

IN THE TAX COURT OF SOUTH AFRICA
HELD AT CAPE TOWN

CASE NO: 13002

In the matter between:

ABC (PROPRIETARY) LIMITED

Appellant

And

**THE COMMISSIONER FOR THE SOUTH
AFRICAN REVENUE SERVICES**

Respondent

JUDGMENT: 19 August 2013

DAVIS J

Introduction

[1] This case turns on one crisp question: whether the proceeds of a disposal of a plantation by the appellant were correctly included in appellant's gross income for the 2004 tax year of assessment in terms of s 26 (1) of the Income Tax Act 58 of 1962 ('The Act') read together with paragraph 14 (1) of the First Schedule to the Act.

[2] It was agreed between the parties that an alternative dispute, namely, the extent to which capital gains tax may be payable on the disposal of the plantation

if the proceeds do not constitute gross income, would stand over for later determination.

[3] A number of the facts which are critical to the disposition of this case are common cause: Appellant acquired a plantation business from D (Pty) Ltd and D Properties (Pty) Ltd ('D Entity') in 2001 in terms of a 'sale of business agreement' of 3 October 2001. The purchase price of R 11 956 121 was attributed to the standing timber. Appellant then disposed of the plantation to E (Pty) Ltd ('E') in terms of 'heads of agreement' for the sale of a business date 21 February 2003, read with a 'settlement agreement' dated 29 July 2004. The consideration for the plantation over and above the costs of the land was in the amount of R 144 700 000.

[4] In an additional assessment, with a due date of 1 September 2010, the respondent taxed the net proceeds arising from the sale of the plantation as part of appellant's gross income in terms of s 26 (1) of the Act. Appellant now contends that s 26 (1) does not apply and thus the net proceeds should only have been taxed as a capital gain as in the original assessment.

The relevant provisions of the Act

[5] Section 26 (1) of the Act provides that:

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

Paragraph 14 of the First Schedule to the Act which deals with ‘the computation of taxable income derived from pastoral agricultural or other farming operations provides:

- ‘(1) Any amount received by or accrued to a farmer in respect of the disposal of a plantation shall, whether such plantation is disposed of separately or with the land on which it is growing, be deemed not to be a receipt or accrual of a capital nature and shall form part of such farmer’s gross income.
- (2) Where any plantation is disposed of by a farmer with the land on which it is growing the amount to be included in such farmer’s gross income in terms sub-paragraph (1) shall-
 - (a) if the amount representing the consideration payable in respect of the disposal of the plantation is agreed to between the parties to the transaction, be the amount so agreed to; or
 - (b) failing such agreement, be such portion of the consideration payable in respect of the disposal of the plantation as in the opinion of the Commissioner represents the consideration payable for the plantation.’

[6] Given that it was agreed that the appellant had not engaged in a scheme of profit making, the only question for determination by this court is whether the deeming provision applies, which would, in turn, justify the additional assessment of 1 September 2010. Expressed differently, the dispute concerns whether the appellant carried on 'pastoral, agricultural or other farming operations' between the relevant years of assessment and, if it did, then whether the proceeds of the disposal of the plantation were 'derived from such operations'.

Appellant's argument

[7] The core submissions made by the appellant may be summarised thus:

1. It acquired ownership of a plantation as an investment;
2. It contracted with E to carry on plantation and thus farming operations and for its/E's own benefit, on its/E's own behalf and for its/E's own account.
3. It disposed of the plantation to E in due course, which plantation was never part of its business operations as it did not farm.

[8] Mr Kuschke, who appeared together with Mr Emslie on behalf of the appellant submitted that the appellant was a passive investor in farming land. After it acquired the land, it granted a usufruct to E and retained a bare *dominium* on which it earned no income and expended no income in any of the operations which were only and exclusively undertaken by E. In turn, E's only obligation towards the appellant was to safeguard the appellant's investment by maintaining

the plantation rotation system in accordance with best practice and to return the same quantity of timber to the appellant in due course on termination of the agreement between them.

[9] In this connection, Mr Kuschke relied heavily on a written note prepared by Mr X, the director of appellant, which Mr X had compiled, pursuant to a meeting which he had held with Mr Y, a director of E, in which the latter had explained the basis by which the appellant was to acquire the D plantations. This document was dated 12 July 2001. In explaining the contents of this document, Mr X described the meeting pursuant to which the document had been prepared thus:

“Mnr X: Y het vir my verduidelik dat die plaas was beoog word om gekoop te word in ABC gerigistreeer sou word en dat ek die direktuer van die maatskappy sal wees en dit sal hou vir 29 jaar, ons sal die plaas, die plaas in die maatskappy hou vir 29 jaar. En dit is 'n langtermyn visie gewees wat ons geneem het op daai stadium.

Mnr Kuschke: Wel as u regs weer in dieselfde reël oor die bladsy beweeg dan sien u daar 'n syfer van R45 miljoen.

Mnr X: Ja, die transaksie sou plaasvind met D Entity want hulle wou op 'n baie dringende basis al hulle bates in Knysna verkoop rond slomp die hele totaal vir R 45 miljoen en die transaksie sou opgebreek word in twee komponente, die een sou toerusting wees, die toerusting wat op die plaas is, en dan sou die ander gedeelte sou dan ABC se eiendom word naamlik die vaste eiendom en die bome...”

[10] Thus Mr X testified that of the total figure of 45 million, 5.5 million was attributed to equipment. In regard to the balance of R 39.5 million, he explained that this was made up as follows:

“Mnr X: [A]s u sien onder die hofie plantasies, eiendom en bome is daar ‘n syfer R 39.5 miljoen en hierdie wat so in ‘n blokkie getrek is het die – het dit oopgemaak R 8 miljoen was die Hout Eiendom ooreenkoms wat die plywood of die saamgeperste houtafdeling sou verkoop word aan Hout Eindom vir die bedrag van R 8 miljoen. Dan is daar ‘n erf gewees op daardie stadium was dies syfer genoem R 1.5 miljoen dis ‘n eiendom wat ook daar in Knysna omgewing was, sou ook verkoop word aan ‘n derde party en dan sou ABC die bare dominium hou van die plaas vir’n bedrag van R10 miljoen en dit is R 19.5 miljoen en as u my vergun kan ek voortgaan en vir u verduidelik dat F Co. sou dan die R 19.5 miljoen aan die regterkant van hierdie bladsy R 19.5 miljoen Suid Afrika inbring in die vorm van Duitse Mark en dit sou inbetaal word in die H Bank se bankrekening wat ABC sou open en die R 19.5 miljoen sou dan in daardie bankrekening inbetaal word.”

[11] Mr X thus testified that appellant’s holding company F Co., a company registered in Switzerland, had provided the necessary R 19.5 million, which comprised a ply wood agreement to the value of R 8 million, property in Knysna to the value of R1.5 and the balance consisted of a bare *dominium* of R 10 million.

[12] In Mr Kuschke’s view, this document was a particularly important objective piece of evidence which supported appellant’s contention that the agreements

empowered E to farm actively on the plantation for its own account without acquiring ownership of the land and that the plantation was then to be 'warehoused' in the appellant. Thus the passive ownership of the land and of the plantation were to be and indeed were divorced from the farming operations which had been carried on by E, which alone had the use of the land and of the plantation as well as the right to the yield of the plantation for the duration of the agreement between itself and the appellant.

[13] In a further explanation of the nature of the transaction as described by Mr X in his hand written document, Mr Kuschke referred to the evidence of Mr Y, who as a director, acted on behalf of E. Mr Y explained that, on 2 May 2001, E concluded written agreements with D Entity as sellers of the plantation, in terms of which E agreed to acquire from D Entity all of the assets and businesses of D Entity (the sellers), as a going concern, including the land and the plantation for a total purchase price of R 45 million.

[14] The main board of E's holding company then blocked the acquisition by E of the land and the plantation because, at that time, it was group policy not to acquire fixed property in South Africa which might negatively affect its consolidated balance sheet and thereby the share price of the listed holding company in the event that the value of fixed property was to decrease.

[15] Mr Y testified that, accordingly, he had to 'find somebody else to own the land'. In this connection, he telephoned Mr Z, who acted on behalf of F Co., to propose that F Co. which, as an investment holding company, had an investment interest in the pine furniture industry in Europe and therefore enjoyed certain broad synergies with E, to enquire whether it was prepared to invest in assets which E was now no longer able to acquire, namely the land and the plantation business. In this connection Mr Z, who also testified before the court, said:

“He (Mr Y) came to me saying I have this land, I have this forest, I have contracted, I am not allowed to take it, I assure you if you will trust me on my experience, this is good investment can you help? So it wasn't as if we both went looking for a business together.”

[16] As a result of these conversations, the agreements between D Entity and E were cancelled and, somewhere between 02 May 2001 and 1 June 2001, it was orally agreed that the purchaser would be the appellant (a wholly owned subsidiary of F Co.) which would acquire the subject matter of the cancelled agreement substantially on the terms and conditions as they later came to be documented in a written agreement. The effective date of these oral agreements was 29 June 2001, on which date appellant took possession, inter alia, of the plantation and on which date it paid for the plantation.

[17] The original allocation of the purchase price of R 45 million had been made by Mr S of D Entity and given to Mr Y. This allocation was then carried

over into the substituted agreements. According to Mr Z, “From what we could see on a basic view there seem to be a little bit of a fire sale.” He further testified that, “I think this was the reason why we came into the picture, maybe offered the opportunity in that I believe he was very interested to enter this aspect of the business but was refused permission by his board to own land and therefore had to find a solution.”

[18] Mr Kuschke therefore submitted that the evidence of Mr Y and Mr Z, taken together, was to the effect that an oral agreement had been concluded between Mr Z, representing F Co., appellant’s sole shareholder, and Mr Y, on behalf of E. In terms of this agreement, E would, for its own account, conduct forestry and plantation operations on the land, the use of which was granted to it by the appellant, which had no desire or interest in farming. E was to use the plantation acquired by appellant for this purpose and for an indefinite period of time. Furthermore, the oral agreement provided that E would assume responsibility for all expenditure and risk and, in particular, the obligation to insure the plantation against the risk of fire.

[19] While the stipulated contractual period of 29 years was not definitive of any dispute, it was anticipated at the time, both by the appellant and E, that their agreement would endure for a considerable period of time, given the long term nature of investment in plantations, in which trees take some 29 years to mature. Furthermore, the assets and equipment necessary to operate the plantation were sold directly to E by D Entity with effect from 29 June 2001. From that time, E

immediately commenced farming operations (plantation) on the land owned by appellant which E had acquired the right to so use.

[20] Mr X insisted throughout his evidence that; “Daar was nie geboor nie”, that is by the appellant. In this connection, Mr Kuschke referred further to the evidence of Mr Z who testified:

“I made it clear at the time that there was no possibility of F Co. being involved in forestry operations in SA. We were able to be investors but we had no desire of particular skill to do any more than that. Furthermore I’d say that F Co. its investment holding company is very careful not to be involved in other businesses in order to maintain its tax status in Switzerland.”

[21] According to Mr Y, he persuaded the main board of E to change to policy concerning the owning of land in South Africa. The policy changes were described by Mr Z thus:

“E had changed their policy on one side and on the other side they were interested to protect sources of timber and therefore one of the ways to do that is to buy our own forest.”

[22] Accordingly, on 21 February 2003 appellant concluded an agreement, styled ‘heads of agreement with E and E Africa (Pty) Limited (‘E Africa) in terms of which the plantation was sold to E and E Africa. The heads of agreement

recorded that, pursuant to the strategic decision of E Africa Holdings (Pty) Limited to expand its timber division by the investment and/or acquisition of forestry and plantation activities, E entered into negotiations with appellant in respect of the business. After extensive negotiations during the last quarter of 2002 and research into the change of circumstances relating to the business of the appellant and E's plans to erect a sawmill in the Cape region, the parties reached an agreement for the sale of the plantation to E. E, with the assistance of E Africa, conducted the plantation operation business, as a result of which, it had the capabilities and expertise to conduct the business with a view to expanding the E Africa facility and other timber – related industries in the Cape. Accordingly, the parties agreed that estimated purchase price would be some R 108 500 000, subject to a valuation by an independent valuer.

[23] Mr Y testified that these heads of agreement were signed 'to keep that (the price of timber) from running away from us'. There was a considerable debate about the accuracy of the heads of agreement. Mr Y said that there were significant inaccuracies in the heads of agreement. For example, in his evidence he was referred to clause 2.3 thereof:

"E (Pty) Ltd, with the assistance of E Africa had managed the business on behalf of the seller, as a result of which the seller obtained capabilities and expertise, to conduct the business.

Just stopping at 'manage the business on behalf of the seller', did E manage the business on behalf of ABC like an agent would manage a business for a principal?

Mr Y: No M'lord, we did the operations for our own profit and loss but in a sense we did manage the forest on behalf of them to keep it in rotation and to manage it and keep it to a certain level of maintenance.”

[24] In more general terms Mr X said this about the heads of agreement:

“Ek het ‘n fout begaan deur hierdie ooreenkoms te teken want daar was nie – en hulle het ook vir my gesê dit was aanvanklik net ‘n voorlopige dokument en dat die behoorlike ooreenkoms mettertyd opgestel sou word, en uit hoofde daarvan het ek toe gesê goed ek sal dit teken.”

Under cross-examination, Mr X, with regard to these heads of agreement, went on to say:

“Dit was maar net om die dinge in prinsiep of in beginsel vas te maak, en dat behoorlike ooreenkomste mettertyd uitgetrap sal word en bespreek sal word”. He also said of the heads of agreement: “Die indruk wat ek gehad het is dat dit iets is wat vinnig aanmekaar gesit is, ... en dat daar ‘n verdere ooreenkoms sou aangegaan word.”

[25] Accordingly, Mr Kuschke relied on a settlement agreement, which was effective 1 June 2004, and which had been entered into by the parties to resolve their disagreements and to clarify their original intention, which they claimed was not reflected in the ‘heads of agreement’..

[26] In terms of this settlement agreement, the parties concluded that the final purchase price would be R 159 700 000 of which an amount of R 144 700 000 would be allocated to the plantation and R 15 million to immovable property. In terms of this agreement, appellant's business was described as meaning 'the immovable property and the plantation'. In turn, the plantation was defined as 'the standing timber on the immovable property and, for purposes of expressing the value thereof as part of the purchase price,' it included the plantation business (the business of commercial forestry operations) including the plantation sale assets and machinery, equipment and plantation contracts, all as a going concern.

[27] Standing timber was defined as the trees planted on the immovable property for commercial harvesting purposes. Immovable properties was defined as meaning immovable property which was described in annexure A to this agreement, on which the plantation was situated.

[28] The appellant, in addition, agreed to pay a bonus management fee of R 12 million to E for the exemplary manner in which it had performed its obligations in relation to the stewardship of appellant's plantation.

[29] Mr Y described this as a rebate on the value of the forest, because the value 'was running away from E '. In this connection Mr Z said:

“I think it’s a misnomer to look at this as a management fee. There was a lot of discussion about how well E would manage the forest and so on, and I think ultimately we agreed that there should be some recognition of their stewardship rather than management, and I suppose you needed a phrase, I think for the documents.”

[30] For VAT purposes it was agreed that the parties had, subsequent to the original agreement of 21 February 2003, taken further advice to the effect that VAT was payable at a rate of 14% and not 0% as had originally been agreed.

[31] Accordingly, Mr Kuschke submitted that the appellant had disposed, not of an income earning activity and therefore not of a business as a going concern, but of land and a plantation thereon. To the extent that respondent had contended that the method of valuing the plantation was indicative of the fact that what was being sold was a business as a going concern, Mr Kuschke submitted that the plantation was sold after being valued with reference to the future income stream that could be produced by the business of commercial forestry operations. This did not mean that a business of commercial forestry had actually been conducted by the sellers. The valuation exercise rather involved a hypothetical and notional enquiry in order to obtain an accurate valuation of land with a plantation thereon.

[32] To the extent that it could be argued that E had acted on behalf of the appellant, a contention which was strenuously denied by appellant, Mr Kuschke submitted that this would not result in appellant being 'a farmer' as contemplated in paragraph 14 (1) of the First Schedule. The appellant had derived no income therefrom and did not have and could not have held the requisite profit motive or intention to qualify it as a farmer in terms of paragraph 14 (1) of the First Schedule.

[33] In this connection, Mr Kuschke relied heavily on ITC 1548; 55 SATC 26. In this case, a taxpayer, who was a farmer, earned income from rendering shearing and harvesting services to other farmers utilising his own equipment. He sought to deduct part of the cost of his shearing and harvesting machinery in terms of paragraph 12 (1)(j) of the First Schedule from the income he earned by rendering those services to farmers on the basis that this was income derived by him from 'farming operations'. In his judgment, Conradie J (as he then was) referred to the principle that it was permissible to ascertain the meaning of an expression in the signed version of an Act by having regard to a restricted meaning in the unsigned version. He held that, while the expression 'farming operations' as used in the signed English version of the Act, might be capable of encompassing the appellant's shearing and harvesting services for others, they could not be seen as falling within the equivalent Afrikaans term 'boerdery' and a farmer who sheared and harvested for another did not carry on 'boerdery'. Accordingly, the learned judge found that the term 'farming operations', as

employed in the Act, included only those activities carried on by a farmer on his own land and from which he derived an income.

[34] In these circumstances the farmer need not be the owner of the land but he must have the right to the land and to its yield. Only then could he be considered to be a farmer for the purposes of the First Schedule. In conclusion Conradie J said the following at 29:

“Die uitdrukking vir ‘farming operations’ in die Afrikaanse weergawe is ‘boerdery’. Mnr Clegg se betoog was dat stroop en skeer... onteenseglik boerderybedrywighede is as hulle deur ‘n boer op sy eie grond verrig word. As dieselfde aktiwiteite nou namens ‘n ander op ‘n ander se grond verrig word, behou hulle hul karakter, sê hy, as boerderybedrywighede. Dit maak immers nie saak, dui die betoog verder, of ‘n boer sy inkomste verdien deur self te plant of te saai of vee te teel en of hy deur ander boere vergoed word on dieselfde werksaamhede namens hulle te verrig nie. Mens kan nog skeer of stroop sien as ‘farming operations’. Mens kan hulle egter nie sien as ‘n boerdery nie. ‘n Boer wat vir ‘n ander stroop of skeer, bedryf nie ‘n boerdery nie. (Vergelyk *Ernst v Commissioner for Inland Revenue* 1954 (3) SA 392 (A) te 322H tot 323A.)”

[35] Accordingly, Mr Kuschke, on the strength of this judgment, contended that the appellant did not have the right to the yield of its plantation. By contrast, it granted this right to E for the duration of its agreement with E. The appellant also did not have the use of the land and the plantation, which right it had also grant to E for the duration of the agreement. The appellant did not derive any income

from the land and the plantation of the use of which it granted to E to farm for its own benefit on its own behalf and for its own account.

[36] Accordingly, on the strength of this decision, the only entity which should be regarded as 'the farmer' in terms of paragraph 14 (1) in relation to the plantation owned by the appellant, was E, because only E had the right to the yield of the plantation for the duration of the agreement. Only E had the use of the land and plantation, which right had been granted to it by the appellant for the duration of the agreement between them. Furthermore, only E derived an income from the land on the plantation, the use of which had been granted by the appellant to it for its own benefit, on its own behalf, and for its own account.

Evaluation of the appellant's case

[37] Mr Sholto-Douglas, who appeared together with Mr Janisch and Mr Cassim on behalf of the respondent, correctly submitted that the key question in the present dispute was to determine whether there was a sufficiently close or direct connection to the owner between the income generated and the farming activities conducted on the property. This determination would allow a court to ascertain whether s 26 (1) read together with paragraph 14 (1) of the First Schedule of the Act was applicable. Mr Sholto-Douglas submitted that the reason why an owner of land such as appellant should be regarded as conducting farming operations was because it retained a direct interest in the farming operations particularly the success or failure thereof. It could hold the agent or manager to a particular standard of management and it benefitted directly from the fruits of that management.

[38] In this connection, Mr Sholto-Douglas referred to ITC 1630; 60 SATC 59 where the owner of a farm had leased the farm to a third party against consideration of 15% of the gross proceeds of the lessee's crop. Galgut J (as he then was) pointed out that, whether in a particular case a person received particular consideration derived from 'farming operations', was a question of fact and not of law. In his view, for income to be derived from farming operations there had to be a direct connection between the farming operations and the income. Galgut J posed the indicated question thus:

"Whether by concluding the contract it did, (was) the income which the appellant thereby derived ... directly connected to the farming operations carried out by its lessee."

In ITC 1630 the Commissioner had contended that the connection was not direct and that;

"Because it was the lessee alone which conducted the farming operations, the true direct source of the consideration was cede with the appellant's ownership of the farm."

With this proposition, the court disagreed:

"In our view, however, the relationship between the said consideration and the farming operations was indeed a direct one. The consideration was not a fixed rental, which ... would have deprived the rental income of having been directly derived from farming operations. On the contrary the consideration due to the appellant depended entirely on the crop yield and would therefore have varied as the yield varied. Even if the lessee's costs were to be ruinous and he were

therefore to show a net loss, the appellant would nevertheless have become entitled to its agreed percentage on whatever the crop had yielded. The appellant had a right to the percentage of the crop yield and as such had a direct interest in the crop itself. (my emphasis)”

[39] In support of this argument, Mr Sholto-Douglas referred to the agreement with D, whereby appellant acquired the plantation business and in which the agreement was described as ‘a sale of business agreement’. In terms of this agreement, appellant expressly agreed to acquire the business ‘as a going concern’. The business meant ‘the business of forestry, timber growing, plywood manufacturer and property leasing as conducted by the sellers up to the effective date.’ A separate recordal reflected that the business ‘includes properties’ which were defined as ‘the fixed property, including plantations thereon’. Accordingly, upon the conclusion of this agreement with D, appellant acquired the exclusive right to deal with the plantation as its own business ‘including the right and freedom to carry out the management and tending of saplings and growing trees to thin and harvest trees and to take the proceeds of harvesting.’

[40] In cross examination of Mr X the following passage is illuminating:

“Mnr Sholto-Douglas: So ons weet ABC het nie die oes besighied gekry nie, dit wil sê die toerusting en die kontrakte ensovoorts, maar ABC het altyd die reg gehad om sy eie plantasies te oes deur homself of deur ‘n ander, is dit reg?

Mnr X: Dit is so ja.”

[41] Turning to the sale by appellant in 2003, Mr Sholto-Douglas emphasised that, in the heads of agreement to which reference has already been made, appellant warranted to E that it was the true and lawful owner of the business and all assets forming part thereof (Clause 7.1 of that agreement). It agreed to sell ‘the plantation’ business which means the business of commercial forestry, operations ... as a going concern. (Clause 3.1) The purchase price of the business was to be the sum of the value of the land and ‘the standing timber, plantation stocks and other assets as valued by an independent nationally recognised value’. (Clause 4.1)

[42] In a resolution in February 2004 appellant ratified and approved ‘of the sale of the forestry business as a going concern’.

[43] Mr X was cross examined in this regard. Of particular significance is the following:

“Mnr X: Dit is ’n resoluëie wat opgestel deur die ouditeure (‘O’) wat aanduiding gegee het tot die opstel van hierdie dokument was die feit dat daar ’n klomp dokumentasie was gestuur was van E se kantore na O verlore geraak het en dit was ’n samevatting van al die resoluëies wat om al die transaksies wat in hierdie maatskappy was te stipuleer, en u sal sien dit is deur myself en deur Mnr K van F Co. onderteken.

Mnr Sholto-Douglas: Is daar enige rede om te glo dat hierdie weergawe van die resolusies nie heeltemal akkuraat is nie?

Mnr X: Ek het geen rede om te dink dat dit nie akkuraat is nie.”

[44] Mr Z was referred to the minutes of a meeting between F Co. and appellant held in Pretoria on February 2004 in which the following resolution was adopted:

“The company ratified and approved of the sale of the forestry business as a going concern to E (Pty) Ltd date 21 February 2003.”

Mr Z testified that this resolution was incorrect as appellant did not own a forestry business. He was forced, however, to concede that the resolution had been signed by Mr K on behalf of F Co. and Mr X on behalf of the appellant.

[45] On the basis of this evidence, Mr Sholto-Douglas submitted that the court should not consider what he referred as ‘litigation-focus semantics’ but rather examine carefully the substantive evidence as to the continuous and close link between appellant and the farming operations, supported by various unguarded statements made by the parties themselves describing the relationship accurately in terms of it being a plantation business. In his view, it was clear that appellant was at all times, through E, carrying on farming operations in respect of the plantation.

[46] In summary, respondent contended that, although appellant contracted with E to manage the plantation, this did not mean that appellant had not carried on farming operations within the meaning of s 26(1). On the contrary, it retained a direct, real and commercial interest and involvement in its plantation business for the whole period under review and hence taxable income was derived directly from the farming operations.

Conclusion

[47] Whether appellant retained a direct and substantial interest in the plantation and the plantation farming business such that it must be regarded as having conducted farming operations is a question of fact. It depends on an evaluation of the evidence presented during the case. The Court was confronted with two diametrically opposed versions. Appellant's witnesses, Mr Y, Mr X and Mr Z were insistent that appellant had made an investment, to the effect that it 'warehoused' the land and plantation thereon. However, it never engaged in farming operations which were done independently and separately by E, for the latter's sole account. On the strength of documentary evidence in particular, respondent insisted that appellant stood to be classified as a farmer.

[48] Without wanting to impugn the credibility of any of appellant's witnesses, it would have been highly surprising if any other version would have been forthcoming from them. To this extent therefore, the court is obliged to evaluate their evidence with a great degree of care through the prism of documentary

evidence which was so presented. The outcome of this evaluation may more accurately determine whether appellant has discharged the required onus.

[49] In ITC 1185; 35 SATC 122 at 123 Miller J (as he then was), in my view, provided the cleared set of principles to guide tax courts in the exercise of the evaluation of such evidence. He held that:

“The Court’s function is to determine, on an objective overview of all the relevant facts and circumstances, what the motive, purpose and intention of the taxpayer were. The Court added:

‘In other words, whatever a taxpayer may tell the Court has to be analysed through the prism of the objective facts presented to the Court.’

Miller J then said:

This is not to say that the Court will give little or no weight to what the taxpayer says his intention was, as it sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer’s evidence under oath and that of his witnesses must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the Court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts.” (my emphasis)

Even if the witnesses' evidence is not rejected for lack of credibility, their evidence must be evaluated against documentary evidence, after which evaluation the requisite inferences can be drawn and probabilities assessed.

[50] Apart from the documentary evidence, to which reference has already been made and which was emphasised by Mr Sholto-Douglas on behalf of the respondent, there is additional evidence which was drawn to the attention of the Court. Thus the signed heads of agreement on 21 February 2003 provided in paragraph 3.2 as follows:

“The business is sold as a going concern, as one individual transaction and with effect from the effective date it is recorded that since the business is an enterprise capable of separate operations, being sold as a going concern and as an income earning activity, the sale falls within the ambit of section 11 (1) (e) of the Value Added Tax Act, 1991 as amended (“the VAT Act”) and therefore Value Added Tax (“VAT”) is payable at a rate of Zero percent.”

[51] I accept that this entry was reversed and VAT was later paid but the fact that the document was signed by the relevant parties contained in this provision is itself instructive. Arguably, on its own, it might not be sufficient to draw on inference. Thus the accounts of appellant become instructive. In the financial accounts for the year ending June 30, 2002, the following note appears under the heading ‘plantation sales’. ‘In the current year no sales were recognised. Sales will be recognised when the plantation is sold’. A further note entitled ‘inventory’ provides as follows:

“The amounts attributable to the different categories are as follows: Plantation R 11 956 121. The plantation is still growing and will be sold in the future. Growing of timber is one of the main objectives of the company.”

[52] In an invoice generated by E in favour of appellant on 25 June 2004 the following appears: “Plantation management fee: R 12 000 000.00.”

[53] This description also appears in Clause 2.5.12 of the settlement agreement:

“*Bonus Management Fee*’ means the bonus in the sum of R 12 million (Twelve Million Rand) plus VAT which L has agreed to pay E of the exemplary manner in which E managed the forestry business of L in the period prior to E acquiring the L Businesses.” (my emphasis)

When confronted with this description, Mr Z claimed that E did not manage the plantation on behalf of appellant and that the more appropriate word was ‘stewardship or trusteeship’. In a further attempt to distance himself from the clear description of a management fee given in the invoices, the contents which was adverse to appellant’s case, he employed different phrase: ‘a tree caring agreement’ and ‘a complete responsibility agreement’ rather than concede that there was a management agreement.

[54] In the light of this evidence, it is prudent to return to consider the testimony of appellant's witnesses. In particular, I do not consider that Mr Sholto-Douglas was unfair when he described Mr X as 'a puppet director' who was not involved in any policy discussion and made no substantive decisions affecting appellant. He merely implemented the instructions of F Co., which were apparently conveyed to him through members of E. In particular, Mr X referred to a Mr M who was employed by E:

“Wel hy (Mr M) het van tyd tot tyd met my geskakel en gevra ek moet dokumentasie kom teken namens ABC (as per earlier name of appellant) en hy het ook onderneem toe nadat ons hierdie vagadering op 4 Junie 2004 gehad het ...”

[55] Mr Z who was the only witness who could provide the Court with insight into the intention of F Co., was the director thereof but responsible for investments. The evidence presented to this Court indicated that he was not the sole decision maker and that other directors of F Co., in particular, a Mr K, played a significant role in deciding to acquire the plantation for the kind of strategic reasons that fell outside of Mr Z' scope of responsibility. Mr Z confirmed the position thus:

“I don't speak for all of F Co. I am more involved on an investment side. There were other parties who were more involved with the furniture business in a broader sense.”

[56] When the objective evidence, particularly the range of documents to which I have references, including contracts and financial statements are considered. They all indicate in the direction that appellant was conducting a business of plantation farming. Even in the event that beneficial consideration is given to appellant's case by virtue of amendments to various documents, it would appear that the thrust of contemporaneous documentation supports respondents' case, to the extent that appellant has not discharged the onus of proving that its intention differed from that which is recorded in these financial documents, contracts, minutes and resolutions, namely that it had bought and sold the plantation businesses as a going concern and that it employed E to manage its plantation business on its behalf. Expressed in the terms employed in ITC 1185, when the evidence of Messrs Y, X and Z is tested against the documentary evidence, the probabilities cannot be said to favour appellant's version to justify a conclusion that it has discharged its onus.

Reversal of double deduction of management fee

[57] It appears that the respondent erred in the additional assessment and that it added back to taxable income the sum of R 97 932 321, being the proceeds of the sale less the costs of the acquisition and the management fee. However, the management fee had already been allowed as a deduction in the original assessment and, accordingly, there was a double deduction which had been taken into account. Hence the amount to be added back to appellant's taxable income should be R 109 932 321 rather than R 97 323 231 in terms of the additional assessment.

The objection in terms of Rule 10

[58] During his address to the Court, Mr Kuschke contended that the respondent's statement of grounds of assessment in terms of Rule 10 was not based on a case that E had acted as the agent of the appellant in conducting of farming operations. In particular, Mr Kuschke emphasised the section of the Rule 10 statement headed 'Commissioner's contentions' which, in his view, set out respondent's case. Nowhere from paragraph 38 to 50 was any mention made that E had conducted plantation operations on behalf of the appellant.

[59] Mr Kuschke is correct that these passages of the Rule 10 statement do not specify the exact role of E. However, in paragraph 15 it is expressly stated:

"The appellant appointed E (Pty) Ltd (E) to manage the business on behalf of the appellant. This was recorded in the minutes of the meeting of the shareholder and board of directors of the appellant held during February 2004."

[60] As Mr Sholto-Douglas correctly pointed out, the trial was run on the basis, at least in part, on the applicability of the contentions in paragraph 15. Indeed, in his opening address Mr Kuschke clearly was concerned to deal with these questions. He provided the following summary of the legal relationships between the parties:

"So one gets the picture, we would suggest, in due course of a pure land owning and obviously plantation holding operations – I put that in speech marks – by the taxpayer in a separate and discrete farming business being run in respect of

those trees which never became the revenue stream on foot (sic) or the expenditure burden of the taxpayer.”

[61] In addition, Mr Kuschke referred in his opening address to a request for particulars and, in particular, the question ‘does the respondent accept that E conducted farming operations in and upon the plantations not as an agent’, to which a negative reply was provided by respondent.

[62] In short, an examination of the opening address reinforces the general observation that appellant knew the case which was to be mounted by respondent in order to justify its assessment and framed its own case accordingly. In my view, there is no justification in the submission by Mr Kuschke, that the respondent ran a case which was not prefigured in the Rule 10 statement and which therefore disempowered or disadvantage appellant from raising questions regarding whether E acted as an agent for the appellant, in the conduct of a plantation business.

Conclusion

[63] In the result, the proceeds of the sale of the plantation by appellant were correctly included in appellant’s gross income in the 2004 year of assessment by virtue of s 26(1) of the Act read together with paragraph 14 (1) of the First Schedule.

[64] It is therefore ordered:

1. The appeal is dismissed.
2. The initial assessment be amended by the addition of an amount of R 12 000 000 by virtue of s 129 (b) of the Tax Administration Act.

DAVIS J