THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 115/2015

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

KLUH INVESTMENTS (PTY) LTD **RESPONDENT**

Neutral citation: *CSARS v Kluh Investments (Pty) Ltd* (115/2015) [2016] ZASCA 5 (1 March 2016).

Bench: Ponnan, Willis and Zondi JJA and Fourie and Kathree-Setiloane AJJA

Heard: 16 February 2016

Delivered: 1 March 2016

Summary: Income Tax – whether taxpayer conducting farming operations for the purpose of s 26 of the Income Tax Act 58 of 1962 read with paragraph 14 of the First Schedule to the Act.

ORDER

On appeal from: Western Cape Division of the High Court, Cape Town (Traverso DJP, Allie and Rogers JJ sitting as court of appeal): judgment reported *sub nom Kluh Investments (Pty) Ltd v Commissioner, South African Revenue Service* 2015 (1) SA 60 (WCC).

The appeal is dismissed with costs, such costs to include those consequent upon the employment of two counsel.

JUDGMENT

Ponnan JA (Willis and Zondi JJA and Fourie and Kathree-Setiloane AJJA concurring):

[1] The Thesen Group of companies owned property in Knysna on which they conducted forestry, timber-growing and a plywood manufacturing business. During May 2001, Steinhoff Southern Cape (Pty) Ltd (Steinhoff) concluded written agreements with Thesen Company (Pty) Ltd and Thesen Properties (Pty) Ltd (collectively referred to as Thesen) in terms of which the former or its nominee, as purchaser, agreed to acquire for the total purchase price of R45 million, all of the assets and the business as a going concern of the latter, including the land and the plantation – with which this case is concerned. However, the board of Steinhoff's ultimate holding company blocked the acquisition of the land and plantation because it was at that time their policy not to acquire fixed property in South Africa. As a result, as it was put in the evidence, Steinhoff had to then 'find somebody to own the land'. In the event, agreement was

reached that Steinhoff would purchase Thesen's machinery and equipment, including the latter's sawmill for R15 786 881, and the respondent, Kluh Investments (Proprietary) Limited (Kluh), a special purpose subsidiary of a Swiss company, Fihag Finanz und Handels AG (Fihag), would acquire the remaining assets for R29.5 million.

[2] Consequently, Thesen agreed to the cancellation of the May 2001 agreements. And, although an oral agreement had been reached between the parties by June 2001, substitute agreements were only executed during October of that year. On 29 June 2001, Kluh took possession of the plantation and the land. In terms of the written agreement executed on 3 October 2001, the purchase price of R29.5 million was apportioned as follows: R11 596 121 to the plantation; R12 528 459 to the land; and the balance to other assets. Kluh retained the land and plantation but onsold the other assets, including an erf, the plywood business and certain trademarks to third parties. By the beginning of 2003, prompted in part by escalating timber prices and the scarcity of plantation resources, Steinhoff had a change of heart – it arrived at the conclusion that it would be desirable to acquire the plantation and land that Kluh had purchased from Thesen during 2001.

[3] In the result, on 21 February 2003, Steinhoff and Kluh concluded a written agreement of sale. The subject of the sale was described as being 'the plantation business', which was defined in clause 3.1 of the agreement as 'the business of commercial forestry operations, which includes the plantation sales assets, machinery and equipment and plantation contracts carried on by [Kluh] at the plantations and the plantation immovable property as defined, as a going concern'. Clause 4 of the agreement recorded that:

'4.1 The purchase price of the business will be established by an independent nationally recognised valuer, whose valuation will specify the value of:

a) the immovable land;

b) the standing timber, plantation stocks and other assets.

4.2 The purchase price will be as valued by the valuer provided that the value of the standing timber and plantation stocks as at 30 June 2003 will be not more than R98 million

(Ninety Eight Million Rand), and the value of the immovable land will not be less than R10.5 million (Ten comma Five Million Rand).'

[4] Certain disputes arose between the parties flowing from that agreement. Those were resolved by way of a settlement agreement concluded on 29 July 2004. In terms of that settlement agreement, which had a new effective date of 1 June 2004, the 'final purchase price' of the combined assets was agreed at R159.7 million, of which R144.7 million was in respect of 'the plantation', which was defined in clause 2.5.9 as:

'the Standing Timber on the Immovable Property and, for the purposes of expressing the value thereof as part of the Purchase Price, includes the plantation business (ie the business of commercial forestry operations) including the Plantation sale assets, machinery and equipment and Plantation contracts, all as a going concern'.

[5] The appellant, the Commissioner for the South African Revenue Service (SARS), assessed Kluh to tax on the basis that the proceeds of that sale formed part of its gross income by virtue of s 26(1) of the Income Tax Act 58 of 1962 (the Act) read with paragraph 14(1) of the First Schedule thereto. The Tax Court (per Davis J) agreed with SARS. It accordingly dismissed Kluh's appeal to it and ordered that '[t]he initial assessment be amended by the addition of an amount of R12 million by virtue of s 129(b) of the Tax Administration Act'. The full court of the then Western Cape Division of the High Court, Cape Town (per Rogers J, Traverso DJP and Allie J concurring), in overturning the decision of the Tax Court, held that the proceeds of the sale were not gross income in terms of s 26(1) of the Act. The full court accordingly issued the following order (para 91 of its judgment):

'(a) The appeal is upheld with costs, including those attendant on the employment of two counsel.

(b) The order made by the tax court on 19 August 2013 is set aside and replaced with an order in the following terms:

"(i) The appellant's appeal against the additional assessment in respect of its 2004 tax year, with a due date 1 September 2010, succeeds and the said additional assessment is set aside.

(ii) The capital gains tax treatment arising from the appellant's acquisition and disposal of the plantation and land which was the subject of the additional assessment is remitted to the tax

court for determination on the pleadings already filed in the tax court on the capital gains tax issues.'"

SARS appeals with the leave of this Court.

[6] Section 26(1) of the Act provides:

'The taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule.'

The term 'farming operations' in the provision shall, insofar as it is derived from such operations, be determined in accordance with the provisions of the Act, but subject to the provisions of the First Schedule (*Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A) at 304G). The First Schedule is concerned with the 'Computation of Taxable Income from Pastoral, Agricultural or other Farming Operations'. It deals in detail with how taxable income derived from farming operations is to be computed. To the extent here relevant, paragraph 14 thereof reads:

'(1) Any amount received by or accrued to a farmer in respect of the disposal of any plantation shall, whether such plantation is disposed of separately or with the land on which it is growing, be deemed not to be a receipt or accrual of a capital nature and shall form part of such farmer's gross income.'

[7] The primary issue in this appeal is whether Kluh was 'carrying on farming operations' as contemplated by s 26(1) of the Act. As Corbett CJ observed in *D & N Promotions (Pty) Ltd* (above) at 305G:

'It is normally to the advantage of a farmer that income earned by him be classified as derived from farming operations because he can then deduct therefrom the type of expenditure referred to above; whereas such expenditure cannot be deducted from income not derived from farming operations. Conversely it is to the advantage of the *fiscus* that such income be classified as income not derived from farming operations.'

In a somewhat ironical reversal of roles, in this case it is the taxpayer who contends that it was not conducting farming operations and SARS who asserts that it was. Both the Tax Court and the full court approached the enquiry on the basis that the 'critical' or 'important' facts for the purposes of answering the question whether the appellant was

carrying on farming operations were common cause. However, on those common cause facts they reached starkly contradictory conclusions.

[8] In arriving at its conclusion, the Tax Court stated (paras 48 and 56):

'Without wanting to impugn the credibility of any of appellant's witnesses, it would have been highly surprising if any other version would have been forthcoming from them. To this extent therefore, the court is obliged to evaluate their evidence with a great degree of care through the prism of documentary evidence which was so presented. The outcome of this evaluation may more accurately determine whether appellant has discharged the required onus.

. . .

When the objective evidence, particularly the range of documents to which I have references, including contracts and financial statements are considered. They all indicate in the direction that appellant was conducting a business of plantation farming. Even in the event that beneficial consideration is given to appellant's case by virtue of amendments to various documents, it would appear that the thrust of contemporaneous documentation supports respondents' case, to the extent that appellant has not discharged the onus of proving that its intention differed from that which is recorded in these financial documents, contracts, minutes and resolutions, namely that it had bought and sold the plantation businesses as a going concern and that it employed Steinhoff to manage its plantation business on its behalf. Expressed in the terms employed in ITC 1185, when the evidence of Messrs van der Merwe, Pretorius and Evans is tested against the documentary evidence, the probabilities cannot be said to favour appellant's version to justify a conclusion that it has discharged its onus.'

[9] It thus seems, as the full court observed, that: 'the tax court did not find persuasive the oral testimony of the witnesses who said that [Kluh] was not conducting and did not intend to conduct a plantation business'. In my view, the full court was justified in declining to endorse the approach of the Tax Court, for, as this court recently reiterated in *Commissioner, South African Revenue Service v Pretoria East Motors (Pty) Ltd* 2014 (5) SA 231 (SCA) para 8:

'It is so that the taxpayer's *ipse dixit* will not lightly be regarded as decisive. But it must be considered together with all of the other evidence in the case. And, given the unfavourable position of having the onus resting upon it – a "formidable and difficult" one to discharge (per Trollip JA; *Barnato Holdings Ltd v Secretary for Inland Revenue* 1978 (2) SA 440 (A) at 454A-B)

– the interests of justice require that the taxpayer's evidence and questions of its credibility be considered with great care. Indeed the taxpayer's evidence under oath and that of its witnesses must necessarily be given full consideration by the court, and the credibility of the witnesses must be assessed as in any other case that comes before the court. (See *Maland v Kommissaris vir Binnelandse Inkomste* 1983 (3) SA 1 (A) at 18E.) It thus remains the function of the court to make a determination of the issues that arise for decision on an objective review of all of the relevant facts and circumstances. Not the least important of the facts, according to Miller J (*ITC* 1185 [1972] 35 SATC 122 (N) at 124) –

"will be the course of conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or participation in similar transactions. The facts in regard to those matters will form an important part of the material from which the court will draw its own inferences against the background of the general human and business probabilities".'

[10] There is no definition of 'farming operations' in the Act and whether or not a person's economic activity constitutes farming operations is essentially a question of fact (*D & N Promotions (Pty) Ltd* (above) at 306A-B). The full court thus correctly held in para 9 that: 'the questions whether a person is carrying on farming operations and whether particular income has been derived from farming operations are questions of fact . . .'. It then added:

'But the interpretation of s 26(1) and para 14 is a matter of law. Once all the facts relevant to determining whether the case does or does not fall within s 26(1) and para 14 have been ascertained, the question whether on those facts there has been a carrying on of farming operations seems to me to be a question of law. Even if it were regarded as a question of fact or a mixed question of fact and law, it is not the sort of matter in regard to which an appellate court would need to display the caution or deference mentioned in *Mkhize* and earlier cases to similar effect.'

Later the full court observed in paras 53, 55 and 60 respectively:

'Insofar as SARS' argument rests on the closeness of the connection between the disposal proceeds and the conducting farming operations, I consider that the argument (and the finding of the tax court) conflates two distinct issues. Section 26(1) does not apply merely because there has accrued to the taxpayer income which has "derived from" farming operations; the section applies to a person carrying on farming operations to the extent that his income is

derived from such operations. Two questions must therefore be answered: (i) Was the person whom SARS wishes to tax a person carrying on farming operations during the year of assessment in question? (ii) If so, did the particular item of income in dispute derive from those farming operations?

. . .

However, where the first of the two questions I have identified is in issue, it is impermissible to proceed directly to the second question as if it will also provide an answer to the first. The question is not whether the accrual to the taxpayer of a particular item of income is directly connected to the farming operations of any person but whether it is directly connected to (ie derived from) the farming operations of the taxpayer himself.

. . .

If, on the facts of the present case, one were to conclude that the appellant was conducting farming operations, I think it would follow almost as a matter of course that the proceeds of the disposal accrued to the appellant as a farmer. Ordinarily such a disposal would be of a capital nature but para 14 of the First Schedule deems it to be gross income. The real issue in the present case is not the second one (a sufficiently close connection between the income and farming operations) but the threshold enquiry whether the appellant was carrying on farming operations.'

[11] The approach of the full court conduces to confusion. As Innes CJ put it in *Commissioner for Inland Revenue v George Forest Timber Co Ltd* 1924 AD 516 at 523: 'It is dangerous in income tax cases to depart from the actual facts; the true course is to take the facts as they stand and apply the provisions of the statute.' The facts here are: Steinhoff had initially purchased the plantation itself, with the intention of carrying on its own farming operations thereon, as already mentioned, but was not permitted to proceed with this agreement because the board of its ultimate holding company prevented it from owning the land, due to the Group's then policy not to own land in South Africa. Steinhoff thus acquired from Thesen, independently of Kluh, all the equipment and the personnel required to carry on farming operations on the plantation. When Thesen disposed of the plantation to Kluh in 2001, it was already a mature plantation in rotation. The plantation, which had been well managed by Thesen (which was regarded by the witness Mr Van der Merwe of Steinhoff as having one of the best plantation teams in the country), had reached the stage where it could annually yield a

steady and sufficient number of mature trees for commercial felling, with younger trees taking their place year by year. Steinhoff, which owned the equipment necessary for conducting the plantation operations and employed the employees who worked on the plantation (mostly taken over from Thesen), was entitled to harvest the timber for its own account. Kluh owned no equipment and had no employees. All operational income and expenditure were earned and incurred by Steinhoff and reflected in its accounts. Thus, Kluh's financial records and financial statements for the period between the acquisition and the disposal of the plantation reflect no operational income and expenditure. The oral arrangement between Kluh and Steinhoff was for an indefinite duration and, due to the Steinhoff group policy in 2001 not to own land in South Africa, it was expected to endure for a lengthy period – although either party could obviously have terminated the arrangement on reasonable notice. On termination of the arrangement, the plantation would comprise trees of the same volume and quality as at the commencement. This meant that Steinhoff, in conducting the plantation operations, had to keep the plantation in rotation and perform such other pruning, thinning and maintenance as would ensure that, upon termination, it could restore the plantation as in its June 2001 state. Planting was not required as seedlings grew naturally. Steinhoff was required to manage the plantation using best practice so that, what was described as, Forest Stewardship Council certification could be obtained, thereby ensuring that the timber would qualify for export to Europe. Steinhoff, which was responsible for fire protection, had insured the plantation against fire in the light of its obligation to restore the plantation to Kluh at the end of the arrangement. In the event, Kluh derived no income from the actual day-to-day plantation farming operations and incurred no corresponding day-to-day expenditure.

[12] Thus from the very beginning Kluh wanted nothing to do with any farming operations. Quite apart from the fact that it had neither the appetite for the risks associated with farming nor the requisite skills, equipment and personnel to undertake farming operations, the whole *raison d'être* of Kluh's involvement was to acquire bare ownership of the land and the plantation, which Steinhoff was prevented from doing.

That being so, it was hardly surprising that the full court answered, what it described as the 'threshold enquiry', thus (para 83):

'. . . Here, however, the appellant did not even start to conduct plantation operations. From the outset the appellant made the plantation available to Steinhoff so that the latter could conduct plantation operations for its own profit and loss.'

That conclusion, ought, ordinarily at any rate, to have been dispositive of the primary enquiry in the matter. It was thus unnecessary for the full court to have proceeded – as it did - to an interpretation of s 26 of the Act. For present purposes, whether it was correct in its interpretive exercise need hardly detain us. I accordingly specifically refrain from commenting one way or the other on the correctness of the full court's approach.

[13] The further branches of SARS' argument must now be considered. SARS contends that: first, the purpose of paragraph 14(1) of the First Schedule to the Act is to extend tax liability by treating the proceeds of the disposal of a plantation as gross income; second, the mere disposal of a plantation by its owner constitutes the conduct of farming operations for purposes of s 26(1), irrespective of the extent to which the owner was involved in the actual conduct of farming operations prior to or separately from such disposal, and, third, the farming operations were conducted by Steinhoff 'on behalf of' Kluh.

[14] *As to the first*: Paragraph 14(1) is a deeming provision which, on its own wording, only applies to a farmer in respect of such farmer's gross income. 'A farmer' in that provision is clearly a short-hand for a person carrying on farming operations as contemplated in s 26(1). Carrying on 'farming operations' as contemplated in s 26(1), is clearly the necessary prerequisite that triggers the applicability of the whole of the First Schedule, including the deeming provision in paragraph 14(1). It must follow that the deeming provision itself cannot be employed to determine whether or not a taxpayer is 'a farmer' or differently put 'a person carrying on farming operations'. Accordingly, the content of the deeming provision in paragraph 14(1), namely that 'any amount . . . shall . . . be deemed not to be of a capital nature and shall form part of such farmer's gross income', is the consequence of carrying on farming operations, and cannot itself be

determinative of whether a person is or is not carrying on farming operations ie whether a person is 'a farmer' as contemplated in paragraph 14(1). In short, the deeming provision in paragraph 14(1), on its plain wording, only applies to farmers, and logically one cannot use the deeming provision itself to determine who is and who is not a farmer. It must follow that the first contention advanced by SARS is fallacious because one cannot use a deeming provision that only applies if Kluh is a farmer to determine whether Kluh is a farmer.

[15] *As to the second*: To say, as SARS does, that the purpose of paragraph 14(1) is to extend tax liability by including the proceeds of the disposal of a plantation in gross income may well be misleading. The general rule is that s 26(1) and the First Schedule to the Act does not apply unless the taxpayer is carrying on farming operations. SARS suggests that reading s 26(1) and paragraph 14(1) together, the proceeds of the disposal of a plantation must constitute income derived from farming operations, otherwise they would not be 'captured by s 26(1)'. SARS thus asserts that: 'the act of disposing of a plantation in its entirety is itself recognised by the Act as a farming operation. It must follow that in so doing, the owner is at that very moment 'carrying on farming operations', in accordance with s 26(1), irrespective of what else he or she has done in relation to the plantation. As I have already pointed out, paragraph 14(1) only applies where 'farming operations' as contemplated in s 26(1) are carried on. Paragraph 14(1) then deems the proceeds of the disposal of a plantation not to be of a capital nature and requires such proceeds to be included in the farmer's gross income. It does not cause any proceeds to be 'captured by s 26(1)' as contended by SARS. Paragraph 14(1) recognises that the disposal of a plantation is not per se a farming operation. As Maasdorp CJ observed in *Chotabhai v Minister of Justice and Registrar of Asiatics* 1911 AD 13 at 59, '. . . when it is said that a thing is to be deemed to be something, it is not meant to say that it is that which it is deemed to be. It is rather an admission that it is not that which it is deemed to be, and notwithstanding it is not that particular thing, nevertheless, for the purposes of the Act, it is deemed to be that thing.' Even where the taxpayer is a farmer, paragraph 14(1) contemplates that the proceeds of the disposal of a plantation are in fact of a capital nature. This is why a farmer's proceeds from the

disposal of a plantation are deemed not to be of a capital nature and are required to be included in the farmer's gross income in terms of paragraph 14(1). Such proceeds are not 'captured by s 26(1)', as suggested by SARS, but simply included in the farmer's gross income in terms of paragraph 14(1). It may be so that s 26(1) brings the deeming provision in paragraph 14(1) into operation, but it is wrong to say that the mere disposal of a plantation is therefore recognised as a farming operation. It seems to me, that the presence or absence of what is signified by the 'carrying on of farming operations' as contemplated in s 26(1), and by the words 'a farmer' and 'such farmer's' in paragraph 14(1), must therefore be determined without placing any reliance on the deeming provision in paragraph 14(1). Indeed, from the bar in this court, counsel for SARS was constrained to concede that his argument would only be tenable if we were to substitute the word 'taxpayer' for that of 'farmer' in paragraph 14(1). That we cannot do. Moreover, paragraph 14(1), triggered by s 26(1), recognises that the proceeds of the disposal of a plantation are in fact of a capital nature, but only in the case of a farmer. If such proceeds were in fact not of a capital nature there would be no need for the deeming provision and indeed for paragraph 14(1). In *Commissioner for Inland Revenue v George Forest Timber* (above) at 523-4, Innes CJ stated:

'The facts here are that the company did not purchase the timber separately; it bought the land, and the trees went with it, because they were attached to and formed portion of the realty; that they were by far the most valuable portion, and that they induced the purchase, cannot affect the legal position. As and when acquired the trees growing on the soil were not in the same position as goods in a warehouse.'

The Learned Chief Justice added (at 526):

'. . . Land with a valuable forest upon it was bought in order that a revenue might be obtained from it by felling, working-up and then selling the timber. No doubt the trees constituted the chief value of the property, and formed the inducement for its acquisition. But the same might be said of the stone or the clay in land purchased for the purpose of a quarry or a brickfield. They formed part of the realty to which they acceded, and they passed with it.'

[16] *As to the third:* SARS's counsel put his case to Mr Evans, the CEO of Kluh, as follows:

'Mr Sholto-Douglas: I'm going to ask you to comment on a final proposition, and that is simply this, that Kluh farmed the plantation, not by itself getting its hands dirty, but by employing a manager in the form of Steinhoff to do the dirty work, and paying it in wood that was harvested, and R12 million. That is what we get out of all the documentation and all this history, and that's the true state of affairs.

Mr Evens: I'm sorry, I can't agree.

[Mr Sholto-Douglas]: In short, Kluh was a plantation farmer and SSC [Steinhoff] its manager.

Mr Evans: Again, I'm sorry, I can't agree.'

But, even if Steinhoff in some sense acted on behalf of Kluh, that would not make Kluh a farmer as contemplated in paragraph 14(1). On the facts, Kluh did not have the right to the yield of the plantation – it had granted this right to Steinhoff for the duration of the agreement. Kluh also did not have the use of the land and the plantation, which right it once again had granted to Steinhoff for the duration of the agreement between them. And Kluh did not derive any income from the land and the plantation, the use of which it had granted to Steinhoff to farm for its own benefit, on its own behalf, and for its own account. Thus, the only entity which could be regarded as a 'farmer' (as contemplated in paragraph 14(1)) in relation to the plantation owned by Kluh, was Steinhoff. On this score the full court (para 86) concluded:

'I think Mr Kuschke was correct in submitting that, at most, Steinhoff was managing the appellant's investment while at the same time managing its own farming operations. I do not believe that the documents or witnesses intended to convey more than this. Steinhoff could not be regarded as having been managing the farming operations on behalf of the appellant for a fee (in the form of felled timber) when the appellant stood to make no profit or loss from the farming operations. The only risk which the appellant faced, if Steinhoff failed to conduct itself in accordance with the agreed standard, was that its investment's value might suffer, a risk which a landlord or bare *dominium* owner would also face if the tenant or usufructuary breached his obligations.'

In my view that conclusion cannot be faulted.

[17] In the result, SARS' appeal must fail and it is accordingly dismissed with costs, such costs to include those consequent upon the employment of two counsel.

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V M Ponnan

Judge of Appeal

APPEARANCES:

For Appellant:	AR Sholto-Douglas SC (with him MW Janisch SC and H Cassim) Instructed by: The State Attorney, Cape Town The State Attorney, Bloemfontein
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