

**(Reportable)**

**IN THE TAX COURT**

**PRETORIA**

**CASE NO: 12886**

In the matter between:

**Mr S** Appellant

and

**THE COMMISSIONER FOR SARS** Respondent

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**JUDGMENT**

**Delivered: 21 October 2010**

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**R D CLAASSEN J:**

1.

The issue in this appeal turns on the question of whether the shares that Appellant bought in the 2008 tax year were trading stock or a capital asset.

2.

The facts are not in dispute, only the inferences to be drawn therefrom.

The uncontested facts have been clearly set out by the Respondent's

counsel Mr Xulu in his heads of argument and it is convenient to quote them here, with a few minor amendments of my own:

“7. *The taxpayer during the year of assessment in dispute was employed by the N Group Holdings as a Director.*

8. *N introduced a scheme known as the N Employees Share Incentive Scheme. The purpose of the scheme was to reward and retain the best performing employees.*

9. *In furtherance of the objectives of the employees share incentive scheme:*

9.1 *during the calendar year 2003 the appellant was issued with 100,000 share options. These options duly vested to the appellant in 2006. These share options were issued to the appellant for R2.67.*

9.2 *Further, during 2004 the taxpayer was issued with a further 75,000 share options by his employer N, which could be exercised in tranches of 20% (i.e. 15000 per year) per year thereafter, starting in June 2006. These*

*share options were offered and issued to the appellant for R4.36.*

10. *During May and June 2007 the appellant exercised his rights in connection with the share options:*

10.1 *On 15 May 2007 the appellant acquired 100,000 shares which options were issued to him in 2003 and also acquired one tranche of 15,000 issued to him in 2004; and*

10.2 *On 1 June 2007 the appellant acquired a further tranche of 15,000 shares that were issued to him in 2004. The appellant effected a cash based exercise, in terms of which the appellant bought the share options and retained the shares.*

10.3 *On the acquisition dates, the market value or share price was R14.68 and R15.58 respectively.*

11. *The market value of the shares, at the end of the 2008 year of assessment, declined and was trading at R9.57 per share. The appellant in the 2008 year of assessment, in light of the*

*decline in the share price, took a view that the shares constitute 'trading stock' in his hands.*

- 12. As consequence of the aforementioned view, the Appellant took the market values of the shares at the acquisition date as **(R14.68) and (R15.58)** respectively as representing the balance of the opening stock and took the market value at the end of the 2008 tax year **(R9.57)** as the closing balance of the trading stock. As consequence thereof, he claimed as a notional deduction, an amount totalling R677.800 being the difference between the listed share price on the acquisition date (May & June 2007) and the share price at the end of the 2008 tax year.*
  
- 13. SARS disallowed the claim for the deduction of the said amount on the basis that: the Appellant did not carry on a trade as a share dealer and accordingly; the appellant did not incur any loss; and the shares were not trading stock. Further, SARS contended that even if it were to be held that the shares constituted trading stock the values that must be taken into account is the cost price / amount actually paid for the shares at the acquisition date **(R2.54 and R4.36)** and the*

*values at the end of the tax year, and accordingly the Appellant did not incur any loss.*

14. *Pursuant to the disallowance of the objection, the Appellant lodged an appeal to the disallowance of the objection. The Appellant relied on the same grounds as relied on in his objection to the assessment.*

15. *On 29 November 2009 this appeal served before the Tax Board sitting at Megawatt park. The Chairperson of the Tax Board, having considered the evidence and arguments presented by SARS and the Appellant, held that the Appellant was not a share dealer, and accordingly the appeal was dismissed.”*

3.

The Appellant also claimed a deduction in respect of his membership fees of the South African Institute of Chartered Accountants (SAICA). The basis therefore was that he did outside consulting work i.e. beyond his normal employment. In order to be able to do that he had to be a member of SAICA. He thus claims his membership fee as a necessary trade

expense. Initially SARS denied his claim but at the appeal however, this claim was conceded by the Respondent.

4.

Only the Appellant testified during the appeal. None of his evidence as such (i.e. apart from his contentions and inferences) was denied. His evidence was that he was aware of the two share incentive schemes that were available to him. The main scheme is the one referred to in paragraph 8 of the background facts set out earlier. The other scheme was the so-called European option (a scheme managed by ABC (Pty) Ltd and wherein N shared). The basis of how it works is not relevant except that it was also only available to employees of N who were allotted so-called "*phantom shares*" that were programmed by Investec to be sold at certain stages. Employees had to pay a premium in order to partake in the scheme and could also buy a further certain percentage in.

5.

Appellant's evidence was that at the latest during 2007, if not earlier, he decided to look into the options offered to him. He did this because he was aware that the market was very buoyant at that stage and he considered

that he could possibly make a “*quick buck*” if he buys and sells at the right time.

6.

It is common cause as stated above, that he could have bought them and resold immediately and still have made a profit because he obtained them at a bargain price. That is, in fact, still the situation today.

7.

Appellant referred to an article in the Business Day which appeared during 2007 which clearly indicates that the market was bullish and that a further growth in price of up to 30% was expected. This article appears on page 14 of the dossier. The first sentence of the ultimate paragraph reads as follows:

*“It seems the market is expecting the current year’s earnings growth to be better than the experts, but is certainly expecting N to achieve at least 30% in 2008. Most of the current demand for the share seems to be from long term investment. The investors are buying for the long term potential and the share price could well reach R18 over a year from now.”*

It was due to that sentiment that he bought the shares. He was very clear in his evidence that he bought for no other reason than to resell when the shares go up even further. He was expecting it to go up to R18 per share.

8.

The fact of the matter is however, that almost immediately after he bought the shares (May and June 2007) the economy and the stock market crashed. He was thus not in a position to sell and realise a profit – at least not to the extent that he had expected. (It is common cause that he did not sell any of the shares at all during the rest of the tax year).

9.

As stated, his evidence, stands uncontradicted. The Respondent's attitude was simply that since:

9.1 The Appellant is a salaried employee;

9.2 The share options came to him without him having gone out to actually look for shares to buy and sell;



9.3 He was not what one might label in the normal parlance as a “*share dealer*”;

9.4 He did not in fact, sell any of the shares during that tax year.

10.

he was not a share dealer. Appellant’s case is further that he made a notional loss in the sense that the market value of the shares dropped in that period. Of course, as stated he could still have sold them at a profit but decided not to do so because he clearly wanted a higher profit margin. This was also not contested in evidence.

11.

This case then turns on the provisions of Section 11(a) and 22(2) of the Income Tax Act, 58 of 1962. The relevant portions read as follows:

**“11(a)** *expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;”*

**“22(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.”*

This Court only has to decide whether Appellant can be classified as a trader for purposes of this transaction or not.

## 12.

It is common cause between the parties that:

12.1 A once-off venture can classify as a trade for purposes of the definition of a trade or stock in trade;

12.2 Shares *per se* are certainly capable of being such stock in trade;

12.3 The Court must have reference to all surrounding circumstances to decide what the true nature thereof is.

13.

In **New State Areas Ltd v CIR 14 SATC 155** it is stated that the true nature of each transaction must be enquired into to determine whether it is capital or revenue. At page 170 the following is stated:

*“Its true nature is a matter of fact and the purpose of the expenditure is an important factor.”* (my emphasis)

In **BP Southern Africa Ltd v C: SARS 69 SATC 79** the Supreme Court of Appeal held as follows in paragraph 7:

*“The purpose of the expenditure is important and often decisive in assessing whether it is of a capital or revenue nature – often decisive.”*

(It then refers to the **New State Areas** case with approval)

14.

To our minds none of the facts relied upon by the Respondent as set out in paragraph 9 above detracts from Appellant’s uncontested evidence referred to above. An interesting comment is raised by one of the assessors that in normal accounting practice a “*short term investment*” i.e. one that would normally fall into the category of stock in trade, is 12 months. In this scenario

it would mean that Appellant had not yet had the full 12-month period to resell the shares.

15.

Another factor is the fact that Appellant is not one that has invested to any relevant measure in shares as capital assets. If that were so, it would have been much easier to classify this transaction as another capital investment. The evidence is however clear that this was a once-off trade where he saw an opportunity to make (a rather big) profit.

16.

One further comment needs to be made. If the Respondent's view, viz. that because Appellant did not sell the shares in that tax year he is not a trader, is to be upheld, it could lead to the assumption that stock must be sold within the same year of acquisition in order to qualify as stock in trade. That could never be the position and in fact the Act provides specifically how stock in trade, not sold during the year of acquisition, is to be dealt with.

17.

Thus, in view of the Appellant's uncontested evidence, together with the common cause facts, and the fact that a "trade" can consist of a single

“*venture*”, it is the finding of this Court that the Appellant’s appeal must be allowed and it is found that the acquisition of the shares became stock in trade.

18.

The issue as to whether Appellant in fact incurred a trade loss (i.e. a notional loss) was not properly aired during the hearing and the matter must be referred back to the Commissioner to make a revised assessment in view of this judgment.

19.

No costs were asked for during the hearing. Since Mr S argued his case in person his costs are not relevant at this stage and no finding is made in respect of costs.

20.

We thus make the following order:

1. The appeal is upheld with the following result:

- 1.1 Appellant's membership fees of SAICA are held to be a deductible expense for purposes of income tax;
  
- 1.2 The Appellant's shares held in N are held to be stock in trade i.e. that Appellant was with respect thereto, acting as a trader in those shares, during the 2008 tax year.

This is a unanimous decision of the court.

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**R D CLAASSEN**  
Judge of the High Court