accepting that the taxpayer’s future intentions were indeterminate, may be artificial and unhelpful. In such circumstances a better approach is to accept the indeterminacy and factor that into the enquiry. Other relevant factors are set out in *Natal Estate*, at 202 in fine, but the list is not exhaustive.

Effective date

[33] The tax court rightly noted that it had been accepted by all the relevant parties that the MOU gave rise to a binding commitment to acquire the JDG shares at the purchase price to be determined as at 26 June 2002 and bearing interest from that date. The full court found that the effective date of the transaction as a whole dated back to 26 June 2002, that 'it is accordingly at that date that one must look when considering the period for which the asset was held' and that the shares were effectively acquired during June 2002, not December 2003.

[34] I agree with what was said by McCreath J on behalf of the full court in *Commissioner for Inland Revenue v General Motors SA (Pty) Ltd* 1982 (1) SA 196 (T) at 204A, namely:

'Finally, I consider that the correct approach in a matter of this nature is not that of a narrow legalistic nature. What has to be considered is the commercial operation as such and the character of the expenditure arising therefrom. This is perhaps but another way of expressing the concept that it is the substance and reality of the original loan transaction that is the decisive factor.'

(See also *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* [1999] ZASCA 64; 1999 (4) SA 1149 (SCA) at para 1.) In this regard I find the following remarks of Lord Hoffman in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] 1 All ER 865 at para 32, instructive:

'The innovation in the *Ramsay* case was to give the statutory concepts of "disposal" and "loss" a commercial meaning. The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in a case of a concept such as a "disposal", the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions.'

If the receipt or accrual arises from a detailed commercial transaction the transaction must be considered in its entirety from a commercial perspective and not be broken into component parts or subjected to narrow legalistic scrutiny.

[35] In substance and in commercial reality the purpose of the acquisition of the shares must in my judgment be determined as at 26 June 2002, in the context of events leading to the MOU.

Directing mind

[36] The tax court found that Mr Jooste was the 'brain' and the 'mind' of Capstone. On the view that it took of the matter, the full court found it unnecessary to decide this issue. I am convinced, however, that this finding of the tax court was wrong.

[37] Generally the intention of a company must be determined by ascertaining what its directors acting as such intended. (See *Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd* 1956 (1) SA 602 (AD) at 606G-H.) But in *Trust Bank* Botha JA explained at 669A-D:

'Just as there cannot in a case of a one-man company be any reason in principle why it should be incompetent for him to give evidence as to what the intention of his company at any given time was, *Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd*, supra at p.606, so I can see no reason in principle why the persons who are in effective control of a company cannot give evidence as to what was the intention or purpose of a company in relation to any matter at any given time. That the management committee was for practical purposes in effective control of the affairs of the respondent bank is clear from the evidence. It was under its leadership that the respondent's business activities had been diversified to such an extent that, in addition to ordinary commercial banking, it had become engaged in a number of other incidental business activities as indicated above. I cannot find any reason in principle why the intention of the members of the management committee in regard to any matter in which it was concerned on behalf of the respondent cannot be taken to indicate the intention of the respondent.'

[38] Mr Daun was de facto in control of the shares from their effective acquisition to their disposal. Mr Daun therefore determined the purpose of their acquisition. At the time of their disposal, he, aided by Mr Schouten, was in any event the controlling director of Capstone. Whether or not the shares should be sold, was solely the decision of Mr Daun.

Mr Daun's intention

[39] Thus Mr Daun's intention at the time of effective acquisition of the shares had to be determined. As the full court indicated, the findings of the tax court in this regard were somewhat ambivalent. The following would, however, appear to be its central findings, irrespective of who had determined the intention (paras 77-78):

'The evidence concerning the intention of acquisition is thus not definitively in appellant's favour; it does no more than show that there was always an intention to realise the shares for a significant profit. The question was not if but when a sale would occur. Hence, a profit making intention was always a dominant purpose within the mind of those who controlled appellant; . . .

[T]he evidence does not provide an answer, on the probabilities, that this was to be a long term investment. There may have been a purpose to so hold, but there is no clear proof of it being the dominant purpose . . . When both the purpose at the time of acquisition and sale are considered, it cannot be concluded, on the probabilities, that a long term investment was realised to best advantage. To the contrary, the mixed intention had converted into a clear purpose of selling to "cash" in on the profit.'

The full court disagreed and summarised its findings as follows (para 24):

'In summary, the appellant's intention when it first decided to acquire the JDG shares was to make a strategic investment in a leading company in the furniture industry and to hold those shares for however long it took to turn around the Profurn ship, which was anticipated to take in excess of three years.'

[40] In my view both approaches are flawed. In the tax court the fact that, if the turnaround strategy involved in the takeover of Profurn by JDG was successful, Mr Daun, as an investor and entrepreneur, wanted to recover his investment together with an increase in its value, did not mean that a profit-making intention was his purpose in making the investment, much less the predominant purpose. Nor was it correct to say that this was not a long term investment. The duration of the investment was dependent on Mr Sussman's skills in merging the two businesses as well as factors beyond the control of either Mr Daun or Mr Sussman, such as the general economic climate. On the other hand the full court stopped its enquiry at the first stage, without exploring further the implications of the strategic investment made by Mr

Daun. A more rounded and complete consideration of the whole transaction was called for.

[41] Before us, counsel for the Commissioner disavowed reliance on a change of intention after the effective acquisition of the shares. The essential submission for the Commissioner was that from the outset, that is when the transaction was first contemplated in early to mid-2002, the intention was to acquire the shares for resale at a profit, that that intention never changed and that the shares were acquired as trading stock. The argument for the Commissioner therefore correctly recognised that if this were shown not to be the case, the proceeds would be capital.

[42] The witnesses for Capstone were Mr Daun, Mr Jooste, Mr J P Burger, the chief financial officer of FirstRand, Dr Lategan, Mr Sussman, Mr Müller and Mr Pagden. The tax court did not comment on the credibility of the witnesses. No doubt that is because no adverse comment was called for. The evidence reads well. It portrays Mr Daun as a straight forward, no-nonsense businessman who regarded a handshake agreement as binding and more important than hundreds of pages of legal documents. There can be no criticism of any of the other witnesses. Mr Daun’s evidence was materially corroborated by all the other witnesses. His evidence was not detracted from by objective facts or the probabilities and, importantly, was not contradicted. It follows that there was no reason not to accept the evidence of Mr Daun as to the aim with which the shares were acquired or the circumstances in which they were sold.

[43] Mr Sussman said that because of past experience he expected the turnaround of the business of Profurn to take a long time and that ‘what was of paramount importance was to have a shareholder that would be behind us through these difficult times’. Mr Burger said that FirstRand needed somebody that was prepared to put long term capital into the business. Both therefore required a long term investment for the purpose of rescuing the business. Both found what they had required in Mr Daun when he made the commitment in terms of the MOU. He in turn said that what he did was ‘not

like buying shares'. He explained that he made an entrepreneurial long term investment aimed at rescuing Profurn's ailing business. He inter alia said:

'But at that time it was an investment in uncertain surroundings with huge risks. You didn't know what happens, and therefore it was not suitable to make a quick buck, but first you had to re-organise, to restructure this new business which has got huge problems.

. . . For me it was a difficult rescue operation which, in the end, with the help of David Sussman's management, went successful.'

[44] If after three to five years the rescue operation was successful, several options would be available. I refer to the following evidence of Mr Daun:

'And I was thinking at that time, my personal thinking, that we need perhaps four to five years when we – until we could see real results out of this effort to rescue this business.

MR SHOLTO-DOUGLAS: And what would you do after the three to four years, or four to five years?

MR DAUN: This on that time was fully open, but for me was quite interesting, I have known out of other shares deals in South Africa, when you're a 20% shareholder in a quoted company, you have a lot of options and possibilities. You could increase your shares. I could – I didn't know where the share price was going. I was prepared, perhaps, when the public was negative, that I buy further shares on the market perhaps to go to maturity or to control it.

. . .

MR SHOLTO-DOUGLAS: Your original intention was to hold these shares until such time as the transaction had bedded down, although you may not have excluded other options as well, is that right?

MR DAUN: No, I had the full theoretically possible options when I have – I told you before, when I have of the South African quoted company more than 20% of the shares and in case it develops in a certain direction I got a good base as a strong shareholder to control, to get control of this business. I could buy further shares on the market, you know this option created for me as well huge traction, it was nothing in stone, so I could have been – it could have been, I'm looking back I should have done it, it could have been that I bought more shares, more shares, and get control solely of the operation including Profurn.

. . .

But I must be clear I was long term original, I had all options open, and I had a good management, therefore I felt positive.

. . .

MR SHOLTO-DOUGLAS: Yes, no I understand, I think we understand each other there now, I mean essentially your share in the benefit of the transaction with what you were going to get on resale of the shares, not what you were going to get in the form of a dividend cheque if JD Group declared a dividend?

MR DAUN: One option was the sale of the share, other option is utilise 20% to form another merger, and I get other shares, you know it's not only selling, when you have only 1000 shares you have only one option to sell the shares. When you have 20% you have so many options, of this I can talk about one hour.

MR SHOLTO-DOUGLAS: I understand that, I understand you had many options, one of them was to sell the shares at an increased price and take the profit.

MR DAUN: Yes, yes.'

Mr Jooste confirmed this in the following terms:

'Claas and I never discussed, and I think I tried to explain it this morning, how we would exit JD. We spoke about what we would do if it goes wrong. We spoke about a long term investment in the industry.'

[45] Mr Daun obviously made the investment because he was of the opinion that the rescue operation could be successful. And it was naturally anticipated that a turnaround of the business would result in an increased share price. But this is neutral, it says nothing about the aim of the acquisition. Virtually every capital asset is purchased in the hope and anticipation that it will increase in value and in contemplation of the possibility that it may in future be sold at a profit. Mr Daun contemplated a resale of the shares at a profit as one of several possibilities. These possibilities were to be explored at the appropriate time in future.

[46] At the time of the effective acquisition of the shares their disposal at a profit was by no means inevitable. First, the prospects of the rescue operation succeeding were uncertain. An investment of a very large sum of money ─ originally R300 million ─ was made in the anticipation that Mr Sussman's managerial skills would not only make a success of the rescue but, over an indeterminate period, provide some return in the form of growth in

the value of the investment. The risks involved were substantial bearing in mind that Profurn was staring insolvency in the face. The element of salvaging something from Mr Daun’s existing investment in Profurn could not have been absent. And when he committed himself to the deal Mr Daun had no idea of how long his commitment would have to last. Second, if the rescue operation was successful, all options were open. Finally, in regard to a possible sale Mr Daun testified that the tradability of a block of shares of this magnitude was low. His undisputed evidence was that he would never have been able to trade these shares in the market.

[47] Counsel for the Commissioner placed considerable stress upon the conversation between Mr Jooste and Mr Pagden and Mr Jooste’s knowledge in November 2003 of the possibility of disposing of the shares through a book building exercise. But Mr Daun had no knowledge of the concept of book building at all before he was informed thereof by Mr Jooste during January or February 2004 when the latter was in Germany to attend a furniture fair. The conversation between Mr Pagden and Mr Jooste at the coffee shop in San Francisco during November 2003 therefore pales into insignificance. What transpired is in any event clear from the evidence of both Mr Pagden and Mr Jooste. Only a brief discussion (‘a minute or two’) took place to the effect that it would be possible to do a book building transaction in respect of the JDG shares. No decision was taken and Mr Jooste said that it was not his decision in any case. But Mr Pagden sensed an opportunity to make a deal and pursued it. This led to the presentation for a book building transaction made by Mr Pagden to Mr Daun in March 2004 when Mr Daun was in Johannesburg for a Steinhoff board meeting.

[48] Because of his commitment to Mr Sussman, Mr Daun could only consider this opportunity if it had the blessing of Mr Sussman. When he spoke to Mr Sussman, this is what transpired:

‘And obviously I didn’t know book building. He didn’t know it. He says, yes, this is ─ ja, I said, David, but I have to go back to Germany to think about the whole thing, if it is worthwhile. My plan was long term. I have to discuss this with my supervisory board at home, that’s my wife and family.

But in case, David, I asked him, when we would consider to sell, it's against our understanding. What would you say, I asked David. I said would you have any complaints, because I never would consider this thing when you would say no. And then I was quite surprised, and David was laughing, he said, the whole thing, this restructuring of Profurn and this new group works far quicker or better than I thought. If you really decide ─ I would not recommend that you move, but if you decide to go out, I would not complain about it because then I get new, it might be exciting, partners or shareholders, but it's your decision, he said to me.'

[49] Mr Jooste was in fact opposed to selling the shares. He attempted to persuade Mr Daun not to do so by saying that the share price might rise further (as it did) and that there might be other restructuring possibilities in future. Eventually he only managed to persuade Mr Daun to withdraw the seven million shares from the book building exercise, half of which was obtained by Mr Jooste through Mayfair Speculators (Pty) Ltd.

[50] Back in Germany, Mr Daun's wife (and financial confidante) urged him to sell on the ground that he was overexposed in South Africa. And so it happened that after much consideration Mr Daun decided to sell the shares. It is abundantly clear that from the perspective of Mr Daun, this decision was the result of the unsolicited and fortuitous offer of book building.

[51] The Commissioner argued and the tax court accepted that the short term of the Gensec loan and the nature of the equity kicker indicated an intention to fund the loan repayments by way of the sale of the shares. But the loan agreement was entered into on 5 December 2003, long after the MOU. In any event, the equity kicker was payable irrespective of whether the shares were sold or not, the short term of the loan was fully explained and it is common cause that refinancing of the transaction would have presented no difficulty.

[52] In my judgment it is clear from the evidence that the first and primary purpose of the acquisition of the shares was to rescue a major business in the retail furniture industry by long term investment of capital. This involved a

commitment of capital for an indeterminate period involving considerable risk and only a very uncertain prospect of a return. Assuming the rescue was successful, it was uncertain what would happen next. In effect all options were open. All of this was consistent with an investment of a capital nature that was realised sooner than initially expected because of skilled management and favourable economic circumstances. It was not a purchase of shares as trading stock for resale at a profit. The factual findings of the tax court in respect of the intention with which the shares had been purchased, were therefore clearly wrong. Although the full court did not say so in so many words, I am satisfied that it was convinced on appeal that the findings were wrong. It did say that (para 27) 'these findings are contrary to the weight of the evidence' and continued to make its own factual findings to the contrary. At any rate, this is what the full court should have found. I find that Capstone proved on a balance of probabilities that the proceeds were of a capital nature. The appeal must therefore be dismissed.

Cross-appeal

[53] In the result the conditional cross-appeal falls away. It remains to consider the cross-appeal. It raises the question whether the indemnity settlement formed part of the base cost of the shares for purposes of capital gains tax.

[54] In terms of paragraph 20(1)*(a)* of the Eight Schedule to the Act, the base cost includes 'expenditure actually incurred in respect of the costs of acquisition' of an asset. It is trite that 'expenditure actually incurred' refers to an unconditional legal obligation to pay. The words 'in respect of' connote a causal relationship. (See *Stevens v Commissioner, South African Revenue Service* [2006] ZASCA 117; 2007 (2) SA 554 (SCA) para 20.)

[55] It is beyond question that the contingent liability of Capstone in terms of the indemnity to FirstRand formed part of the consideration for the acquisition of the shares. Had payment in terms thereof taken place during the 2005 year of assessment, it would have constituted part of the base cost of the shares. The unconditional obligation in terms of the indemnity settlement to pay R55

million to Daun et Cie was undertaken in substitution of the contingent obligation to FirstRand. The full court rightly said that the liability to FirstRand was 'converted' into liability to Daun et Cie. Whether this was financially a wise step is immaterial, as is the fact that it was taken after the sale of the shares. The causal link with acquisition of the shares was not broken. The acquisition of the shares remained the *causa causans* of the indemnity settlement. I am therefore unable to agree with the conclusion of the full court that (para 59) the indemnity settlement was 'entirely separate from the acquisition of the JDG shares' and therefore a *novus actus interveniens*. It was the mechanism by which the contingent liability incurred as part of the acquisition of the shares was monetised and rendered a quantifiable component of the cost of the shares.

[56] The Commissioner accepted that the liability in terms of the indemnity settlement was incurred during July 2004, that is, in the 2005 year of assessment. In my judgment the liability incurred by Capstone to pay the amount of R55 million to Daun et Cie was an 'expenditure actually incurred' in respect of the acquisition of the shares. It follows that the cross-appeal must succeed.

[57] The following order is issued:

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

2.1 The cross-appeal is upheld with costs, including the costs of two counsel.

2.2 It is declared that the liability undertaken by the taxpayer during July 2004 to pay the amount of R55 million to Daun et Cie Aktiengesellschaft, formed part of the base cost of the acquisition of the shares in JD Group Ltd.

C H G van der Merwe
Acting Judge of Appeal

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