

Crossing the Rubicon: Is the use of a realisation company still a viable tax planning tool?

W.R. Uys, K.L. de Hart, J.S. Wilcocks & J.M.P. Venter

ABSTRACT

In this article the principles established in the *Natal Estates*, *Berea West* and *Founders Hill* cases read together with the relevant legislation and other related cases are analysed. The aim is to determine whether the interposition of a realisation entity when selling immovable property with the view to protecting the capital nature of receipts in respect of the property, is a viable tax planning tool for the 21st century. The Supreme Court of Appeal in all three cases applied the so-called “crossing the Rubicon” metaphor to determine the point when the realisation of a capital asset transforms into a scheme of profit-making and thus becomes taxable. The decisions in these three cases, if closely analysed, confirm that the courts have provided complimentary rather than conflicting viewpoints on how the “crossing the Rubicon” metaphor is applied in practice. It is concluded from the analysis that a realisation entity should be used only to realise an asset when there are compelling reasons, other than for pure tax planning purposes, for its use. This conclusion is reached because current legislation ensures that the appreciation in the value of the asset up to the point of the change in use, from capital to revenue, remains capital in nature and will thus be taxed as a capital gain under the Eighth Schedule of the Income Tax Act. In practice therefore, the use of a realisation entity should be considered only in circumstances where the protection of the capital nature of an asset for purely tax reasons is not the main reason for the interposition of a realisation company or any other intermediary entity, but is set up, for example, to administer a deceased or insolvent estate, or to comply with legislation. Any tax advantage gained in these circumstances can be regarded as an inadvertent consequence and thus there is a possibility that the tax advantages gained will not be regarded as income of a revenue nature.

Mr W.R. Uys and Ms K.L. de Hart are in the Department of Taxation, University of South Africa. Prof. JS Wilcocks and Prof. JMP Venter are in the Department of Financial Intelligence, University of South Africa. E-mail: uyswr@unisa.ac.za; dhartkl@unisa.ac.za; wilcojs@unisa.ac.za; ventejmp@unisa.ac.za

Key words: crossing the Rubicon, realisation company, scheme of profit-making, intention, capital versus revenue, best advantage, disposal of property

In January 59 B.C., when Julius Caesar decided to cross the waters of the Rubicon River, he set in motion events that would change the course of history. But not even the mighty Caesar could have foreseen that this event would still be referred to more than 2 000 years later by our judiciary in the context of deciding whether the sale of an asset is capital or revenue in nature for tax purposes. Since the latter part of the 20th century, the South African courts have on occasion used the phrase “crossing the Rubicon”¹ to describe and assist in determining the capital or revenue nature of a receipt from the disposal of an asset.²

Just as Caesar crossed the Rubicon River to begin a war from which there was no return, the term “crossing the Rubicon” in tax parlance is a metaphor that refers to the taxpayer crossing the boundary between selling an asset to its best advantage which results in a capital gain,³ and embarking on a scheme of profit-making or trading, resulting in the inclusion of the proceeds in gross income.⁴ In South African tax law the Rubicon metaphor represents a critical concept because if an amount received is considered to be a revenue receipt or accrual,⁵ it is taxed at an individual taxpayer’s marginal normal tax rate or, in the case of a non-natural person, at such non-natural person’s applicable tax rate.⁶ On the other hand, if the receipt is classified as being capital in nature, it is only taxed at the effective capital gains tax rate,⁷ resulting in a significant tax saving for the taxpayer.⁸

Over the years, the courts have considered several factors⁹ in order to determine whether taxpayers have changed their intention and crossed the Rubicon with the

1 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

2 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD); *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (2) SA 614 (A); *CSARS vs Founders Hill*, (509/10) [2011] ZASCA 66.

3 *Commissioner of Taxes vs Booysens Estates Ltd*, 1918 AD 576 at 580; *Californian Copper syndicate vs Internal Revenue* (1904) Sc (Court of Cession) LR 691 at 694.

4 *Supra* at 1.

5 Income Tax Act, No 58 of 1962: Section 1: “Gross income” definition.

6 The 2016 year of assessment: Non-natural persons (e.g. companies) at 28% and individuals at a maximum marginal rate of 41%.

7 The 2016 year of assessment: Non-natural persons (e.g. companies) have an effective rate of 18.48% and individuals have a maximum effective rate of 13.53%. Before the introduction of capital gains tax in 2001 (Income Tax Act, No 58 of 1962: Eighth Schedule), if the amount received was capital in nature it would not be subject to any income tax.

8 Tax is a consideration when directors decide to sell an asset as their primary objective is to maximise shareholder value.

9 *SIR vs Trust Bank of Africa Ltd*, 1975 (2) SA at 667 and *CIR vs Richmond Estates (Pty) Ltd*, 1956 (1) SA 602(A) stated that the facts of each case have to be considered independently as no check list can be developed.

resulting receipts being classified as revenue rather than capital in nature.¹⁰ The purpose of this article is to analyse the metaphor “crossing the Rubicon” as used by the Supreme Court of Appeal in the mid-1970s, for the first time in *Natal Estates Ltd vs Secretary for Inland Revenue*,¹¹ and thereafter in *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*,¹² as well as the more recent *CSARS vs Founders Hill*.¹³ These latter two decisions have seemingly created a conflicting precedent as to whether the receipts by a realisation entity when disposing of property should be classified as capital rather than revenue receipts. The contribution that this article makes is to reconcile the principles established from the case law and relevant legislation, and in so doing determine if a realisation entity continues to be a viable tax planning tool in the 21st century to protect the capital nature of an asset.

The Rubicon story

The cost of Julius Caesar’s¹⁴ lifestyle far exceeded his income, resulting in serious debt problems for the Roman general. Despite receiving money for political favours in approximately 63 B.C., he soon faced further mounting debt and insistent debt collectors. To improve his debt situation, Caesar accepted the position as governor of Cisalpine Gaul (northern Italy), Illyricum (south-eastern Europe) and later Transalpine Gaul (southern France). Caesar’s military achievements had made him famous throughout the Roman Empire, threatening to eclipse his good standing with the Roman Senate. After the successful conclusion of the Gallic wars, the Roman Senate, afraid of Caesar’s growing popularity, relieved him of his military command and ordered him to return to Rome. With the threat of a debt prosecution hanging over him, Caesar was faced with the choice of either standing trial in Rome for his mounting debts or defying the Roman Senate and being charged for treason.

In terms of Roman law, no Roman general was allowed to cross a border into the Roman Republic (known as Italy today) without the permission of the Roman Senate. The border between the Roman Republic and Cisalpine Gaul (where Caesar

10 *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (2) SA 614 (A); *CSARS vs Founders Hill*, (509/10) [2011] ZASCA 66; *John Bell and Co (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (4) SA 415 (A); *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD); *Californian Copper Syndicate vs Internal Revenue*, (1904) Sc (Court of Session) LR 691 at 694.

11 1975 (4) SA 177 (AD).

12 1976 (2) SA 614 (A).

13 (509/10) [2011] ZASCA 66.

14 Gaius Julius Caesar was born in 100 BC and died in 44 BC. Thayer, B. 2013. *The Parallel Lives by Plutarch*. Volume VII, 1919: Loeb Classical Library. [Online] Available at: http://penelope.uchicago.edu/Thayer/E/Roman/Texts/Plutarch/Lives/Caesar*.html#11 [Accessed: 16 August 2013].

was governor) was a small river called the Rubicon. Julius Caesar led his troops from Gaul to the northern banks of the Rubicon, where he paused to consider whether or not to cross. Crossing the Rubicon effectively meant that he was declaring war on the Roman Senate, a treasonable act that was punishable by death. After some consideration, he and his troops crossed the Rubicon, thereby starting a civil war in Rome. By crossing the Rubicon, Caesar took an irrevocable step that committed him to a specific course of action. The Rubicon can thus be described as the historical point of no return. This historic event inspired JA Holmes in *Natal Estates*¹⁵ to refer to the actions of the taxpayer that resulted in a receipt changing its nature from capital to one that is revenue in nature, as the point of no return. When the taxpayer enters into a scheme of profit-making, rather than merely disposing of a capital asset to its best advantage, the taxpayer has metaphorically crossed the Rubicon.

South African courts have, for a long time, recognised that a taxpayer is entitled to take steps to realise an asset to its best advantage without changing the nature of the receipt.¹⁶ However, as soon as there is a “scheme of profit-making”¹⁷ involved, the taxpayer is regarded as having crossed the Rubicon. Thus, where an asset is originally held as a capital asset, there must be an enquiry into the conduct and actions of the taxpayer before and while the asset is held to establish the taxpayer’s intention at the time the asset is disposed of.

To assist in establishing the taxpayer’s intention, the courts have provided some guidelines as to when it considers a taxpayer has entered into a scheme of profit-making and it is at that point that the taxpayer is deemed to have crossed the Rubicon. The various decisions of the courts have indicated that the intention of the taxpayer when purchasing the asset first has to be established and, thereafter, it has to be determined whether there was a change in intention by the time the asset was disposed of.¹⁸ One of the most important factors in establishing the intention of the taxpayer is to consider the taxpayer’s own *ipse dixit*,¹⁹ but it is not always the decisive factor unless objective factors corroborate what the taxpayer says. Sometimes objective factors are completely at odds with what the taxpayer says, in which case the taxpayer is usually unable to satisfy the onus of proof that he or she must bear and will thus lose his or her case.²⁰

15 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

16 *CIR vs Stott*, 1928 AD 262; *Platt vs CIR*, 1922 AD at 51; *Commissioner of Taxes vs Booyens Estates Ltd*, 1918 AD 576; *Californian Copper Syndicate vs Inland Revenue*, (anno 1904, 41 Sc LR 691).

17 Actions are similar to a person trading: *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD); *General Reinsurance Co Ltd vs Tomlinson*, [1970] 2 All ER 436; *ITC 448*, (1939) 11 SATC 95; *Chennels vs C of T*, (1936) 8 SATC 186; *Melrose Trust Ltd vs CIR*, 1935 TPD 136.

18 *John Bell and Co (Pty) Ltd vs SIR*, 1976 4 SA 177 (A); Olivier, L. 2012. Capital versus revenue: Some guidance. *De Jure*, Volume 45(1) at 172-178.

19 The taxpayer’s own evidence of what happened.

20 Section 102 of the Tax Administration Act, 28 of 2011.

As most cases are open to a subjective interpretation of the facts, the judiciary has contributed to a list of up to 48 different objective tests²¹ that can be used to determine if the taxpayer's *ipse dixit* reflects his motive, purpose and intention. Thus, when determining whether a taxpayer has indeed crossed the Rubicon and became a trader,²² all the facts of the case must be considered and weighed against the intention as stated by the taxpayer in his or her *ipse dixit*.

The relatively recent decision handed down in *Founders Hill*,²³ appears to have created confusion among taxpayers as to whether the formation of a realisation company to dispose of fixed property to protect the integrity of the capital nature of the asset is still a viable tax planning tool. The decision, *prima facie*, appears to be completely at odds with the *Berea West Estates* decision and has been severely criticised by Broomberg²⁴ and Judge Dennis Davis.²⁵ According to Judge Dennis Davis, Chairperson of the South African Tax Review Committee, the decision reached by JA Lewis in *Founders Hill* has:

“...swept away significant precedent by way of a misunderstanding of the significant implications of critical tax cases, in particular *Natal Estates* and *Berea West*. It has accordingly caused a level of uncertainty among taxpayers which Revenue could be hard pressed to meet...”

This article analyses the judgment in *Founders Hill* in order to establish whether the judgment does in fact contradict the previous decisions in the *Natal Estates* and *Berea West Estates* cases and thus, whether the use of a realisation property to realise fixed property, is still a viable tax planning tool.

***Natal Estates*: The Rubicon and the point of no return**

In 1849 Captain William Smeardon founded the village of Mount Edgecombe on a plot of land given to him under the British Byrne Emigration Scheme. Ten years later in 1859, he proceeded to build a sugar mill on the land. As the sugar mill was not very profitable, he decided to sell it to Marshall Campbell in 1895. With this purchase, Marshall Campbell embarked on a journey resulting in the creation of

21 Coetzee, H. 1998. Profit-making and capital gain. *Accountancy SA*: March 1998. [Online] Available at: <http://www.accountancysa.org.za/archives/1998/1998Mar/columns/profit.htm>. [Accessed: 26 January 2014].

22 This implies that the proceeds will be included in the taxpayer's gross income as it is not capital in nature.

23 *CSARS vs Founders Hill*, (509/10) [2011] ZASCA 66.

24 Broomberg, E. 2011. NWK and Founders Hill. *The taxpayer*, Volume 60 at 187: Cape Town.

25 Davis, D. 2011. Floundering up Founders Hill. *The taxpayer*, Volume 60 at 123: Cape Town; Davis, D. 2011. The only flag for Founders Hill should be white – a rebutter. *The taxpayer*, Volume 60 at 182: Cape Town.

one of South Africa's sugar milling giants, Natal Estates Limited.²⁶ Until its closure in 1994 the Mount Edgecombe Sugar Mill formed an integral part of the sugar industry in KwaZulu-Natal.²⁷

Around 1850, Marshall Campbell and his parents arrived in South Africa on the sailing ship, the *Conquering Hero*. Their immigration to South Africa was facilitated under the Byrne Emigration Scheme, a scheme that assisted more than 2 500 English emigrants to settle in Natal. Campbell's father worked on the construction of Durban's North Pier. Using his savings he purchased land on the Umdloti River,²⁸ started a sugar cane farm and imported South Africa's first sugar crushing machine. By the time he died, Campbell's father was a prominent sugar cane planter and miller. Marshall followed in his father's footsteps as a sugar cane farmer. In 1897 he founded South Africa's first sugar refinery. After settling with his family in Mount Edgecombe, he became a member of the Natal Legislative Council and later a Senator of Natal. His contribution to the development of the country and the sugar industry was rewarded with a knighthood in 1915.²⁹ Marshall's legacy is still evident today in the launching of rickshaw rides in Durban, with which he assisted, as well as the establishment of KwaMashu, a township outside Durban meaning "the place of Marshall" in Zulu.³⁰

In 1920, Natal Estates Ltd (a South African company owned by the Campbell family) was formed to buy, as a going concern, the property and sugar milling activities, which had been developed during the preceding 25 years, from Campbell's English company. Natal Estates Ltd continued its sugar production activities, purchasing various plots of land, which were developed as sugar plantations, as well as purchasing existing plantations in Natal. Around 1970³¹ the company sold a number of properties in seven areas north of the present-day Durban, which is part of the current Ethekweni metropolitan municipality.³² The capital or revenue nature of the proceeds of these sales was the basis of the dispute between the taxpayer and the Commissioner for Inland Revenue ("Commissioner") in the *Natal Estates* case.

26 Phoenix Foundation Trust. 2013. Phoenix Foundation Trust: History. [Online] Available at: <http://www.phoenixfoundationtrust.org.za/history.html> [Accessed: 5 August 2013].

27 Supra.

28 Campbell's farm was called "Muckleneuk" (a Scottish word meaning "great bend").

29 Wikipedia. 2013. Marshall Campbell. [Online] Available at: http://en.wikipedia.org/wiki/Marshall_Campbell [Accessed: 16 August 2013].

30 The KwaMashu township was originally owned by Natal Estate Ltd as part of its sugar farms.

31 *Durban North Traders Ltd vs CIR*, 1956 (4) SA 594 (A), 21 SATC 85 held that where a person holds a property for a long period it indicates that an amount is of a capital nature.

32 La Lucia, Umhlanga Rocks, Effingham Estate, KwaMashu Extension, Ottawa Township, Phoenix and Mount Edgecombe.

The first property disposed of by Natal Estates Ltd, was the KwaMashu land, which had been acquired in 1921 as a sugar plantation. Due to the population growth in the Durban area, the company received a notice in 1962 stipulating that the land would be expropriated³³ as it was required for the intended expansion of the KwaMashu township. The land was duly expropriated and the proceeds of the expropriation were held by the court to be capital in nature on the basis that although the directors³⁴ might have suspected for some time before the notice was received that the land might be taken to expand KwaMashu, they did not foresee such a possibility when the land was originally purchased. The judge noted that although the company had a policy to develop plantation land into residential units where possible, there was no evidence that indicated that its original intention,³⁵ in relation to the land expropriated to be used for the KwaMashu³⁶ township expansion, had changed.

Having ruled on the relatively easy decision in relation to the KwaMashu land, the court then turned its attention to the nature of the proceeds of the disposal of the two crown jewels of the Natal Estates Ltd's property portfolio, namely the La Lucia and Umhlanga Rocks land.³⁷ Both of these properties are situated on the coast approximately 20 kilometres to the north of Durban. From the time the company acquired the property in 1921, this land had the potential for its future development into valuable residential property.³⁸ The majority of the land could, however, only be used as a sugar cane³⁹ plantation, which then supplied the required sugar cane to operate the company's mills. When the company decided to sell the property almost

33 Land that is needed for a public amenity can be taken from the owners by expropriation, whether or not they want to sell it. However, they are usually paid compensation. The Expropriation Act, 63 of 1975 was the ensuing legislation that replaced the original method of notice of expropriation. Legalcity. 2014. You and your rights: Expropriation of land. [Online] Available at: <http://www.legalcity.net/Index.cfm?fuseaction=RIGHTS.article&ArticleID=3533759> [Accessed: 23 August 2014].

34 As a company is not an individual that can testify to its intention, the directors act as spokespersons for the company. *North-West Development Corporation (Pty) Ltd vs Solid Doors (Pty) Ltd*, [2004] ZANWHC 13; *CIR vs Richmond Estates (Pty) Ltd*, 1956 (1) SA 602 (A), 20 SATC 355.

35 In *Commissioner for Inland Revenue vs Stott*, 1928 AD 252 the court held that the original intention is important unless it can be shown that there was a change in intention.

36 It was acquired to be used as a capital asset (plantation) to produce income.

37 Umhlanga Rocks is named after the Ohlanga River which reaches the Indian Ocean three kilometres north of the town. The name means "place of reeds". Umhlanga Rocks was initially home to San hunter-gatherers and was later occupied by Nguni-speaking people who were united under King Shaka in the early 1800s into the Zulu nation.

38 The court indicated in *Natal Estates* that the possibility of a future development cannot be seen as indicating a dual intention or the intention to sell at a profit when acquiring an asset, as this potential is subject to the occurrence of an uncertain event.

39 In *CIR vs Paul*, 1956(3) SA 342 the court found that the sale of redundant land is still capital in nature.

50 years later⁴⁰ at a profit of R8 108 839,⁴¹ the Appellate Division had to decide whether the sale of the property constituted a gain of a capital or revenue nature.

From its creation, the company periodically expanded its property portfolio by buying additional land to develop as sugar cane plantations. The company used all its properties as income-producing assets as they provided the necessary sugar cane to maintain the activities of its mills. However, due to an ever-increasing need for residential property along the Natal coast and the receipt of various unsolicited offers,⁴² the company decided to investigate the possible development and sale of some of its coastal properties. In 1943, the directors of the company adopted a report that would act as a guide to ensure the harmonious usage of its land.⁴³ The report recognised that some coastal properties might be worth more as residential properties rather than as sugar plantations. The report included large-scale plans for the development of sugar cane land into residential properties and proposed the development of all the necessary amenities and infrastructure, such as roads, sewerage, water supply, open spaces, schools and shopping areas before disposing of the land, rather than selling it to an independent developer.⁴⁴ These developments would ensure that the company realised the best value from the land.

Despite the adoption of the report, the directors decided not to engage in any development activities until the property development activities became more profitable than the sugar cane farming. In 1959, Natal Estates Ltd applied for and received a Need or Desirability Certificate in terms of the Town Planning Ordinance⁴⁵ in respect of the portion of its La Lucia land (the development of the Umhlanga property only commenced in 1968). The minutes of the directors' meeting at that time, however, indicated that the directors were still of the opinion that it was not yet the appropriate time to develop the land.

Three years later, in 1962, the company became a wholly owned subsidiary of Sir JL Hulett & Sons Ltd.⁴⁶ Sir James Liege Hulett⁴⁷ was born in England and arrived in

40 *Durban North Traders Ltd vs CIR*, 1956 (4) SA 594 (A) found that the longer a person owned a property the more likely it is that it is a capital asset.

41 This was the value in 1969 and 1970, the equivalent profit in June 2013 would be R439 157 649. Statistics South Africa. 2013. *CPI Index*. Pretoria. [Online] Available at: <http://beta2.statssa.gov.za/?s=cpi&site=publications> [Accessed: 13 June 2013].

42 *ITC 1481 (1988) 52 SATC 285* (Eastern Cape Special Court) held that this might indicate that an amount is of a capital nature as no active marketing of the property took place.

43 Bailey, DE. 1987. The origins of Phoenix, 1957-1976: The Durban City Council and the Indian housing question. [Online] Available at: <http://researchspace.ukzn.ac.za/xmlui/handle/10413/6448> [Accessed: 19 January 2014].

44 *Supra*.

45 27 of 1949.

46 In *Elandsheuwel Farming (Edms) Bpk vs SBI*, (1978) 39 SATC 163, the court held that a change in shareholding could be an indication that there was a change in the intention of a company.

47 17 May 1838-1928.

South Africa in 1857 as a chemist's assistant. He experimented with planting various crops and soon became one of Natal's sugar magnates, owning various properties. James and his family lived on the Kearsney homestead, only fourteen kilometres from the Zululand border, during the Bombarta rebellion. When war broke out in 1879, Zulu impis raided cattle within 25 kilometres of the homestead. The fortified Kearsney residence became the centre of resistance against the expected Zulu attack. When the Zulus crossed the river, all the residents in the area flocked into the laager, which remained in a state of siege during the rebellion, but was never attacked. Later, James served as a cabinet minister in the Natal Government and in 1902 he led the delegation to the coronation of Edward VII. He was knighted for his services to the colony, which included the founding of Kearsney College in 1921 and the establishment of Sir JL Hulett & Sons Ltd, the predecessor of the current Johannesburg Stock Exchange listed Tongaat Hulett Ltd.⁴⁸

Soon after this change in shareholding of Natal Estates Ltd, the directors established a "Land Committee" to investigate the selling of the property. The committee obtained the services of town planners, consulting engineers and architects to assist in the development and sale of certain pieces of the La Lucia land. By April 1964, 2 350 lots in the La Lucia township had been laid out of which 188 had been sold. In the company's 1964 Annual Report, the orderly development of the property is referred to and the report included pictures and descriptions of the planned developments. To facilitate this orderly development, the company established a nursery to supply trees and even agreed on street names for the new development.

Initially the company developed and laid out the township and approved all applications for residential construction. To speed up the development programme, Natal Estate Ltd's holding company (being the sole shareholder) entered into a joint venture⁴⁹ with mining giant Anglo American Corporation Ltd (currently listed as Anglo American Plc) in 1968.⁵⁰ In the meantime, the sale of lots in La Lucia and later also in Umhlanga Rocks proceeded with large tracts of land being sold during 1969 and 1970. Although some lots were sold to individuals, the majority of the land owned by the company in La Lucia and Umhlanga Rocks was sold in bulk to the joint venture. These joint ventures took over the development and sale of the individual stands.

48 Kearsney Manor. 2007. Kearsney Manor – A brief history. [Online] Available at: <http://www.kearsneymanor.co.za/home-history.htm> [Accessed: 9 April 2015].

49 A joint venture can be described as a joint arrangement between different companies. This would provide for certain rights to accumulate to the different companies to the arrangement, including the net assets in respect of the arrangement. The joint venture in this case was established between private companies, in which case the holding company owned an interest of 45% and Anglo American, the majority interest of 55%.

50 During 1968 the Anglo-American Corporation entered into an agreement with the Hulett's Group.

After considering the extent and active nature of the actions taken by the taxpayer (Natal Estates Ltd) the court held that the taxpayer was not merely taking action to realise the property to its best advantage, but in the case of the La Lucia and Umhlanga Rocks land, it had commenced on a scheme of profit-making. Although the lower court had held that “the sales were not the fruits of trading, but the realisation of land it had acquired and originally held as capital”, the Appellant Division judges found that the taxpayer had indeed crossed the Rubicon with these sales and the total proceeds were held to be part of gross income and thus taxable.

Unfortunately there was no provision in the Income Tax Act at that time to mitigate the “all or nothing” nature of the profit on the sale of the land, namely that the full proceeds were included in gross income and only the original cost of the land was regarded as an expense. No account was taken of inflation and the natural increase in the value of the property as a result of supply and demand factors. The decision was based on the fact that the township development plans that had been drawn up and combined with the other active development activities carried out on the La Lucia and Umhlanga Rocks properties during that time, therefore the activities were viewed as part of a scheme of profit-making. The judgment nevertheless reaffirmed the principle that an asset can be disposed of to its best advantage without compromising its inherent capital nature, but that the taxpayer in the *Natal Estates* case had gone beyond merely realising the asset to best advantage by actively rather than passively being involved in the disposal of the land. The taxpayer had crossed the metaphorical Rubicon.

It is interesting to note that the court in the *Natal Estates* case never “lifted the corporate veil” in order to ascertain the intention of the new shareholders when the company was purchased by Sir John Hulett and Sons Ltd in 1962. It is implied in the judgment that the new shareholders had, at the time of becoming the shareholders of Natal Estates, the intention of realising some of the land held by the company at a profit. The failure to take this factor into consideration is in contrast to the Appellate Division decision in *Elandsheuwel Farming (Edms) Bpk vs Sekretaris van Binnelandse Inkomste*⁵¹ where the court “lifted the corporate veil” and looked at the intention of the shareholders when they purchased the company that owned the land. The court held that the shareholders in question wanted to make a profit on the sale of the land in the company and it did not matter whether the profit was made in the hands of the company or in its own name.

With the introduction of the taxation of capital gains under the Eighth Schedule of the Income Tax Act in 2001, the rather harsh tax treatment of the proceeds on the

51 [1978] 1 All SA 391 (A).

sale of the land as was the case in *Natal Estates*, has been mitigated. The legislation now provides that where there has been a change in intention from capital to revenue with regard to the use of an asset, which has been disclosed by the taxpayer to the Commissioner for the South African Revenue Service (SARS) at the time of the change in intention, the capital nature of the asset acquired at that point is protected and only the subsequent profit from the time of the change in intention becomes fully taxable.⁵² Thus, if the use of an asset is changed from a capital asset to trading stock, the taxpayer is deemed to have disposed of the asset for capital gains purposes at the market value of the asset at the time of the change of use or intention.⁵³ At the same time the taxpayer is deemed to have reacquired the asset as part of trading stock at the market value at the time of the change of intention.⁵⁴ This will result in only the profit on a disposal of the asset (which is now regarded as the taxpayer's stock-in-trade) after the change of intention, being taxed as revenue in nature. Furthermore, the deemed capital gain calculated at the time of the change of intention will be included in the taxable income of the taxpayer in the year of assessment during which the change in intention took place, with the capital gain being taxed at the applicable inclusion rate for capital gains purposes.⁵⁵ Non-compliance with the requirements could lead to an additional administrative burden in order to ensure that the more favourable treatment as a capital gain is applied.⁵⁶ However, any further analysis of the administrative burden arising in this regard is considered to be beyond the scope of this article.

Barely a year after the *Natal Estates*⁵⁷ decision, the Appellant Division in the *Berea West Estates*⁵⁸ case again had to consider whether or not the sale of property constituted the crossing of the Rubicon. In this case the taxpayers used a realisation company to sell its property to its best advantage.

52 Paragraph 12(1) and 12(2)(c) of the Eighth Schedule of the Income Tax Act, No 58 of 1962.

53 The taxpayer will therefore realise a capital gain of the difference between the base cost (basically the original cost plus the cost of any improvements) and the market value at the time of the change of intention.

54 This value will be deductible as the cost of the trading stock under section 22(3)(a)(ii) of the Income Tax Act.

55 The 2015 year of assessment: In terms of par 10 of the Eighth Schedule of the Income Tax Act, No 58 of 1962, the inclusion rate for non-natural persons (e.g. companies) is 66.6% of the net capital gain in taxable income and 33.3% of the net capital gain for individuals (and special trusts).

56 Chapter 9 of the Tax Administration Act, 28 of 2011.

57 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

58 *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (2) SA 614 (A).

Berea West Estates: The use of a realisation company

After annexing Natal in the 1843, Jonas Bergtheil,⁵⁹ a significant land owner in the Cape Colony, was appointed as a director of the Natal Cotton Company. After unsuccessfully searching in England for potential settlers in the Natal region, he went to Germany and managed to attract forty German families to cultivate cotton in the new colony. In 1846, Hermann Wilhelm Königkrämer and his family arrived from Lenen, Westfalen, in the new British colony, Natal. The majority of Bergtheil colonists settled in New Germany just outside Port Natal (later renamed Durban). After a very short time it was clear that the climate in Natal was not suitable for growing cotton and most of the settlers survived by growing vegetables and selling them to the growing population of the town of Port Natal. After settling on a farm in the New Germany area, Hermann married Marie Wehrmann and two years later Hermann's eldest son, also called Hermann Wilhelm, was born.

Twenty-one years later the young Hermann Königkrämer married 17-year-old Elise Westermeyer, the daughter of another German settler living in the New Germany area. Initially they were married in community of property, but in 1890 they entered into a postnuptial agreement specifically to exclude the community of property clause. This left Elise with a small estate and Hermann owning a farm in Berea West, in the Durban area. This piece of land became the centre of the events that followed. When Elise died in 1912, she left her small estate to their 13 children, subject to a usufruct⁶⁰ in favour of Hermann. After her death some of their children decided to contest the postnuptial agreement. In 1922, in order to settle the dispute with his children, Hermann agreed to form an *inter vivos* trust⁶¹ with his 13 children as the beneficiaries. He donated half of the farm⁶² to the trust. However, before the transfer could be completed, Hermann passed away. On 15 August 1927, after his death, the half of the farm that he had intended to donate to the trust was consequently transferred to the trust.

In Hermann's will he bequeathed the other half of the farm to his 13 children. The transfer of the farm could not be completed as set out in his will, as there was not enough money in the estate to pay the taxes and the costs that were due. As a result of the Great Depression in the early 1930s it was not possible to sell the property as a whole. A couple of years later, selling agents were appointed to subdivide the property

59 Jewish Encyclopaedia. 2011. Bergtheil, Jonas. (Adaptation from the Jewish Chronicle: 1900). [Online] Available at: <http://www.jewishencyclopedia.com/articles/3071-bergtheil-jonas> [Accessed: on 28 August 2013].

60 The right to use the "fruits" of the property.

61 In South African law this refers to a so-called "living trust".

62 This related to the value Elsie would have received if they were married in community of property.

and sell the more affordable individual lots. Towards the end of 1937 the liabilities in the estate were finally fully paid off. Thus, ten years after Hermann's death, half of the future proceeds from the sale of the property lots could be distributed to Hermann's heirs. As the other half of the property belonged to the trust, such proceeds were distributed to the beneficiaries of the trust, who were fortunately the same people.

As the estate could only be finalised once all the property was sold, the administration of the estate and trust became very complicated due to the economic climate and the difficulties created by seven of the heirs and beneficiaries passing away and being replaced by their children. The executor of the estate, the trustees and the heirs met in 1950 and agreed to create a company to take over the remainder of the property⁶³ in exchange for shares in a new company (Berea West Estates (Pty) Ltd). After issuing the shares to the 23 heirs and beneficiaries, the executor was able to finalise Hermann's estate after 22 years.⁶⁴

Berea West Estates (Pty) Ltd (hereafter Berea West) was established as a private company with limited liability.⁶⁵ The following objectives were included in its articles of association:⁶⁶ taking transfer of the land, realising the property to the best advantage of the shareholders and distributing the net profits as dividends to the shareholders. The articles of association stated that after the realisation of the property, the company had to be wound up and all remaining funds had to be distributed to the shareholders.

The shareholders⁶⁷ of the company received shares, as well as first, second and third debentures,⁶⁸ which had to be repaid as and when money became available. The company also obtained a first mortgage bond over the property which was used to pay all the outstanding liabilities of the estate and the trust and transfer costs.

As part of the process of selling the property in order to finalise the estate, the executor obtained approval for the establishment of various townships on the

63 The remaining land consisting of 15 lots comprising 620 acres situated on the outskirts of the township of Westville, outside Durban.

64 The Master of the High Court supported this application stating that "to effect these individual transfers would ... entail ... almost incredible and insoluble complications. ... It is, I think, the only practical solution other than realisation of their land by the Executors and distribution in cash to the heirs on both sides. To do this would entail either severe loss in realising as a block or, probably, many years of further difficult administration by the Executor if sold piecemeal ... The solution commends itself to me ..."

65 The public were not able to subscribe to the shares in the company (clause 2(a) and 13 of the agreement).

66 The articles of association describe the actions which a company can perform and acts as guidance to the intention of the taxpayer *CIR vs Richmond Estates (Pty) Ltd*, 1956 (1) SA 602 (A).

67 Shares and debentures were issued to the beneficiaries of the trusts as well as the heirs of Hermann's estate in proportion to their rights.

68 In *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (2) SA 614 (A) the court indicated that if a taxpayer uses his/her own capital it is an indication that the intention is to hold the asset as a capital asset, while using loan capital could indicate the intention to use it as stock-in-trade.

property, subject to certain conditions imposed by the local municipality. Initially the directors considered selling the property as a unit, but the price it could obtain would not enable it to repay the debentures and mortgage loan. It therefore had to continue with the development of the property to repay its debt.

The conditions imposed by the municipality in regard to developing the townships included that the owner was responsible for roads, the water supply and certain physical surveys. The developer had to meet all the conditions before any of the lots could be marketed. Due to financial constraints, the development took place over an extended period of time between 1950 and 1970.⁶⁹ The money received from the sale of one property was used to develop the next property and any surplus was applied to repay the mortgage and debenture debt. At no stage did the company develop any other property.

Despite its best efforts to sell the property, initially the market for the lots was limited. This changed dramatically in 1964 when the National Party, as part of its apartheid⁷⁰ policy, declared the area a “Whites only” area under the Group Areas Act.⁷¹ This resulted in a sharp increase in the value of the lots, which enabled the company to repay all of its debt by 1968 after the sale of some lots.

In spite of submitting tax returns every year from its inception, the first time the company was assessed for tax was in 1967. The company objected to the profit from the sales being included in gross income, stating that the profit from the sale of the land was capital in nature as the sales were as a result of realising the property inherited as part of Hermann’s estate some 40 years earlier, to its best advantage. The original intention of the company was to acquire the property as a capital asset so that the administrative problems associated with the winding-up of Herman’s estate could be minimised.⁷² In arriving at its decision, the court turned to the “crossing of the Rubicon” metaphor as espoused in the *Natal Estates* case⁷³ and investigated the actions of the taxpayer realisation company in its efforts to sell the property. The Special Court considered the objects in the company’s Memorandum of Incorporation⁷⁴ and the method followed to realise the property. It held that the company did not merely realise its asset to best advantage, but had also crossed the Rubicon and it had thus changed its original intention and begun a scheme of profit-making.

69 Continuous activities are normally an indication that the person is carrying on a business *CIR v Strathmore Exploration Ltd*, 1956 (1) SA at 596H.

70 Apartheid refers to an official policy of racial segregation formerly practiced in the Republic of South Africa, involving political, legal, and economic discrimination against non-whites. Government Information and Communication System. 2012. Yearbook 2012. Pretoria.

71 Group Areas Act is the title of three acts (*Group Areas Act Act No. 41 of 1950, Group Areas Act No. 77 of 1957, Group Areas Act No. 36 of 1966*) that assigned racial groups to different residential and business sections in urban areas.

72 *Lace Proprietary Mines Ltd v CIR*, 1938 AD 267.

73 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

74 Companies Act, 61 of 1973.

The Appellant Division of the High Court,⁷⁵ in reversing the findings of the lower Court, held that the original intention of the deceased was to acquire the land as a capital asset. As the taxpayer merely acted as a realisation company for the benefit of the deceased's heirs,⁷⁶ in that after the realisation of the property it was wound up and the assets distributed among the shareholders, the proceeds were regarded as being capital in nature.

In deciding whether the taxpayer (*Berea West Estates*) had acted as a true realisation company, JA Holmes considered the objective of the agreement that led to the formation of the company, the principal objects of the newly formed company,⁷⁷ the agreed-upon manner in which the company would be wound up after the realisation of the property, and whether there were any shareholders in the company other than the original beneficiaries of the property.

The court agreed that Berea West acquired the property as the *alter ego* of the heirs and beneficiaries and, therefore, it embodied their intentions. The fact that the company was involved in development transactions was necessary because if it had not done so, it would not have been able to settle its debts. The transactions entered into extended over a number of years, as the proceeds from the sale of one property had to be used to develop the next property. The court held that although various transactions took place, which might have indicated that the taxpayers had commenced trading as part of a scheme of profit-making, the particular circumstances dictated how the company acted. Accordingly, the company had not crossed the Rubicon.

The principles established in the *Natal Estates* and *Berea West* cases prevailed for a couple of decades until the judge in the *Founder's Hill* case seemingly "changed the rules".

Founders Hill: A realisation company that was deemed to have crossed the Rubicon

AECI⁷⁸ was formed in 1924 as a result of the merger of Nobel Industries and the manufacturing arm of De Beers Consolidated of Kimberley. The primary purpose of the new company was to produce detonators and blasting explosives for the gold and diamond mines in South Africa, with phosphatic fertiliser as a by-product. One of AECI's factories, built in 1896, was at Modderfontein, close to Johannesburg in the Transvaal Province (now Gauteng). During the 1920s, 1930s and 1940s the

75 Currently the Supreme Court of Appeal.

76 The company acted as the vehicle or machinery by which the property could be realised and not to trade.

77 It was not the intention, nor the business of the taxpayer, to buy and sell the properties for profit.

78 AECI Ltd. 2013. History. [Online] Available at: http://www.aeci.co.za/aa_history.asp [Accessed: 21 August 2013].

company increased its fertiliser production as part of expanding its agriculture and other chemical businesses.

Initially, due to the dangerous nature of manufacturing explosives, AECI had to have large buffer zones of open land around all of its factories, including the Modderfontein factory, where no developments were allowed. Fortunately, during the last century, the process of manufacturing explosives improved dramatically, resulting in less risk and a reduction in the size of the buffer zones required around factories where explosives were manufactured.

More than 100 years after establishing the Modderfontein factory, the reduction in the size of the buffer zones resulted in surplus property becoming available for resale. During 1998, the directors of AECI, after receiving legal advice based presumably upon the decision in *Berea West*,⁷⁹ decided to establish Founders Hill (Pty) Ltd (hereafter Founders Hill) as a wholly owned subsidiary to realise its surplus property.⁸⁰

Portions of the properties sold to Founders Hill had already been subdivided and developed by AECI and were sold to third parties within a short period of time. The remainder of the land, including Founders View North and South, were rezoned for industrial use. Initially Founders Hill incurred expenses of R11 million on acquiring, developing and marketing the properties. Thereafter only holding expenses were incurred.

In 1998, Mr Van Vugt was appointed by AECI as its new managing director. Shortly after his appointment, a marketing company called Heartland Properties (Pty) Ltd (hereafter Heartland) was appointed to facilitate the selling of the various surplus properties owned by AECI and its subsidiaries. Mr Van Vugt anticipated that much higher prices could be achieved for the properties if they were more skilfully and comprehensively marketed. He conceded that, although more tax would be payable on the profits gained from the selling activities, the higher profits obtained would cover the additional taxes.

The court in *Founders Hill* pointed out that, from the manner in which Heartland marketed the properties on behalf of Founders Hill, it was clear that it viewed the property as its stock-in-trade. If the property was considered to be stock-in-trade, it is clear that the taxpayer was trading in the properties as part of a scheme of profit-making, which implied that the taxpayer had already crossed the Rubicon before this point.

79 *Berea West Estates (Pty) Ltd vs Secretary for Inland Revenue*, 1976 (2) SA 614 (A).

80 The main objective of the company according to the minutes of directors meetings was identical to that of the holding company (the Taxpayer).

JA Lewis indicated that the “intention test” and the objective factors that are used to determine intention are only relevant where a taxpayer acquires a capital asset. She ruled that the realisation company acquired the property from AECI to develop and resell it at a profit and thus she did not need to consider the intention of the selling company in her judgment. Her commencement point in the judgment was that the property was held as stock-in-trade and thus the profits arising on the sales were revenue in nature. JA Lewis justified her decision by considering foreign law doctrines developed by the Supreme Court of Canada in *Balstone Farms Limited vs Minister of National Revenue* [1968] SCR 205 to ascertain the correct tax law position in regard to the disposal of stock-in-trade by a realisation company.⁸¹ She considered Canadian case law to be appropriate as it also recognises the principle of a realisation company being a company created to facilitate the sale of a property for the benefit of its shareholders or their creditors.⁸² In terms of Canadian law, the profit of a pure realisation company will remain capital in nature, but if the company starts acting in the same manner as a trading company, the profit will be taxable. These principles resembled those established in the *Natal Estates* and *Berea West* cases, which led the judges in *Founders Hill* to conclude that Canadian case law supported South African law in this respect.

In *Balstone Farms* the taxpayer had acquired land and subsequently subdivided it, providing potential clients with different opportunities to acquire portions of the land. The Canadian judges held that the real purpose of the Balstone Farms’ business was to acquire farm land with a view to selling it to realise profits. The property was in fact stock-in-trade when it was acquired and on disposal was, therefore, revenue in nature.

Applying the principle developed by the Canadian court in *Balstone Farms*, the South African court found that the structure of the transaction and circumstances surrounding the creation of Founders Hill could be used to determine its real intention. As the holding company (AECI) sold the property to Founders Hill with the intention that it should develop and sell the property at a profit, the directors of AECI had crossed the Rubicon when the decision was taken to sell the property. The formation of Founders Hill was merely part of a scheme of profit-making and thus the profits were revenue in nature and, therefore, taxable.⁸³ It does not appear as if the taxpayer even advanced an argument to the effect that the realisation company

81 Section 39 of The Bill of Rights in the Constitution of South Africa, 1996 requires the courts to observe the principles of international law and may consider foreign law as applied in foreign judgments.

82 Simon, JA. 2008. *Simon's Taxes*, 3rd edition (B 1) at 214. London: Stevens.

83 The transactions in question did not attract capital gains tax as introduced by the Taxation Laws Amendment Act 5 of 2001.

was formed for reasons other than for purely tax planning reasons. If this had been done, then the taxpayer could have argued that it be treated in the same way as the taxpayer in the *Berea West Estates* case had been treated.

Although the decision in *Founders Hill*, read with capital gains tax legislation,⁸⁴ clearly shows that realisation entities are no longer viable for purely tax planning purposes, the decision in *CIR vs Pick 'n Pay Employee Share Purchase Trust*⁸⁵ sheds further light on the possible reasons for setting up an intermediate entity to further the interests of a taxpayer for reasons other than for purely tax planning purposes.

Pick n Pay Employee Share Purchase Trust Scheme: Intermediate entity set up with no scheme of profit-making

In *Pick n Pay Employee Share Purchase Trust* a trust was created to afford employees the opportunity to buy shares from the employer. The trust procured the shares in terms of section 133 of the then Companies Act, 61 of 1973, that permits a company to purchase its own shares for the benefit of its shareholders (employees) at market value and then sell them to the employees at the same price. If an employee left the employ of the company, the trust purchased the shares from the employee at its market value. The shares were then resold to the new employees of the company at their market value. Inevitable, either a profit or loss was made by the trust as a result of the market value of the shares either increasing or decreasing between the time an employee left the company and the time that the new employee joined the company. The purpose of the trust was to fulfil a passive but important role, which was not to actively pursue a scheme of profit-making.

The Appellate Division⁸⁶ held that although the use of a trust might advance the notion of trading for profit, it was not the intention or purpose of the created trust in the circumstances of the case, to carry on business by trading in shares for profit. Thus, in such circumstances, the use of a realisation entity or any similar intermediate entity would, it is submitted, remain an appropriate tool to further the intention and objectives of the taxpayer, even if at the same time it resulted in a tax benefit.

84 Section 12(2)(c) of the Eight Schedule of the Income Tax Act, 58 of 1962 (as amended).

85 1992 (4) SA 39 (AD).

86 *CIR vs Pick n Pay Employee Share Purchase Trust*, 1992 (4) SA 39 (AD).

The use of realisation companies: Reconciliation of adopted principles in tax legislation and case law

After considering a number of underlying principles in respect to the realisation of property, but before the decision in the *Founders Hill* case, Simon⁸⁷ postulated the following statement:

[I]f a company is formed for the purpose of facilitating the realisation of property and the company does no more than act as the means whereby the interests of its beneficiaries may be properly realised in the property, surpluses made from sales of the property are not taxable as trading profits since such surpluses are capital receipts.⁸⁸

With the decision in the *Founders Hill* case, the use of intermediary entities for tax purposes in order to protect the capital nature of the proceeds when selling property or other assets, no longer appears to be a viable option for protecting the capital nature of the underlying asset. The exception is in limited and very specific circumstances, such as to alleviate the difficulties experienced in winding up an estate (*Berea West Estates*) or trading with no scheme of profit-making in mind (*Pick n Pay Employee Share Purchase Trust*). What is clear, however, is that paragraph 12(2) (c) of the Eight Schedule of the Income Tax Act⁸⁹ has removed the necessity to protect the capital nature of the underlying asset by forming a realisation company. In effect, paragraph 12(2)(c) achieves the same result as setting up a realisation company. Nevertheless, the taxpayer – in order to protect the capital nature of the underlying asset – must declare to SARS the intention to begin trading actively in the asset at the time the taxpayer’s intention changes or the benefit may be lost.⁹⁰

The question of when the Rubicon has been crossed in relation to realisation companies appears to be settled as follows:

Firstly, if the property was originally purchased as a capital asset and the subsequent introduction of a realisation entity merely to act as a vehicle through which the property could be passively realised, it would not change the nature of the proceeds provided that the realisation entity does not actively commence trading and thereby cross the Rubicon (*Natal Estates*⁹¹).

Secondly, is there any justification for the existence of the realisation entity, other than the realisation of the property for purely tax purposes? If there is no justification other than for purely tax reasons to set up a realisation company, then the profits from the sale of the asset in the realisation company will become taxable.

87 Simon, JA. 2008. *Simon's Taxes*, 3rd edition (B 1) at 214. London: Stevens Supra.

88 Supra.

89 The Income Tax Act, 58 of 1962 (as amended).

90 It is beyond the scope of this article to discuss what the tax consequences would be if the taxpayer does not disclose the intention in respect of the underlying asset to SARS in the particular year of assessment that the change takes place.

91 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

In establishing the intention of the original owner of the property for setting up a realisation company for non-tax purposes, such as for easing the administrative burden (*Berea West Estates*), protecting the asset from creditors (*Berea West Estates*) or to comply with legislation (*Pick n Pay Employee Share Purchase Trust*), the court will consider the terms of the Memorandum of Incorporation⁹² in order to determine the realisation company's objectives. These objectives will indicate whether the property will be realised for the best benefit of the shareholders, or whether the company will enter into a scheme of profit-making. As indicated in *Founders Hill*, if the original owner changed his/her intention from owning the property as a capital asset to disposing of it as part of a scheme of profit-making, the use of the realisation entity cannot change this fact (*Natal Estates*). In cases like this the realisation entity will acquire the property as stock-in-trade as part of a scheme of profit-making. It is important to note that based on the *Founders Hill* case, the *Berea West* decision should not be used to substantiate the use of a realisation entity as a tax planning tool in circumstances where a methodical disposal of property is planned as part and parcel of a scheme of profit-making.

Even if the realisation company is set up for reasons other than for tax planning purposes, there is always the danger that the realisation company will be taxable on the proceeds if the realisation entity engages in activities similar to that of a property developer, as was the case in *Natal Estates*⁹³ and *Founders Hill*.⁹⁴

Conclusion

The decisions in the *Natal Estates*, *Berea West* and *Founders Hill* cases are important and instructive as they set out guidelines to determine the capital or revenue nature of an asset when it is realised. From the analysis of these three cases, it is submitted that the courts provided complimentary rather than conflicting viewpoints on the meaning of the phrase, "crossing the Rubicon".

The promulgation of paragraphs 12(1) and 12(2)(c) of the Eighth Schedule to the Income Tax Act for the taxation of capital gains protects the appreciation in the value of the asset up to the point of the change in intention in its use from a capital to a revenue asset. This reinforces the importance of taxpayers meeting the requirement of paragraph 12(2)(c) when there is a change in intention and the asset becomes trading stock. The taxpayer must be aware that neglect to consider these provisions

92 Each provision in the Memorandum of Incorporation of a company must be consistent with the Companies Act, 71 of 2008 (as stipulated under section 15). It must set out the responsibilities of the shareholders, directors and others (see the definition of "Memorandum" in the Companies Act, 71 of 2008).

93 *Natal Estates Ltd vs Secretary for Inland Revenue*, 1975 (4) SA 177 (AD).

94 *C:SARS vs Founders Hill*, (509/10) [2011] ZASCA 66.

could lead to the taxation of the full proceeds while only allowing the original cost of the asset as a deduction as was the case in *Natal Estates*. Thus, the full capital appreciation until the time the taxpayer's change in intention will not be taxable as revenue income, but will be taxed as a capital gain.

The cases discussed in this article provide guidance as to ascertaining the taxpayer's intention, namely, if a taxpayer has entered into a scheme for profit-making and if so, at what point? This will determine what portion of the profit realised on the disposal of the property will be treated as a capital gain.

This article makes a contribution to the field of South African taxation by providing a reconciliation of the principles that must be considered before considering the use of a realisation entity. It is submitted that the decision in the *Founders Hill* case is not contradictory to the decision in the *Berea West Estates* case. In fact, the decision compliments the reasoning in the *Berea West Estates* case and gives an appropriate explanation of when the metaphorical Rubicon has been crossed. From the *Founders Hill* case, it is clear that the judiciary will consider that the metaphorical Rubicon has been crossed at the time when the realisation company is formed and the asset is transferred to that entity, if the realisation company is formed purely for tax planning purposes. The only way to dispute this *prima facie* determination is to bring evidence to the effect that the realisation company was formed for reasons other than for tax planning purposes. In such a case, any tax advantage arising is merely an inadvertent consequence of the main reasons for forming the realisation company in the first place, as can be clearly seen from the *Pick 'n Pay Employee Share Purchase Trust* case and, therefore, there has been no crossing of the Rubicon and thus no scheme of profit-making.

References

Acts

- South Africa. 1950. Group Areas Act (Act No. 41 of 1950). Pretoria: Government Printer.
- South Africa. 1957. Group Areas Act (Act No. 77 of 1957). Pretoria: Government Printer.
- South Africa. 1962. Income Tax Act (Act No. 58 of 1962). Pretoria: Government Printer.
- South Africa. 1966. Group Areas Act (Act No. 36 of 1966). Pretoria: Government Printer.
- South Africa. 1973. Companies Act (Act No. 61 of 1973). Pretoria: Government Printer.
- South Africa. 1996. Constitution of the Republic of South Africa. Pretoria: Government Printer.
- South Africa. 2008. Companies Act (Act No. 71 of 2008). Pretoria: Government Printer.
- South Africa. 2011. Tax Administration Act (Act No. 28 of 2011). Pretoria: Government Printer.

Books, articles and other publications

- AECI Ltd. 2013. History. [Online] Available at: http://www.aeci.co.za/aa_history.php [Accessed: 21 August 2013].
- Bailey, DE. 1987. The origins of Phoenix, 1957–1976: The Durban City Council and the Indian housing question. [Online] Available at: <http://researchspace.ukzn.ac.za/xmlui/handle/10413/6448> [Accessed: 19 January 2014].
- Broomberg, E. 2011. NWK and Founders Hill. *The taxpayer*, 60. Cape Town.
- Coetzee, H. 1998. Profit-making and capital gain. *Accountancy SA*: March 1998. [Online] Available at: <http://www.accountancysa.org.za/archives/1998/1998Mar/columns/profit.htm>. [Accessed: 26 January 2014].
- Davis, D. 2011. Floundering up Founders Hill. *The taxpayer*, 60. Cape Town.
- Davis, D. 2011. The only flag for Founders Hill should be white – a rebutter. *The taxpayer*, 60. Cape Town.
- Garven, B. 2011. The Supreme Court of Appeal rules on the tax implications of “realisation companies”. [Online] Available at: <http://www.bowman.co.za/eZines/Custom/Tax/AugustNewsletter/Tax-Implications.Html> [Accessed: 20 March 2014].
- Government Information and Communication System. 2012. Yearbook 2012. Pretoria.
- Jewish Encyclopaedia. 2011. Bergtheil, Jonas. [Online] Available at: <http://www.jewishencyclopedia.com/articles/3071-bergtheil-jonas> [Accessed: 28 August 2013].
- Kearsney Manor. 2007. Kearsney Manor – A brief history. [Online] Available at: <http://www.kearsneymanor.co.za/home-history.htm> [Accessed: 9 April 2015].
- Legalcity. 2014. You and your rights: Expropriation of land. [Online] Available at: <http://www.legalcity.net/Index.cfm?fuseaction=RIGHTS.article&ArticleID=3533759> [Accessed: 23 August 2014].
- Olivier, L. 2012. Capital versus revenue: Some guidance. *De Jure*, Volume 45(1).
- Phoenix Foundation Trust. 2013. Phoenix Foundation Trust: History. [Online] Available at: <http://www.phoenixfoundationtrust.org.za/history.html> [Accessed: 5 August 2013].
- Simon, JA. 2008. Simon’s Taxes, 3rd edition (B 1) at 214. London: Stevens.
- Statistics South Africa. 2013. CPI Index. Pretoria. [Online] Available at: <http://beta2.statssa.gov.za/?s=cpi&sitem=publications> [Accessed: 13 June 2013].
- Thayer, B. 2013. The Parallel Lives by Plutarch. Volume VII, 1919: Loeb Classical Library. [Online] Available at: http://penelope.uchicago.edu/Thayer/E/Roman/Texts/Plutarch/Lives/Caesar*.html#11 [Accessed: 16 August 2013].
- Wikipedia. 2013. Marshall Campbell. [Online] Available at http://en.wikipedia.org/wiki/Marshall_Campbell [Accessed: 16 August 2013].

Case law

- Balstone Farms Limited v Minister of National Revenue*, [1968] SCR 205.
- Berea West Estates (Pty) Ltd v Secretary for Inland Revenue*, 1976 (2) SA 614 (A).

- Californian Copper Syndicate v Internal Revenue*, (1904) Sc (Court of Session) LR 691.
Chennels v Commissioner of Taxes (refer COT), (1936) 8 SATC 186.
Commissioner of Inland Revenue (refer CIR) v Paul, 1956(3) SA 342.
CIR v Pick 'n Pay Employee Share Purchase Trust, 1992 (4) SA 39 (AD).
CIR v Richmond Estates (Pty) Ltd, 1956 (1) SA 602 (A).
CIR v Stott, 1928 AD 252.
CIR v Strathmore Exploration Ltd, 1956 (1) SA.
COT v Booyens Estates Ltd, 1918 AD 576.
CSARS v Founders Hill, (509/10) [2011] ZASCA 66.
Durban North Traders Ltd v CIR, 1956 (4) SA 594 (A).
Elandsheuwel Farming (Edms) Bpk v SBI, (1978) 39 SATC 163.
Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue, 1996 (3) SA 942 (SCA).
General Reinsurance Co Ltd v Tomlinson, [1970] 2 All ER 436.
ITC 448 (1939) 11 SATC 95.
ITC 1481 (1988) 52 SATC 285.
John Bell and Co (Pty) Ltd v Secretary for Inland Revenue, 1976 (4) SA 415 (A).
Lace Proprietary Mines Ltd v CIR, 1938 AD 267.
Melrose Trust Ltd v CIR, 1935 TPD 136.
Natal Estates Ltd v Secretary for Inland Revenue, 1975 (4) SA 177 (A).
North-West Development Corporation (Pty) Ltd v Solid Doors (Pty) Ltd, [2004] ZANWHC 13.
Platt v CIR, 1922 AD.
SIR v Trust Bank of Africa Ltd, 1975(2) SA.