IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

CASE NO: 426/2001
Reportable

SAMRIL INVESTMENTS (PTY) LTD **APPELLANT**

AND

COMMISSIONER FOR THE SA REVENUE SERVICE **RESPONDENT**

CORAM: ***HEFER AP, SCHUTZ, STREICHER, FARLAM JJA, LEWIS AJA***

HEARD: **6 September 2002**

DELIVERED*:* **25 September 2002**

Summary: Income Tax - distinction between capital accrual and revenue – sale of building sand.

JUDGMENT

JJF HEFER

HEFER AP :

[1] The appellant is the owner of the farm Droëvlei in the Malmesbury district. For many years the company's income consisted solely of the proceeds of the sale of farm products and rentals received from an associated company for the grazing on the farm. But between January 1994 and February 1996 a total amount of more than R2m flowed into the appellant's coffers as a result of an agreement entered into with Mr JH Karsten for the removal of building sand from the farm. R774 704 was earned in the 1995 income tax year and was assessed by the Receiver of Revenue as part of the company's gross income for that year. After an unsuccessful objection to the assessment on the ground that the amount in question represented a capital gain the appellant appealed to the Cape Income Tax Special Court. The appeal was dismissed and the assessment confirmed. With the necessary leave the appellant has now appealed to this Court.

[2] The usual test for determining the true nature of a receipt or accrual for income tax purposes is whether it constituted a gain made by an operation of business in carrying out a scheme for profit-making. According to the decision of this Court in *Commissioner for Inland Revenue v Pick`N Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A) at 57E-G this means that the receipt or accrual was not fortuitous but designedly sought and worked for. However, it must be borne in mind that profit-making is also an element of capital

accumulation. As Wessels JA said in *Commissioner for Inland Revenue v Stott* 1928 AD 252 at 263

> "every person who invests his surplus funds in land or stock or any other asset is entitled to realize such asset to the best advantage and to accommodate the asset to the exigencies of the market in which he is selling. The fact that he does so does not alter what is an investment of capital into a trade or business for earning profits."

Every receipt or accrual arising from the sale of a capital asset and designedly sought for with a view to the making of a profit can therefore not be regarded as revenue. Each case must be decided on its own facts with due regard to the distinction between capital and the income derived from the productive use thereof as described *inter alia* in *Commissioner for Inland Revenue v George Forest Timber Co Ltd* 1924 AD 516 at 522-523 and taking account of all the circumstances of the case.

[3] It must also be borne in mind that s 82 of the Income Tax Act 58 of 1962 casts the burden of proving that any amount is exempt from or not liable to tax on the person claiming such exemption or non-liability. Thus, where the court is not persuaded on a preponderance of probability that the income derived from the sale of an asset is to be regarded as capital gain, it must be included in the taxpayer's gross income.

[4] In the present matter the respondent submits that the appellant conducted the business of selling sand and that it did so in carrying out a scheme of profit-making. The appellant's contention on the other hand is that it disposed of the

right to acquire the sand on Droëvlei in a single transaction which did not constitute the carrying on of a business. Both parties rely for their contentions mainly on the terms of the written agreement in pursuance of which the sand was excavated and removed. It may be mentioned in passing that Mr Karsten approached one of the appellant's directors, Mr Currie, with an offer for the removal of the sand towards the end of 1993. An oral agreement was concluded and Karsten commenced his operations during January 1994. On 25 March 1994 the oral agreement was reduced to writing. The terms of the written agreement relevant to the present enquiry are the following:

> "**2**. The Seller does hereby grant to the Purchaser the right to acquire the entire deposit of sand on the farm.
>
> **3**. The Seller shall in its sole discretion decide from which areas of the farm sand may be removed from time to time.
>
> **4.1** It is recorded that neither of the parties can estimate the extent of the building sand deposits available. The parties are thus unable to determine the value to be placed on the right to remove the sand. The parties have thus agreed that the right to remove sand shall be valued by the Purchaser settling upon the Seller for the right to remove the sand the sum of R4,00 (four rand) per cubic metre of sand removed plus Value-Added-Tax thereon.
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> **4.2** The consideration shall be reassessed at the option of the Seller on the first day of January 1995 and thereafter on the first day of each and every succeeding year.
>
> **4.3** The Purchaser shall pay in advance, prior to the commencement of removal of sand, a deposit for 5000 (five thousand) cubic metres of sand. Immediately the total amount of 5000 cubic metres has been removed the Purchaser shall pay for the next quantity of 5000 cubic metres.
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> **4.4** Payment shall be effected by bank or building society guaranteed cheques and the Purchaser shall not be entitled to perform any work on the abovementioned farm or remove any sand until payment has been so made.

> **5.3** All bulldozing, excavation, loading and transport of the sand will be at the sole cost and expense of the Purchaser as will be the provision of the equipment and machinery required to perform such functions.
>
> **5.4** At the conclusion of mining operations on each area comprising two hectares, the Purchaser shall procure the immediate restoration of such area according to the rehabilitation guidelines and programme laid down by the Department of Mineral and Energy Affairs."

[5] The agreement was plainly one of purchase and sale and the first question which presents itself is whether the subject matter of the sale was sand (as submitted by the respondent) or the right to acquire the sand on Droëvlei (as contended for by the appellant).

Clause 2 of the agreement cannot be read in isolation; the agreement must be construed as a whole against the background of the surrounding circumstances. Looking first at the agreement itself one is immediately struck by the use in clause 2 of the curious notion of a right to acquire the sand. It is difficult to understand how the appellant could have sold the right to acquire the sand without selling the sand itself and, if one were to ask how the purchaser, having merely obtained the right to acquire the sand, had to set about in order to obtain the sand itself, the answer must plainly be that all he had to do was to take delivery by excavating and loading it as envisaged in clause 5.3. It follows, therefore that, despite its clumsy wording, clause 2 conferred upon the purchaser the right to the sand itself. For the same reason clause 4.1 which creates the impression that the right to remove the sand from the farm was conferred separately from the right to acquire it, takes the matter

no further. It merely affirms the right to remove the sand which is in any event implicit in clause 2 read with clause 5.3. Finally, to confirm that it was indeed the sand that was purchased, one merely has to turn to clause 4.3 which provides that the purchaser would pay in advance for 5000 cubic metres of sand and, immediately upon the removal of the first 5000 cubic metres, would pay for the next quantity of 5000 cubic metres.

The evidence about what had happened before the conclusion of the agreement points the same way. Mr Karsten was a dealer in building sand whose only concern seems to have been to secure supplies for his business. In his dealings before the conclusion of the oral agreement with Mr Currie he offered to pay for the sand at what was then the ruling price in the area. Mr Currie accepted. Both Mr Karsten and Mr Currie testified in the Special Court but neither explained how the reference to the right to acquire the sand, which had never come up in their discussions, found its way into the written agreement later prepared by the appellant's auditors. On the facts we know of no reason for the introduction of the concept of the sale of a right.

[6] The next question is whether the income derived from the sale of the sand falls to be classified as a gain made by the operation of a business for carrying out a scheme of profit-making. In this regard the President of the Special Court said in the court's judgment:

> "What, in my view, is pivotal to the present enquiry are the provisions of sub-clauses 4.3 and 4.4 of the written agreement in terms whereof the right to perform mining operations and remove sand from Droëvlei was dependent upon the

> payment in advance by means of bank or building society guaranteed cheques of an amount equal to the agreed value of 5000 cubic metres of sand and that when that quantity had been removed such right could be extended/revived only by means of repeated similar payments. The amount of R774 704 is the equivalent of at least 38 such payments. In my view the appellant did not dispose of the right to remove sand from Droëvlei in a single transaction as submitted by advocate Emslie, but the dealings between the parties, when viewed holistically and against a commercial backdrop, had all the characteristics of the trading in sand as a commodity in tranches of 5000 cubic metres each."

[7] I agree that, in order to judge the true nature of the income from the sale of the sand, the enquiry should extend to all the dealings between the parties during the period of about two years over which the payments were received. Viewed in this manner the multiplicity of the amounts received (cf *Modderfontein B Gold Mining Co Ltd v Commissioner for Inland Revenue* 1923 AD 34 at 46; *Commissioner for Inland Revenue v Lunnon* 1924 AD 94 at 98), coupled with the fact that the income was generated by exploiting the resources on what was admittedly a capital asset and was plainly designedly sought and worked for, affords at least *prima facie* evidence that it was in the nature of revenue and not capital. The only evidence which may point the other way is that of Mr Currie to the effect that he merely sought to improve the company's land by removing an unwanted subsoil layer of sand. But the Special Court regarded his evidence in this regard as suspect. Although I have no doubt about Mr Currie's honesty, his evidence relating to the reason for the removal of the sand is not convincing. The appellant has accordingly not discharged the onus resting on it in terms of s 82.

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

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JJF Hefer

Acting President.

Concur:

Schutz JA
Streicher JA
Farlam JA
Lewis AJA