Review

Trading stock: Implications of the capital gains tax provisions

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It has long been understood that the intention influencing the acquisition of an asset is decisive in deciding on whether the proceeds on sale are of a capital or of a revenue nature, unless there was a change of intention on behalf of a taxpayer. That change of intention has been catered for in the capital gains tax (CGT) legislation as a change of use. There is a correlation between the concepts in that by and large they are the same. However, there are some subtle and some not so subtle changes that have arisen and the message to be gleaned from the cases are in the main that (a) the time of the change of intention, when there is one, is critical; (b) the definition, application and valuation of trading stock is always to be considered in capital/revenue cases; (c) despite the advent of CGT, the arguments surrounding capital vs revenue are unlikely to reduce – the differences in taxation are too great to make the cases less relevant. A further complication that appears to have arisen is the deemed disposal of share dealers’ trading stock when such dealers emigrate. There appears to be the potential for double tax in that the deemed disposal of such stock gives rise to proceeds for CGT purposes as contained in paragraph 12 and 35 of the Eighth Schedule to the Income Tax Act, but also for normal tax purposes in terms of s22(8). This apparent double taxation is, it is submitted, just that – apparent.

Key words: Trading stock, capital gains tax, deemed disposal, change of use, change of intention, capital versus revenue.

INTRODUCTION

With the advent of capital gains tax (CGT), the legislation made provision for the change of usage of an asset, either from capital to revenue or vice-versa. Prior to the CGT era the legislation only dealt with change of use indirectly, and then only in respect of trading stock used otherwise than for trade. The change of use of a capital asset has been dealt with by case law where the change of intention has been examined in some detail. The change of use arising from emigration and the residence rules have not been dealt with previously by case law.

The trading stock definition part (ii) includes anything the proceeds of which is or will be gross income, in terms of trading stock: a capital asset becoming a revenue asset is therefore trading stock. Section 22(2) includes in opening stock trading stock that was not closing stock in the immediately preceding year of assessment.

One of the factors examined in capital versus revenue cases is the change of intention of a taxpayer. An asset acquired as an investment asset and subsequently disposed of normally results in proceeds of a capital nature and is thus excluded from gross income.

However, if the taxpayer changes his or her intention regarding the asset in question and treats it as stock-in-trade, or as a floating capital, or disposed of it in a scheme of profit-making, the proceeds are gross income. Although many of these cases have considered assets as stock-in-trade or floating capital, very few have referred to the definition of trading stock.

This article examines the correlation between the change of use concept as contemplated in the CGT legislation and the change of intention examined by the courts, and, where applicable, the message to be drawn from the court’s interpretation of the change of use concept. A further aspect dealt with is the cessation of
residence status and the treatment of trading stock that may not be directly related to a permanent establishment in the Republic. The application of paragraph (para) 35(3)(a) is examined in this regard.

METHOD OF RESEARCH

The research has been carried out through a study of the literature relating to this subject, an examination of the relevant law and court cases and the application of the case law principles to the current legislation.

TRADING STOCK DEFINITION

Trading stock is defined in section 1 of the Income Tax Act (the Act) as anything acquired (in the widest sense of the word and including mining operations as contemplated in s15A) for eventual sale or exchange, whether directly or through a process of mining or manufacture, or change of intention.

The second part of the trading stock definition in the introductory part of this study includes “anything (ii) the proceeds from the disposal of which forms or will form part of his gross income.” This part of the definition has been commented on in various cases, but more specifically in De Beers Holdings (Pty) Limited v CIR 1986 (1) SA 8(A), 47 SATC 229 at 256 where Corbett JA said: “Part (2) of the definition is somewhat cryptic and in its application may lead to circuitous reasoning (eg[sic], often the question as to whether the proceeds of the disposal of an article constitute gross income is answered by considering whether the article was trading stock, or stock-in-trade, in the hands of the seller.”

Whether one considers part (i) or (ii) of the definition of Trading stock, an asset acquired for resale, whether initially or resulting from a change of intention, would be trading stock. Once established as trading stock, it is submitted that section 22 of the Act becomes applicable.

Sections 22(1) and (2) require that taxable income be increased by the cost price (as defined in s22(3) and (3A)) of closing stock and reduced by opening stock respectively. Section 22(2)(a) defines opening stock as the previous year’s closing stock and, significantly, s22(b) includes trading stock that was not part of the previous year’s closing stock, in such opening stock.

It would appear from the literature that the s22(2)(b) provision caters for an asset that was capital in nature but as a result of a change in intention has become trading stock during the year. In that case it would be included in opening stock at its cost price (Williams, 2006; Stiglingh et al., 2010) Subsection (b) clearly requires that any asset that was held at the end of the previous year of assessment and that became trading stock during the current year of assessment, be included in opening trading stock in that current year of assessment.

Assets are either of a capital or of a revenue nature and the proceeds are therefore either of a capital or revenue nature (Pyott Limited v CIR 1945 AD 128, 13 SATC 121). If the asset was of a revenue nature, the proceeds on disposal will be included in gross income and thus, it is submitted, the asset is trading stock (second part of the definition of trading stock). It is submitted, therefore, that the subsection does envisage the inclusion in opening stock the cost price of a capital asset that becomes trading stock during the year of assessment.

With the advent of CGT, the treatment of the change of use has been codified. Paragraph 12(2)(c) of the Eighth Schedule to the Income Tax Act provides that the change of use is a deemed disposal for CGT purposes at market value. Therefore, it is that market value that will fall to be included in opening stock in terms of s22(2)(b) read with s22(3)(a)(ii).

Trading stock ceasing to be trading stock (that is, now treated as a capital asset) is dealt with by para 12(3) of the Eighth Schedule read with section 22(8)(b)(B). In this situation the law has been clear. Section 22(8) deals with the treatment for tax purposes of trading stock not disposed of as part of trading and require that the market value of that stock be recouped. Section 22(8)(b)(v), inserted in 2001, specifically deals with this problem. This affects CGT to the extent that the recouped market value now becomes base cost for CGT purposes.

This treatment is confirmed in the South African Revenue Service (SARS) Interpretation Note 65 dated 24 February 2012 at paragraph 4.3.5.

EIGHTH SCHEDULE CHANGE OF USE

Para 12(1) read with para 12(2)(c) of the Eighth Schedule deems a non-trading stock asset that is now held as trading stock to have been disposed of at market value for CGT purposes and immediately re-acquired at that market value, which value is expenditure incurred for the purposes of para 20(1)(a) (base cost for CGT purposes), a seemingly circular reference.

The para 20(1)(a) base cost is modified by para 20(3) which reduces said base cost by any amount allowable or deemed to have been allowed in determining taxable income before taxable capital gains. That amount would be expenditure incurred in terms of s11(a), but also, if it is submitted, an amount which in terms of s22(2) has been taken into account as opening stock. Section 22(2) includes stock not held as closing stock in the previous year and, as pointed out above, includes capital assets converted to trading stock as opening stock at the cost price determined by s22(3)(a)(ii), being the market value.

Since s22(2) requires that opening trading stock “be taken into account” in determining taxable income, this is a deemed deduction as contemplated by para 20(3) and therefore reduces the para 20 base cost of the converted
asset.

The treatment of trading stock converted to a capital asset is much clearer. Section 22(8)(b)(v) and (B) includes a recoupment of market value in income. Para 12(3) includes the market value in base cost for CGT purposes. It is submitted that in both cases the market value will be at the time of the change of use or intention.

A disposal of an asset triggers CGT. Since trading stock is included as an asset, the disposal thereof will result in proceeds as defined in para 35, but para 35(3) excludes from proceeds any amount “that must be or was included in gross income or was taken into account when determining the taxable income ...”. Since the disposal of trading stock is taken into account in determining taxable income, such proceeds are not proceeds for CGT purposes.

**CORRELATION BETWEEN CHANGE OF INTENTION AND CHANGE OF USE**

An asset is either a capital asset or a revenue asset (Pyott Ltd, supra). The courts have held that the intention of acquisition is paramount in determining whether or not the proceeds on disposal are of a capital or of a revenue nature, but that the intention may change to, as mentioned by Holmes JA in *Natal Estates Limited v SIR 1975 (4) SA 177 (A), 37 SATC 193 at 216, “Selling an asset in the course of carrying on a business or embarking on a scheme for profit.”

Counsel for both sides in the *Natal Estates (supra)* case were in agreement that the increase in value of an asset from the time it was acquired to the time the intention changed to treating it as trading stock was not taxable. Holmes JA said in passing and without expressing an opinion as to the correctness or otherwise of that contention that “It might be conceivable that ... the exclusion of that amount from the profit might be upheld under the Act as it stands, as being a capital accrual and not gross income, as defined.” It is unknown whether the Secretary in fact altered the assessments to take that comment into account. The court upheld the assessments in respect of certain of the land sold. The Secretary “determined the profits from these sales of lands to be part of the appellant’s income.” Paragraph 12(3)(c) deems such a change to be a disposal at market value for CGT purposes, effectively codifying the comment by Holmes JA.

The courts are at one, that the original intention of acquisition of an asset, whether as a capital asset or as a revenue asset, may change at some time prior to the sale thereof. In this regard Holmes JA said “Important considerations include, *inter alia* the intention of the owner, both at the time of buying the land and when selling it (for his intention may have changed in the interim); ... From the totality of the facts one enquires whether it can be said that the owner has crossed the Rubicon and gone over to business, or embarked on a scheme, of selling such land for profit, *using the land as his stock-in-trade.*

In *CIR v Richmond Estates (Pty) Limited 1956 (1) SA 602(A), 20 SATC 355* the taxpayer carried on business as a speculator in land. The company acquired land in order to sell at a profit (trading stock) but later decided to retain that land as an investment – a change of intention. The court found that the facts upheld this contention and that the subsequent sale of that land was the sale of a capital asset. Centlivres JA said that (SATC:361) “… the character of assets held by a company can be altered by a change of intention in regard to those assets ...” and referred to various cases in this regard. He said at SATC: 362 that “The decision with to sell capital assets ... at a profit cannot *per se* make the resulting profit subject to tax.”

Change of intention is an accepted fact of tax life. What is not clear, however, is how the transition from a capital asset to trading stock or vice versa was dealt with under the tax law prior to the advent of CGT. Very few cases referred to the trading stock provisions. Even the *Natal Estates (supra)* case where s22 was referred to by both counsels, did not deal with those provisions. In fact s22 seems to have been sidelined very effectively by Holmes JA.

Section 22(2)(b) includes in opening trading stock, stock not on hand at the end of the preceding year of assessment. It would appear from the literature that this provision caters for an asset that was capital in nature but as a result of a change in intention has become trading stock during the year. In that case it would be included in opening stock at its cost (Williams, 2006; Stiglingh et al., 2010).

In *ITC 1222 (1974), 37 SATC 17(C)* the court applied this principle to shares previously held as capital assets and now transformed into trading stock, saying, at 23, that “The opening stock value in that year would, according to the terms of s 22(2)(b), be the cost price to such person of the trading stock *whether that stock was acquired in that year of trading or had been acquired in a previous year.*” (My emphasis).

Subsection (b) clearly requires that any asset that was held at the end of the previous year of assessment and that became trading stock during the current year of assessment, be included in opening trading stock in that current year of assessment. Prior to the advent of CGT the cost price of that stock will, it is submitted, have been its cost rather than the market value. The issue does not appear to have been raised in our courts.

Trading stock becoming a capital asset is dealt with in s22(8). The market value would have been included in income as a recoupment. With the advent of CGT this has been made abundantly clear by para 12(3) of the Eighth Schedule which refers to the s22(8) recoupment and makes that amount the base cost for CGT purposes.
Change of use is not specifically mentioned in the sections and paragraphs noted previously, but with a term that has come to be used in conjunction with the events contemplated in those provisions. It is submitted that what is contemplated is the change of the character of the asset either from being a revenue asset to capital or vice versa. As explained by the courts, this change is evidenced by a change in the intention of the taxpayer in the application of that asset. It is submitted that the concept of "change of use" and "change of intention" are synonymous.

MESSAGES FROM CASE LAW

It is instructive to examine several cases where there has been a change in intention of a taxpayer and to apply the legislation as it stands to illustrate its usage and to attempt to extract what messages there may be from those cases. In this respect, the Richmond Estates and Natal Estates (supra) cases are examined, being classic cases regarding this issue.

In addition, CIR v George Forrest Timber 1924 AD 516; 1 SATC 20, Matla Coal v CIR 1987 (1) SA 108 (A), 48 SATC 223 and Ernst Bester Trust v CSARS (282/2007) [2008] ZASCA 55 (26 MAY 2008), 70 SATC 151 cases are examined, being cases where the disposal of apparently capital assets have resulted in gross income.

In George Forrest Timber (supra) the company acquired land with non-renewable trees thereon. It was agreed by all parties concerned that the value of the land without the trees was negligible (1 SATC 20: 20). Felled trees were sold and a portion of the cost of the timber sold was claimed as a deduction (SATC: 21). The court held that the proceeds on disposal were gross income but that no portion of the cost of the timber was deductible – it was an acquisition of a capital nature.

Innes CJ held at SATC: 22: "... the property was actually dealt with in accordance with the purpose for which it was acquired: namely, the production of revenue through the channel of the company's ordinary business. The trees were felled, the timber was put through the saw mill and the planks or logs when they came from the mill were sold as portion of the ordinary stock-in-trade. The price obtained was portion of the company's revenue; it was money received in the course of its business." and then at SATC: 24 said: "... the timber purchased as portion of the land should not be regarded as ordinary merchandise purchased for sale, ...".

It is submitted that this should have been trading stock since the plantation itself was in fact acquired for the purpose of resale. Here we have a clear case of a capital asset disposed of on revenue account - effectively a capital asset that becomes trading stock, but with no deduction of cost or of opening stock (The definition of and provisions relating to trading stock were not yet in the Act). There is no mention in this case of a change of use either.

It should be noted that as legislation now reads, the cost of the plantation acquired would be deductible in terms of para 15(1)(b) of the First Schedule to the Act.

In addition, para 20 of the Eighth Schedule includes the cost of acquisition in base cost. The capital gain will have been determined as the market value less the proportionate cost of acquisition of the plantation – a more equitable result than the original.

In Matla Coal (supra) the issue was whether or not the sale of coal rights resulted in gross income. Matla owned the mining rights to mine certain coal. The company was managed by Trans-Natal, a coal mining company (48 SATC 223:239). What the actual payment by Escom to Matla was for was not certain, but having discussed the facts Corbett JA at SATC:245 said: "...in the result, therefore, the payment of R9 365 000 underwent a metamorphosis. At the actual time of payment, viz 20 February 1980, it was the consideration for the purchase of coal rights; and on 29 September 1980 it became the consideration for the restraint under-takings."

He continued as follows at SATC:245,246: "How must it be classified from the fiscal point of view in [246] determining Matla's liability for income tax for the tax year which ended on 30 June 1980? Counsel was not able to refer us to any authority directly in point; nor am I aware of any. On principle, however, it seems to me that the payment must be characterized either with reference to the position which obtained at the time of payment (cf Mool v SIR 1972(1) SA 675(A) at 684E-H) or, at the latest, to the position which is obtained on the last day of the fiscal year (cf Caltex Oil(SA) Ltd v SIR 1975(1) SA 665(A) at 675E-676D, 677G-678A; and see Silke on South African Income Tax 10 ed para 2.17). It is not necessary to choose between these alternatives since in this case the position which was obtained as at the time of payment persisted unchanged until the end of the fiscal year."

The time of change is significant as the law now reads because there could be a deemed disposal for CGT purposes and the deemed disposal would be at market value at the date of change.

In the Matla case, however, it was found that the coal rights had not been acquired for the purposes of resale and therefore, that the proceeds in any case were of a capital nature. In addition Corbett JA said at SATC:247:
“It seems to me that the coal itself can only be regarded as stock-in-trade and become the subject-matter of a sale in the course of a business once it is separated from the land of which it forms part, that is, is mined (Cf the remarks of Innes CJ in *CIR v George Forest Timber Co Ltd* 1924 AD 516, at 523-4, 525-6)."

The last quote is significant in that it seems to confirm that a capital asset can be disposed of on revenue account ostensibly without a change of intention. It is submitted, however, that there is a vast difference between the extracting of minerals by mining and the acquisition of a plantation to dispose of the trees.

There was no change of intention in the *Matla Coal* case. The proceeds were therefore capital and would have been taxed as a capital gain had the Eighth Schedule been in force at the time. The gain would have been the proceeds less the base cost as determined in terms of para 20.

In *CSARS v van Blerk* (supra), the issue was whether or not the proceeds from the sale of sand extracted from the taxpayer’s farm was gross income. The purchaser of the sand extracted it and removed it (62 SATC 131: 133). Davis J said, at SATC: 137: “In my view the record of the sales of sand, albeit to a single purchaser, had all the characteristics of trading in this commodity. Respondent employed his sand as his stock in trade. Trading stock is defined in s 1 of the Act … In the present case; sand was sold on a regular basis over a number of years. In itself, this is indicative of a taxpayer who was engaged in a trade and employed the sand in the nature of trading stock pursuant to a scheme of profit making. … It is apparent that when respondent bought the farm in 1983, he employed it for two separate and distinct purposes, namely: (a) to employ the land in farming operations; and (b) to sell the sand thereon.”

Davis J held that the sand was in fact trading stock as defined. At no stage did the taxpayer canvass a deduction either under s11(a) or as opening trading stock. It is submitted that neither would have been successful as the sand itself was not acquired separately for resale but was extracted from the land and remained part of the capital asset until extracted. It may, however, have been opening stock in terms of s22(2)(b) but this aspect was not raised at all.

The sand saga was continued in *Ernst Bester Trust v CSARS* (supra). In this case, the issue of opening trading stock was raised and discussed. The extraction and sale of the sand was similar to the *van Blerk* case: the purchaser extracted and removed the sand (SATC:156 para [9]). Heher JA at SATC:158, paragraph [19] agreed with the lower court that the sale of sand resulted in gross income.

As regards the contention by the taxpayer that he was entitled to an opening stock deduction in terms of s22(2) Heher JA held at 160: “[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. … [24] … 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 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.” It is inherent in the foregoing that the court considered the sand as part of the capital land asset until separated. With regard to the inclusion of the sand as opening stock in terms of s22(2)(b) and s22(4) the court rejected that contention.

In both examples of sand cases a capital asset was used for trading stock. The court did not reject the idea that the sand became stock in the *Ernst Bester Trust* case (supra). It rejected the idea that s22 was applicable to stock acquired and disposed of in the same year of assessment. With respect to the Court, it is submitted that, that is a misreading of s22, and especially s22(2)(b) read with 22(4). It is submitted that, either s22(2)(b) applies to trading stock not held at the end of the previous year of assessment or it does not. It is further submitted that one cannot choose to apply the section to one type of stock only (that is, stock on hand at the end of a year of assessment). If the submission is right then again the market value of the stock at the time of its change from being a capital asset, is proceeds for CGT purposes and is the cost price for normal tax purposes. That market value is then part of opening trading stock in terms of s22(2)(b).

The *CIR v Richmond Estates (Pty) Limited* case (supra) revolved around a piece of land acquired originally for resale, but subsequently used to build on and let, making it a capital asset. Due to various circumstances the land was subsequently sold and the Commissioner assessed the proceeds as gross income. Centlivres CJ said at SATC:361: "That the character of assets held by a company can be altered by a change of intention in regard to those assets is clear from the case of *CIR v Leydenburg Platinum Limited* 1929 AD 137 at 144, where the Court decided that there was a change of policy by the company concerned which resulted in capital assets becoming stock-in-trade of the company.”

The Court held that there was a change of intention, that the land in question became a capital asset and that the subsequent sale resulted in proceeds of a capital nature. At SATC: 362 Centlivres CJ said: “The decision was to sell capital assets and the fact that a taxpayer decides to sell capital assets at a profit cannot per se make the resulting profit subject to tax.”

In this case, the company will have been entitled to a deduction of the cost of the land on acquisition in terms of s11(a), but would have carried that cost as closing stock in that year and as opening stock in the next year of assessment. The conversion to a capital asset will
have resulted in a recoupment of the market value of the property at the time of the conversion in terms of s22(8) and the difference between that and the value in opening stock should have been included in taxable income. The subsequent sale, held to be of a capital nature, would have resulted in a capital gain being the difference between the proceeds and the conversion market value, assuming that the Eighth Schedule had applied at the time.

In *Natal Estates Limited v SIR* (*supra*) the issue was the use and sale of land for township development purposes. The land had previously been used for sugar cane farming. Holmes JA at 198 drew a clear distinction between “Realising a capital asset” and “Selling an asset in the course of carrying on a business or embarking on a scheme for profit. ... Cases in this Court ... recognise the relevance of a change of intention on the part of the owner, that is to say, a change from the original intention when acquiring the asset;”. Several other cases were discussed, but the tenor of those cases was that the intention at acquisition of an asset may be different when the asset is sold – a change could have taken place in the interim.

Holmes JA dismissed the application of s22 (wrongly, it is submitted) but, in this case, had the Eighth Schedule applied, the market value of the properties in question will have been the deemed proceeds for CGT purposes at the time of the change of intention to treat them as trading stock. As mentioned previously, the comments regarding the treatment for trading stock purposes have now been legislated for. In this case, it is clear that some time prior to the sale of the land in question, the company commenced treating them as trading stock. It is likely that the market value when that treatment commenced was different from the ultimate selling price. It is submitted that this again illustrates the importance that is likely to be placed on the time of the change of intention in capital versus revenue cases in the future.

It is submitted that the lessons to be learned from these cases are:

A. the time of the change of intention when there is one, is critical;
B. the definition, application and valuation of trading stock should always be considered in capital/revenue cases;
C. despite the advent of CGT, the arguments surrounding capital versus revenue are unlikely to reduce – the differences in taxation are too great to make the cases less relevant.

PARAGRAPH 35(3) AND EMIGRATION

If a share dealer emigrates, does that person have a deemed disposal of his trading stock at market value, and if so, does para 35(3) apply?

Para 35(3) of the Eighth Schedule to the Act requires that the proceeds, as determined by para 35(1), be reduced by “(a) any amount of the proceeds that must be or was included in the gross income of that person or that must be or was taken into account when determining the taxable income of that person before the inclusion of any taxable gain.”

Para 35(1) determines the proceeds from the disposal of assets for CGT purposes as being “... the amount received by, or accrued to, or is treated as having been received by, or accrued to or in favour of, that person in respect of the disposal, ...” (my emphasis).

Para 12(1) deems certain events to be disposals at market value and immediate re-acquisition at that market value. Para 12(2)(a) applies para 12(1) to a person who ceases or commences residence in the Republic, other than in respect of immovable property situated in the Republic or assets attributable to a permanent establishment in the Republic. A permanent establishment is essentially a fixed place of business.

Trading stock is normally an asset that is attributable to a permanent establishment, whether in the Republic or otherwise. In the case of a person ceasing to be a resident, therefore, the stock will normally not be deemed to have been disposed of. However, if the trading stock is shares, these would be deemed a disposal since they are not normally attributable to a permanent establishment in the Republic. The source of the proceeds from the trading in shares is the place the capital is employed and where the trading is controlled (*Overseas Trust Corporation Limited v CIR* 1926 AD 444, 2 SATC 71; *CIR v Black* 1957 (3) SA 536 (A), 21 SATC 226).

Therefore, on the face of it, share trading stock is deemed to be disposed of at market value in terms of para 12(1) and (2)(a) for CGT purposes. The base cost would be the para 20 costs reduced by amounts allowed as a deduction for normal tax – that is, the cost of the shares – resulting in a base cost of zero. Consequently, included in taxable income would be that market value.

There would no longer be trading stock as the taxpayer is no longer a resident. However trading stock has been applied for a “purpose other than the disposal thereof in the ordinary course of his trade” (s22(8)(b)(iv)) for a consideration less than market value and not for domestic purposes, as a donation, or as an in specie distribution as contemplated in s22(8)(a) and (b)(i), (ii) and (iii). Section 22(8)(b)(B) requires the recoupment of the market value of that trading stock to be included in the income of that taxpayer for that year of assessment.

However, it seems that in terms of s22(8) the market value is to be included in income and in terms of para 12 of the Eighth Schedule, that same value is proceeds for CGT purposes. This double taxation cannot have been the intention of the legislature.

A capital gain is defined as the excess of proceeds over base cost. Para 11 deals with disposals and para 12 with deemed disposals. Neither of those paragraphs
actually refers to proceeds. Para 35 therefore is applicable, it is submitted, to both disposals and deemed disposals despite the reference in para 12 to the market value. That reference, it is submitted, simply quantifies the proceeds.

Para 35 defines proceeds inter alia as receipts and accruals “treated” as such – that is, deemed to be a receipt or accrual. It is submitted that it refers to the market value contemplated in para 12. Para 35(3) refers to amounts included in gross income or taken into account when determining taxable income. As mentioned above, the market value of the trading stock is, in terms of s22(8), taken into account in determining taxable income and therefore reduces the proceeds for CGT purposes in terms of para 35(3).

Even if the legislation does not lend itself to the above interpretation, it is unlikely that double taxation will apply. As mentioned in the SARS Comprehensive Guide to Capital Gains Tax, Issue 3 at 10: “2.3 Double deductions and double taxation[…] Although, the Eighth Schedule applies to both capital assets and trading stock, double deductions and double taxation are generally prevented by para 20(3)(a) in the case of expenditure and para 35(3)(a) in the case of receipts or accruals. To the extent that the double taxation issue is not addressed specifically, there is a “necessary implication” that the same amount shall not be taxed twice in the hands of the same taxpayer”.

It is submitted therefore, that para 35(3)(a) does apply to the deemed proceeds arising from the emigration of a share dealer in respect of his trading stock.

CONCLUSION

The lessons to be learned from law case in respect of capital versus revenue cases are that:

1. the time of the change of intention when there is one is critical;
2. the definition, application and valuation of trading stock should always be considered in capital/revenue cases;
3. despite the advent of CGT, the arguments surrounding capital vs revenue are unlikely to reduce – the differences in taxation are too great to make the cases less relevant.

The emigration of a share dealer triggers a deemed disposal of those shares not linked to a permanent establishment in the Republic, for CGT purposes. The result of proceeds as defined by para 35 of the Eighth Schedule to the Income Tax Act will apply. No double taxation of the deemed disposal will result.

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