COMMISSIONER FOR INLAND REVENUE v LYDENBURG PLATINUM LTD
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Division:	Appellate
Judges:	DE VILLIERS ACJ AND CURLEWIS AND STRATFORD JJA
Date:	9 and 22 November 1928
Also cited as:	1929 AD 137

Income tax - Sale of properties - Whether proceeds income or receipt of capital nature - Primary intention in acquisition of properties - Effect of change of policy in conduct of business - Form of statement of case - Costs - Section 7, Act 40 of 1925.

Appeal from a decision of the Witwatersrand Local Division. Respondent company was registered on the 19th December, 1924, with a nominal capital of £92,500, divided into 370,000 five shilling shares. Of these shares 160,000 were issued as fully paid - up vendor's shares, 40,000 were issued to the L.P. Syndicate as consideration for properties purchased and 120,000 were subscribed in cash (realising £30,000), and 50,000 were held in reserve.

The objects of the company, as set out in the memorandum of association, included:-

(i) the acquisition by purchase or otherwise of land and mining properties of every sort, and more particularly the purchase of all the assets of a company known as the L.P. Syndicate Ltd.;

(ii) the acquisition of prospecting rights for base or precious metals and precious stones;

(iii) prospecting for minerals, metals and precious stones;

(iv) the sale of land and rights owned by the company;

(v) mining in all its branches;

(vi) the erection and maintenance of reduction works;

(vii) dealing in precious metals;

(viii) the sale of the whole or any part of the company's assets;

(ix) the promotion of a company and the transfer of the rights and assets of the company to such a company.

Provision was made in the memorandum that save where special provision was made no object should be in any way limited or restricted by reference to any other paragraph or the name of the company.

Under the contract with the L.P. Syndicate, Ltd., the respondent company acquired its assets for £10,000, the purchase price being satisfied by the issue of 40,000 shares in the company. The company had as working capital the sum of £30,000.

After acquiring the properties from the syndicate (to which reference is made in the judgment as the assets listed from (a) to (q) the company carried on certain development work on certain of its claims, including sinking a shaft to prove the reef, but on striking a strong flow of water, the operations were brought to a stop. While they had been in progress the company's technical adviser had discovered the existence of the platinum - bearing reef on other properties, and it was decided to employ the company's resources in the acquisition, as expeditiously and secretly as possible, of the properties upon which the reef had been discovered. The properties so acquired did not form a contiguous block and a distance of some twenty - five miles separated the two properties most distant from each other. These additional properties are referred to as the assets listed (r) to (aa).

The purchase of these properties exhausted the cash resources of the company.

Thereafter one Knacke, a director of the company, after an inspection of the company's properties in association with its technical advisers, proposed to the board of directors that he should be given an option for the purchase of the bulk of the company's properties with a view to their resale to a company to be formed with the larger capital necessary for the development of the large extent of reef - bearing property acquired. This proposal was adopted. The director in question proceeded to London, where the new company was formed. It was agreed that the new company should acquire the bulk of the appellant company's assets for a cash payment of £160,000 and 480,000 fully paid up shares of a nominal value of £1 each, the cash and shares being handed over by Knacke to

the appellant company as consideration for the sale of the assets to him.

It was further agreed that the respondent company should be entitled to guarantee the subscription of 80,000 shares at par, and in respect of this guarantee the board of the respondent company claimed that it should be allowed to participate in an issue of fully paid - up shares to the underwriters. This claim was not admitted, but after prolonged negotiations it was agreed that the respondent company should be allowed to purchase 80,000 ordinary shares and 40,000 vendors' shares for the sum of £80,000, the payment to be satisfied out of the £160,000 cash to be paid by Knacke for respondent company's assets.

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The action of the board of directors was approved by the shareholders in extraordinary meeting, and it was further resolved that the 120,000 shares acquired in the manner described above should be distributed amongst the shareholders.

In assessing the respondent company in respect of the year of assessment ended 30th June, 1925, the Commissioner for Inland Revenue brought into account the sum of £160,000 and the value of the 480,000 vendors' shares acquired by the company in respect of this disposal of its properties, the value of the shares being taken to be £480,000. To this assessment the company objected on the grounds:-

(i) that the cash received in respect of the sale was a receipt or accrual of a capital nature;

(ii) that the shares received did not constitute profit;

(iii) that if the amount was chargeable with tax, the value of the shares did not exceed 13s. 4d. a share.

The Special Court for hearing Income Tax Appeals held that the Commissioner had been correct in bringing both the cash received and the value of the shares into account in determining the company's taxable income, but found the value of the shares to be 9s. a share. It held further that the transaction in respect of the acquisition of 120,000 shares did not affect the consideration received for the sale of the company's assets.

The company, being dissatisfied with the determination, required the following questions of law to be submitted by stated case to the Witwatersrand Local Division of the Supreme Court:-

(a) Was there evidence before the Special Court to support its finding that the company's profits derived from the sale of its assets were income and not accruals of a capital nature?

(b) Was there evidence before the Special Court that assets numbered (a) to (q) in the schedule were acquired by the company solely with the intention of mining them? If so, could any subsequent change of intention cause the profits from the resale of those assets to be accruals other than accruals of a capital nature?

(c) Whether on a true construction of the contract between the company and Mr Knacke, there was a single sale between these parties whereby the price paid by Mr Knacke for the company's assets was £80,000 in cash and 600,000 shares in the Lydenburg Platinum Areas, Ltd.?

After certain preliminary proceedings in connection with the form of the statement of case[1] the Witwatersrand Local Division (DE WAAL, J.P.) held that the primary object of the company was to mine for platinum and that accordingly the cash and shares received from the new company were accruals of a capital nature and not assessable as income, but ordered the company to pay the costs in respect of the previous application for the amendment of the statement of case.

The Commissioner for Inland Revenue appealed, and the company cross - appealed on the question of costs in respect of the application for amendment of the statement of case.

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Held, reversing the decision of the Witwatersrand Local Division, that the profits resulting from the sale were obtained in an operation of business in a scheme for profit making, the company, when ceasing from its mining work and devoting its resources to the acquisition of additional properties, having been actuated by the hope and expectation of making substantial gains by the purchase and disposal of the properties acquired.

Held, further, that the properties earlier acquired from the L.P. Syndicate, Ltd., had been included in the business of buying and selling properties, and that the profits resulting from their disposal also fell within the category of income.

Held, further, that the negotiations in connection with the acquisition by the company of the additional 120,000 shares, though dependent upon the sale of the company's properties, resulted in a second contract that stood upon its own footing, and was not a term of the contract for the sale of the properties so as to affect the consideration received for that sale.

Held, further, on the cross - appeal, that the court below had been right in its order as to costs on the application for the amendment of the statement of case, as the record was sufficiently complete without the addition of the

documents which had been ordered to be annexed.

Commissioner for Inland Revenue v Stott (1928, A.D.; 23 SATC 253), distinguished.

STRATFORD JA said that the respondent company had been assessed for income tax for the year ending 30th June, 1925, in respect of certain profits made by it by the sale of its properties during that year. On appeal to the Special Court the assessment was confirmed, whereupon a case was stated for the decision of the Witwatersrand Local Division in which, in effect, the question was submitted whether, on the facts set out in the case, those profits were income or accruals of capital. A second question was submitted as to the nature of those profits. The first question was answered in favour of the respondent company's contention that the profits were not income but of the nature of accruals of capital. That decision rendered it unnecessary for the Local Division to answer the second question. The correctness of that decision was now challenged, and both questions were now submitted to this Court. Certain costs were also incurred by an application to the Local Division to annex certain documents to the stated case. The costs of that application were ordered by the Local Division to be paid by the respondent company, and the company had cross - appealed against that order.

The facts on which the dispute arose were fully set out in the stated case, but to elucidate the points to be discussed in this judgment

a short summary was necessary. The respondent company was registered on the 19th December, 1924, with a capital of £92,500 divided into 370,000 five shilling shares. Of these 320,000 were issued, and the balance of 50,000 were held in reserve. The case stated that 160,000 were issued as fully paid vendor shares and the balance of 160,000 were subscribed in cash at par, but Mr *Millin* had explained by referring to the contract with the vendor syndicate that £10,000 was due to it under the contract of purchase from that syndicate. That payment of £10,000 was made by the company issuing to the vendor syndicate 40,000 shares, so that £30,000 was subscribed in cash and not £40,000 as stated and that sum of £30,000 represented the working capital of the company.

The objects of the company set out in the memorandum were ten in number. Shortly stated they were as follows:-

1. To acquire properties, mining claims, etc., more particularly the properties comprised in the agreement with the vendor syndicate;
2. to acquire prospecting rights for precious and base metals;
3. to prospect and search for minerals;
4. to sell land and rights owned by the company;
5. to carry on the business of miners and mining;
6. to acquire and construct crushing works, hydraulic works, electric works etc.;
7. to buy, sell, retain and deal in bullion . . . and concentrates of special metals;
8. to sell the whole or any part of the assets, property, and undertaking of the company for money and shares or stock of any company having similar objects. Also to let, mortgage, abandon, dispose of or otherwise deal with all or any of the company's property, and also to reconstruct, refloat or otherwise deal with the company and with all its rights and property;
9. to promote and be interested in any other company and to transfer to such company all or any part of its assets.

Finally there was the provision in 10 that -

"the intention is that the objects specified in each paragraph (or in each of the first paragraphs) of this clause, shall except where otherwise expressed in such paragraph, be in no ways limited or restricted by reference to or inference from the terms of any other paragraph or the name of the company."

The purchase from the syndicate referred to was duly completed. It was stated that the vendor syndicate was formed in September, 1924, had a working capital of £7,000 which it had exhausted in prospecting and securing properties at the time of the sale.

The company then proceeded to do some development work at the farm "Mooihoek." It opened up some of the claims and sunk a shaft but on encountering a strong flow of water, development was stopped. "The reason for this stoppage was that the company did not want to expend money upon a pumping plant in view of the more important work which had first to be done and for which had first to be done and for which the funds of the company were required.

The work which had to be done and for which the funds were required consisted of the purchase as expeditiously

and secretly as possible of all properties upon which the reef discovered by the company's technical adviser was found by him to exist."

The statement of the case proceeds as follows:-

"The company's technical adviser had whilst the development work on Mooihoek was in progress, discovered platinum on the farm Dwarsrivier and advised the purchase of this farm by the company. The owner required a cash price of £20,000 for the mining rights of this farm. As a result of this and other fresh discoveries of platinum - bearing reefs the company thereafter obtained an option to buy Dwarsrivier for £20,000 and bought other properties. In the course of carrying out this work the properties set out in Schedule A under letter (r) to (aa) were acquired by the company.

By the purchase of the properties mentioned in the last preceding paragraph the cash resources of the company were exhausted."

This cessation of work and acquisition of further properties admittedly took place before the 23rd February, 1925, the date on which Mr Knacke, one of the directors of the company, after a visit to its properties in the Lydenburg district, wrote a long letter to the company. The letter was a report of the impression and views of the writer, gathered from his inspection and consultation with Dr. Merensky and Mr Schlesinger, the company's consulting engineer. He stated his conclusion to be that the occurence of platinum on the properties of the company was in the nature of a low grade proposition with enormous tonnage, requiring a large capital to be worked profitably. The writer adopted the estimate

of Mr Schlesinger that £250,000 would be required as working capital, then he proceeded:-

"In order to profit by the present high price of the metal and to make use of the favourable market for platinum shares now existing in London I consider it highly advisable that as soon as possible a powerful company be formed under the auspices of a strong London finance group, and I, therefore propose to go to London almost immediately to discuss the matter with my group there.

"I have already forwarded Mr Merensky's report and described to them my views on the great possibilities of the new discovery, whereupon I received a cable reply telling me the great interest they take in the matter and requesting me to come over.

"Naturally, in order to enable me to meet their wishes and to come to business without unnecessary delay, I must come to them provided with powers to deal and to conclude the transaction. I therefore suggest that your Board gives me the right, say up to the end of June, to take over from your company and bring in into a new company to be formed all their rights and options to the freehold and/or mineral rights, discovery rights and claims on the farms now held under contract by you.

"It is understood that from said rights are excluded the rights to the farms Leeuwvallei No 1238, Graaiuitzicht No 1222 and Sterkfontein No 1223, as also the cash assets of your company, and that any purchase money paid out by you prior to the date of taking over by the intended company, for transfer to your company of mineral rights or freehold of any of your farms, will be refunded out of the working capital of the intended new company.

"The new company to have the nominal capital of £1,500,000 to be allocated as follows:-

"To the Vendors, the Lydenburg Platinum, Ltd., a cash payment of			
and in fully - paid - up shares	Subscribed working capital in cash at par	To the Underwriters	
for guaranteeing the subscription of cash in fully - paid - up shares			
Reserve			
£160,000	480,000	350,000	
£510,000	380,000	30,000	
£1,500,000			."

On the 25th February, 1925, the directors approved of Mr Knacke's offer and promised to support the confirmation of an agreement when placed before the shareholders. It was also agreed that 80,000 of the shares of the new company should be reserved for subscription by the shareholders of the respondent company at par. Mr Knacke then proceeded to London and cabled on the 9th April asking approval for the increase of the capital of the proposed new company to £1,600,000. This the Board agreed to, but claimed that for guaranteeing subscription for the 80,000 shares the shareholders should receive 80,000 promoter shares. This last claim was not agreed to by Mr Knacke and numerous cables were exchanged by parties. Ultimately, on the 30th April, 1925, the company cabled:

"We will buy 80,000 with 40,000 bonus shares,"

and on 5th April Mr Knacke cabled:

"I agree to sell your firm 80,000 cash shares and 40,000 vendor shares for £80,000,"

and on the same day he also cabled *inter alia*:

> "I to pay you the hundred and sixty thousand pounds cash and four hundred and eighty thousand fully - paid - up pound shares in English company . . . your cash and four hundred and eighty thousand shares will be deposited on my sale to English company with trustee who will deliver against completion . . . I will deliver to you at completion eighty thousand cash shares and forty thousand vendor shares you have from me against eighty thousand pounds cash which sum the trustee shall pay me against my delivery these shares."

This was the final agreement between the parties confirmed by the shareholders of the respondent company.

It was in respect of the profits thus accruing to the respondent company that it was assessed by the Commissioner for Inland Revenue. The Special Court confirmed the assessment deciding, however, that the profits assessable were £160,000 and 480,000 vendor shares valued by that Court at 9/ - per share. The questions submitted in the stated case were somewhat unfortunately worded, but both in the Local Division and in this Court counsel agreed that the correctness or otherwise of the respective contentions set out in paragraphs 4 and 5 of the case was the real issue in the matter.

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Two questions, therefore, arose on those contentions, the first was whether the profits realised by the respondent company by the sale of its properties to the new company were profits taxable as income under the Income Tax Act or were accruals of a capital nature and therefore not taxable. And the second is whether the profits so made should be taken to be £160,000 cash and 480,000 shares in the new company or £80,000 cash and 600,000 shares in that company.

The principles to be applied in a case like the present, in order to answer the first question, were now well settled. In the *Overseas Trust Corporation, Limited v Commissioner for Inland Revenue* (1926, A.D. 444)3 INNES, C.J. said: "When an asset is realised 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. 694) - '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.'" Applying this test to the present case the question was whether the profits made by the respondent in the above transaction were made in the course of its business in carrying out a scheme for profit making or whether the whole transaction was a mere change of investment? The test to be applied in the case of an individual was not quite the same as the test in the case of a trading company as explained in *Smith v Anderson* (15 Ch. D. 247), and in *Commissioner for Inland Revenue v Stott* (1928, A.D. at page 262)4 WESSELS, J.A., said: "As a general rule one or two isolated transactions cannot be described as the carrying on of a business," there the learned Judge was clearly dealing with the case of an individual for he said later on: "If you are dealing with a company one of whose objects is to buy and sell land, then the company might well be considered to be doing the business of selling and buying land even though it carries out only a single transaction." So that "continuity" (as it had been called) was a necessary element in the carrying on of a business in the case of an individual but not of a company. Indeed, many cases had come before the Court where there had only been one profit - making

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transaction of a company, and that fact had never been relied upon as in any way decisive of the question whether the profit had been made in the carrying on of the company's business or otherwise. In the case of a company the Court had primarily to look at its objects laid down in its constitution and next at its actual operations. In the case of most companies they were empowered in their "Memorandum of Association" to carry on more businesses than one; sometimes it was clear from the memorandum that one business was the main business, and the others were merely ancillary to the main purpose, but there was nothing to prevent a company carrying on more businesses than one if its constitution empowered it to do so. But a rule of construction had been adopted and applied by the English Courts under which the main or dominant object of a company was ascertained; all other objects, however independently expressed, were then regarded as ancillary to that object and controlled thereby. See Palmer's *Company Precedents* (12th ed., part 1, page 454). The ascertainment of a company's main or primary object was of importance whenever there was a question of the destruction of the substratum of a company. To prevent the application of that rule it had now become usual to insert in the memorandum the words appearing in clause 10 of respondent company's memorandum. The effect of those words no doubt was that if more than one object was expressed in a memorandum, the elimination of any one object did not invalidate the others. See *Marks and Aaronson v Registrar of Companies* (1921, TPD 203). But whether the words now precluded the enquiry - as Mr *Millin* had suggested they did - as to what was the company's primary object, was a question on which personally his Lordship had some doubt. However, holding the view he did in regard to the later activities of the respondent company it was not necessary definitely to decide what was its first object. The question had been argued at length before that Court because of the view expressed by INNES, C.J. in *Commissioner of Taxes v South Deeps, Limited* (1918, A.D. at page 606): "So that the primary object of the South Deeps must be taken to that of a gold mining company, its other objects being merely ancillary thereto." Then in regard to the argument that a new business had been embarked upon, the learned CHIEF JUSTICE said: "The *onus* was upon the Commissioner to establish that proposition."

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But whatever the respondent's primary business might have been his Lordship was satisfied, for reasons presently to be stated, that the profits in question resulting from the sale to the new company were obtained in an operation of business in a scheme for profit - making. When the respondent ceased its mining work and devoted its remaining cash resources to the acquisition of the properties enumerated in the Schedule (r to aa) it did so because of the information, by that time obtained, of the value of those properties. The technical adviser of the company had found that the platinum - bearing reef existed on them, and particularly advised the purchase of Dwarsrivier where platinum had also been discovered. Further there was force in Mr *Millin's* contentions, that Mr Knacke's opinion expressed in his letter of 23rd February, 1925, to the effect that the mineral proposition as a whole was low grade and required a large working capital, must have been shared by the other members of the directorate, for that opinion was based upon technical advice equally available to the Board. And though it appeared that the properties (r to aa) were acquired just prior to the date of that letter, it was again a reasonable inference that the information and technical opinion which the letter disclosed were, to a very large extent, disclosed to the Board before that date. In any event the policy decided upon of stopping mining work and devoting the remaining cash resources to the acquisition of more mineral - bearing properties, was unquestionably dictated by the hope and expectation of making substantial gains by buying cheaply "expeditiously and secretly" properties which, from their own private information, the Board had reason to believe were very valuable. Whether at the date of purchase the Board had definitely formed the intention to secure those profits by resale, or by mining, was not necessary to say, for the facts of the case convinced his Lordship that a profitable resale or resales were certainly in their contemplation. There were these two methods of turning the valuable acquisitions to profitable account; both were business methods of making gains authorised by the company's memorandum. Securing profits by mining must have been a deferred method since fresh capital was required, whereas the other method offered immediate results and required no further capital. When, therefore, shortly afterwards the Board decided to sell, their choice was definitely in favour of this method of doing business in preference to the other. The profits were therefore, in his Lordship's

judgment, made in the carrying on of a business in a scheme for profit - making. Or, to use another phrase to be found in the cases, those profits were "income derived from capital productively employed," and the whole operation was not merely a change of investment.

There remained to be considered whether that portion of the profits derived from the resale of properties originally acquired by the respondent company (enumerated a to q in the schedule) were to be classed in the same way. It had been objected by appellant's counsel that that question did not arise out of the questions stated, and that under the provisions of sec 57 of Act 40 of 1925 the deduction of a named sum should have been specifically claimed before the Commissioner. His Lordship preferred, however, to base his conclusion upon material rather than upon technical grounds. For, even though it were assumed that these properties were originally acquired for the purpose of carrying on the business of mining the subsequent events to which reference had been made pointed to a clear change of policy in regard to the use to which they were put. If, indeed, the above conclusion was correct that the business of buying and selling was embarked upon in respect of the properties (r) to (aa) it was hardly open to doubt that the earlier acquired properties were deliberately included in that business and that all the profits were made of the same business operation. In *Stott's* case (*supra*) WESSELS, J., at page 264, dealing with the intention of the original purchase said: "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 the present case a new factor had intervened of a decisive character, namely the deliberate adoption of the policy of selling the company's properties to make profits.

The first question, therefore, should have been answered in favour of the appellant's contention.

The next question was whether the profits should be taken to consist of £80,000 and 600,000 shares (as the respondent company contended) or of £160,000 and 480,000 shares (as the appellant contended). The answer to that question depended upon whether the agreement by the company to take 80,000 subscribed shares and

40,000 vendor shares for £80,000 was merely part of the whole transaction relating to the sale of the company's properties or was an independent bargain. The cable correspondence undoubtedly showed that the respondent company attached great importance to the right, which it ultimately obtained, to get 80,000 ordinary shares and 40,000 vendor shares for £80,000 and it insisted upon the making of that bargain as a condition of the transaction of sale of the company's properties. To that extent no doubt, the making of the two bargains were dependant one upon the other, in the sense that if one had not gone through the other would not; but when made, there were two agreements, one an agreement for sale of the company's properties for the consideration mentioned, and the other an agreement of sale of 120,000 shares for £80,000, the roles of purchaser and seller being reversed. Mr *de Wet* had frankly admitted that that was the position. The parties agreed to make two bargains or none at all. It could be put in the following form: A agreed to sell properties to B if B would sell shares to A. Two contracts were then made each with its agreed *causa*, and each transaction stood on its own footing. It could not, therefore, be said that the purchase and sale of the shares was a term in the contract of sale of the properties, by which last contract the profits in question in this case had been made. It followed then that the respondent company got £160,000 and 480,000 shares for the sale of its properties. Whether the company could claim to deduct from the profit, made on that sale, the loss it apparently made on its purchase of shares was not a question which was

before the Court. The question which had been put must be answered in favour of the appellant.

There remained the cross - appeal. After the stated case was prepared, but prior to the hearing, an application was made in the Local Division by the respondent company to have certain records of evidence and annexures put in, or alternatively that the case should be referred back for certain annexures to be made and for certain findings to be given. From the judgment of Mr Justice GREENBERG, who heard the application, it would appear that substantially the application was refused, but the learned Judge acceded to it to the extent of referring the case back for the purpose of attaching merely annexures referred to in the reasons for judgment of the Special Court. The learned Judge ruled that the costs of the application should be decided at the hearing. When

the case was argued before Mr Justice DE WAAL, he ordered respondent company to pay the costs; his reasons were given in the concluding words of his judgment: "I am satisfied that it will become apparent on a close analysis of the judgment of the President of the Court that all those annexures were dealt with by the President in the reasons given by him for the judgment of the Special Court."

His Lordship agreed entirely with that view, the questions submitted by the stated case did not require, for their discussion and answer, any of the documents which Mr Justice GREENBERG directed should be annexed - the record was sufficiently complete without them. The cross - appeal, therefore, failed.

The result was that the appeal succeeded with costs in both Courts, and that both questions submitted in the stated case must be answered in favour of the appellant.

The cross - appeal was dismissed with costs.

DE VILLIERS, A.C.J., and CURLEWIS, J.A., concurred.

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Footnotes

1 3 SATC 85.
2 2 SATC 71.
3 2 SATC 71.
4 3 SATC 253.