

SUPREME COURT OF APPEAL OF SOUTH AFRICA

PRESS RELEASE

10 May 2011

STATUS: Immediate

CSARS v Founders Hill (509/10) [2011] ZASCA 66 (10 May 2011)

Please note that the media summary is intended for the benefit of the media and does not form part of the judgment of the Supreme Court of Appeal

The Supreme Court of Appeal today upheld an appeal against a decision of the Tax Court, Johannesburg, which had held that Founders Hill, a wholly owned subsidiary of AECI Ltd, formed for the purpose of developing and selling land surplus to the needs of AECI, had realized assets of a capital nature and that the profits it made were not taxable as income.

AECI had owned land in Modderfontein, Johannesburg for many decades. An explosives factory had been built on it in 1896, and was extended in 1937. Much of the land was required as a buffer between the factory and areas where people lived and worked. But as technology changed, the extent of the buffer was reduced. Economic and social developments also required that the land be used for housing and industry. AECI took steps to subdivide and develop the land for the purpose of selling it as land for residential, business and light industrial purposes.

Acting on legal advice, in 1993 AECI formed Founders Hill as a 'realization company' with the express purpose of realizing the land which AECI sold to it to 'best advantage'. It commenced doing so and engaged the services of another AECI subsidiary, Heartland Properties, to further develop and market the land.

The Commissioner initially did not regard profits on sales of the Modderfontein as taxable income. (And in the tax years in issue, capital gains tax had not yet

been introduced.) But for the tax years 2000 and 2001, he issued a revised assessment on the basis that the profits were taxable income. He also levied penalty interest.

Both the Commissioner and Founders Hill approached the question whether the erven sold were capital assets or stock-in-trade on the basis that Founders Hill had acquired capital assets: the Commissioner contended that the company had changed its intention and had become a trader in land. Founders Hill maintained, on the other hand, that it had merely realized capital assets to best advantage. The tax court found for Founders Hill. It held that the company had not 'crossed the Rubicon' (a phrase used in a seminal case on crossing the divide between realizing assets held previously as investments and selling the assets as its business: *Natal Estates Ltd v Secretary for inland Revenue* 1975 (4) SA 177 (A)). Founders Hill was thus not liable to pay the assessed income tax or interest.

On appeal to it, the Supreme Court of Appeal took a different approach. It held that once an entity acquires assets for the purpose of selling them, it trades in those assets. There are exceptional cases where a realization company or trust is required in order to facilitate the sale of assets (for example, where different people owned them, but to sell to best advantage the interposition of another entity is required). But this case was not exceptional and Founders Hill had traded in the land it had acquired from AECl for that purpose.

The SCA considered, however, that Founders Hill should not be liable for penalty interest, since it had mistakenly believed that it was doing no more than realizing the land as advantageously as it could and had disclosed all the facts to the Commissioner in its tax returns. It thus upheld the appeal, and replaced the tax court's order so that the Commissioner's revised assessments stood save to the extent that Founders Hill was not liable to pay the penalty interest.