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OCHBERG v COMMISSIONER FOR INLAND REVENUE 5
SATC 93

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Division:	Appellate
Judges:	DE VILLIERS CJ, WESSELS, CURLEWIS, STRATFORD AND ROOS JJA
Date:	10 April 1931
Also cited as:	1931 AD 215

Income tax - Private company - Issue of shares to principal shareholder - Consideration for services rendered - Whether income or fictitious increase of capital - Benefit as element in income - Findings of fact by Special Court - No appeal to Supreme Court - No power of remission by Supreme Court for further findings - Onus of proof of liability for tax - Not restricted - Intention a question of fact - Assessment of annual profit under continuing contracts - Sections 7, 57, 58(7) and 60, of Act 40 of 1925.

Appeal from a decision of the Cape Provincial Division of the Supreme Court.

Appellant, a financier with a wide range of interests, many of which he controlled through private companies in which he held the preponderance of the shares, had appealed to the Income Tax Special Court against the inclusion in his taxable income of the following items:-

(a) An amount of £4,893, being the face value of 4,843 fully paid up shares of £1 and 1,000 fully paid up shares of 1s. in the Airton Timber Company, Ltd., allotted to him by that company;

(b) an amount, being the profit, as estimated by the Commissioner, which had accrued to the appellant from the sale of certain lots in a property known as the Marks Estate;

(c) a further amount, being the profit, as estimated by the Commissioner, which had accrued to the appellant from the sale of certain portions of a property known as the Southfield Estate.

Item (a) had accrued to the appellant under the following circumstances. The Airton Timber Company, Ltd., had been floated by the appellant, who had provided the whole of the capital initially subscribed. The nominal capital of the company was £10,000, consisting of 9,950 £1 shares and 1,000 1s.

shares. At the commencement of the year of assessment covered by the assessment under appeal, 5,107 £1 shares had been subscribed, and of those appellant held 5,101, the remaining 6 being held by subordinates and members of appellant's family. During the year of assessment there were allotted to appellant shares representing the balance of the nominal capital. In connection with this allotment a memorandum of agreement was lodged with the Registrar of Deeds in terms of section 97 of the Companies Act of the Cape Province (Act No 25 of 1892) in which the consideration for the allotment was stated to be:-

(1) The cession of a lease secured by appellant from the South African Railways of land suitable for a siding and receiving site for timber;

(2) financial assistance to be given to the company in connection with certain shipments of timber, and

(3) appellant's goodwill (which was stated to mean that appellant would continue to pledge his credit on behalf of the company as he had done in the past).

Item (b) consisted of an estimated profit arising out of the sale of certain lots into which the property in question had been cut up. Originally the property, which was some eight acres in extent, had been cut up into 83 lots by one D, who had acquired an option over it and had effected the provisional sale of some of the lots. Appellant acquired D's option and purchased the estate. He confirmed the sales already made by D, and sold the remaining lots, the sale occupying a period of five years. On some of the lots he erected houses, which he let for a time and then finally sold. The estimate of profit made by the Commissioner was not disputed by the appellant.

Item (c) consisted of an estimated profit (which was also not disputed) arising from the sale of lots in another property acquired by the appellant. A portion of this property had been cut up into lots and a plan prepared by a previous owner. Appellant erected three houses on the property under a contract whereunder the builder was to share in any profits on sale. The houses were sold within five months of erection, after having failed to secure tenants. While the houses were being built appellant was approached by an agent with a proposal that he should sell plots on the estate for a commission. Appellant agreed. A plan of the portion to be sold was prepared.

Sales of the plots had ceased at the end of the year of assessment, and after the close of that year the remainder of the property was sold by appellant as a whole.

The appellant contested the assessment made upon him on the grounds that none of the items disputed constituted income within the meaning of the terms of the Income Tax(Consolidation) Act, No 40 of 1925.

The Special Court for hearing Income Tax Appeals confirmed the assessments, holding as regards item(a) that as the company was a separate *persona* to the appellant the agreement evidenced a real and substantial contract between the two contracting persons under which appellant received the shares, the value of which was not disputed, partly as consideration for the right of occupation of leased premises (constituting income under section 7(1)(d) of Act No 40 of 1925) and partly for the rendering of financial services, an incident in appellant's business as a financier. As regards the sale of

Page 95 of 5 SATC 93

plots and properties on the Marks and Southfield Estates, the Court held that while the facts did not establish that appellant was a dealer in land, the profits made by the appellant were the result of operations of business in carrying out a scheme of profit-making, and therefore constituted income and not capital.

The appellant, being dissatisfied with this decision as being erroneous in law, required the Special Court to state a case to the Cape Provincial Division of the Supreme Court. After an application to that Division in connection with the form in which the case should be stated (see *Ochberg v President and Members of the Income Tax Special Court*, 4 SATC 227), the questions for decision were submitted in the following form:-

Did the facts support the finding of the Special Court:

(1) That the shares constituted income;

(2) that the profits made by the appellant in the Southfield Estate and Marks Estate transactions were gains made by operations of business in carrying out schemes of profit making;

(3) was the Commissioner justified in assessing appellant upon the estimated profit of £667 in respect of the Southfield Estate for the year ended 30th June, 1927, in view of the fact that the remaining extent of the estate was only realised in the following year and the profit ultimately resulting showed a different figure?

Question(3) was added at the instance of the Supreme Court (JONES and SUTTON, JJ).

The Cape Provincial Division (WATERMEYER and VAN ZYL, JJ.) found itself unable to deal with Question(1), and ordered the matter to be referred back to the Special Court for further information on the following points:-

(a) Whether the true consideration for the issue of the shares was that disclosed in the agreement;

(b) whether the shares did not really represent undistributed profits of the Airton Timber Company, Ltd., which had been issued as bonus shares, the transaction being disguised so as to make it appear that the shares were issued for a consideration;

(c) if the true consideration were that disclosed in the agreement, then what proportion of the shares was given as consideration for the lease and what proportion for financial help.

As regards Question(2), the Court held that as the decision of the Special Court found merely that the transactions were entered upon with a view to profit making and not that a business of land-jobbing was carried on, the issue was one of fact and not law, and so was not appealable. The Court, therefore, could not answer the question.

As regards Question(3), the Court found itself in doubt as to the exact meaning of the question, but-

If it raised the question whether the Commissioner was justified in making an estimate, no facts had been stated upon which the Court could find that he was not justified;

if it questioned the figure of the estimate, that was a question of fact and could not be dealt with;

if it meant that the Commissioner could not in law calculate the profits made on sale of a part of the land, but must wait until all the land

Page 96 of 5 SATC 93

had been sold before calculating the profit, then, as the income tax is an annual tax, in the case of land bought for sale at a profit when the sale of lots may extend over many years, the Commissioner must make a calculation of the profits of each year for the purpose of assessing the seller's income tax for that year.

The appellant having appealed against the judgment as a whole and the Commissioner having cross-appealed against the order referring back the question of the issue of shares in the Airton Timber Co., Ltd., for the finding of

further facts.

Held, (unanimously), that the Cape Provincial Division had erred in sending the case back for further findings of fact for while the findings of the Special Court could be referred for the elucidation of any point which was ambiguous in the findings, the statement of the relevant facts was the function of that Court only, and the Supreme Court must deal solely with the questions of law arising from the facts presented.

Held, further(unanimously), that the question whether the transactions in the Marks and Southfield Estates were entered into for the purpose of seeking a profit was one of fact, and no appeal could lie.

Held, further(unanimously), that the third question, which had been inserted by direction of the Cape Provincial Division, was not one which could be brought before the Court, as it had not been dealt with by the Special Court, but that if it questioned the power of the Commissioner to assess for each year of assessment the proportionate profits for that year of an undertaking extending over more than one year, the third answer given by the Cape Provincial Division was the correct one.

Held, further(unanimously), that the Supreme Court in dealing with a case stated by the Special Court was entitled to consider the facts set out as found in the judgment of that court when annexed to the statement of cases as a part of that statement as well as those specially detailed in the statement.

Held, further(unanimously), that section 57 of the Income Tax Act, No 40 of 1925, throws upon the taxpayer the *onus* of proving that any amount assessed by the Commissioner is not taxable, and not only of establishing that an amount which has first been proved by the Commissioner to be income is not so liable.

Held, further, by a majority (WESSELS and STRATFORD, JJ.A., dissenting), that the value of the shares received by appellant from the Airton Timber Co., Ltd., was on the facts as disclosed by the statement of the Special Court, income in the hands of the appellant.

Commissioner for Inland Revenue v Collins (1923, A.D. 347), distinguished.

DE VILLIERS CJ: I have read the reasons prepared by my brother ROOS, and if the Court had been unanimous would have been well content to leave it at that. But as my brothers WESSELS and STRATFORD take a different view I propose to give my reasons shortly for holding that the 5,843 shares received by appellant from the Airton Timber Company, Limited constitute income. "Gross

Page 97 of 5 SATC 93

income" is defined in sec 7(1) of the Income Tax Act of 1925 as "the total amount whether in cash or otherwise received by or accrued to or in favour of any person, other than receipts or accruals of a capital nature" during the year of assessment. Now it is admitted that the shares were received by appellant and were issued to him for services rendered and as remuneration for the use or occupation of premises during that year (sec 7(1)(b) and(d)). They would therefore clearly fall under income unless for some valid reason they can be said to be receipts or accruals of a capital nature. And it is admitted that if the same shares had been received by any other person, such receipt would have been income clearly and unmistakably, and could not have been considered as a receipt or an accrual of a capital nature. That appears to me to conclude the matter, for I am at a loss to understand how what is income if received by A for services rendered can be said to have changed its nature into capital when received by B equally for services rendered. But the argument is that when the transaction is analysed it will be seen that the appellant has derived no benefit or so little benefit from the transaction that on the principle *de minimis non curat lex* it may be said that there was in fact no benefit and therefore no income. In my opinion in determining whether the amount is income or capital this circumstance does not affect either the nature of the transaction or the nature of the value received. It is therefore entirely irrelevant and should not be taken into consideration. The reasoning ignores the very clear provision of the law that any receipt constitutes income with the single exception of a receipt or accrual of a capital nature. Only in the one case where the receipt in one of a capital nature, only in that case does it not fall within income. In all the other cases the law says it is to be regarded as income. Whether and to what extent the person may have benefited by the receipt of the income is irrelevant, for that cannot alter the nature of the receipt, converting what is income into capital. The amount of benefit may or may not be a good reason for the Legislature to step in and alter the law, but it cannot affect our decision. As long as the law is what it is, the receipt is income and as such liable to income tax.

I do not profess to be conversant with all the intricacies of company manipulation. But I am by no means satisfied that there is no benefit to the appellant in the receipt of the shares.

Page 98 of 5 SATC 93

If there is no benefit to him the obvious question is why did he enter into the agreement at all, and why did he give what must be presumed to be valuable consideration for the shares? It is no answer to say that whereas formerly he held the whole of the issued capital, 5,000 shares in all let us say, he now holds 10,000 shares, the whole of the issued capital. That may be true. But it is not the whole truth. To state the proposition in that way ignores the vital circumstance that whereas formerly 5,000 shares were unissued and were therefore at the disposal of the company, those 5,000 shares have now been transferred to him. No doubt if in these circumstances the company

were to go into liquidation, as the only shareholder he would in the one case receive not more than in the other, in other words in either case he would receive the whole of the assets. But companies do not exist merely for the purpose of going into liquidation, and in the meantime the appellant has received and is free to dispose of 5,000 additional shares in the open market which he did not have before of the value of let us say £1, shares which the company might have disposed of a par to others. Why should he escape income tax merely because by a mathematical computation it can be shown that after the transaction his relative holding in the assets of the company is the same as it was before? I confess I would be at a loss to understand why a transaction of this kind is entered into at all if there were no benefit to the taxpayer. But there is still another aspect of the matter. The company was presumably enriched to the value of £5,000 by the services rendered and the lease and by that amount the value of the assets of the company has appreciated, which upon liquidation he would in any case have been entitled to all the assets of the company is to ignore the fact that but for his services the assets to divide would have been less by £5,000. But I do not propose to labour this point for in my view the amount of benefit to the taxpayer is quite irrelevant. He received 5,893 shares which it is not disputed were worth their par value, and the Court need not therefore enquire whether he actually was benefited to that extent. Of that he is the best judge.

The fact is the law is not concerned with the amount of benefit accruing to a person from a certain income. It is sufficient to determine that what the appellant has received is income and not

capital. What repercussions the receipt of that income may have upon the rest of his property does not matter. The appellant himself has placed what is presumably the market value upon the shares he received. Having decided that it is income and not capital the Court is content to accept that as the value of those shares.

But there is another difficulty in the way of the appellant. It is admitted that there may be a slight benefit to him to the amount of about £3 in the receipt of the shares. That shows that however small or large the benefit, the receipt of the shares is income and not capital. For it can hardly be contended that as to the value of £3 the receipt of the shares was income, whereas as to the remaining £4,890 in shares the receipt was of a capital nature. Any attempt to determine which shares under the circumstances are income and which capital is clearly foredoomed to failure.

Reliance is placed upon *The Commissioner for Inland Revenue v Collins* (1923, A.D. 347). But there is a vast difference between that case and this. In the former case the profits were capitalised and the bonus shares issued to each individual shareholder strictly *pro rata* his holding and by virtue of that holding. Here the shares were issued for services rendered, just as presumably they would have been issued to any outsider for the same services rendered. What connection can there be between such a transaction and the fact that the person who rendered the services and to whom consequently the shares were issued happened to be not only a shareholder, but virtually the sole shareholder. How could what is after all a purely fortuitous circumstance affect the legal position so as to convert what is received by an outsider as income into capital when received by him. If, instead of being the only shareholder, he had been the holder of say 1,000 shares could it have been contended that as there had been a dilution in the value of these shares say by half, the income he received is less by £500?

I entirely agree with the view that the Court may look at the substance of a transaction. But that argument must be employed with judgment, more especially in company law. The law endows a company with a fictitious personality. The wisdom of allowing a person to escape the natural consequences of his commercial sins under the ordinary law, and for his own private purposes virtually to turn himself into a corporation with limited liability may well be open to doubt. But as long as the law allows it the Court has to recognise the position. But then too the person himself must

abide by that. A company, being a juristic person, remains a juristic person separate and distinct from the person who may own all the shares, and must not be confused with the latter. To say that a company sustains a separate *persona* and yet in the same breath to argue that in substance the person holding all the shares is the company is an attempt to have it both ways, which cannot be allowed. In *The Commissioner for Inland Revenue v Collins* the question turned upon whether a dividend had been declared or whether the profits had been capitalised. The argument as regards the substance of the transaction was therefore relevant. Here it is sought to extend the argument to a circumstance extraneous to the transaction itself and which cannot affect the true nature of the transaction.

I agree with my brother ROOS for the reasons he gives that the case of *The Commissioner for Inland Revenue v Collins* has no application here.

ROOS, J.A.: Three questions were stated by the Special Income Tax Court to the Cape Provincial Division in terms of sec 60 of Act 40 of 1925, arising out of the assessment of income tax upon appellant for the year ending 30th June, 1927.

The first question was whether the facts as found by the Special Court supported its finding that certain 5,843 shares, 4,843 of the nominal value of £1 each and 1,000 shares of 1s. each, in the Airton Timber Company, Limited, constituted income.

The second question was whether the facts found by the Special Court supported the finding that the profits made by the appellant in the sale of the Southfield and Marks Estates were gains made by operation of business in carrying out schemes of profit making.

The third question was whether the Commissioner was justified in assessing appellant upon the estimated profit of £667 in respect of the Southfield Estate for the year ended 30th June, 1927, in view of the fact that the remaining extent of the Estate was only realised in the following year and the profit ultimately resulting showed a different figure.

The Cape Provincial Division found it impossible to answer the first question and referred the matter back to the Special Court to take such evidence as it deemed advisable, and for finding upon the following points, viz.:

(a) Whether the true consideration for the issue of the shares is that disclosed in the agreement;

Page 101 of 5 SATC 93

(b) whether the shares did not really represent undistributed profits of the Airton Timber Company Limited, which were issued as bonus shares, the transaction being disguised so as to make it appear that the shares were issued for a consideration;

(c) if the true consideration is that disclosed in the agreement, then what proportion of the shares was given as consideration for the lease and what proportion for financial help.

The second question was considered by the Cape Provincial Division to be a question of fact and, therefore, finally decided by the Special Court under sec 58(7) of Act 40 of 1925, and not appealable under sec 60 of that Act.

The third question was, according to the Cape Provincial Division, inserted by order of that Court on the application of the appellant prior to the appeal being heard there. The Court added that it did not seem to have been brought before the Special Court and no decision had been given by that Court. Under these circumstances the Court added that it was doubtful whether it could be brought up before that Court owing to the provisions of sec 58(7) of Act 40 of 1925. Even if this objection were answered the Court stated that difficulties arose owing to the ambiguity of the question. After dealing with the ambiguities the Court said that if the question meant that the Commissioner cannot in law calculate the profit of the part of the land sold during the year for which tax was assessed, but that he must wait for the sale of the whole land after the termination of that year before calculating the profit, then the Court was of opinion that the contention could not be supported.

Before dealing with the answers given to these questions there are two contentions, raised on behalf of appellant, which affect all the questions and which should be dealt with at once. The first arose on the form of the Special Case where the Special Court says in paragraph 6:-

> "This Court having considered the facts proved and admitted and the arguments adduced on behalf of the parties held, for the reasons set out in the judgment annexed hereto and marked 'A' (which is to be deemed to be a portion of the statement of case) that the amounts in question had been rightly included in appellant's taxable income."

Page 102 of 5 SATC 93

It is contended by appellant that this Court may only regard facts found in the paragraphs preceding paragraph 6 and that the judgment is only annexed for its reasons and not for the facts upon which these reasons are based. This is an interpretation of paragraph 6 which is an impossibly narrow one and I cannot see how it is possible to divorce the reasons in that judgment from the facts upon which it is based.

The other question of general application to the whole matter is the interpretation of sec 57 of Act 40 of 1925 which lays down that the burden of "proof that any amount is exempt from or not liable to the tax chargeable under this Act or is subject to any deduction, abatement, or set off in terms of this Act shall be upon the person claiming such exemption, non-liability, deduction, abatement or set off." It is contended by the appellant that the words "tax chargeable" mean "income tax" and that the *onus* is only placed upon the taxpayer after the Commissioner has proved that the amount is "income liable to income tax."

The answer to this contention is that it would make the section meaningless and useless. The section means that an amount received by the taxpayer, on which an assessment has been made by the Commissioner, is taxable unless the taxpayer shows that it is not income.

It is now possible to deal specifically with the answers of the court below to the three questions submitted for decision.

Both parties claimed that the Court had no power to remit the first question for further evidence and findings. This, in my opinion, is the correct view. It is for the Special Court to submit its findings of fact and in terms of section 60 of the Act to state the questions of law arising from those findings for the decision of the Court. If the Court were allowed to send these cases back to the Special Court to take further evidence and for further findings of fact we would gradually find a kind of appeal on the whole matter coming into existence, which will be of a much wider nature than that intended by the legislature. This would be contrary to both the spirit and the meaning of secs 58(17) and 60 of Act 40 of 1925. It must not be taken to lay down that a stated case cannot be remitted to the Special Court to clear up ambiguities in respect of the form in which the questions themselves are stated. Having come to the above conclusion it was, therefore, necessary for that Court, and is now necessary for this Court, to

decide the first

Page 103 of 5 SATC 93

question on the material which has been placed before it. The contract under which the appellant received the shares in question reads as follows:-

> "The said Isaac Ochberg in accordance with the resolution passed at a meeting of the Board of Directors held on Tuesday, the 18th November, 1926, agrees to transfer on the original terms and rental the lease secured from the South African Railways of 1 and a quarter acres of land, which land adjoins the Company's present property in Maitland and will be of important assistance to solve the Company's difficulty with sites for receiving the large quantities of timber arriving and due to arrive. The said Isaac Ochberg further agrees to continue up to the end of the year to assist the Company financially to enable it to lift from Sweden and Finland the parcels of timber purchased for shipment this reason on very favourable terms before the rise took place, and on which the Company expects to make a very substantial profit. In consideration of the above and Mr Isaac Ochberg's goodwill, the Company agrees to allot to Isaac Ochberg the whole of the reserve shares of the Company to the nominal value of £4,893 (four thousand eight hundred and ninety-three pounds), being 4,843 fully paid £1 shares and 1,000 1s. shares of the Company."

The term "goodwill" in the above agreement is stated by the Special Court to mean that appellant would continue to pledge his credit on behalf of the company as he had done in the past. That agreement was lodged with the Registrar of Deeds in terms of sec 97 of Act No 25 of 1892(Cape), reading as follows:-

> "Every share in any Company under this Act shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash unless the same has been otherwise determined by a contract duly made in writing and filed with the Registrar at or before the issue of such share, and further unless such share in terms of such contract be issued in exchange for a consideration of valuable services rendered to the Company in furtherance of its objects, or in exchange for or in consideration of valuable property rights or privileges acquired by the Company in furtherance of its objects in which case, though not actually fully paid up, such share shall be considered to be fully paid up, and shall entail no further responsibility or liability upon the members to

Page 104 of 5 SATC 93

> whom it has been or shall be issued, or upon subsequent holders, than would have been entailed upon them if the share had been actually fully paid up in money. Any director or other person who signs or issues or connives at the signing or issue of any document entitling or purporting to entitle any other person to a fully paid up share in any Company under this Act, when, as a fact, the whole amount of such share has not been paid in cash, shall be liable to make good to the *bona fide* holder of such share any damage which he may suffer by reason of the said share not having been fully paid up, and shall in addition, be liable to a fine not exceeding one thousand pounds sterling, or to imprisonment with or without hard labour for any period not exceeding two years or to both such fine and such imprisonment unless:-
>
> (a) such share was issued in terms of a contract duly made and filed as in this section provided, and
>
> (b) such share was issued in consideration of valuable services rendered to the Company in furtherance of its objects or in exchange for or in consideration of valuable property acquired by the Company in furtherance of its objects.
>
> Provided that every share certificate shall state in words the sum which has been paid in respect of each of the shares to which such certificates refers, and shall also state the nominal capital of the company and the number and nominal value of the shares into which such capital is divided; and every director or other person who shall issue or sign a certificate which does not accurately set forth the said information shall be liable to a fine not exceeding one hundred pounds, in respect of each certificate so issued or signed."

The value placed by the Commissioner on the shares was £4,893, which was also the nominal value and the value appearing in the books of the appellant. This value was not disputed by the appellant before the Special Court. There is nothing to show when the Airton Timber Company, Limited was formed or registered. It was formed with a nominal capital of £10,000, consisting of 9,950 £1 shares and 1,000 1s. shares. The initial subscription of capital was £107, provided by the appellant. Thereafter from time to time further shares were issued to appellant until, at the commencement of the year of assessment, the subscribed capital of the company stood at £5,107 of which appellant held £5,101 and certain six

Page 105 of 5 SATC 93

persons one £1 share each. The appellant controlled the company. The result of the contract was that appellant received the balance of the shares of the company. The contention of the appellant before the Special Court is stated as follows:

> "That the shares received from the Airton Timber Company, Limited, were received as a gift given by the one man company, controlled by the appellant to the appellant himself, or alternatively if he received them for value they

did not constitute income."

In the judgment of the Special Court appellant's contention is set out as follows:

"There is no substance in the agreement of the 18th November, 1926, and the transaction evidenced by this agreement is a fictitious one."

The appellant in this Court based his argument on the fact that appellant before the transaction held all the issued shares except six, that he was in full control of the company, that the further issue to him of the unissued shares gave him no benefit that he did not already have, and that at most the 6 £1 shares would shrink in proportion to his increased holding to about one-half of their value and only to the extent of that shrinkage was the appellant benefited. It seems to me impossible to hold that a contract of this nature, solemnly registered under sec 97 of Act 25 of 1892(Cape), can be regarded as fictitious. Full effect must be given to the transaction which means in terms that an asset of the value of £4,893 is paid for the goodwill and the financing of the company by the appellant, and for the cession of a lease. This asset is received during the year of assessment ending 30th June, 1927, and must be included in his taxable income if it falls under sec 7 of Act 40 of 1925. Sec 7 defines "gross income" as meaning the total amount whether in cash or otherwise received by or accrued to or in favour of any person, other than receipts or accruals of a capital nature in any year. . .assessable under this Chapter. The examples given under(a) to(f) in that section include amounts for occupation of premises and for services rendered and the section adds that "the generality of this definition shall not be deemed to be limited by anything contained in paragraphs(a) to(f)." The deductions in the Income Tax Act do not affect this case and if the transaction stands alone it is impossible to urge that it does not fall under the Act. The point is, however, made that it is

necessary to consider the relationship between appellant and the company and that if one considers that relationship he in truth obtains nothing under the contract. The argument runs thus, that the appellant before the year of assessment ending 30th June controlled the company by holding 5, 101 shares of the value of £5,101 as against six shares of the value of £6, and he therefore at that time was the owner of practically all the assets of the company, that his receipt of the balance of the shares did not affect his position except as far as the shrinkage in the relative value of the six shares was concerned, and that as he financed the company which had his goodwill before the transaction, he continued to finance the company, and it had his goodwill after the transaction. It may be that it was a foolish agreement to enter into, and that the result of its being entered into halved the value of the old shares which he had acquired at some previous date, but that does not alter the fact of the transaction. The halving in value of his previously acquired shares is obviously loss of capital. The acquisition of the new shares is obviously income. Supposing that someone other than the appellant had entered into precisely the same agreement with the company that appellant entered into. He would not be able to evade liability for income tax on the amount of £4,893. How can appellant avoid such liability merely because he stands in a special position towards the company? It is argued that appellant was not benefitted by the transaction. That is certainly not the test. If it were the test, it is clear that he is benefited by the company having put it out of its power to make a similar agreement assigning these unissued shares to some person other than the appellant. That benefit has value and this fact in itself differentiates the case from *Collin's* case referred to below. Again if the view expressed in this judgment is not correct, at what precise stage would appellant become liable where he has most of, but not all, the issued shares before the agreement takes place? Would he be liable if instead of the holdings of other shareholders being only of the nominal value of £6 they had been of the value of £100 or £1,000? If so for what amount? It seems to me that if benefit is an element then the moment a benefit is shown to have resulted to the appellant, he is liable to income tax on the undisputed value of the shares received by him. Appellant's contention is based upon the decision in *Commissioner for Inland Revenue v Collins* (1923, A.D. 347). This case lays down that when a company by resolution decided to

increase its capital and towards that end to capitalise undivided profits and to distribute the relative shares as a bonus among the shareholders in proportion to their holdings, the shares so distributed were "receipts or accruals of a capital nature" in terms of sec 6 of Act 41 of 1917 and were not assessable for supertax in terms of that Act. I think that a perusal of the case makes it quite clear that if the company had first declared a dividend, and thereafter entered into agreements with the shareholders to take shares for the dividend so declared the shareholders would have been liable. The case proceeded on the basis that there was no intention to declare or distribute a dividend and that the shareholders obtained nothing when they obtained the so-called bonus shares as their proportionate shareholding in the company remained precisely the same after the bonus shares were distributed as it was before. This case followed very authoritative cases decided in England and America, which were, however, in each case the majority and not the unanimous decisions of the Court. The cases were: *Inland Revenue Commissioner v Blott* (125 L.T. 497) and *Eisner v Macomber* (9 A.L.R. 1570); MASON, J., in the Transvaal Provincial Division puts the position in *Collin's* case (page 351) in the following way:-

The interest of a shareholder in a company is a capital interest; it is represented by share certificates; an increase in the number of his share certificates, so long as it represents the same interests does not affect the fact that the share certificates represent just the same amount of capital as before; the only result is that there is a consequent dilution of the value of each share. A stock dividend shows that the company's accumulated profits

have been capitalised instead of being distributed or retained as a surplus available for distribution; far from being a realisation of profits it tends rather to postpone such realisation, of profits it tends rather to postpone such realisation, and denies the shareholder any present participation in the profits. The essential and controlling fact is that the stockholder has received nothing out of the assets of the company for his separate use and benefit; the profits in question remain the property of the company, subject to business risks which may wipe out the whole investment. Having regard to the very truth of the matter and not to form, he has received nothing that answers the definition of income.

Page 108 of 5 SATC 93

The case was primarily decided in this Division on that basis. The Legislature was not satisfied with the position and dealt with the non-distribution of profits by a company in sec 32 of Act 40 of 1925 and with the issue of bonus shares in sec 29(c) of that Act. These provisions naturally do not affect the reasoning and judgment in *Collin's* case. I cannot however see that that case governs the present one or can be extended to cover its facts. Here the question is whether the shares received fall under sec 7 of the Act. Surely they form an amount received "in cash or otherwise". They are given for services to be rendered and for the cession of a lease. They have value. An assessment having been made they fall, in every respect, within the language of the Statute as being income and it lies upon the appellant to show the contrary in terms of sec 57 of the Act. Can the appellant dispute the position by proving that a special relationship exists between himself and the company which at the moment, that he received the asset, reduced his prior shareholding by 50 per cent in value? If in a case of this kind the shares accrued to him as capital the question would be concluded by sec 7 of the Act. But did he receive them as capital? On the contrary he received them as ordinary remuneration for services to be rendered and for the cession of a lease and therefore as ordinary income, which he himself values in his books at a certain figure. It seems to me that the fact that he previously held practically all the issued shares and that therefore the unissued shares which he obtained under the agreement did not increase the value of his holding, does not affect the case because if his contract is a valid one he received a value under that contract. The true position is that the receipt of that value as income reduced the value of his previously acquired capital. This reduction would have taken place if the unissued shares had been issued to a third party on exactly the same terms which are contained in his contract. In this latter event he could not set off his shrinkage in capital value against his taxable income; in the present case he cannot do so either. On these grounds I am of the opinion that the first question should be answered against the appellant.

The next question was dealt with by the Court *a quo* as being a finding of fact, viz., that the intention of the appellant, when purchasing the properties in question was not to invest his money but for the speculative purpose of purchasing with a view to making profits on resale. It seems to me that the question whether a person

Page 109 of 5 SATC 93

bought property for a specific purpose is a question of fact and in no sense of the word a question of law. It is quite true that in the cases of *Platt v Commissioner for Inland Revenue* (1922, A.D. 42) and *Commissioner for Inland Revenue v Stott* (1928, A.D. 252),1 it was held that the question whether a person carried on the business of a land-jobber or land speculator was a question of law. But the question whether a series of transactions found to have taken place justifies the conclusion that they amount to proof of the carrying on of a business is an inference which is a question of law. If each of these transactions is itself found to have been entered into with the intention of making a profit and not for investment, this is simply a finding of fact. If it had been necessary to answer the question the facts accepted overwhelmingly justify the Special Court's finding even without the invocation of sec 57 of the Act.

The appeal upon the second question, therefore, fails.

The third question was stated by the Cape Provincial Division to have been inserted in the case stated by that Court on the application of the appellant to that Division. It is further stated in the judgment of that Court that it does not seem to have been brought before the Special Court and no decision was then given upon it. The Cape Provincial Division doubted whether, therefore, in view of the provisions of sec 58(7) of Act 40 of 1925 it could be brought before that Court. It seems that this is the correct view and that there was no need for the Court *a quo* to deal with the question. The actual facts underlying this question are not set out in the stated case. The Cape Provincial Division has, however, dealt with it but found it impossible, on account of its ambiguity, to supply the answer. Of the three contentions which that Court lays down as possible under that question, I am of opinion that the third, which is to be found with its answer in the judgment is the most natural one, viz.:

"If the appellant's real contention is that the Commissioner cannot in law calculate the profit made on the sale of part of the land, but must wait until all the land has been sold before calculating the profit, then we are of opinion that such a contention cannot be supported. The Income Tax is an annual tax, and its rate may vary from time to time. In the case of

Page 110 of 5 SATC 93

land bought for the purpose of sale at a profit, the sale of lots may extend over many years, and the Commissioner must make a calculation of the profits of each year for the purpose of assessing the seller's income tax for that year."

This is undoubtedly the correct answer (*vide inter alia* sec 5 of the Act). It is clear that there is no difficulty in arriving at the correct estimate mathematically; and this view is scarcely disputed, but the appellant in this Court sought to place a fourth interpretation on this question viz., whether the Commissioner was entitled to place an estimate on the value when he knew, before the assessment was finally settled by him, that the balance of the estate had been sold after the termination of the year of assessment and showed a result other than his estimate. There is no material in the facts found by the Special Court to justify this form of question depending upon the knowledge of the Commissioner, and the question as drafted is not susceptible of this interpretation. It is, therefore, unnecessary to deal with the question in that form.

In so far as it is necessary to answer the third question, it is answered against the appellant.

As the appellant has failed on all three issues, the respondent is entitled to costs in the Provincial Division and in this Division.

CURLEWIS, J.A., concurred.

WESSELS, J.A.: I regret that I cannot take the same view as the majority of the Court on the first point raised. I have read the reasons of my brother STRATFORD for differing on the first point, and I agree with his reasons and conclusion. We know from our experience in the Law Courts that juggling with shares of a private company is a favourite method adopted by certain persons who control such companies in order to seek to evade the income tax laws, and therefore the Courts must be careful to analyse transactions of this nature and to insist on the principle that the individual who controls the private company is not to be regarded as if he were the company. Juridically the controlling individual and the Company itself must be kept apart and distinct, even if he be the sole shareholder. *Prima facie*, therefore, what the sole shareholder receives from the private company during the year of assessment must be regarded as income flowing to him from the company. Viewed in this light the 4,893 shares received by the appellant from

Page 111 of 5 SATC 93

the Airton Timber Company would appear *prima facie* to be gross income, and as the shares are admitted to be of the value of £1 each, appellant *prima facie* received during the year of assessment the value of £4,893, and therefore he ought to be called upon to pay income tax on that amount. But though the juggling with shares in a private company is sometimes resorted to, we must be careful not to assume that such has taken place in any particular case. We must analyse the transaction and see whether in fact the transaction shows that an amount of money or its equivalent has been received by the shareholder from the company, or whether such an amount not of a capital nature has accrued to him or in his favour from any source within the Union. After all, the object of the Income Tax Act is to tax a man's income. No doubt the words "gross income" in the definition are wide and the Court must give that wide interpretation to the words. It has been repeatedly decided that the Court is not concerned with the fairness or unfairness of the impost, nor is it concerned with whether the taxpayer has or has not made a profit. It only enquires whether or not an amount of money or its equivalent has in fact been received by the taxpayer. If this amount is not of a capital nature he must pay income tax thereon. At the same time the Court has pointed out, both in *Booysen's* case (1918, A.D. 576), in *Collin's* case (1923, A.D. 347) and in *Crowe's* case (1930, A.D. 122),2 that what the Act intends to tax is income. It has also been repeatedly laid down by this Court that when considering whether an amount received by the taxpayer is income or not, we must not merely look at the form of the transaction but at its real nature. This principle is a principle of general application in our law. It is a fundamental principle and applies as well to the interpretation of statutes as to every other transaction in a civil society. We must therefore take all the facts into consideration and judge from all the facts whether the amount received is gross income. This principle underlies such cases as *The George Forest Timber Company's* case (1924, A.D. 516),3 *Scott's* case (1928, A.D. 252), *Crowe's* case (1930, A.D. 122) and others.

Now it was never the intention of the legislature to take away from a person a portion of his estate because he is fictitiously supposed

Page 112 of 5 SATC 93

to have received a sum of money which upon analysis it is clear he did not in fact receive. Fictitious income is not gross income. If the Court is satisfied, upon scrutinising a transaction which on the face of it has the appearance of having added money to a man's estate, that in fact the transaction has not added a penny to his estate, then it will not consider such fictitious accrual as gross income. I admit that if these shares in question had not been issued to Ochberg but to someone else, then such recipient's estate would have been enriched by the value of the shares and he would have to pay income tax upon such value. He could not set up as an excuse that he had a controlling influence in the company. But this is not the case here for he owns all the shares of the company. We have to take into consideration that Ochberg in his individual capacity owns the whole (I say the whole because for the purposes of this analysis the six shares may be neglected) of the assets of the company. It would be incorrect to say that he is the company, for in a juridical sense he is not, even though he may be regarded popularly as such in a practical sense. But nothing can alter the fact that the assets of the company are all his, and that the shares of the company held by him merely show how much of the assets of the company would upon liquidation form part of his estate. This is a crucial fact when we come to consider whether in fact his estate has been increased by the amount of £4,893, and if his estate has not been increased I fail to see how he can be said to have received any amount during the year of assessment or how anything has accrued to him or his estate. I agree with the reasons and

conclusion of my brother STRATFORD that it was the intention of the legislature that we should look to the substance of the transaction and not to its mere superficial appearance. I cannot conceive that the legislature ever intended that the State should take away a portion of a man's capital when in appearance he seems to have received an amount of money, but when in fact he has received no money and no money's value: when the sum total of his assets after the so-called receipt is exactly the same as it was before. By increasing the capital of the private company, of which the appellant held all the shares, the appellant has in his individual capacity added nothing to his estate.

The principle which underlies the Income Tax Act is that the State takes a percentage of the moneys or money's value which has accrued to the taxpayer during the year of assessment. In other

Page 113 of 5 SATC 93

words that he pays his tax not out of his capital but out of his incomings. If, therefore, we assume that Ochberg possessed nothing besides his interest in this company, then if he is liable to pay income tax and super tax on the face value of the 4,983 shares, he will not be able to pay the tax out of moneys or the value of money which has increased his estate but he will be obliged to realise his capital in order to pay his income tax. This seems to me contrary to the whole tenor of the Act.

For these reasons I differ from the majority judgment and agree with the views expressed by my brother STRATFORD.

STRATFORD, J.A.: In my judgment the first question submitted by the Special Court should have been answered in the negative. Prior to and at the date of the issue of the 4,893 new shares the capital of the company (a one man company) was £10,000 divided into 9,950 shares of one pound each and 1,000 shares of one shilling each; of this amount 5,107 one pound shares were issued and 5,101 were held by the appellant. As the value of the six held by the others, relative to the question at issue, is negligible, I propose, for the purpose of my remarks, to assume that the appellant was the sole shareholder of all the issued shares. In pursuance of an agreement of the 18th November, 1926, and for the consideration therein mentioned the balance, of the unissued shares in the capital of the company, viz., 4,843 one pound shares and 1,000 one shilling shares were issued as fully paid shares to the appellant. It was not disputed that they were worth their par value. The question submitted in effect is whether the receipt of this allotment in the circumstances stated amount to a receipt of income by the appellant.

In the court below and again in this Court importance seems to have been attached to the value and nature of the consideration given by the appellant for the issue. In the view I take of the matter it is immaterial whether the appellant gave full consideration or none at all. In neither case was the allotment to him income within the meaning of the Income Tax Act. Let us take the two assumptions in turn: first, that the services rendered and the lease were both of no value. It is merely stating the obvious to say that in such case an issue of a share per share to the previous existing holder of all the shares does not give him anything he did not have before; both before and after this issue he holds all the shares of a company whose assets have not varied - the holding

Page 114 of 5 SATC 93

is expressed in different units and that is the only change. It is true that in certain events he may be forced to pay to the company the par value of the shares, for it is illegal to issue shares for no consideration or at a discount, but that is not a matter that concerns the present enquiry. The next assumption is that the services and the lease are valuable and that the company's assets are increased by their receipt. In this case it was argued that the appellant could be richer *pro tanto* by the new issue of shares to him. A moment's reflection, however, will show that this is not so. The company obviously is the richer for having valuable services conferred upon it and the person who holds the total number of shares gets the exact equivalent of the added wealth by reason of his shareholding, and this whether the total number of shares is multiplied or not-so long as he holds all the shares his interest in the assets of the company remains the same both before and after the increased issue. This conclusion as to the value of an issue of new shares to one who already owns all the shares in the company need not be further elaborated, for, I do not imagine that it is seriously challenged; and in any case the simple result, above stated, is one that must be arrived at by following the same line of reasoning adopted in the cases to which I shall have to refer.

The serious objection preferred against the opinion I entertain on this matter is that, though it may be true intrinsically and substantially that the appellant is not benefited by the new issue to him because antecedently he holds all the shares, it is not permissible to regard his antecedent position, we must look to the fact of the issue alone and disregard the fact that the appellant was already the sole shareholder. Once it is admitted or proved, that the shares issued to him have a value, that value represents income within the meaning of the Act. It is said to be quite irrelevant that his previous shareholding depreciates to the exact extent of the value of the new issue -such depreciation is a capital loss, which cannot be deducted from his income. This is, indeed, highly technical, but if we are compelled in law to shut our eyes to the real substance of the transaction and to regard only the receipt of the shares divorced from the position of the recipient in relation to the company, then the solution of the problem, through harshly unjust, is simple and, of course, is adverse to the appellant. There is, however, the authority of this Court that a question of this kind must be regarded from the point of view of substance

Page 115 of 5 SATC 93

and not of form. In my view the decision in *Commissioner for Inland Revenue v Collins* (1923, A.D. 347) is directly in point. The question there was whether bonus shares distributed to shareholders in proportion to their holdings

constituted "income" of the recipients within the meaning of the Income Tax Act of 1917. It was held both by the Transvaal Provincial Division and by a full bench of this Court that it did not. The reasons given in support of that conclusion, as also the reasoning in the cases cited with approval by the Court, appear to me to be convincing in favour of the present appellant's contention. It is necessary, of course, to appreciate the strict analogy of an issue of bonus shares *in proportion to existing holdings*, to the case of a new issue *to the holder of all the shares.* In the case of the capitalisation of surplus profits and the distribution of the bonus shares in proportion to existing holdings, it was the fact that the new shares went to *existing* shareholders strictly in proportion to *their previous holding* that lead to the conclusion that each shareholder was no better off than he was before, and this conclusion was made the determining reason for deciding that there was no accrual of income. It must be obvious that, relative to the question under discussion, there is no difference in effect between issuing all the new shares to the previous holder of half the share capital and the other half to the previous holder of the other half of the share capital. Increasing the number of old shareholders, therefore, will not destroy the similitude to the present case so long as-and this is important-the issue is made strictly proportionate to existing holdings. The bonus shares in *Collin's* case(*supra*) were of course issued in proportion to existing holding, and it was by regard to the position of each shareholder before and after the issue to him of his bonus shares that the conclusion was reached in England, in America and in this Court that such shareholder did not receive income when taking bonus shares. The leading American case is thus summarised by Mason, J.:

> The interest of a shareholder in a company is a capital interest; it is represented by share certificates; an increase in the number of his share certificates, so long as it represents the same interest, does not affect the fact that the share certificates represent just the same amount of capital as before; the only result is that there is a consequent dilution of the value

> of each share. A stock dividend shows that the company's accumulated profits have been capitalised instead of being distributed or retained as a surplus available for distribution; far from being a realisation of profits, it tends rather to postpone such realisation, and denies the shareholder any present participation in the profits.
>
> The essential and controlling fact is that the stockholder has received nothing out of the assets of the Company for his separate use and benefit; the profits in question remain the property of the Company, subject to business risks which may wipe out the whole investment. Having regard to the very truth of the matter and not to form, he has received nothing that answers the definition of income.

In this Court Innes, C.J., said:-

> "The Company has parted with no assets-no money or moneysworth-and the shareholders have received none. The profits dealt with remain in the business as they were before; the only difference is that as they have become portion of the capital they are represented by shares; but these shares do not increase the holder's interest in the Company; that also remains exactly what it was before. The distribution being *pro rata* his interest in the old capital plus the undivided profits under the old holding was exactly the same as his interest in the increased capital under the new holding. The total assets of the Company have not been changed, and his original share represented the same proportion of the then issue as his increased shares do of the increased issue. The intrinsic value of the new shares is therefore lower than the intrinsic value of each share before the increase of capital. As remarked in *Eisner v Macomber* "the new certificates simply increase the number of shares with the consequent dilution of the value of each share." The market price may not always reflect the intrinsic value. That is frequently the case with shares. The increase of capital may give a fillip to the Stock Exchange quotation; or the larger number of shares available may affect their sale. Speculation may also play its part. But the fact remains that the intrinsic value of each shareholder's interest in the Company is unaffected by the increase of capital."

And Solomon, J.A., sums up the controversy thus:

> "And the whole question between the majority of the law Lords in *Blott's* case and Lord Sumner, who delivered, the chief dissenting judgment, seems to be whether the substance of the transaction or its form should prevail."

And he goes on to say that the substance of the whole transaction must be looked to rather than the methods adopted to carry it out. In the present Act, of course, there is now an express provision (section 29(c)) for including bonus shares as income, but such inclusion can in no way affect the clear legal principles as laid down in *Collin's* case. We are not dealing in this case with an issue of bonus shares against undistributed profits, and the section cannot be invoked against the appellant. Even under the section the nominal value of the bonus shares and not the true value is the measure of the income received. The section operates as a warning against companies in this country against issuing bonus shares and the harshness of the section is easily avoided by issuing shares against subscription of the par value by the shareholder. It may be suggested with confidence that one of the main reasons why prosperous companies issue bonus shares against undistributed profits is because distributable profits warrant an increase of dividend in the future and as a matter of policy the directors prefer maintaining the existing rate of dividend on the larger issue to raising it on the original number of shares. It is a matter of no material difference to the shareholder which method is adopted. The shares rise in the market on a share-bonus declaration because of the implied intimation that the profits of the company warrant the same distribution on the large issue, in

other words, the declaration is regarded as equivalent to the promise of a larger dividend accrual to each original shareholder (and see remarks as to the reason by Innes, C.J., above).

I cannot but regard the reasoning adopted in *Collin's* case(*supra*) as well as that in cases there cited as conclusive on the question before us. Indeed, in the present case there is not the same material for the view expressed by Lord Sumner in his dissenting judgment in regard to bonus shares, for he was able with plausibility to dissect the issue into two operations, first the declaration of a cash dividend and then payment for the bonus shares with that dividend. The issue to the appellant in this case does not

permit of such a dividend - the choice lies between regarding on the one hand the issue solely, apart from the position of the recipient and its material worth to him, and on the other hand looking to the real nature of the issue and its value to him. The conclusion with which I cannot agree is arrived at by looking at the value of the issue in the abstract regardless of its value to the recipient, and it is because, in my view, *Collins'* case is decisive in this regard that I accept the relative and not the abstract measure of value. Thus the receipt of the new shares by the appellant did not add to or vary his previous interest in the assets of the company; his share in the assets was unaltered, in the same way and for the same reason as it was held that the recipient of a bonus share issued *pro rata* did not alter the value of his prior holding. If this is the correct way of approaching the problem, then it follows that the appellant received nothing at all. but to follow *Collins'* case more exactly it is perhaps better to state the conclusion somewhat differently, namely, that the accrual is of a capital nature since it is only obtained by a corresponding diminution of capital previously possessed: what is taken in the right hand is simultaneously and automatically surrendered by the left. To assess the appellant in respect of this issue which clearly brought no added wealth to him, would be to work a manifest injustice upon him, and unless forced to do so by express words of the Legislature we should avoid doing so. I can find nothing in the Income Tax Act which compels us to designate as income something which every principle of reason and commonsense tells us is nothing of the kind.

Footnotes

SATC 1 253.

SATC 2 133.

A Tax Cases 3 20.