IN THE TAX COURT

CASE NO: 11283

In the matter between:

A LTD **Appellant**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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J U D G M E N T

MBHA, J:

INTRODUCTION

[1] As at the beginning of 1994, the appellant ("A Ltd") held a 98% interest in its subsidiary, B Limited ("B Ltd") via its 60% controlling interest in C Limited ("C Ltd").

[2] It is common cause that this 98% shareholding in B Ltd was a strategic long-term investment of a capital nature.

[3] On 1 June 1994 the appellant acquired a 15,6% direct shareholding in B Ltd for an amount of R300 724 524,00

[4] On 16 September 1999, which was in the appellant's 1999 year of assessment, the appellant sold its 15,6% shareholding in B Ltd for an amount of R141 021 605,00 to C Ltd in which the appellant held a 60% controlling interest.

[5] In its 1999 tax return, the appellant claimed as a loss, a deduction equal to the difference between the amount of the purchase of the shares in B Ltd and the sale, being R159 702 919,00.

[6] The appellant was requested to motivate the deductibility of its loss and it stated that the loss was of a speculative nature and therefore deductible.

[7] The respondent did not accept this motivation and disallowed the deduction on the basis that the loss in question was of a capital nature.

[8] On 28 November 2003, the appellant lodged an objection, in terms of section 81 of the Income Tax Act 58 of 1962 ("the Act"), contending that the B Ltd shares were acquired with the intention of selling them at a profit and,

accordingly, that the amount in question was not of a capital nature and was deductible in terms of section 11(a) of the Act.

[9] On 29 December 2003 the respondent disallowed the objection on the ground that the shareholding in B Ltd was of a capital nature and accordingly that the loss did not qualify for deduction in terms of section 11(a) of the Act.

THE ISSUES

[10] The issues in this appeal, as defined in the respondent's Amended Statement of Grounds of Assessment and the appellant's Amended Statement of Grounds of Appeal, can be summarised as follows:

10.1 whether, when acquiring the B Ltd shares, the appellant did so with the intention of holding the shares as a capital investment or as part of a scheme of profit-making; and

10.2 if the appellant had acquired the shares as part of a scheme of profit-making or as trading stock, was the appellant entitled to a deduction of the original cost of such shares in the amount of R300 721 524,00 in its 1999 year of assessment in terms of section 22(2) of the Act?

DISCUSSION ON THE MERITS

[11] The appellant contends that it is entitled to the deduction of the relevant amount in terms of section 22(2) of the Act on the basis that the B Ltd shares it acquired constituted trading stock as defined, in its hands, because:

11.1 the shares were acquired for purposes of sale or exchange by the appellant; and

11.2 the subsequent proceeds from the disposal of the shares in 1999, formed part of the gross income of the appellant.

[12] The appellant relied, in the alternative, on the principle of mixed intentions, specifically that it had a secondary purpose of profit-making when it acquired and held the B Ltd shares.

[13] The appellant also relied on the so-called “all in” principle by which, according to the appellant’s witness Mr Y, all of its assets, no matter how strategic and of whatever nature, be it shares or mines or property, were acquired simply to be resold. If they were sold at a loss, the argument went, such loss was always part of income and therefore deductible.

[14] Clearly, the essential issue in this case is whether the intention of the appellant, in acquiring the B Ltd shares, was to hold them as a capital investment in order to derive income therefrom in the form of dividends (i.e. to

derive income from the productive use thereof), in which case they were of a capital nature, or to acquire them as trading stock.

[15] It is trite that intention is a state of mind. Regarding the intention of a company, I can do no better than quote Botha JA in the case of *SIR v Trust Bank of Africa Ltd* 1975 (2) SA 652 (A) at 669A-D where he said:

> "*Just as there cannot in the case of a one-man company be any reason in principle why it should be incompetent for him to give evidence as to what the intention of his company at any given time was, Commissioner for Inland Revenue v Richmond Estates (Pty.) Ltd., 1956 (1) S.A. 502 (A) at p. 606, so I can see no reason in principle why the persons who are in effective control of a company cannot give evidence as to what was the intention or purpose of the company in relation to any matter at any given time.*"

The learned judge continued in the same passage:

> "…*I cannot find any reason in principle why the intention of the members of the Management Committee in regard to any matter in which it was concerned on behalf of the respondent cannot be taken to indicate the intention of the respondent.*"

[16] It accordingly follows that the evidence tendered on behalf of the appellant, namely that of Messrs X and Y is of fundamental importance regarding the appellant's intention at the critical time of acquiring and subsequent disposal of the B Ltd shares. Needless to say, their evidence will obviously be assessed and weighed in the light of the probabilities and the objective facts in this case.

[17] Mr Y stated that he was intimately involved with the acquisitions and disposals made by the appellant and that he was aware of the purpose for which such acquisitions and disposals were made. Mr X also stated that he was aware of the intentions of the controlling minds of the appellant as he frequently discussed these matters with his deceased father X snr, while he was the deputy chairman. Both he and Mr Y went on the road show during May 1994 and were required to know and discuss the group strategy pertaining, *inter alia*, to the appellant's intentions regarding its 15,6% shareholding in B Ltd.

[18] Both Y and X were adamant that the intention with which the appellant acquired and held the 15,6% shareholding in B Ltd was to dispose of it at a profit. The intention was that this 15,6% shareholding in B Ltd would be disposed of in one of three ways:

18.1 As the public float on a listing of B Ltd on the Johannesburg Stock Exchange ("JSE").

18.2 As a private placement of the shares with a foreign investor who was interested in the fast moving branded consumer goods industry in which B Ltd was involved; and

18.3 As a disposal to C Ltd.

[19] In evaluating the evidence of X and Y, it becomes necessary to examine, in a fair amount of detail, all the circumstances leading up to the appellant's acquisition of the 15,56% shareholding in B Ltd.

[20] As I have already mentioned, the appellant's 98% shareholding in B Ltd, as at the beginning of 1994, was a strategic long-term investment of a capital nature. According to Mr X, B Ltd was the star performer in the group, was highly profitable and accounted for approximately one-quarter of the appellant's profits. It should also be kept in mind that although the appellant held substantial mining interests, approximately 72% of its assets were made up of its industrial holdings via C Ltd.

[21] During April 1994 the appellant decided, through its executive committee, that B Ltd should tender R411 million to secure the assets, goodwill and trademarks of the principal business of W Co. from the U Ltd. By so doing, B Ltd would substantially expand its existing business by adding to its list of fast-moving consumer goods and brands.

[22] There is no question that from the appellant's group perspective, this was a massive capital investment. B Ltd had R111 million cash and there was a need for the additional R300 million to fund this capital investment. The evidence by both X and Y, and by resolutions and other relevant documentation, shows conclusively that the appellant went about actively looking at various ways in which this capital investment could be financed. The specific and possible financing methods identified were the following:

1. B Ltd could have listed its own shares on the JSE and utilised the resultant capital to make the purchase;

2. C Ltd could have listed further shares of its own on the JSE (it was already listed) in order to achieve the same result;

3. A Ltd could have lent the R300 million to B Ltd which already had R111 million each of its own; and

4. A Ltd could have listed further of its own shares using the resultant capital to purchase the R300 million unlisted B Ltd shares necessary to complete the transaction.

[23] It is trite that the appellant followed and adopted the last mentioned option when it, in June 1994, successfully placed 2 481 000 of its N ordinary shares to foreign investors. A public announcement to this effect made was made by the appellant on 1 July 1994.

[24] In his evidence, Mr Y confirmed that he was the author of the funding document with the heading "*Funding For A Major Acquisition By B Ltd*" ("B Ltd"), which deals with the various financing options that were explored. Significantly, the opening paragraph of this document states: "*B Ltd has tendered R411 million to secure the assets, goodwill and trademarks of a principal business in the food sector. B Ltd intends to finance this partially from its internal resources (R111 million) …*". On page 5 of this document it is

expressly stated that "*Undoubtedly this acquisition will have a major long-term strategic benefit to B Ltd's activities whilst the immediate costs in terms of earnings per share dilution will be small*".

[25] In my view, Mr Y's aforesaid document quite clearly explains the appellant's capital intent regarding the purported acquisition of the 15,6% shareholding in B Ltd.

[26] In his evidence, Mr Y confirmed that he was involved in all discussions with regard to the funding of the W Co.'s acquisition. The minutes of the meeting of the appellant's executive committee held on 24 February 1994 where Mr Y was present, confirm in no uncertain terms that options for financing the W Co. purchase, was a specific item on the agenda.

[27] Mr Y was specifically asked why was the appellant interested in the acquisition of W Co. He replied saying that W Co. was considered a strong brand which had superior distribution methods to those of B Ltd particularly in the informal market. It was then felt that W Co.'s ability to market it in the townships would enable additional value to be added to B Ltd's own brand.

[28] To my mind, there can be no doubt whatsoever that appellant's intention in the main was geared, wholly, to an acquisition of a capital investment.

[29] Furthermore, regarding the various financing options for the deal which I have alluded to, there is no doubt that had the first three methods been

followed, no question could have arisen in regard to the capital nature of any aspects of the appellant's proposed investment in the W Co. acquisition. It follows logically, that in adopting the fourth and last option, a restructuring of A Ltd's strategic 98% interest in B Ltd (via C Ltd) would necessarily have to occur in order for it to acquire directly the 15,6% shareholding in B Ltd's expanded capital. This in effect meant that A Ltd's existing 98% shareholding in B Ltd (via C Ltd) would have to be diluted to 82% i.e. less the 15,6%. Thus, by acquiring the 15,6% shareholding directly in B Ltd, A Ltd continued to retain its strategic 98% interest in B Ltd. Put simply, the appellant continued to hold on to its 98% strategic long-term capital investment in B Ltd.

[30] It therefore becomes patently clear that the 15,6% direct holding that appellant acquired in B Ltd never became stock in trade or part of a scheme of profit-making as appellant alleges. Clearly there were other reasons why the particular financing method was chosen.

[31] Both Messrs X and Y testified and confirmed in no uncertain terms, that it was cheaper for the appellant to adopt the last-mentioned option i.e. the course of issuing A Ltd's shares than any of the other financing methods already mentioned. This, in fact, is specifically recorded in one of the minutes of meetings of the executive committee of the appellant. Most importantly, Mr Y confirmed under cross-examination that the appellant's subsequent issuing of its shares to foreign markets in pursuance of this financing method, had nothing to do with any desire to speculate, but that it had to do, entirely, with how the financing of the W Co. acquisition could be done cheaply.

[32] It is clear to me that up to this point, at least, that appellant's intention was to make a capital investment in B Ltd. In an effort to try to explain away the clear capital intentions of the appellant, both Messrs X and Y tried to make out a case for speculative intention on the part of the appellant, saying this was manifest from the fact that the appellant had intended an immediate listing of B Ltd and the immediate sale of its shares on the JSE.

[33] As the evidence unfolded, however, it became apparent that there was no intention of listing B Ltd in the foreseeable future, and certainly not within the year as suggested in the appellant's grounds of appeal. What in fact emerged from the evidence was the following:

33.1 A reference to the summarised income statements of B Ltd showed that had A Ltd wished to list B Ltd, it could and would have done so. Contrary to the evidence of Mr X that the proposed listing could not be done because the profits of B Ltd declined sharply after the W Co. acquisition, profits had in fact increased steadily through 1994 and 1995. Indeed by June 1995, turnover was up by 35% on the previous year, and profit was up by 29%. The annual reports of A Ltd and the reviews for both 1994 and 1995 bear this out. These documents show beyond any doubt that B Ltd had achieved an average compound growth in earnings of 27%. The documentation further shows that B Ltd's operating profit had risen from R115,6

million to R128,9 million, and a further growth in earnings was anticipated. The chairman of A Ltd predicted that B Ltd's ongoing strong performance was expected for the rest of 1995.

33.2 The annual reports of A Ltd also directly contradict directly the suggestion of any intention to list and sell the shares in B Ltd. These reports show that A Ltd had intended at all relevant times, to continue to build on B Ltd's position in the domestic market with regard to branded food products. This, in my view, is a further unquestionable demonstration of A Ltd's capital intent when it acquired the 15,6% shareholding in B Ltd. This is reflected in this recordal of A Ltd's Review of Operations for the year ending 1994: "*This acquisition (of W Co.) has provided an enhanced portfolio of leading brands, giving B Ltd meaningful entry into the R1 billion South African market. While W Co. will benefit from Ltd's' strengths, W Co.'s extensive distribution operation will considerably expand B Ltd's existing capacity.*"

33.3 Significantly, no Board minutes of A Ltd were tendered indicating even a discussion of any proposed listing of B Ltd.

33.4 On the contrary, in the minutes of the meeting of A Ltd's executive meeting on 28 October 2003, which Mr Y attended, it is specifically recorded "*As of now, not interested in pursuing listing.*" In fact, at a subsequent meeting of A Ltd's executive

committee on 10 February 1994, A Ltd's stockbroker, one Mr P, raised the listing of B Ltd specifically as the time was "*opportune to do so*". This advice was never accepted.

33.5 The additional minutes of A Ltd's executive meeting on 24 March 1994 show unequivocally that A Ltd considered B Ltd's long-term prospects to be good and that safeguards were in place to guard against any short-term uncertainties in the B Ltd investment.

33.6 Mr X sought, unconvincingly I must add, to pass off the minutes of A Ltd's executive committee I have referred to (and others) as being an incomplete and attenuated record. However, there is no shred of evidence which casts any doubt on the veracity of those minutes. He in fact tried to suggest that the court should rather have regard to his unrecorded lunchtime meetings with his father Mr X, some years ago where the latter apparently made the appellant's alleged capital intent clear. Unfortunately, this was never corroborated in any manner whatsoever.

33.7 On 22 April 1994 B Ltd made a public announcement in the press with the heading "*ACQUISITION OF THE ENTIRE BUSINESS OF THE W CO. DIVISION*" in which B Ltd stated that various financing alternatives for the financing of the W Co. acquisition were presently being evaluated and that this was

"not expected to result in the listing of B Ltd in the immediate future" (my emphasis). In my view, this killed the notion of any listing of B Ltd, at least in the short term, altogether.

33.8 Mr Y conceded finally that a listing of B Ltd was not on the cards as amongst others, the market perception was that it would take time for B Ltd to digest and merge with W Co. As such any listing could not be considered until this digestion and merging had occurred and had profitably been seen to have been done.

33.9 Finally, none of the members of the executive committee were called to testify about B Ltd's prospective listing.

[34] As I mentioned earlier, the financing method opted for by appellant *vis-à-vis* the W Co. acquisition, was to offer its ordinary shares to foreign markets. In pursuance of this method, the appellant prepared and produced a prospectus in respect of the overseas placement.

[35] The entire contents of this prospectus make clear, undoubtedly, the appellant's strategic and capital holding in B Ltd, specifically *vis-à-vis* the W Co. acquisition.

35.1 On page 6 of the prospectus, the following is recorded:

> "*Those of the Group's businesses positioned to benefit from increased infrastructural and other fixed domestic*

> *investment activity include construction, cement, steel merchanting and engineering, while A Ltd's interests in frozen food procurement and distribution of* <u>*branded fast moving consumer goods*</u>*, (my emphasis) … could be expected to benefit from any resumption in consumption growth.*"

35.2 The prospectus continues thus on page 7:

> "*In May 1994, the B Ltd acquired W Co., the subsidiary of U Ltd (a subsidiary of T Industries plc) for a consideration of approximately R411 million. The directors consider the acquisition of W Co. to be an important step in A Ltd's strategy of developing its interests in the branded fast-moving consumer goods market.*"

The conclusion is then made that it is intended that W Co. will (in future) operate as a free standing division within B Ltd.

[36] Potential overseas investors were thus encouraged to believe that the group as a whole, including B Ltd in particular, would produce strong earnings well into the future, and that they should invest accordingly. There is nothing in the prospectus that suggests that they were being invited to put up the R300 million (for the W Co. acquisition) as a short term speculation on the JSE as Messrs X and Y would like the court to believe. Furthermore, there is no mention of any intended listing of B Ltd.

[37] I observed that when Mr X was specifically asked about what was explained to potential investors during the overseas road show, when they asked about the unusual structures of A Ltd's intended simultaneous direct (15,6%) and indirect (82%) shareholding in B Ltd, he was patently guarded in

his reply. He was not quite forthright in his reply about what he and Mr Y told the overseas investors about the patently incongruous shareholding of A Ltd in B Ltd.

[38] Significantly, as is expressly recorded in the minutes of A Ltd's executive meeting on 30 June 1994, X and Y gave a report back on the road show saying, *inter alia*, that it had been very successful and that overseas investors wanted to do new things ("*blue skies*") and equity value growth. There is no mention whatsoever of overseas investors being prepared to invest in any short-term speculation.

[39] Mr Y confirmed during his evidence that the unusual structure by which A Ltd held shareholding in B Ltd – both directly (15,6%) and indirectly was contrary to that expected generally by the market where A Ltd operated. The express reason advanced for creating this unusual structure appears from the appellant's own correspondence to the respondent dated 19 August 2002. I quote from the relevant paragraphs in the said letter, thus:

> "*The shares were acquired with effect from 1 June 1994 and were held directly by A Ltd in B Ltd so* ***as to provide B Ltd with the prerequisite funding to acquire W Co. Division*** *from the U Ltd.*"

[40] It is clear to me, therefore, that the structure was not created for any speculative reasons but that it was a by-product of the method of financing which was particularly undertaken for the W Co. acquisition.

[41] The respondent's sole witness Prof Z, who was called as an expert, testified that he had not, in tens of thousands of instances, come across a case where a company trafficked in the shares of its subsidiary as A Ltd had done with B Ltd. In his view it was extremely rare for an investment company (like A Ltd) to have two different intentions simultaneously in respect of its subsidiary, one speculative and short term (15,6%) and the other (82%) as a strategic investment. Prof Z's testimony in this respect was not challenged and remains uncontroverted.

[42] Mr X's contention that the second option that was open to the appellant of disposing of its 15,6% shareholding in B Ltd – which in his view was adequate proof that the appellant had a speculative intent when it acquired that shareholding – was by a private placing of its shares with a foreign investor who would be interested in the fast moving branded consumer goods industry in which B Ltd was involved.

[43] Firstly, this is not supported by any evidence, documentary or otherwise. Secondly, it was never shown that there was any foreign investor 'waiting in the wings' so to speak. If there was one, there was no suggestion that it was even considering making any offer, whether for the full 15,6% shareholding or any part of it, or that the foreign investor was at all interested in a minority stake in B Ltd.

[44] The third option by which the appellant could dispose of the 15,6% shareholding, according to Mr X, was to dispose of it to C Ltd. This was, in

my view, totally untenable. It will be recalled that Mr Y, in spelling out the clear advantages to A Ltd for following the particular financing option for the W Co. deal that appellant finally adopted, ruled out this option. So much of this clearly appears from the funding document Mr Y prepared, to which I have already referred in paragraph [24] above. I will however in due course deal with appellant's ultimate disposal of the B Ltd shareholding to C Ltd in September 1999 which effectively gave rise to this case.

[45] It was submitted, in the alternative, that A Ltd's acquisition and holding of the 15,6% shareholding in B Ltd, was in pursuance of A Ltd's carrying on of a secondary business of dealing in shares for profit (i.e. mixed intention). In support of this argument, reliance was placed on the case of *African Life Investment Corporation (Pty) Ltd v SIR* 1969 (4) SA 259 (A).

[46] Reliance on *African Life Investment* is in my view misplaced. Whilst the case unquestionably confirms the possible existence of mixed intentions held by a taxpayer, the facts of that case indisputably show that the taxpayer concerned had followed an "*active investment policy*" as opposed to a "*passive one*". *In casu*, there is no shred of evidence that was tendered to show that when A Ltd acquired the 15,6% shareholding in B Ltd, it did so in pursuance of any "*active investment policy*". As I have already conclusively found, the 15,6% shareholding was acquired and done as a particular financing method for the W Co. Co. acquisition, the entire result of which was clearly a capital acquisition. In any event, the very first potential benefit to A

Ltd alluded to by Mr Y - for adopting the financing option chosen – was a long term holding. This effectively puts paid to any attempt to suggest that by acquiring the 15,6% shareholding in B Ltd, A Ltd was engaged in any meaningful share jobbing. At best for A Ltd regarding this 'mixed intention', disposing of the B Ltd shareholding in the future for a profit could have been one of several possibilities, none of which was dominant. In any event, this so-called mixed intention by A Ltd is not even a ground of appeal.

[47] I now turn to the further alternative argument submitted on appellant's behalf, namely that appellant was an "*all in*" company. According to Mr Y, all A Ltd's assets without any exception, were acquired simply to be resold. This bizarre assertion, extended, according to Mr Y, even to A Ltd's controlling interest in C Ltd, and in, amongst others, FW Ltd. A Ltd's strategic holding in the latter two entities is solely with a capital intent. This is patently self-evident.

[48] But according to Mr Y, none of these assets were acquired to be held and earn an income from them. All A Ltd's assets fell to be treated in the same way as the jobbing enterprise carried on by Mr Y in listed gold shares. Thus, so the argument went, even unlisted shares in private companies such as B Ltd, were acquired solely for the purpose of resale.

[49] Mr Y's evidence in this respect is so ludicrous and grossly improbable that the court has no hesitation to reject it.

[50] I now turn to the manner in which A Ltd disposed of its 15,6% shareholding in B Ltd.

[51] It was submitted that the circumstances in which the appellant disposed of the 15,6% shareholding in B Ltd was not in any way inconsistent with them having been acquired as trading stock, for the purposes of disposal. The argument went further that because of the downturn in the fortunes of B Ltd, the appellant had not been able to dispose of the shares at a profit in any one of the manners previously contemplated and accordingly the decision to dispose of the shares had been deferred. It is then concluded that when the restructuring of the group took place in 1998, it was not feasible for the appellant to continue to hold onto the shares any longer even though the disposal would have resulted in a significant loss.

[52] A closer look at the actual circumstances by which the disposal of the 15,6% shareholding took place however reveals that the above assertion cannot be sustained. The evidence discloses conclusively that other than the disposal of the B Ltd shares, A Ltd similarly also disposed of its other assets for example *ABC (Pty) Ltd, BD (Pty) Ltd and SA Ltd.* The disposal of these assets was a result of A Ltd's decision in 1998 to unbundle and when it embarked on a restructuring exercise. It is trite that when the latter assets were sold as part of this unbundling, A Ltd realised a profit on the sales.

[53] It is quite interesting to note that when the respondent attempted to tax the resultant profit, the appellant, in its letter to the respondent dated 23 February 2000, expressly stated that the shares in the above companies were disposed of as a result of the company's decision to unbundle, that the profits on their disposal did not arise in the ordinary course of business but rather as a result of the forced disposal due to the unbundling of A Ltd, and that the profits were deemed to be capital.

[54] It is patently clear that the disposal of the B Ltd shares to C Ltd was not fortuitous or in the course of any share jobbing or profit-making scheme as the appellant would like us to believe.

[55] Furthermore, it is, clear, that when the appellant has realised a profit after disposing of its asset, it conveniently asserts that such disposal is of capital but when a loss has been incurred, as alleged in this case, it wants everyone to believe that it was disposing of its stock in trade or that it was in the ordinary course of business.

[56] A conspectus of all the evidence, the minutes of meetings of A Ltd's executive committee, its prospectus, annual reports and all other relevant documentation shows beyond any doubt that the 15,6% shareholding in B Ltd was acquired and held as a capital investment.

[57] I accordingly find that the appellant has failed to discharge the *onus* of showing that it acquired the shareholding in B Ltd either as a scheme of profit-making or as trading stock. It follows that this appeal must, accordingly, fail.

[58] I have nonetheless deemed it necessary to comment on the appellant's reliance on section 22 of the Act. I am of the view that even if I were to find that the 15,6% shareholding in B Ltd was acquired and held as part of a scheme of profit-making and were part of A Ltd's trading stock, the expense of the purchase of R300 million, incurred in 1994, cannot nevertheless be claimed as a deduction in the 1999 year of assessment. The reason for this is that A Ltd did not in the 1994 tax year and in the ensuing tax years take the expense into account, whether as opening stock, purchases or closing stock.

[59] In the case of *Caltex Oil (SA) Limited v Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 673-674 Botha JA said that: "*In determining the taxable income of a person carrying on any trade in any year of assessment, there is, in terms of section 11(a) deductible from such person's income the expenditure actually incurred by him in the production of the income* ***during that year of assessment.***"

See also *Silke* para 7.7, *Edgars Stores Ltd v CIR* 1988 (3) SA 876 (A)

[60] Section 22 of the Act provides that:

"*22. Amounts to be taken into account in respect of values of trading stocks.*

(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 other (other than farming), be taken into account in respect of the value of any trading stock held and not disposed 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 of fashion, decrease in the market-value or for any other reason satisfactory to the Commissioner; and

(b) …

(1A) …

(2) 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 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."

[61] It must be pointed out that section 22, significantly, does not provide for any deduction of anything at all from taxable income, unlike section 11(a)

which expressly provides for what may be deducted. Furthermore it is clear that section 22 is subject to section 11(a).

[62] The purpose of section 22 can best be described by way of an example. A trader who makes purchases for sale during a particular year incurs by so doing expenditure in the production of income. The purchased stock becomes his "*floating capital*" which he intends to turn into profit. Section 11(a) of the Act allows the cost of the purchase to be written off in the year in which it was acquired. However, this would distort his taxable income because at the end of the year he might not have sold all or any of the stock.

[63] Section 22(1) of the Act, using the word "*shall*", requires the trader at the end of the year of assessment to "*take into account*" the value of the trading stock which he acquired, held and did not dispose of by the end of the year. He must then deduct it from the expenditure on purchases during the year, thus arriving at the true expenditure incurred during that year in the production of the particular income derived from that expenditure in that year.

[64] On the other hand, having compelled him to deduct from his purchases his closing stock, he must be given the benefit of it in the following year, again via the imperative use of the word "*shall*". What then has to be taken into account is no longer the expenditure in terms of section 11(a), since that expenditure was incurred in the previous year, but the opening stock. Thus, the opening stock to be taken into account in respect of taxable income for the following year is precisely the same stock as the closing stock in the prior

year, because it is "*held and not disposed of by him at the beginning of the year*".

[65] Section 22 does not state specifically in any way what may be deducted nor does it provide for any deductions at all. To ascertain that, one has to read its provisions together with those in section 11(a). It is only if section 11(a) was made to apply *ab initio* that section 22 comes into operation.

[66] Thus, if in year 1, a share dealer acquires shares as trading stock, he may deduct the cost as an expense in that year. At the end of the year, however, insofar as he has not disposed of all the shares, he must bring them into account as closing stock at their cost price.

[67] It follows that from a bookkeeping or accounting perspective, that the share dealer will be in a nil position if he sold none of the shares because he is required ("*shall*") to show them as closing stock. At the beginning of year 2, he will show the shares again at their cost price, and so on until he eventually sells them. When that eventually happens then in that year they become in effect a deduction because they have been disposed of, not because of their character as opening stock but because they were originally properly claimed under section 11(a).

[68] Of fundamental importance is that the actual deduction in respect of the cost price (of the shares) must have been made and taken into account in

the determination of taxable income in the year of their acquisition (in terms of section 11(a)), and in addition in each year thereafter until disposition there must be appropriate figures for closing and opening (in terms of section 22).

[69] The whole purpose of section 22 is clearly to prevent fraud and abuse hence it must be strictly complied with.

[70] It is also clear that a plain meaning of the words of section 11(a) and section 22 must be strictly complied with in the relevant years, in this case 1994 to 1998, in order to result in a deduction in 1999 via the application of section 11(a) in 1994. It is trite that A Ltd never claimed any deduction of the cost of the shares during the period 1994 to 1998.

[71] All trading expenditure (losses in the expense sense) must, to be claimable, be taken into account and claimed in the year which they were incurred.

[72] In my view it was imperative for A Ltd to have claimed the deduction in its tax returns for the purpose of assessment in any given year, even if the shares were not sold in that year.

[73] For all these reasons stated above, I am of the view that the appellant's reliance on section 22 is misplaced.

[74] The following order is accordingly made:

The appeal is dismissed.

Dr. H.A COETZEE-ACCOUNTANT MEMBER	**JUDGE B H MBHA - PRESIDENT**

Mr N. MATLALA-COMMERCIAL MEMBER

Dates of hearing: 30-31 July, 1-3, 7-8 August 2007

Date of judgement: 26 October 2007

Counsel for appellant: Adv. P.A. Solomons SC

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