



THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

REPORTABLE
Case no: 282/07

In the matter between

ERNST BESTER TRUST

APPELLANT

and

**THE COMMISSIONER SOUTH AFRICAN
REVENUE SERVICE**

RESPONDENT

**Coram: HARMS ADP, NAVSA, HEHER, CACHALIA JJA and SNYDERS
AJA**

Heard: 5 MAY 2008

Delivered: 26 MAY 2008

**Summary: Income Tax – Act 58 of 1962 – sales of sand – capital or revenue; s
22 – trading stock deduction – when allowed – SARS practice.**

**Neutral citation: This judgment may be referred to as Ernst Bester Trust v
Commissioner South African Revenue Service (282/2007) [2008] ZASCA 55 (26
MAY 2008).**

—

HEHER JA

HEHER JA:

[1] This is an appeal against a judgment of Davis J sitting in the Income Tax Special Court, Cape Town. (The appellant will be referred to as ‘the taxpayer’ in this judgment.) The learned judge dismissed the taxpayer’s appeal against the refusal to sustain its objections to an assessment which treated sales of sand extracted from the taxpayer’s farm, Klein Môrewag, during the years of assessment 2000, 2001 and 2002 as revenue rather than capital¹. He also rejected an alternative submission that, in the event that the Commissioner had properly categorised the nature of the income as revenue, the taxpayer was entitled to an opening stock deduction in respect of trading stock held by it at the beginning of each of the years of assessment. Both issues were re-argued before us.

[2] The late Mr Van Zyl Bester purchased the farm in 1965. He farmed grapes and grain on it until his death in 1989. About 1980 he was approached by representatives of Malans Transport. They had identified a commercially attractive sand deposit on the farm (as they also did on neighbouring properties, see *Samril Investments (Pty) Ltd v Commissioner, South African Revenue Service* 2003 (1) SA 658 (SCA) and *Commissioner, South African Revenue Service v Van Blerk* 2000 (2) SA 1016 (C)). From time to time thereafter Mr Van Zyl Bester sold sand to Malans Transport or an entity, Brickrush CC, which controlled it.

[3] The taxpayer acquired Klein Môrewag by bequest from Mr Van Zyl Bester. It

¹ The amounts in question were R81 228, R433 127 and R653 391 respectively.

leased the farm to the testator's son, Mr Ernst Bester, who pursued on it agricultural interests similar to those previously practised. He was the only witness to testify for either party before the tax court. He was both a trustee and beneficiary of the Trust.

[4] The taxpayer derived some income from the lease² but a great deal more from sales of sand, irregular though they were for some years. The circumstances which gave rise to such transactions were described by the witness. By the time the taxpayer acquired the farm its potential to provide income by disposal of sand was known to the trustees. This sand did not provide a particularly productive base for viticulture and when, not long after the taxpayer took over, Mr Ernst Bester was approached by representatives of Brickrush to sell sand to it, he took the opportunity to re-establish the vineyards affected by the sale on more fruitful soil elsewhere on the farm. This practice he subsequently repeated as and when the opportunity arose.

[5] As to the substance of the agreement concluded between Mr Ernst Bester on behalf of the taxpayer and Brickrush, the tax court was largely dependent on his say-so. Apparently there had been in existence a written contract which was destroyed in a fire. The witness produced an unsigned copy of an agreement the origin and date of which was uncertain. He testified that the terms of sale were substantially as reflected in that document and the court accepted his word.

[6] As reflected in that document the terms material to the present dispute are the following:

² A fixed annual rental of R72 500 during the relevant tax years.

1. The subject of the sale ('Koopsaak') was defined as 'Sand geleë op die Terrein'. In turn, the site ('Terrein') was identified as 'Die gedeelte van die Eiendom wat aangedui is op die aangehegte kaart as ABCDE en in geel ingekleur is'. That plan was not proved in evidence but some indication of the probable location and extent of the site is derivable from a motivation submitted by Brickrush in support of its successful application for a mining licence to which reference is made below. Mr Ernst Bester identified the site on a map of the farm on which the location of the sand deposit is also indicated. As the surface area of the deposit far exceeds that of the site it would seem that the rights granted to Brickrush must have been extended at some stage after the mining licence application to which reference is made below. The property, 'Eiendom', is defined in the document as the farm Klein Môrewag, Malmesbury.

2. '4. VERKOPING

4.1 Die EIENAAR verkoop hiermee aan die KONTRAKTEUR die KOOPSAAK.

4.2 Aangesien die partye nie voor die aanvang van verwydering van die KOOPSAAK presies kan bepaal hoeveel sand op die TERREIN voorkom nie, word ooreengekom dat die koopprys wat die KONTRAKTEUR aan die EIENAAR sal betaal vir gemelde KOOPSAAK, gelykstaande sal wees aan die getal kubieke meters sand verwyder vanaf gemelde gebied, vermenigvuldig met R3,50 (DRIE RAND EN VYFTIG SENT), welke koopprys betaalbaar is in opeenvolgende maandelikse paaieimente nie later nie as die 10de dag van elke daarop volgende maand. Voormelde prys per kubieke meter sal jaarliks verhoog word vanaf 1 Januarie elke

jaar met 'n persentasie waarop onderling ooreengekom sal word.

- 4.3 Die KONTRAKTEUR moet op eie koste volledige rekords hou van alle sand wat aldus deur hulle van die TERREIN verwyder word. Hierdie rekord is te alle redelike tye vir die EIENAAR ter insae.'

3. '6.2 Verpligtinge van die Kontrakteur

In die uitoefening van sy regte hierin vervat sal die KONTRAKTEUR:

...

- 6.2.7 alle nie-sanddraende boggrond verwyder en eenkant plaas voordat met die ontginning van sand in aanvang geneem word. Sodanige boggrond sal van tyd tot tyd soos en wanneer die EIENAAR dit mag versoek deur die KONTRAKTEUR op eie koste teruggeplaas word op sodanige gedeeltes van die TERREIN waarvandaan sanddraende grond verwyder is en waar geen verdere ontginning van sand gaan plaasvind nie, maar nie later as 30 (DERTIG) dae na beëindiging van hierdie ooreenkoms nie. Op dieselfde wyse sal die KONTRAKTEUR verplig wees om by beëindiging van die kontrak alle sodanige boggrond terug te plaas, soos hierbo beskryf;

...

- 6.2.12 die nodige toestemming van alle staats- en alle relevante liggame verkry, om hom in staat te stel om met sy bedrywighede voort te gaan.'

4. '6.3 Verbod

Die EIENAAR sal nie die reg hê om gedurende die bestaan van hierdie ooreenkoms aan enige derde party die reg te gee om sand te ontgin op die EIENDOM nie.'

5. In terms of clause 11.1 the contractor was required to restore the site by the re-establishment of all non-sandbearing topsoil on termination of the contract.

[7] During or about 1994 Brickrush CC applied for and obtained a mining licence to mine sand on the farm. The supporting motivation included the following averments:

‘Die terrein waarop die voorgestelde mynbou gaan plaasvind is ongeveer 600 meter lank en 300 meter wyd (agtien hektaar).

Die gemiddelde diepte van die ontginbare sand is 0,5 meter d.w.s. oor die totale oppervlakte van agtien hektaar, ontginbare sand van 90 000 kubieke meter. Die waarde van die sandbron teen die huidige markverwante prys sal kapitaal aan die eienaar vir verdere boerdery-bedrywigheede beskikbaar stel.

...

Nege en dertig profielgate is op die terrein gegrawe soos aangedui op die uitlegkaart. ’n Aangehegte tabel wys die afsonderlike profielgate se dieptes aan, die profielgate se x en y koördinate en foto’s van die afsonderlike gate.’

[8] Malans Transport had, it seems, acquired rights over various farms which gave it the ability to pick and choose its sources of supply. No evidence was led to establish the volume of sand which thus became available to the purchaser, or the scope for the utilization of such sources in the open market. It is impossible to know whether all or any given part of the sand deposit on Klein Môrewag represented a commercially valuable asset except in so far as Brickrush chose to separate and remove measured quantities of sand from time to time according to its judgment of the market, location, price, quality or whatever other factors may have influenced its decision to exercise its rights on that farm. None of these obvious factors was however explained or enlarged on in evidence.

[9] It seems clear that Brickrush was free to exploit the deposit as it deemed fit or to ignore it entirely without contractual penalty. The evidence of Bester shows that he and the taxpayer played no part in the extraction or disposal of the sand, took no particular interest in its quality or quantification, was content to allow Brickrush to fix the market price (the starting price for the contract) and made no effort to control the removal of sand from the site or to check the volumes so removed. All that the taxpayer required was due payment per cubic metre of sand removed as and when it suited Brickrush to exercise its rights. In the circumstances the arrangement between the parties resembled a mineral lease with royalty payments to the holder of the rights.

[10] The main contention of the taxpayer before the tax court was that the proceeds derived from the sales of sand were capital in its hands. In its heads of argument the emphasis was shifted to the alternative basis and before us counsel put forward the reliance on capital proceeds with obvious lack of conviction. That was understandable, since to all intents and purposes the principles had been clearly established in *Samril, supra* and the argument could only succeed if that judgment could properly be distinguished on the facts.

[11] In brief, this Court held in *Samril*, (to quote from the headnote at 658H-659B, which correctly summarises the ratio):

‘ . . . that the usual test for determining the true nature of a receipt or accrual for income tax purposes was whether it constituted a gain made by an operation of business in carrying out a scheme for profit-making, which meant that the receipt or accrual should not have been fortuitous but

designedly sought and worked for. However, it had to be borne in mind that profit-making was also an element of capital accumulation, and accordingly every receipt or accrual arising from the sale of a capital asset and designedly sought for with a view to the making of a profit could not be regarded as revenue. Each case had to be decided on its own facts with due regard to the distinction between capital and the income derived from the productive use thereof. It also had to be borne in mind that s 82 of the Income Tax Act 58 of 1962 cast the burden of proving that any amount is exempt from or not liable to tax on the person claiming such exemption or non-liability. Thus, where the Court is not persuaded on a preponderance of probability that the income derived from the sale of an asset is to be regarded as capital gain, it had to be included in the taxpayer's gross income.'

[12] From the evidence adduced before the tax court to which I have referred above there can be no doubt that the amounts received by the taxpayer from Brickrush represented gains made in the operation of an ongoing scheme of profit-making over many years out of the sales of sand ostensibly at a market-related price. There was nothing of chance in such a consequence. It was the result of a contractual relationship designed for that purpose. The taxpayer used the money so derived to finance the development of the farms. All this provides *prima facie* evidence that the income so derived was revenue.

[13] I have referred earlier to the similarity of the parties' arrangement to the terms of a mineral lease. Although such a lease may exhibit certain elements of sale, the periodic payments made by the lessee to the lessor are of a revenue nature: see *Modderfontein B Gold Mining Co Ltd v CIR* 1923 AD 34 at 46-47; *COT v Rezende Gold and Silver Mines (Pvt) Ltd* 1975 (1) SA 968 (RAD) at 970B-971A, 972B-H. It

is not necessary to enquire in such cases whether the land was acquired with a view to re-selling the minerals at a profit. It is enough to say that the rental or royalties are ‘the product of capital productively employed’ and therefore constitute income: *COT v Rezende* at 970H.

[14] In the case of a mineral lease, the value of the land is diminished by the extraction of the minerals, yet the owner’s compensation (rent or royalties) is taxable. I agree with counsel for the respondent’s submission that it does not matter whether the rent is a fixed recurrent amount or whether it is linked to the quantity of minerals removed (as in *Bellville-Inry (Edms) Bpk v Continental China (Pty) Ltd* 1976 (3) SA 583 (C) at 584H), or to the gross profits made by the lessee (as in ITC 652 and the *Rezende* case at 969G).

[15] Thus, where the taxpayer permits another to enter his property and remove sand against a monthly consideration calculated with reference to the volume removed, he is productively employing his capital asset (the farm) in a way which is, at least for fiscal purposes, not materially distinguishable from a lessor under a mineral lease. As was said by Innes CJ in the *Modderfontein* case, above, (at 44) one must have regard not so much to the form as to the real character of the transaction.

[16] What was adduced by the taxpayer to gainsay that conclusion? Mr Emslie, on its behalf, referred to six features, which cumulatively, according to him, distinguished the case from *Samril* and rendered the true nature of the transactions the disposal of a capital asset and not the production of revenue. In this regard the following reminder in the judgment of the court *a quo* warrants repetition:

‘It is trite that distinguishing a case does not entail the mere discovery of different facts. Courts distinguish cases upon a discovery of what facts are regarded as material in the previous case and which formed the basis upon which the decision was predicated. (See *A L Goodhart* (1959) 22 *Modern Law Review* 117).’

[17] The first ground of distinction, so counsel submitted, was that the taxpayer received no advance deposits for each tranche of sand sold, as the seller had in *Samril*. Second, the taxpayer in *Samril* had one of its own employees monitoring the quantity of sand removed while here the appellant relied on the purchaser to carry out that task. Third, the taxpayer in *Samril* had an interest in obtaining as high a price for its sand as possible to assist it to obtain compensation for an expropriated portion of its land; no such consideration influenced the appellant. Fourth, in *Samril*, he submitted, the purchaser of the sand mined it on behalf of the taxpayer whereas Brickrush acquired the permit in its own name. Fifth, the taxpayer’s role on Klein Môrewag was entirely passive. Finally, the content of the agreement between the taxpayer and Brickrush was so minimal as to fall short of trading in sand.

[18] The first four features are distinctions without a difference. None affects the essential (trading) nature of the transaction between the taxpayer and Brickrush. The alleged passivity of the taxpayer is misleading. It was only so because the profit-making transaction was so constructed as to allow it that advantage without derogating from the ongoing inflow of income to it. So also the so-called ‘minimal’ transaction was sufficient to ensure the repeated separation and removal of the sand for a market-related return in the hands of the taxpayer for every cubic metre taken

off the property. The extent of that return during the three years of assessment with which this appeal was concerned shows that its profits were very substantial. There is no suggestion at all in the evidence that, if the farming operations were in anyway curtailed or rendered more expensive, the result was any material negation of such profits.

[19] There being no merit in the distinguishing features raised on behalf of the taxpayer, I conclude that the Special Court was correct in finding that it had not shown that the decision of the Commissioner to treat the receipts from the sales as revenue in its hands was wrong³.

[20] The second question concerns the taxpayer's entitlement to an opening stock deduction. In this regard its counsel blew hot and cold in regard to the basis for his submission. In his heads of argument he accepted that such a claim could only arise after separation of the sand from the remainder of the land comprising the farm. However, when the shoe pinched during oral argument, he cast his client's lot upon the whole deposit *in situ*. Likewise, he initially invoked s 22 of the Income Tax Act 58 of 1962 as the source of the taxpayer's entitlement, but finally relied upon an alleged practice in the Receiver's office. I shall address all of these possibilities.

[21] It is convenient to commence with s 22, the effect of which is to grant a deduction in respect of trading stock held by a taxpayer at the beginning of a year of assessment. 'Trading stock' is defined in s 1. It includes '(a) anything – . . . (ii) the

³ The material facts in this appeal (and certain of the 'distinctions') are closely analogous to those in the Canadian cases of *Orlando v Minister of National Revenue* [1962] CTC 108 and *Minister of National Revenue v Lamon* [1963] CTC 68. So is the conclusion.

proceeds from the disposal of which forms or will form part of [the taxpayer's] gross income, otherwise than . . . ' (the exceptions are not presently relevant). Section 22,

before its supplementation by s 12 of Act 5 of 2001, which catered for capital gains tax, provided (in so far as is relevant hereto):

‘(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be—

(a) in the case of trading stock other than trading stock contemplated in paragraph (b), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being shares held by any company in any other company, has been diminished by reason of damage, deterioration, change in fashion, decrease in the market value or for any other reason satisfactory to the Commissioner;

...

(2) The amounts which shall in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the beginning of any year of assessment, shall—

(a) if such trading stock formed part of the trading stock of such person at the end of the immediately preceding year of assessment be the amount which was, in the determination of the taxable income of such person for such preceding year of assessment, taken into account in respect of the value of such trading stock at the end of such preceding year of assessment;

or

(b) if such trading stock did not form part of the trading stock of such person at the end of the immediately preceding year of assessment, be the cost price to such person of such trading stock.

...

(3) (a) For the purposes of this section the cost price at any date of any trading stock in relation to any person shall, be the cost incurred by such person, whether in the current or any previous year of assessment in acquiring such trading stock plus, subject to the provisions of paragraph (b), any further costs incurred by him up to and including the said date in getting such trading stock into its then existing condition and location, but excluding any exchange difference as defined in section 24I (1) relating to the acquisition of such trading stock.

(b) The further costs which in terms of paragraph (a) are required to be included in the cost price of any trading stock shall be such costs as in terms of any generally accepted accounting practice approved by the Commissioner should be included in the valuation of such trading stock.

...

(4) If any trading stock has been acquired by any person for no consideration or for a consideration which is not measurable in terms of money, such person shall for the purposes of subsection (3) be deemed to have acquired such trading stock at a cost equal to the current market price of such trading stock on the date on which it was acquired by such person: Provided that any capitalization shares awarded by any company to shareholders of that company on or after 1 July 1957 shall have no value as trading stock in the hands of such shareholders: Provided further that options or any other rights to acquire shares in any company which have been acquired as aforesaid shall have no value.'

[22] The *raison d'être* of s 22 was identified and discussed in *Richards Bay Iron & Titanium (Pty) Ltd v CIR* 1996 (1) SA 311 (A) at 315E-323E. See also *CIR v Nemojim*

(Pty) Ltd 1983 (4) SA 935 (A) at 956G-957A.⁴

[23] Counsel for the Commissioner submitted that inherent in s 22 is the premise that the section has no bearing on stock acquired and wholly disposed of during the same year of assessment. I agree. See *Richards Bay Iron and Titanium*, above, at 316H-I. Such transactions are relevant for tax purposes purely for the purposes of s 11 (a) and for the amount of profit or loss that they contribute to the income statement.

[24] The evidence, such as it is in the present case, demonstrates that Brickrush purchased the sand on credit. Brickrush separated the sand only when necessary and removed it forthwith, paying each at month-end for the volume so removed. It could not have taken delivery (and, therefore, acquired ownership) while the sand remained attached to the land. Delivery probably occurred when, having decided upon the exact quantity it required, Brickrush extracted the sand, calculated its volume and removed it from the site. There is no suggestion that sand was, after separation, allowed to lie or accumulate on the farm. From these facts and inferences two conclusions are inevitable. First, that in the overwhelming majority of cases (the only possible exception being separation at the end of a year of assessment and removal a day or two later) separation and disposal took place within the same year and therefore s 22 was of no application to the separated stock. Second, because separation and transfer

⁴ As explained by De Koker and Urquhart, *Income Tax in South Africa*, para 11.9.1:

‘The effect of the trading stock provisions in s 22 is to postpone the deduction of the expense of trading stock purchased until the tax year in which that stock is disposed of. The full cost of acquiring trading stock is deductible under s 11 (a), but the effect of this deduction is matched to the years of disposal by means of the provisions governing closing stock and opening stock.’ The respondent, in the papers before the tax court, correctly described the section as ‘a timing provision’.

of ownership were, to all intents and purposes, if not simultaneous, then at least part of one continuous process, the taxpayer never intended to create or hold trading stock in the separated sand for the short time preceding removal from the farm. For this reason too, s 22 would not have become a relevant factor in the financial history of the sand.

[25] For one or both of these reasons, no doubt, counsel for the taxpayer realized that his client's prospects of success could not benefit from s 22 if the stockpile only came into existence on separation. As I have said he threw himself instead on the uncertain ground of the unseparated *in situ* deposit.

[26] But the taxpayer faces manifest problems in this regard. In its original grounds of objection submitted to SARS in November 2004 its case was stated as follows:

'If the proceeds [received from Brickrush] are as a result of the disposal of trading stock, then in terms of section 22 (4) and 22 (3)(a)(ii) the Trust should be allowed a deduction of the market value of the trading stock, either acquired or when the sand became trading stock, ie on extraction from the ground on or after October 2001.'

The same contention was repeated in the grounds of appeal under rule 11 of the Rules promulgated under GN R467 of 1 April 2003. The judgment of Davis J was based on the stated premise. In his heads of argument the taxpayer's counsel submitted, as a matter 'not in issue', that the sand became trading stock in the hands of his client when it was extracted from the land.

[27] Because of the taxpayer's approach from the outset the Commissioner was not

apprised of the case it was asked to meet during the appeal.⁵ Nor did counsel find

⁵ This did not deter the Commissioner's counsel from arguing strenuously that an unseparated sand deposit was not capable of constituting trading stock. It is unnecessary to pronounce on the correctness of that submission.

himself with the facts necessary to sustain the legal argument. In this regard two shortcomings stand out. First, there was no evidence that the whole or any part of the sand deposit ever transcended a notional stock in trade given the *ad hoc* nature of the purchases and the absence of proof of the size of the market. See in this regard *De Beers Holdings (Pty) Ltd v CIR* 1986 (1) SA 8 (A) at 32H-I. Second, the taxpayer acquired the trading stock for no consideration. It was accordingly deemed by s 22 (4), for the purposes of s 22 (3), to have acquired the stock at a cost equal to the current market price of the stock on the date of acquisition. However, its counsel was obliged to concede that no evidence had been adduced to prove that price and that his reliance on s 22 (3) was accordingly without foundation. Indeed the only scintilla of evidence in this regard suggested that the quantity of mineable sand was not capable of accurate estimation.

[28] The taxpayer's counsel sought refuge in a so-called 'practice' which is described in Silke, *Income Tax*, para 8.112 as follows:

'The practice of SARS is usually to permit as a deduction to a taxpayer who has acquired trading stock for no consideration or for a consideration that is not measurable in terms of money the fair market value of the trading stock at the date of acquisition. Therefore, in the example given, in the year in which the inherited stock becomes the taxpayer's trading stock SARS will allow as a deduction the market value on the date of inheritance, namely R50 000, so that, upon a subsequent realization of the trading stock, the full proceeds less the sum of R50 000 will effectively be taxable.'

[29] Counsel was unable to refer us to any statutory provision which bound us to enforce or empowered us to adopt or sanction this practice (of which no evidence was

in any event adduced). Nor is the formulation capable of enforcement, since what is ‘normal’ within the understanding of SARS is beyond the scope of judicial notice.⁶ In any event, as I have already found, no ascertainable part of the sand deposit could fairly be described as trading stock held by the taxpayer.

[30] The consequence is that the appeal fails. The following order is made:

‘The appeal is dismissed with costs including those consequent upon the employment of two counsel.’

J A HEHER
JUDGE OF APPEAL

HARMS ADP)**Concur**
NAVSA JA)
CACHALIA JA)
SNYDERS AJA)

⁶ De Koker and Urquhart, *loc cit*, say the following:

‘In practice the market value of trading stock acquired for no consideration is allowed as a deduction if that stock is not on hand at the end of the year of assessment in which acquired. This is clearly not authorized by the Act, since the provision described deals with the cost of trading stock which forms part of opening or closing stock, but it is submitted that, on a holistic interpretation, this is the intention of the legislature.’

The statute was not thus interpreted to us by counsel and it is unnecessary to do so *mero motu*.