Synopsis
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Capital v revenue – the debate is not closed

Before the introduction of capital gains tax, taxpayers and SARS would frequently engage in an all-or-nothing contest where a taxpayer disposed of an asset. The earlier case reports are littered with cases relating to the capital-revenue debate. With the introduction of a tax on capital gains, there have been few reported decisions in this connection, principally because the fiscus recovers tax on the disposal in any event. SARS has, however, been engaged in a hard-fought dispute relating to a sale of shares which ended up in the Supreme Court of Appeal, on which judgment was delivered on 9 February 2016.

Background

The appeal in the matter of *C:SARS v Capstone 556 (Pty) Ltd* [2016] ZASCA 2 dealt with a complex corporate rescue operation in the furniture industry, dating back to 2002. At that time, Profurn (a company listed on the JSE) was in severe financial difficulty and its major creditor, FirstRand Bank Ltd ("FirstRand"), sought a means whereby the company might be returned to profitability.

The chief executive of Profurn ("Jooste") referred FirstRand to a German businessman ("Daun") who indirectly held a 13% stake in Profurn. Daun consented to participate in a recapitalisation of Profurn, but insisted that a capital injection would be insufficient to effect a turnaround. The company required sound management, and Daun's participation was subject to one Sussman (who Daun considered was best qualified to turn the business around) being placed in control of the company. Sussman consented to taking over the management, on condition that Daun remained as a shareholder for as long as it took to effect a turnaround.

The parties mutually agreed on a strategy to effect a turnaround, which they anticipated would take in the region of three to five years to achieve.

Under the plan, FirstRand would underwrite a R600 million rights issue and would capitalise a portion of its debt for shares in Profurn. Thereafter Profurn would be merged with the JD Group ("JDG") and the Profurn shares exchanged for JDG shares. FirstRand would then dispose of the JDG shares to Capstone 556 (Pty) Ltd ("Capstone") for R600 million. Capstone would finance the purchase consideration out of an investment of R300 million by a German company controlled by Daun, the issue to FirstRand of R200 million's worth of redeemable preference shares and a new loan from FirstRand of R100 million.

The agreement was substantially reflected in a memorandum of understanding signed by Daun in Germany on 26 June 2002, in which it was expressly stated that risk and reward would pass on that date, notwithstanding that it was subject to the requisite regulatory approval.

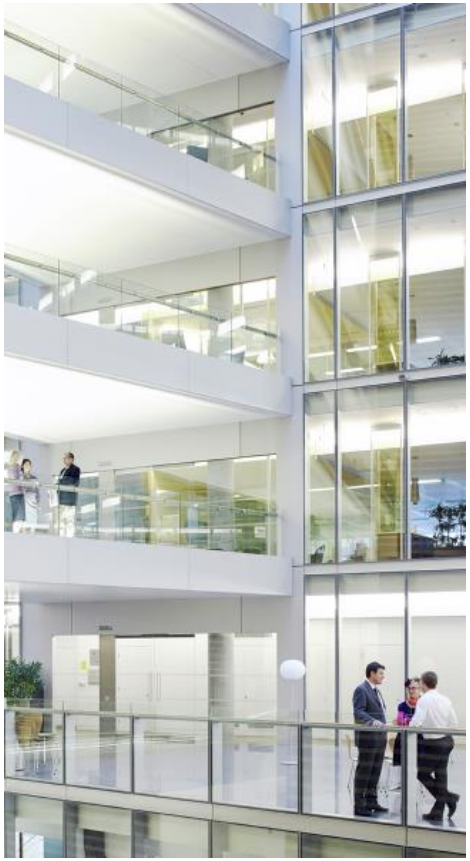
The rights issue raised less than R1 million from shareholders and FirstRand subscribed for the remaining Profurn shares, which, following the merger, resulted in FirstRand holding 42 million shares in JDG.

Capstone was incorporated on 2 April 2003. As a result of amendments to the MOU and subsequent agreements, Jooste was invited by Daun to participate in the transactions and Capstone was designated as the investment vehicle for Jooste. FirstRand ultimately disposed of approximately 35 million of the JDG shares, of which one-half were transferred to Capstone and one half to Daun's German investment holding company. Daun's company duly effected payment for the shares so transferred, and Jooste made the necessary arrangements for the financing of the acquisition by Capstone. FirstRand required the purchasers of the shares each to issue a R62.5 million indemnity relating to potential tax exposures in Profurn, which had been identified in a due diligence investigation.

The arrangements made by Jooste involved the raising of a loan from Genbel Securities Ltd ("Gensec") and the issue of redeemable preference shares to FirstRand. Gensec stipulated that, in addition to interest, it be entitled to a portion of any gain on the disposal of the JDG shares in the future ("equity kicker"). The funds advanced to Capstone by Jooste's interests reflected the same conditions agreed between Jooste and Gensec.

The JDG shares were eventually transferred to Capstone and Daun's company on 5 December 2003. In the interim, the turnaround strategies had been implemented by Sussman and the affairs of the merged businesses had prospered under his management.

"Book-building" is an exercise of sourcing institutional investors who might be prepared to acquire an interest in a listed company in a transaction which is concluded off the stock exchange.



Jooste's participation was subject to a stipulation by Daun that Daun should be placed in control of the entire parcel of 35 million shares. In November 2003, Jooste had become aware, in a brief discussion in San Francisco with a bank official ("Pagden"), that the latter was engaged in a "book-building" exercise for another South African company. This is an exercise of sourcing institutional investors who might be prepared to acquire an interest in a listed company in a transaction which is concluded off the stock exchange. Jooste inquired whether such an exercise might be possible for JDG shares.

Some months later, Pagden approached Daun with a proposal that his bank carry out a book-building exercise for the shares in JDG. Following Daun's acceptance of the proposal, offers for 28 million shares were presented at a price almost three times the price at which they were originally acquired. The offer was accepted and Capstone disposed of 14 million shares held by it on 29 April 2004 and shortly thereafter sold the remaining 3.5 million JDG shares that it held to another company at a slightly higher price.

Jooste then negotiated repayment of the Gensec loan, and Capstone paid the equity kicker in addition to any amounts of outstanding capital and interest as agreed.

At the same time, Capstone agreed to pay Daun's company R55 million under an agreement which provided that Daun's company would assume full liability for the indemnity to FirstRand relating to the contingent tax liability of Profurn.

Capstone therefore had to deal in its 2005 return of income with the taxation of the proceeds on disposal of the shares and the manner in which the expenditure on the equity kicker and the payment for assumption of the indemnity should be dealt with.

In its return, Capstone declared the gain on disposal of the shares as a taxable capital gain and claimed deduction of the equity kicker and the indemnity payment. SARS taxed the disposal as ordinary income and disallowed the deductions claimed.

In the Tax Court, the taxation of the proceeds as a receipt of revenue was confirmed, and, as a result, the equity kicker and exemption payment were held to be deductible.

Capstone took the Tax Court decision to the High Court on appeal, and the Court held that the proceeds were indeed of a capital nature, that one-third of the equity kicker could be included in the base cost of the shares and that the remainder of the equity kicker and the indemnity payment were not deductible and did not form part of the base cost of the shares.

SARS challenged the High Court's finding and the matter thus came before the Supreme Court of Appeal.

The decision

Capital v revenue

In a thorough review of the law, Van der Merwe AJA confirmed the principles that have been established over the past century for distinguishing between proceeds of a capital nature and proceeds of a revenue nature.

The general proposition that applies in matters such as these is stated thus at [24]:

Whilst recognising that it is not universally valid, our courts have in circumstances such as the present consistently applied the test that a gain made by an operation of a business in carrying out a scheme of profit-making, is income and vice versa.

Acknowledging that a taxpayer may have had mixed purposes, the only course is to identify the dominant factor operating to induce the taxpayer to effect the purchase of the asset.

As to what constitutes a scheme of profit making, the Court expressed reservations about arriving at simplistic conclusions, at [26]:

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

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

Thus the mere intention to profit is not conclusive. There must be 'an operation of business in carrying out a scheme for profit-making' for a receipt to be income. That expression refers to the use of the taxpayer's resources and skills to generate profits, usually, but not always, of an on-going nature.

Turning then to the sale of assets, the Court stated that identifying the intention of the taxpayer is key, and (at [28]):

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

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

Acknowledging that a taxpayer may have had mixed purposes, the only course is to identify the dominant factor operating to induce the taxpayer to effect the purchase of the asset.

Establishing the purpose of the taxpayer is a question of fact, and Van der Merwe AJA was at pains to point out that this must be determined by a conspectus of all of the facts and circumstances.

The first important fact was that the acquisition of the share occurred on 26 June 2002 and not on 5 December 2003 when the certificates were issued. From this, it followed (at [35]):

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

The second issue pertinent to the inquiry was whose intention should be identified. Here the Court was dealing with a company, and it was noted (at [37]) that, generally, the intention of a company is determined by ascertaining what its directors acting as such intended; however, authority was cited that the intention may in certain instances be established by reference to persons other than the board of directors to whom authority may have been delegated. On this basis, Van der Merwe AJA found (at [38]):

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

The Court then proceeded to examine the evidence given in relation to Daun's intention. First, the Court summarised the approach to this issue in the Tax Court and the High Court as not being "rounded and complete".

It was evident that SARS was not going to fare well in the consideration of the evidence when Van der Merwe AJA reflected on the credibility of the evidence at paragraph [42]:

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

The Court found that Daun was unshaken in rigorous cross-examination in which SARS' counsel sought to coax an admission out of him that he had intended to turn the shares to profitable account by realisation. The Court summarised this evidence as follows at [45]:

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

It was noted that the surrounding circumstances pointed in favour of Daun's explanation.

SARS' argument that Jooste was in fact the person who caused the accrual to Capstone, because he had set up the book-building operation, was rejected. It was found that the conversation in San Francisco had been of short duration and inconclusive and that Pagden had unilaterally taken the initiative in subsequently proposing the possibility thereof to Daun. The decision to commission the book-building exercise was taken solely by Daun, after consultation with Sussman, to whom he had made a commitment to remain invested, and with his wife in Germany.

The Court therefore found at [52]:

In my judgment it is clear from the evidence that the first and primary purpose of the acquisition of the shares was to rescue a major business in the retail furniture industry by long-term investment of capital. This involved a commitment of capital for an indeterminate period involving considerable risk and only a very uncertain prospect of a return. Assuming the rescue was successful, it was uncertain what would happen next. In effect all options were open. All of this was consistent with an investment of a capital nature that was realised sooner than initially expected because of skilled management and favourable economic circumstances. It was not a purchase of shares as trading stock for resale at a profit.

The remaining issue related to the treatment of the payment of R55 million for the indemnity.

In the following extracts from paragraph [55] of the judgment, Van der Merwe AJA outlined why the payment should form part of the base cost of the shares.

It is beyond question that the contingent liability of Capstone in terms of the indemnity to FirstRand formed part of the consideration for the acquisition of the shares... The unconditional obligation in terms of the indemnity settlement to pay R55 million ... was undertaken in substitution of the contingent obligation to FirstRand... The causal link with acquisition of the shares was not broken. The acquisition of the shares remained the causa causans *of the indemnity settlement... It was the mechanism by which the contingent liability incurred as part of the acquisition of the shares was monetised and rendered a quantifiable component of the cost of the shares.*

The takeaway

The thorough description of the facts and the careful application of the principles of evidence and of the tax law resulted in a clear judgment which has brought to an end a long-running dispute in the course of which the basis of taxation was contested. The judgment makes it clear that in such disputes the evidence relating to the purpose of the parties and credibility of the witnesses is paramount.

The jurisdiction of the High Court in a disputed assessment

Section 117 of the Tax Administration Act 28 of 2011 provides that "The Tax Court . . . has jurisdiction over tax appeals lodged under section 107", *and section 107 provides that a taxpayer who has objected to an assessment and has received SARS' decision in this regard, disallowing the objection, may appeal against the assessment to the tax board or the tax court.*

Many taxpayers who wish to contest an assessment are tripped up by the procedural requirements involved in an objection and appeal to the Tax Court, in particular the tight time limits, and they then find themselves out of time to follow this process.

For this and other reasons, some taxpayers have tried to contest a disputed assessment in the High Court.

Thus, for example, in *Medox Ltd v CSARS* [2015] ZASCA 74; 2015 (6) SA 310 (SCA) the taxpayer tried to impugn disputed assessments on the ground that the Commissioner had acted *ultra vires* in issuing them, and that the assessments were therefore void.

The taxpayer's application to the High Court for a declaratory order to this effect was rejected, and on further appeal the Supreme Court of Appeal affirmed the rejection and held (at para [15]) in regard to the taxpayer's argument that –

"This would render the mechanisms provided in ss 81 to 83 [of the Income Tax Act as it then stood] for objections to and appeals against assessments nugatory and grant aggrieved taxpayers carte blanche to approach the High Court in virtually every instance where they disagree with an assessment made by the Commissioner."

The jurisdiction of the High Court

It goes without saying that the High Court possesses inherent jurisdiction, and the question therefore arises as to the circumstances, if any, in which it will adjudicate a disputed assessment or some aspect of it.

Prior to its amendment in 2015, section 105 of the Tax Administration Act 28 of 2011, which appeared in Chapter 9 of the Act, used to read as follows:

"A taxpayer may not dispute an assessment . . . in any court or other proceedings, except in proceedings under this Chapter or by application to the High Court for review."

The problem with the way this was put was that it could be read as opening up two alternative avenues to dispute an assessment, firstly by way of objection and appeal under Chapter 9 of the Tax Administration Act and, secondly, by applying to the High Court for a review of the assessment.

The existence of a parallel process for contesting an assessment with an overlapping jurisdiction between the Tax Court and the High Court is clearly untenable.

Thus, in *Rossi v CSARS* [2011] ZAGPJHC 16 at para [31] the court rejected the proposition that, in contesting an assessment, an objection and appeal to the Tax Court and an application for review to the High Court are two parallel and alternative procedures for contesting an assessment, because (see para [32]) –

"it is inconceivable that the Legislature intended to create competing and concurrent fora for resolution of tax disputes".

Thus, a taxpayer who fails to set in motion the process for having his objection to an assessment heard by the Tax Court cannot seek equivalent relief by way of an application to the High Court.

In an attempt to put these principles beyond doubt, section 105 of the Tax Administration Act has now been amended by the Tax Administration Laws Amendment Act 23 of 2015 with effect from 8 January 2016 to read as follows – the words in bold within square brackets having now been deleted, and the underlined words having been added:

*"A taxpayer may **[not]** only dispute an assessment . . . **[in any court or other proceedings, except]** in proceedings under this Chapter **[or by application to the High Court for review]**, unless a High Court otherwise directs."*

The takeaway

Regrettably, the amendment to s105 of the Tax Administration Act in respect of the jurisdiction of the High Court in a disputed assessment removes one ambiguity (by making clear that there are not two alternative processes for contesting an assessment), only to introduce a new ambiguity, namely the circumstances in which a High Court will *otherwise direct* – presumably by agreeing to adjudicate some aspect of the disputed assessment by way of review.

A farm owner is not necessarily a farmer

This month the Supreme Court of Appeal finally determined the outcome of a dispute between SARS and a taxpayer concerning the taxation of the proceeds of sale of a farming property on which stood substantial plantations. In this instance, the Court clearly prescribed the approach to be applied in determining whether amounts accruing to a person may be regarded as income from carrying on farming operations.

The case of *C:SARS v Kluh Investments (Pty) Ltd* [2016] ZASCA 5 (1 March 2016) had originally been contested in the Tax Court, where the Court had found in favour of the Commissioner that the proceeds on the sale of the property constituted gross income from farming. The matter had then proceeded on appeal to the Full Bench of the Western Cape High Court (*Kluh Investments (Pty) Ltd v C:SARS* 77 SATC 23), which overturned the Tax Court's decision. SARS then took the issue on appeal to the Supreme Court of Appeal.

The facts

The facts in the matter are relatively uncomplicated.

Steinhoff Southern Cape (Pty) Ltd ('Steinhoff') had entered into an agreement with the Thesen Group of Companies in 2001 to purchase a forestry, timber-growing and plywood-manufacturing business in Knysna. However, the board of directors of Steinhoff's ultimate parent company had not approved the transaction because it did not wish to invest in South African fixed property at that time.

The agreement was therefore cancelled and replaced with an agreement in terms of which Steinhoff acquired all of the operating equipment, including the sawmill; while the fixed property, on which there were substantial plantations of indigenous trees, was acquired by the taxpayer ('Kluh').

Kluh was a special-purpose vehicle owned by a Swiss finance company. Under the new agreement, Kluh was required to pay R29.5 million for the property and equipment. The purchase consideration was allocated between land (R11.6 million), plantations (R12.5 million) and equipment (R5.4 million). Kluh took possession of the assets in June 2001 and retained the land and plantation but sold the other assets to a third party.

The judgment of Ponnan JA at paragraph [11] sets out the manner in which Kluh controlled the property subsequent to its acquisition:

When Thesen disposed of the plantation to Kluh in 2001, it was already a mature plantation in rotation. The plantation ... had reached the stage where it could annually yield a steady and sufficient number of mature trees for commercial felling, with younger trees taking their place year by year. Steinhoff, which owned the equipment necessary for conducting the plantation operations and employed the employees who worked on the plantation ..., was entitled to harvest the timber for its own account. Kluh owned no equipment and had no employees. All operational income and expenditure were earned and incurred by Steinhoff and reflected in its accounts. Thus, Kluh's financial records and financial statements for the period between the acquisition and the disposal of the plantation reflect no operational income and expenditure. The oral arrangement between Kluh and Steinhoff was for an indefinite duration and, due to the Steinhoff group policy in 2001 not to own land in South Africa, it was expected to endure for a lengthy period – although either party could obviously have terminated the arrangement on reasonable notice. On termination of the arrangement, the plantation would comprise trees of the same volume and quality as at the commencement. This meant that Steinhoff, in conducting the plantation operations, had to keep the plantation in rotation and perform such other pruning, thinning and maintenance as would ensure that, upon termination, it could restore the plantation as in its June 2001 state. Planting was not required as seedlings grew naturally. Steinhoff was required to manage the plantation using best practice so that, what was described as, Forest Stewardship Council certification could be obtained, thereby ensuring that the timber would qualify for export to Europe. Steinhoff, which was responsible for fire protection, had insured the plantation against fire in the light of its obligation to restore the plantation to Kluh at the end of the arrangement. In the event, Kluh derived no income from the actual day-to-day plantation farming operations and incurred no corresponding day-to-day expenditure.

In 2003, the Steinhoff Group of Companies changed its intentions regarding the ownership of land in South Africa. In February 2003, Kluh and Steinhoff concluded an agreement of sale.

Ponnan JA at paragraph [3] describes the arrangement as follows:

The subject of the sale was described as being 'the plantation business', which was defined in clause 3.1 of the agreement as 'the business of commercial forestry operations, which includes the plantation sales assets, machinery and equipment and plantation contracts carried on by [Kluh] at the plantations and the plantation immovable property as defined, as a going concern'.

After negotiation, the parties finally reached a settlement on 1 June 2004, at which time Steinhoff agreed to purchase the property for R159 million, of which R144.7 million related to 'the plantation'.

The assessment

SARS assessed Kluh to tax on the proceeds of the sale, contending that the proceeds from the disposal of the plantation constituted income received by or accrued to a farmer, as contemplated in paragraph 14(1) of the First Schedule to the Income Tax Act ('the Act').

SARS claimed that it was authorised to assess the income on this basis based on section 26(1) of the Act, which provides that:

The taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule.

The decision

Ponnan JA examined the reasoning in the Tax Court and High Court judgments. The learned Judge concluded that the Tax Court had not been justified in declining to accept the testimony of the witnesses from whom evidence was adduced on behalf of Kluh. In so doing, the Tax Court had drawn inferences from documentary evidence, but had not given due regard to the actual conduct of Kluh in relation to the assets. Thus, it was found that the High Court had correctly declined to follow the approach to the evidence adopted in the Tax Court. In effect, the conduct of Kluh in relation to the assets, as recorded earlier, strongly corroborated the testimony of the witnesses.

Based on that conduct, Ponnan JA observed (at [12]):

Thus from the very beginning Kluh wanted nothing to do with any farming operations. Quite apart from the fact that it had neither the appetite for the risks associated with farming nor the requisite skills, equipment and personnel to undertake farming operations, the whole raison d'être of Kluh's involvement was to acquire bare ownership of the land and the plantation, which Steinhoff was prevented from doing. That being so, it was hardly surprising that the full court answered, what it described as the 'threshold enquiry', thus (para 83):

> *'. . . Here, however, the appellant did not even start to conduct plantation operations. From the outset the appellant made the plantation available to Steinhoff so that the latter could conduct plantation operations for its own profit and loss.'*

This finding in the High Court should have effectively disposed of the entire inquiry: logically, if Kluh was not subject to the provisions of section 26(1) of the Act, the First Schedule could not apply to it.

SARS, however, was more persistent. It argued (as recorded in [13]) that:

... first, the purpose of paragraph 14(1) of the First Schedule to the Act is to extend tax liability by treating the proceeds of the disposal of a plantation as gross income; second, the mere disposal of a plantation by its owner constitutes the conduct of farming operations for purposes of s 26(1), irrespective of the extent to which the owner was involved in the actual conduct of farming operations prior to or separately from such disposal, and, third, the farming operations were conducted by Steinhoff 'on behalf of' Kluh.

As to the first issue Ponnan JA identified that SARS was attempting to put the cart before the horse, and found (at [14]):

Paragraph 14(1) is a deeming provision which, on its own wording, only applies to a farmer in respect of such farmer's gross income. 'A farmer' in that provision is clearly a short-hand for a person carrying on farming operations as contemplated in s 26(1). Carrying on 'farming operations' as contemplated in s 26(1), is clearly the necessary prerequisite that triggers the applicability of the whole of the First Schedule, including the deeming provision in paragraph 14(1). It must follow that the deeming provision itself cannot be employed to determine whether or not a taxpayer is 'a farmer' or differently put 'a person carrying on farming operations'. Accordingly, the content of the deeming provision in paragraph 14(1) ... is the consequence of carrying on farming operations, and cannot itself be determinative of whether a person is or is not carrying on farming operations i.e. whether a person is 'a farmer' as contemplated in paragraph 14(1). In short, the deeming provision in paragraph 14(1), on its plain wording, only applies to farmers, and logically one cannot use the deeming provision itself to determine who is and who is not a farmer.

The second issue, that mere disposal of a plantation 'makes' a person a farmer for purposes of paragraph 14(1) of the First Schedule was rejected. It was found that SARS had misconstrued the purpose of the provision. Ponnan JA stated [15]:

Even where the taxpayer is a farmer, paragraph 14(1) contemplates that the proceeds of the disposal of a plantation are in fact of a capital nature. This is why a farmer's proceeds from the disposal of a plantation are deemed not to be of a capital nature and are required to be included in the farmer's gross income in terms of paragraph 14(1). Such proceeds are not 'captured by s 26(1)', as suggested by SARS, but simply included in paragraph 14(1). It may be so that s 26(1) brings the deeming provision in paragraph 14(1) into operation, but it is wrong to say that the mere disposal of a plantation is therefore recognised as a farming operation. It seems to me, that the presence or absence of what is signified by the 'carrying on of farming operations' as contemplated in s 26(1), and by the words 'a farmer' and 'such farmer's' in paragraph 14(1), must therefore be determined without placing any reliance on the deeming provision in paragraph 14(1).

Finally, the assertion that Kluh was carrying on farming operations through the agency of Steinhoff was found not to be supported by the evidence. To this contention, Ponnan JA responded (at [16]):

But, even if Steinhoff in some sense acted on behalf of Kluh, that would not make Kluh a farmer as contemplated in paragraph 14(1). On the facts, Kluh did not have the right to the yield of the plantation – it had granted this right to Steinhoff for the duration of the agreement. Kluh also did not have the use of the land and the plantation, which right it once again had granted to Steinhoff for the duration of the agreement between them. And Kluh did not derive any income from the land and the plantation, the use of which it had granted to Steinhoff to farm for its own benefit, on its own behalf, and for its own account. Thus, the only entity which could be regarded as a 'farmer' (as contemplated in paragraph 14(1)) in relation to the plantation owned by Kluh, was Steinhoff.

Judgment was accordingly given in favour of Kluh and the appeal was dismissed.

The takeaway

Two salient features emerge from the judgment in this matter:

- In examining the testimony of witnesses, courts should be astute to consider the evidence as a whole, and not look for support of its findings in discrete pieces of the evidence. The full spectrum of circumstances provided clear evidence that Kluh was not carrying on farming operations, yet the Tax Court was persuaded to discount the testimony of witnesses and determine the issue not by looking at the conduct of Kluh in relation to the land but by reference to a range of documents and the descriptions contained in those documents.
- In the interpretation of a specific provision in the Act which is part of a Schedule which acquires its authority from an empowering provision (a specific section) in the body of the Act, one must first identify whether the taxpayer falls within the scope of the empowering provision. The provisions of the Schedule do not extend the authority of the empowering provision – the Schedule acquires no greater authority than is given to it under the empowering provision. In effect, the Schedule cannot determine whether the empowering provision applies, the empowering provision determines whether the Schedule applies.

SARS Watch 24 February to 22 March 2016

Legislation		
24 Feb	Notice 191: Determination of the daily amount in respect of meals and incidental costs for purposes of section 8(1) of the Income Tax Act	Published in Government Gazette No. 39724 with implementation for years of assessment commencing 1 March 2016
24 Feb	Tax Proposals to the Customs and Excise Act	Taxation Proposals as tabulated by the Minister on 24 February with effect from 14:47 on 24 February 2016
1 Mar	R.209 - Regulations in terms of section 12T(8) of the Income Tax Act	Published in Government Gazette No. 39765 with effect from 1 March 2016
2 Mar	Regulation published in terms of par (a) of the definition of "international tax standard" in section 1 of the Tax Administration Act	Published in Government Gazette No. 39767 on 2 March 2016 with implementation date from 1 March 2016
11 Mar	Notice R239 – Relates to the increase in the rate of customs duty on polyurethane from 0% to free	Published in Government Gazette No. 39799 on 11 March 16 with implementation on 11 March 16
11 Mar	Notice R240 - Relates to the reduction in the rate of customs duty on canned mussels in airtight metal containers from 25% to free	Published in Government Gazette No. 39799 with implementation date of 11 March 16
22 Mar	Notice 338 - Effective date for the new employees' tax deduction tables prescribed in terms of par 9(1) of the Fourth Schedule to the Income Tax Act	Published in Government Gazette No. 39839 with date of inception 1 March 16
Interpretation		
1 Mar	Interpretation Note 89: Maintenance orders and the tax-on-tax principle	This note provides guidance and clarity on the treatment of maintenance orders and the tax-on-tax principles relating to maintenance orders that retirement funds pay while a member is still a contributing member and has not left the retirement fund. General Note 37 dated 31 October 2008 is hereby withdrawn.
9 Mar	Interpretation Note 31 (Issue 4): Documentary proof required for the zero rating of goods or services	This note sets out the documentary proof that is acceptable to the Commissioner as contemplated in section 11(3) in instances where goods or services are supplied at the zero rate.

Binding rulings

23 Feb 2016	Binding General Ruling 28 (Issue 2): Electronic services	This ruling sets out the following: i) information that must be contained on a tax invoice, credit note or debit note in order to satisfy the requirements of sections 20(7) or 21(5); ii) exchange rate that must be applied in order to determine the amount of the VAT charged in the currency of the Republic; and iii) manner in which prices must be advertised or quoted for the supply of electronic services by an electronic services supplier.
23 Feb	Binding General Ruling 11 (Issue 2): Use of an exchange rate	This ruling prescribes the foreign exchange rate that must be used when issuing tax invoices, debit notes or credit notes and determining the output tax due where the consideration for the standard-rated supply is in a foreign currency.
25 Feb	Binding General Ruling 12 (Issue 2): Input tax on the acquisition of a non-taxable supply of secondhand motor vehicles by motor dealers	The purpose of this ruling is to make an arrangement relating to the amount motor dealers may deduct as "input tax" with regard to a second-hand vehicle traded in under a non-taxable supply.
29 Feb	Binding General Ruling 224: Non-resident - Source of income from the operation of ships	This ruling determines whether the profits of a company not resident in South Africa from the operations of ships in international waters and South African ports will constitute gross income as defined in section 1(1) of the Income Tax Act.
1 Mar	Binding Private Ruling 225: Hybrid debt instruments	This ruling determines the dividend tax consequences for a non-resident issuer of hybrid debt instruments.
1 Mar	Binding Private Ruling 226: Transfer of long-term insurance business partly to a third-party and partly intra-group	This ruling determined the income tax, value-added tax, and securities transfer tax consequences of the transfer of the business of a long-term insurer, in part to a third-party long-term insurer and the remainder to a long-term insurer that forms part of the same group of companies.
4 Mar	Binding General Ruling 31: Interest on late payment of benefits	This ruling provides clarity on when an amount constitutes interest as opposed to forming part of the lump sum benefit for purposes of the Second Schedule to the Income Tax Act. This ruling replaces General Note 32.
17 Mar	Binding Private Ruling 227: Share subscription transaction followed by two share repurchase transactions	This ruling determines the income tax, capital gains tax, dividends tax and securities transfer tax consequences resulting from a share subscription transaction followed by two share repurchase transactions.
18 Mar	Binding General Ruling 32: VAT treatment of specific supplies in the short-term reinsurance industry	This ruling deals with: i) taxable supplies made by reinsurers; ii) cedents and intermediaries; iii) reinsurance claims and recoveries; iv) the time of supply in relation to the supply of short-term reinsurance, intermediary services and cedent services; v) information to be reflected on a tax invoice, debit note and credit note as contemplated in sections 20(7) and 21(5) respectively; vi) in respect of the supply of short-term reinsurance - cedent services and the related intermediary services; and vii) approval to issue recipient-created tax invoices, debit notes and credit notes.
18 Mar 2016	Binding General Ruling 14 (Issue 2): VAT treatment of specific supplies in the short-term insurance industry	This ruling sets out the VAT treatment of specific supplies in the short-term insurance industry. The effective dates are dealt with in section 3 of this ruling. This ruling replaces and withdraws Binding General Ruling 14.

Case law

23 Feb	*CSARS v Prudence Forwarding (Pty) Ltd and Grovemaster Trading Enterprise 136 CC*	The issue in this case was whether an original assessment of capital gains tax in 2007 was capable of amendment to give effect to the provisions of paragraph 35(3)(c) of the Eighth Schedule to the Income Tax Act by reducing the proceeds of a disposal pursuant to cancellation of the sale agreement by the reduction of the accrued amount forming part of such proceeds. The judgment was delivered on 13 Nov 2015 in favour of SARS.
29 Feb 16	*Respublica (Pty) Ltd v CSARS*	The issue in this case relates to the VAT treatment in respect of the supply of immovable property to educational institutions in terms of agreements of lease for student accommodation and whether such supply constitutes the supply of "commercial accommodation" as defined in section 1 of the VAT Act.
1 Mar 16	*CSARS v Kluh Investments (Pty) Ltd*	The primary issue in this appeal was whether Kluh was 'carrying on farming operations' as contemplated by s 26(1) of the Income Tax Act.
22 Mar 16	IT0038/2015	The issue in this case was whether the Appellant had discharged the onus to prove "exceptional circumstances" as required in terms of section 104 of the Tax Administration Act 28 of 2011 when seeking extension of the period allowed to a taxpayer for objection to an assessment. The appeal by the taxpayer was dismissed.

SARS publications

24 Feb	Explanatory Memorandum - Revenue Laws Amendment Bill 2016	The Bill provides for the postponement of certain provisions in respect of taxation of retirement benefits and to provide for a correction of the calculation of the amount of a deduction to be included in taxable income in respect of deductible contributions to defined benefit retirement funds.
24 Feb	Revenue Laws Amendment Bill, 2016	This Bill provides for a correction of the calculation of the amount of a deduction in determining taxable income in order to provide for the postponement of the commencement of certain provisions in respect of taxation of retirement benefits and to provide for matters connected therewith.
24 Feb	Media statement: Special voluntary disclosure programme in respect of offshore assets and income	The purpose of this programme is to encourage compliance. Government proposes a special voluntary disclosure programme for individuals and companies to regularise both their tax and exchange control affairs for a limited window period.
26 Feb	Draft Interpretation Note 16 (Issue 2): Exemption from Income Tax: Foreign Employment Income	This note addresses the interpretation and application of the foreign employment remuneration exemption in section 10(1)(o)(ii) of the Income Tax Act.

SARS publications (cont.)

26 Feb	Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill	The purpose of this bill is: i) to amend the rates of normal tax and to amend the Income Tax Act in order to amend rates of tax and monetary amounts; ii) to amend the Customs and Excise Act; iii) to amend rates of duty in Schedule 1 to that Act; iv) to provide for additional relief under the voluntary disclosure programme; and v) to provide for matters connected therewith. The date of commencement is still to be announced.
26 Feb	Draft Rates and Monetary Amounts and Amendment of Revenue Laws (Administration) Bill	The purpose of this Bill is to provide for administrative matters in respect of additional relief under the voluntary disclosure programme and to provide for matters connected therewith.
29 Feb	Draft Interpretation Note 34 (Issue 2): Exemption from income tax: Remuneration derived by a person as an officer or a crew member of a ship	This note provides guidance on the circumstances under which section 10(1)(o)(i) of the Income Tax Act exempts the remuneration derived by a person as an officer or crew member of a ship from normal tax. Comments are due to be submitted by no later than 31 May 2016.
29 Feb	Tax Guide for Recreational Clubs (Issue 3)	This guide provides general guidance on the taxation of recreational clubs in South Africa.
4 Mar	Draft Binding General Ruling on the VAT treatment of the supply and importation of vegetables and fruit	This ruling sets out the VAT rate applicable to the supply and importation of vegetables and fruit; and withdraws Binding General Ruling (VAT) No. 18 dated 27 March 2013, "The Zero-Rating of Various Types of Dates". Comments were due to be submitted by no later than 18 March 2016.
10 Mar	Tables A and B - Average exchange rate	Table A provides a list of the average exchange rates of selected currencies for a year of assessment as from December 2003. Table B provides a list of the monthly average exchange rates to assist a person whose year of assessment is shorter or longer than 12 months.
11 Mar	Press Release: Regulation R.209 - Relating to section 12T(8) of the Income Tax Act	National Treasury agreed to postpone the implementation of transfers until 1 November 2016 to allow more time to consult with product providers on the necessary rules and procedures.
11 Mar	Regulations in terms of section 12T(8) of the Income Tax Act	This regulation has been published for comment that must be submitted no later than 8 April 2016.
11 Mar	Draft Binding General Ruling on Electronic Services supplied via intermediaries	This draft ruling has been published for comment that must be submitted by no later than 22 April 2016.

SARS publications (cont.)

16 Mar	Draft Binding General Ruling: Documentary proof in relation to the deduction of input tax on importation	This draft ruling has been published for comment that had to be submitted by no later than 29 March 2016.
16 Mar	Revenue Laws Amendment Bills B4A and B4B	Bills passed by National Assembly and transmitted for concurrence on 15 March 2016.
16 Mar	Explanatory Memorandum - Revenue Laws Amendment Bill	This explanatory memorandum relates to the Revenue Laws Amendment Bills B4A and B4B of 2016.
16 Mar	Draft Binding General Ruling - The circumstances prescribed by the Commissioner under section 16(2)(g) of the VAT Act	This draft ruling was published for comments which had to be submitted by no later than 29 Mar 2016.
22 Mar	Table 3 - Rates at which interest-free or low-interest loans are subject to income tax	This table relates to the “official rate of interest” as defined in paragraph 1 of the Seventh Schedule to the Income Tax Act.