

ITC January 2015: P3 Q1

With reference to relevant case law discuss whether the receipt of \$500 000 from the sale of Developer's own office building on 1 September 2014 is of a capital nature in terms of the gross income definition in section 8.1 of the income tax act. **15 marks**

Ignore the recoupment of the amounts previously deducted in terms of the 4th schedule to the Income Tax Act.

	Mark plan
General	
There is no definition of capital in the Income Tax Act. In this regard guidance has been sought from the courts as to what constitutes a receipt or accrual of a capital nature.	1
It should be borne in mind that the onus to provide proof that the amount is of capital nature rests on the taxpayer.	1
Intention	
On the basis that the building in question constitutes fixed capital, the most appropriate test will be the determination of the intention at the time in which the building was constructed. In addition, one should assess if this intention did not change in the intervening period.	1
In COT Southern Rhodesia v Levy 1952 the courts held that intention at acquisition is important unless some other factors intervene (not decisive) to show that the article was sold in pursuance of a scheme of profit making.	2
Capital	
At the time when construction started, the intention was to develop the building for own use, i.e. capital in nature.	1
In the CIR vs Richmond Estates case / John Bell case, it was held that the decision 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. This argument will hold water if Developers (as was the case in Richmond Estates) could prove that certain circumstances, other than as part of a scheme for profit making, forced it to sell the property.	2
The taxpayer is entitled to order their affairs/sell the asset to the best advantage. This principle was established in COT Southern Rhodesia vs. Levy 1952.	1
The fact that it was actually used in trade as an asset and claimed allowances could indicate initial intention.	1
One could also argue that the office building is the tree and not the fruit. This principle was argued in the Visser court case.	1
Profit Making	

The question to be answered is whether the transaction is carried out as a profit-making scheme. This is a well-established principle in cases similar to the transaction of Developers. See CIR v Pick 'n Pay Employee Share Purchase Trust and CIR v Stott.	2
The Elandsheuwel Farming (Pty) Ltd case stated that the acts and omissions of a juristic person are controlled by living beings and that they are the brain and the ten fingers of that juristic person (alternative case: Richmonds estates). Accordingly, one must look to the actions of the directors to determine the intention of Developers.	2
The sale of property could be viewed as a profit-making scheme and it should accordingly be treated as revenue as Developers is involved in developing and selling property. For this reason it could be argued that Developers' core business has influenced its decision to sell its building	1
The fact that management has stated that the sharp increase in property prices prompted the sale of the building strengthen the argument above.	1
The tax payer had entered into a similar transaction in 2008 – this could indicate revenue in nature.	1
The taxpayer paid for the construction of the building in cash – this indicates towards revenue in nature	1
The building was held for 6 months when the taxpayer decided to sell – indicates towards revenue in nature	1
CHANGE IN INTENTION - CROSSING THE RUBICON	
Based on the Natal Estates case / John Bell case / Elandsheuwel case, one should consider a number of factors in deciding whether the taxpayer has engaged in a scheme for profit making. These factors include the taxpayer's ipse dixit as to the intention and the degree, nature, duration, extent and marketing operations of the enterprise. From the totality of the facts one then enquires whether it can be said that the taxpayer had crossed the Rubicon and gone over to the business or embarked upon a scheme of selling land for profit.	2
Developers' motive for selling the building was to make a profit. This is a strong indication that its intention has changed and that it has embarked on a profit-making scheme. The activities of advertising the building, coupled with short holding period and the fact that numerous offers were received before one was eventually accepted suggest that the company has crossed the Rubicon.	1
Conclusion	
Based on the assessment of Developers' circumstances, the proceeds on sale of property should be treated as revenue in nature	1
Available	22
Maximum	15