INCOME TAX CASE NO 1185
(1972) 35 SATC 122(N)

Division: Natal Special Court

Date: 21 July 1972

Income - Profit from sale of property - Intention with which property acquired - Whether or not appellant in acquiring property was engaged in carrying on a trade or business or profit-making scheme - Tests to be applied in determining whether profit made represented revenue or capital receipt - Definition of 'gross income' in s 1 Act 58 of 1962.

During 1968 an estate agent was instructed by the executors of a deceased estate to sell three properties situate in a certain area. Two of the properties were zoned according to a town planning scheme as service industrial sites, and the third adjacent property was zoned as a special residential site. The two industrial sites were offered for sale together, and the appellant was made an offer therefor which was accepted during October 1968.

Some time later the estate agent brought it to the notice of the appellant that the third property (the residential site) was also for sale and as a result of this and further negotiations the appellant purchased that property in December 1968.

During 1968 and early in 1969 it was generally known that plans had been formulated for the extension of the activities of a certain industrial organization at a place other than where its existing activities were located. Speculation was rife as to which area in the Republic would be selected for the projected development scheme and the area where the appellant had purchased the aforesaid properties was mentioned as a possibility for the selection. As it turned out the area was so selected and an official announcement confirming the decision was made in May 1969, which had the effect of causing the value of the property in the area to rise considerably.

Within a very short time the appellant was approached with an offer of a good price for the purchase of the residential site which he had acquired and that offer was duly accepted in June 1969. In the result the appellant disposed of the property at a considerable profit, which profit the Secretary included in the appellant's taxable income for the year of assessment ended 28 February 1970.

Against the assessment so raised, the appellant lodged objection on the ground that the profit was a receipt of a capital nature and thus not liable to be taxed. The objection having been disallowed, on appeal -

Held, allowing the appeal, that having regard to the circumstances of the case and on the evidence and general probabilities, the proper inference to be drawn was that the appellant did acquire the property in question with the object of having available a block of three properties for investment and development on a long-term view and, that being so, the profit which he had made on the sale thereof was a capital profit and should not have been included in his taxable income.

Cases cited: CIR v Strathmore Consolidated Investments Ltd 1959(1) SA 469(AD), 22 SATC 213; *CIR v Stott* 1928 AD 252, 3 SATC 253; *CIR v Lydenburg Platinum Ltd* 1929 AD 137, 4 SATC 8; *C of T v Levy* 1952(2) SA 413(AD), 18 SATC 127; *C of T v Glass* 1962(1) SA 872(FC), 24 SATC 499.

MILLER J. President, after setting out the facts, said:

There are probably few, if any questions arising out of income tax legislation which have been considered and discussed in the judgments

of the courts as frequently as the question now before us. The test to be applied when it is necessary to determine whether profit made on the sale of property by a taxpayer represents revenue or a receipt of a capital nature has been formulated in many ways but there is no essential difference to be found between any one formulation and another and in so far as the general approach to the problem is concerned. The fundamental inquiry is whether, in buying and selling the property and thus earning the profit which is the subject of the inquiry, the taxpayer was engaged in carrying on a trade or business or profit-making scheme. If that is what he was doing, the profits are income and taxable in his hands. If however, he held the property as an investment of capital the realization of the asset would simply be a conversion of the capital asset to cash, which he would receive and hold as capital, not as revenue. Perhaps the most important test in considering whether it is the one or the other of these, is the intention with which or the object for which the property was acquired (see *Commissioner for Inland Revenue v Strathmore Consolidated Investments Ltd* 1959(1) SA 469(AD)1 at 477). But it is clear that the application of that test will not in all cases produce the true answer to the fundamental question; a taxpayer might have bought property with the

intention of holding it as an investment of capital for the purpose of earning income but have changed his mind at a later stage and resolved to merge that asset with his ordinary stock-in-trade, as it were, and thenceforth to hold it available to be dealt with in the course of his profit-making business or trade. In such a case, the profit made on realization of the property would be revenue despite the initial intention with which it was acquired (cf *Commissioner of Inland Revenue v Stott* 1928 AD 252,2 *Commissioner for Inland Revenue v Lydenburg Platinum Ltd* 1929 AD 1373). Where the taxpayer had not one clear purpose or intention in acquiring the property but was alive to more than one use, to which he might put it, the inquiry will be to determine, if possible, whether one particular purpose was dominant in his mind. If the court is able to find that there was a dominant purpose, which operated decisively or very substantially in the process which led to the decision to acquire the property, the court will give effect to that dominant purpose or intention (see *Commissioner of Taxes v Levy* 1952(2) SA 413(AD)4 at 421; *Commissioner of Taxes v Glass* 1962(1) SA 872(FC)5 at 880-1).

The difficulty in these cases lies not so much in the formulation of approach but in the application of the principles which must necessarily guide the court. It is no difficult matter to say that an important factor is: what was the taxpayer's intention when he bought the property? It is often very difficult, however, to discover what his 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 it 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. It would certainly be more difficult for one whose business it is to buy and sell properties for profit to persuade the court that in the particular instance which is in issue his intent was to make a capital investment, than it would be for one whose occupation was in no way concerned with dealing in properties and had never before bought or sold property. But just as proof that the taxpayer is normally a dealer in property is no absolute bar to his establishing that a particular acquisition was made as an investment, so proof that a transaction was isolated and far removed from the taxpayer's normal business activities will not necessarily cause the court to accept that the profits of that isolated transaction must therefore be a receipt of a capital nature.

It turn then to the facts and circumstances of the case now before us. Although it is only the transaction relating to the residential site which is in issue in this appeal it is relevant and important to examine also the facts relating to the purchase of the two industrial sites.

The appellant is a married man with a number of children of whom the eldest is 15. During 1968 he was carrying on the business of a trading store in a small village. He had carried on that business for about twelve years. It was a good business, yielding substantial profits. The profit and loss account of the business for the year ended 28 February 1970 reveals a gross turnover of R92 734 resulting in a net profit of R12 750. The appellant also carried on farming on a small scale and in that year suffered a small loss of some R300 on his farming operations. Prior to the purchase of the three properties, the appellant's acquisition of fixed property had been very limited. He had bought a dwelling-house in another town where he and his family lived before settling in the small village, and which he sold when he left the town. While living in the small village he bought a beach cottage for use as such and which he still owns. Since the sale of the residential site in issue in this appeal he has bought a dwelling-house in another city which is occupied by himself and his family, and at that time too he was involved with an estate agent in that city concerning the erection of a small block of flats which they ultimately sold at a loss. These last-mentioned activities took place after the sale of the residential site in issue in this appeal. The appellant's evidence is to the effect that early in 1968 he had a discussion with his accountant, who is also a lifelong friend and practises in the

area in which the aforesaid three properties are situate, concerning his financial position. The accountant was at that time preparing the appellant's financial statements in respect of the year ended 29 February 1968. Substantial surplus funds were available to the appellant, being the accumulated profits from his trading store. About R10 000 to R11 000 was available for investment. The appellant also had a substantial sum of money invested in a mutual fund. The stock market was then flourishing and the value of the Growth Fund units was steadily increasing. He was reluctant to sell them at that stage. It was decided at that conference that the appellant should invest money in land, preferably outside the area where he previously traded because it was considered prudent to do so in the light of the Bantustan concept. The appellant was of the opinion that a good investment for him would be in property which could be let for warehousing. He explained his reasons for that preference. Although the gross rental returns in respect of warehouses would naturally be lower than in respect of more sophisticated premises, the maintenance and overhead expenses involved in building, owning and letting warehouses would be

comparatively low, so that a substantial net return could be anticipated from an investment of that type. His accountant agreed that that might be a good investment and undertook to look out for suitable property for the appellant.

Not long thereafter the appellant was informed by his accountant of the availability of the two industrial sites. The appellant travelled to the area to view the properties and although he was not very impressed by the place as a town he was advised and believed that there was a shortage of warehouse facilities in the town and that the two properties could be developed to fill that need. That is how he came to purchase the two industrial sites from the deceased estate to which I have referred. The residential site had been mentioned in the course of his discussions with his accountant but it was never for a moment considered as one which he might buy.

During the first quarter of 1969 the appellant sought quotations for the supply of materials for the erection of warehouses on the two properties and for electrical installations. He also consulted an architect in regard to plans, which the architect thereafter drew, and as to the architect's willingness to supervise the building work if a 'small reputable builder' could be found to do such work at a reasonable cost. On 2 May 1969 he caused advertisements to be published in a local newspaper and in a financial journal to the effect that the advertiser was prepared to erect a warehouse up to 6000 square feet in an area and inviting inquiries from persons who might be interested therein. These advertisements apparently yielded poor results. It is clear from the evidence that appellant's efforts in regard to utilizing the two properties for warehousing purposes were not the result of an idea conceived after his acquisition of those properties. His evidence that he had that purpose in mind from the very beginning is supported by his accountant. It is not without significance too that the first offer made to the estate agent entrusted with the sale of the properties, on 7 June 1968, referred to an intention to erect a small warehouse on one of the industrial sites. That letter was signed by one 'X' and it suggests that the appellant

was not alone in thinking that the property would be suitable as an investment for that purpose.

The appellant is still the owner of the two industrial sites. He said in evidence that he has refused an offer of R100 000 for those two properties as he still intends to develop them for the purpose of earning income therefrom. In the circumstances, Mr *Behrens*, for the Secretary, admitted that he had some difficulty in contending that the two industrial sites were not acquired with the intention that they be held and developed as an investment, although, for obvious reasons, he was not prepared to concede in this appeal that any profit on a sale of those properties in the future would not be for revenue account. But he said that the acquisition of the residential site fell to be regarded in an entirely different light from that which has been shed on the earlier purchase of the other two properties. As I understood his argument it was that even if the court were satisfied that the two industrial sites were acquired and held as an investment of capital, and not for the purpose of dealing with them or for profitable resale, there was no justification for finding that the residential site was acquired for the same purpose, as the appellant said it was.

Now, as I have already mentioned, the appellant, when he purchased the two industrial sites had not directed his mind at all to the residential site. It was not as a result of his own initiative that he subsequently purchased it. The estate agent who had sold him the other two properties drew his attention to it and emphasized that, having purchased the other two properties, it would be beneficial to own this one too, since it was adjacent to one of the industrial sites, giving frontage on another street. The appellant consulted his accountant concerning the residential site and resolved to buy it despite the lukewarm reception the accountant gave to the proposal, because on one point at least the accountant fully agreed with him and that was that the property would form a very useful adjunct to the other two properties. On the residential site there were two small dwellings, of poor quality, which yielded a total rental of R53 per month. As I have said, that property was zoned for special residential use but there was undisputed evidence that it had been indicated that the property would probably be rezoned for commercial use. The appellant admitted that he did not buy the residential site for the sake of obtaining the rental from the dwellings thereon. He explained that he and his wife believed that the contiguity of the property to the two which he had already purchased rendered it an attractive addition for the purposes of the long-term development and investment which they had in mind. They were at all times mindful of the fact that they might, in the near future, have to leave the small village and that provision should be made for their future residence outside of the Bantustan area and for the education of their children. The accountant, in his evidence, confirmed the appellant's evidence that the main consideration emphasized by the appellant during their discussions was that the 'residential site would form a block with the two industrial sites' and that that consideration decisively influenced him to buy.

It was contended by Mr *Behrens* that the probabilities were against the appellant's account of his reasons and purpose in buying the residential

site. It was argued that on his own showing the appellant did not have the funds available to develop the first two properties to their full capacity let alone the third property which, in any event, was not at that time zoned (and is still not zoned) for the purpose for which the appellant said he planned to use it. It was unlikely, he contended, that the appellant would have contemplated holding the property for long bearing in mind the meagre return it would yield in the shape of rental and that he would in fact lose money by retaining it. Moreover, the appellant was unable, under cross-examination, to show that he had worked out the cost of developing the third property or that he had devised any concrete scheme for the development of the so called 'block' of properties which he had

acquired. It was also emphasized that the appellant had lost no time in selling the residential site after the announcement concerning the industrial development in the area and that this militated against his evidence that he had bought it as a long-term investment for development. The probabilities, it was argued, were that appellant acquired the residential site with the intention of selling it as soon as possible, at a profit so that he could the better finance the development of the other properties, or buy a house in the city.

These considerations are relevant and we have given them due consideration. We are not persuaded, however, that they are sufficiently weighty or cogent to displace the evidence of the appellant and his accountant considered in the light of the facts and probabilities which support their testimony. There is nothing to suggest that the appellant knew or had reason to believe or think that the industrial development would take place in the area in preference to the several other areas which were being discussed as possibilities. It appears to us to be unlikely that had he resolved to purchase a property for resale at a profit he would have chosen this particularly property which, considered on its own individual merits, was by no means an attractive proposition. It was not disputed that the best offer which had previously been obtained by the sellers for the property was R5 659 by a government department, which had not seen fit thereafter to exercise its pre-emptive right to purchase the property for R5 100 which was offered by another prospective buyer. There is clear and credible evidence by the appellant and his accountant (both of whom impressed us as honest witnesses) as to the factors which induced the appellant to buy the residential site and in the light of the absence of demand for the property and the circumstance that his accountant advised the appellant that the price (R8 000) was too high, it appears to us that the appellant's intention and purpose in buying it was far more likely to have been to hold it for development, together with the other properties than to make a profit on resale.

It is true that the appellant had not worked out a development programme in detail, nor calculated the financial outlay which would be necessary for development of the whole block or the returns which might be expected. This does not necessarily operate against him. He frankly conceded that he was more general than specific in his thinking concerning the advisability of acquiring the third property offered to him and that in general terms he considered(a) that it would be useful, on a long-term view, to own the whole block for development and(b) that if it

were to appear in the future that he could not put the property to use, he would probably get his money back on resale, having regard to the normal growth prospects of the area (quite apart from the sensational growth which took place after the industrial development) and to the fact that the property was rent-producing. To this extent, it may possibly be said that there was duality of purpose in the acquisition. But even if that is so, it is clear from the evidence and for the reasons which I have already mentioned that the dominant purpose was to acquire the residential site as an adjunct or accessory to the two industrial sites. The purpose of acquiring the first two properties was, as I have said, to hold them for development and for the erection of warehouses which would be let; and the acquisition of the residential site as an adjunct to the other two, would appear to fall within the scope of that main purpose.

It is necessary to deal briefly also with the Secretary's contention that the sale followed so soon upon the acquisition of the residential site. It is true that at the time when he sold that property the appellant had not yet obtained transfer of that property in his name. The delay appears not to have been due to any fault of his own, but to the various details which had to be attended to in regard to the winding up of the estate and the waiver by the government department of their pre-emptive right.

The fact that a property is sold for a substantial profit very soon after it has been acquired is, in most cases, an important one in considering whether an inference adverse to the taxpayer should be drawn, but it loses a great deal of its importance when there has been a *nova causa interveniens*. The industrial development announcement was undoubtedly such a *nova causa*. It was of such a nature as to make it very readily understandable that even persons who had owned property for investment for some time might be tempted to sell it in the light of the highly enhanced values which attached to properties after the announcement. It is significant here too that the residential site was not put up for sale by the appellant; he was approached very soon after the announcement by a person acting as agent for a company to be formed and it was only after full discussion with his accountant that they settled upon the price of R1 per square foot. The sale, as I have said, took place without the appellant's direct initiative. I therefore do not consider that in this case the expedition with which the property was sold after the announcement in any way detracts from what I have said concerning the main and dominant purpose of its acquisition.

If I may return for one moment to the question of duality of purpose. In this case the appellant, as I have pointed out, conceded that he contemplated the possibility of selling the property in the future, but only if it should prove to be of no use for the purpose which he had in mind. That type of duality of purpose is, I venture to say, present to the mind of almost everybody who ever buys property, even where he is clearly buying it as a dwelling-house for himself or family or for long-term investment. In either case the average purchaser would have regard to the price asked for the property and to the prospects of his recovering his money, or even making a profit, if for some unforeseen

reason he should later decide, or be required, to sell the property.

In all the circumstances of this case we are satisfied, on the evidence and the general probabilities, that the

proper inference to be drawn is that the appellant did indeed acquire the residential site with the object of having available a block of three properties for investment and development on a long-term view. That being so, the profits which he made on the sale of the property are of a capital nature and should not be included in his taxable income.

The appeal is allowed, the assessment for the year ended 28 February 1970 is set aside and the matter is sent back to the Secretary for the purpose of issuing a fresh assessment which shall exclude from the appellant's taxable income the profits made on the sale of the residential site.

Footnotes

1 22 SATC 213.
2 3 SATC 253.
3 4 SATC 8.
4 18 SATC 127.
5 24 SATC 499.