INTERPRETATION NOTE 79 (Issue 3)

DATE: 6 August 2021

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 26 AND THE FIRST SCHEDULE
SUBJECT : PRODUCE HELD BY NURSERY OPERATORS

Contents

Preamble

In this Note unless the context indicates otherwise –

- **"CGT"** means capital gains tax, being the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- **"Eighth Schedule"** means the Eighth Schedule to the Act;
- **"First Schedule"** means the First Schedule to the Act;
- **"nursery"** means a place where young trees or plants are grown for the purpose of sale;
- **"nursery operator"** means a person who grows young trees or plants for the purposes of sale at a nursery;
- **"paragraph"** means a paragraph of the First Schedule;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the valuation of produce held and not disposed of by nursery operators at the beginning and at the end of each year of assessment. A brief discussion is also included on the legislative amendments affecting deceased persons and deceased estates[1] and the transfer of assets between spouses.[2]

2. Background

A nursery operator growing seeds, bulbs, young trees or plants for resale is likely to be a farmer carrying on farming operations. As will become apparent, whether farming operations are carried on is a question of fact.

Section 26(1) stipulates that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule. The First Schedule deals with the computation of taxable income derived from pastoral, agricultural or other farming operations.

The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer's total taxable income for the year of assessment.

The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The Schedule may further apply even after farming operations have been discontinued [section 26(2)].

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1 Section 9HA inserted by section 15(1) of the Taxaion Laws Amendment Act 25 of 2015.

2 Section 9HB inserted by section 20 of The Taxation Laws Amendment Act 23 of 2018.

Both section 26 and the First Schedule apply to farming operations conducted by a nursery operator. Some nursery operators, however, have failed to comply with paragraph 2. Paragraph 2 requires a nursery operator carrying on farming operations to include in that operator's return of income the value of all produce held and not disposed of at the beginning and at the end of each year of assessment.

3. The law

The relevant sections of the Act and paragraphs of the First Schedule are quoted in the **Annexure**.

4. Application of the law

4.1 Introduction

The First Schedule applies to any person who derives taxable income from carrying on pastoral, agricultural or other farming operations. Such a person can include an individual (whether farming alone or in partnership), a deceased estate, an insolvent estate, a company, a close corporation or a trust.

A nursery can consist of any one of the following operations or a combination of them:

- The production of seed and the growing of plants, trees or bulbs for sale.
- The buying of plants and trees, fertiliser and other trading stock for immediate resale.

Whether the particular activity comprises the carrying on of farming operations is a question of fact (see **4.2**). A nursery operator conducting both operations will have to split the operations between farming operations and operations other than farming.

4.2 Farming operations

The expression "farming operations" is not defined in the Act and should be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used.[3]

It has been held that the question of whether a person is carrying on farming operations is one of fact[4] and must be decided considering all the facts of a particular case.

The term "agriculture" is defined in the *Merriam-Webster Dictionary*[5] as –

> "the science, art, or practice of cultivating the soil, producing crops, and raising livestock and in varying degrees the preparation and marketing of the resulting products".

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3 EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworth's at 224.

4 ITC 1319 (1980) 42 SATC 263 (EC) at 264, cited with approval in *CIR v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A), 57 SATC 178 at 183.

5 **www.merriam-webster.com/dictionary/agriculture** [Accessed 1 July 2021].

However, every activity in the nature of farming will not constitute "farming operations". This principle was confirmed by Heher AJA in the Supreme Court of Appeal in *C: SARS v Smith* when he stated the following:[6]

> "In ordinary parlance the phrase 'carrying on farming operations' is capable of several meanings. In the context of section 26(1) it could mean simply 'a particular form or kind of activity' or it could bear a more commercial nuance, 'a business activity or enterprise'.
>
> The Act is directed to the taxation of profit-making activities. There is no apparent reason why the legislature should have intended a taxpayer who farms as a hobby or who dabbles in farming for his own satisfaction to receive the benefits conferred by the First Schedule."

An example of the above principle can be found in ITC 1324[7] in which it was held that a grower who merely intended to sell crops surplus to his needs was not carrying on farming operations.

Therefore, in order to fall within the First Schedule, a farming operation needs to be a trade of the taxpayer.

It is now settled law that the test for determining whether a taxpayer is carrying on farming operations is a subjective one, that is, one based on the taxpayer's intention. This principle was confirmed in the *Smith* case by Heher JA when he stated that –[8]

> "a taxpayer who relies on s 26(1) is (over and above proof that he is engaged in an activity in the nature of farming) only required to show that he possesses at the relevant time a genuine intention to carry on farming operations profitably. All considerations which bear on that question including the prospect of making a profit will contribute to the answer, none of itself being decisive".

The court went on to cite ITC 1185 in which Miller J stated the following:[9]

> "It is no difficult matter to say that an important factor is: what was the taxpayer's intention when he bought the property? It is often very difficult, however, to discover what his true intention was. It is necessary to bear in mind in that regard that the *ipse dixit*[10] as to his intent and purpose should not lightly be regarded as decisive. It is the function of the court to determine on an objective review of all the relevant facts and circumstances, what the motive, purpose and intention of the taxpayer were . . . This is not to say that the court will give little or no weight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer's evidence under oath and that of his witnesses, must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts."

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6 2002 (6) SA 621 (SCA), 65 SATC 6 at 9–10.

7 (1980) 42 SATC 288 (Z).

8 Above at 65 SATC 13.

9 (1972) 35 SATC 122 (N) at 123–4.

10 According to the *Glossary of foreign terms* by J Silke and Justice MM Corbett which forms part of the South African Tax Cases Reports published online by LexisNexis, the expression "*ipse dixit*" means " He himself said it; a bare assertion or statement without proof, resting on the authority of the person who made the assertion or statement".

In evaluating the genuineness of the taxpayer's intention, the nature and extent of the enterprise will be relevant. The following examples of factors to be considered were provided by Erasmus J in ITC 1698:[11]

> "[T]he size and location of the property on which the operation is being conducted, the portion of that property being used for that purpose, capital expenditure, turnover, labour, the regularity and purposefulness of the activity, the time and effort spent thereon by the taxpayer in relation to his other gainful activities, if any, and the existence of a real prospect of profit (or lack thereof). The list is not exhaustive and the permutations of such activities are infinite. None of these considerations is necessarily in itself decisive."

It is not a requirement that a person has to own the land on which the farming operations are carried on but the person must have a right to the land and the yield from it. This principle was illustrated in ITC 1548[12] in which the court found that the shearing and harvesting activities undertaken by a farmer on behalf of others on their land was not farming and neither were the transport services the farmer provided – the farmer was performing a service for other farmers and did not have a right to those farmers' land or the yield from it.

In *C: SARS v Kluh Investments (Pty) Ltd*[13] the respondent company had allowed another company to conduct plantation farming for that company's own account and that company's only obligation was to return the plantation intact when the agreement came to an end. Shortly afterwards the respondent sold the plantation to the other company and at issue was whether the portion of the consideration relating to the plantation had to be included in the respondent's gross income under paragraph 14(1). The court held that paragraph 14 did not apply to the respondent because it was not carrying on farming operations. It did not have –

- the right to the yield of the plantation;
- the use of the land and the plantation; or
- derive any income from it.

The factors referred to in the above cases are not exhaustive and whether farming operations are being conducted will depend on all the facts and circumstances of each case.

The same test that is used to determine whether a person is carrying on farming operations applies to a nursery operator. In this regard, a nursery operator must grow seed, bulbs, young plants or trees on a sufficient scale with the intention of making a profit before it can be said that farming operations are being carried on. A person who purchases such items for immediate resale at a profit will not be farming, nor will a person who grows such items as a hobby.

The following factors which are not exhaustive serve as a useful means in determining whether the activity of a nursery operator is being conducted:

- size and location of the property;
- the portion of the property that is being used for nursery operations;

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11 (2000) 63 SATC 161 (SEC) at 170.

12 (1991) 55 SATC 26 (C).

13 2016 (4) SA 580 (SCA), 78 SATC 177.

- capital expenditure incurred;
- labour utilised for nursery operations;
- regularity of the activity;
- time and effort spent on nursey operations in relation to other gainful activities; and
- the existence of a real prospect of making a profit.

4.3 Nursery produce

Section 22 deals with amounts to be taken into account in respect of the value of trading stock and specifically excludes farming.

Under paragraph 2 a nursery operator's return of income must include the value of all produce held and not disposed of at the beginning and at the end of each year of assessment.

In relation to the meaning of "held", *Juta's Tax Library* states the following:[14]

> "[I]t is therefore considered that a taxpayer holds stock for this purpose where that **stock is owned, and not merely physically held**. The owner, not the possessor, must therefore account for the stock. This view is shared by Meyerowitz (at 9.89). … ."
>
> (Emphasis added)

In ITC 1873[15] the court was called upon to decide on the meaning of "held and not disposed of" in the context of grapes that had been supplied to a co-operative by a farmer. The farmer's grapes were crushed and mixed by the co-operative with the grapes and grape juice of other members as part of the initial wine-making process. The issue was whether the farmer still had produce that could be said to be held and not disposed of which could be brought to account as closing stock. Allie J stated the following:[16]

> "The word *'held'* is supplemented and reinforced by the phrase *'and not disposed of'* because the phrase is conjunctive. The complete phrase *'held and not disposed of'* makes it patently clear that the produce must have formed part of the farmer's farming produce and the farmer must still have a legal right to the produce as at the financial year-end.
>
> It does not mean that the farmer must have had physical possession or control of the produce at the year-end. If that was what the legislature intended, it would have used words that clearly conveyed that meaning."

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14 D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: RS 21, 2016) in Commentary on Income Tax – section 22.

15 (2014) 77 SATC 93 (WC).

16 At 103.

On appeal in *Avenant v C: SARS*[17] the SCA held that "produce on hand and not disposed of" includes the fractional ownership of pooled produce and therefore included the taxpayer's undivided share in the grapes that had been crushed and merged with the grapes of other farmers. As regards the issue of ownership and possession, the court concluded that –[18]

> "in the present case where ownership is retained by the appellant [the taxpayer] but possession is not, the produce is clearly 'held' for the purposes of para 2 of the First Schedule".

Once produce has been sold under an unconditional contract and the taxpayer no longer has legal ownership of it but is unconditionally entitled to the consideration for it (that is, the consideration constitutes gross income in the taxpayer's hands), the produce will no longer be considered to be "held and not disposed of" for the purposes of the First Schedule. Produce disposed of under an instalment credit agreement which provides that ownership will pass only once the whole or a portion of the purchase price has been paid is regarded as having been disposed of and hence must be excluded from closing stock. In these circumstances, section 24(1) deems the purchase price to be included in gross income when the agreement is entered into.

The expression "held and not disposed of" therefore means produce owned by the taxpayer which has not been disposed of.

The value of consumable stores, such as fuel, spare parts, fertilizer and materials for packing, held at the end of the year of assessment for farming purposes, must not be brought to account as trading stock because section 22 excludes a trade of farming. Such amounts will also not be brought to account under paragraph 2 since they do not comprise produce. However, to the extent that such consumable stores are held for non-farming purposes, such as fertiliser acquired for resale, they must be brought to account under section 22.

The amount that a farmer may claim as a deduction for consumable stores may, however, be limited under section 23F when the liability for the goods has been incurred but the goods have not been supplied during the year of assessment.

The term "produce" is not defined in the Act and its ordinary dictionary meaning is therefore retained, which is natural or agricultural products as opposed to manufactured goods.[19]

In *Avenant's* case cited earlier, the court confirmed that produce in the form of pulp from harvested grapes had to be accounted for as part of closing stock, notwithstanding that it comprised work-in-progress. If such an inclusion in closing stock did not occur, there would not be a proper balancing of income and expenditure in the year of assessment.[20]

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17 [2016] JOL 36039 (SCA), 78 SATC 343.

18 Above at SATC 356 in paragraphs 25 and 28.

19 D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: RS 9, 2004) in Commentary on Income Tax: / First Schedule / paragraph 2. In *R v BHIGJEE* 1953 (2) SA 783 (N) at 784 the court held that unlike mealie meal, sugar was not a product of farming operations.

20 Above at SATC 355.

The general rule is that crops accede to the soil in the same way that permanent buildings or improvements do.[21]

Seeds planted can result in crops that are incorporated with the soil by a process of nature, and become one with that from which they draw their nourishment.[22] This principle is based on the rationale that the owner of the soil, which nourishes the seeds or plants, should become the owner of the eventual product.[23] Crops are, however, not inseparable from the soil since they can be reaped or removed once they have ripened or matured.[24] Growing crops are therefore part of the land with no separate existence and do not constitute produce until they have been harvested or picked when mature or ripe. For this reason, crops growing at the end of the year of assessment are not required to be brought into account for income tax purposes.

Consequently, the value of growing crops is excluded from opening stock at the beginning of the succeeding year of assessment. Plants grown, which are not yet ready for sale, will fall into this category of growing crops and must not be brought into account as produce.

There are, however, limitations and exceptions to the rule that everything that is planted in the soil becomes part of the soil. Such an exception exists for plants, bulbs, shrubs or trees, which are destined to be removed like those in a nursery, since they retain their identity as movables and do not become part of the soil.[25] In *Gore NO v Parvatas (Pty) Ltd*[26] it was held that bulbs which are planted as bulbs and are to be removed from the soil as such must be distinguished from plants that are grown from seeds which take root and bear crops that are then harvested. Unlike the growing crops the bulbs are destined to be removed and do not form part of the soil. The decisive factor as to whether something becomes movable is the intention of the person who planted it.

The court was satisfied that bulbs planted in the soil with the intention of being removed from it, retained their identity as movables.[27]

The question whether a bulb is produce for tax purposes will depend on the reason for its removal from the soil. Bulbs which are removed from the soil for sale will comprise produce. Bulbs removed from the soil as part of a natural growing cycle, for example, with the intention of replanting them in preparation for the next season, will not comprise produce, since they are not ready for sale. The onus is on the nursery operator to distinguish between the two types of bulbs.

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21 *Secretary for Lands & another v Jerome* 1922 AD 103.

22 *Secretary for Lands & another v Jerome* above at 105. See also *Macdonald Ltd v Radin NO & the Potchefstroom Dairies & Industries Co Ltd* 1915 AD 454 and *Gore NO v Parvatas (Pty) Ltd* 1992 (3) SA 363 (C).

23 See *Secretary for Lands and Another v Jerome* above at 105. See also CG van der Merwe "Planting and Sowing" 27 (First Reissue Volume) *LAWSA* [online] (My LexisNexis: 31 October 2001) in paragraph 336.

24 *Secretary for Lands and Another v Jerome* above at 110.

25 *Burrows v Mc Evoy* 1921 CPD 229. See also CG van der Merwe *Sakereg* 2 ed (1979) Butterworth's at page 245/246.

26 1992 (3) SA 363 (C). See also *Burrows v McEvoy* 1921 CPD 229 at 235/236 and *LAWSA* above in paragraph 336.

27 At 670. In this case the court referred to Pothiers *Traite de la Communauté* where it was said that a nurseryman's bulbs, once transplanted from the soil where they originally grew, retain the quality of movables which they acquired when they were first taken out of the soil. They are not considered

A difficulty arises with seedlings and other plant material (including bulbs) produced and grown in containers for ultimate sale in the same containers. SARS accepts that such items will have a value as produce only once they have matured sufficiently to be in a saleable condition. The onus remains on the nursery operator to make that determination on a sound basis.

The related expenditure incurred in getting the plants, trees, seedlings or bulbs to a marketable state should generally be deductible under section 11(*a*) read with section 23(*g*) on the basis that it was incurred in the production of income in carrying on a trade.[28] Examples of such expenditure include labour and fertilizer. Capital development expenditure incurred on items such as irrigation schemes and the erection of farm buildings will qualify for deduction under paragraph 12 provided all the requirements of that provision are met. The proceeds derived from the sale of the plants and bulbs are included in gross income in the year of assessment in which the sale takes place.[29]

4.4 Valuation of produce

4.4.1 Valuation method

Paragraph 9 stipulates that the value to be placed on produce included in any return shall be a fair and reasonable value.

A reasonable value is considered to be the lower of production cost or market value.

The term "market value" is not defined for the purposes of the First Schedule but in the context would bear its ordinary meaning of the price which could have been obtained upon a sale of the produce between a willing buyer and a willing seller dealing at arm's length in an open market.

In *C: SARS v Volkswagen South Africa (Pty) Ltd*[30] the taxpayer had sought to write down the cost price of its closing stock under section 22(1)(*a*)on the basis of the lower of cost and net realisable value (NRV). The accounting standard IAS 2 prescribes the use of NRV for writing down the value of trading stock for accounting purposes. The court held that NRV was not an acceptable basis for writing down the value of trading stock under section 22 because it took into account expenditure to be incurred after the end of the year of assessment such as distribution costs, sales incentives, and insurance. While section 22(1) does not apply to farming, it is considered that the principle established in this case is equally applicable in the determination of the value of produce under paragraph 9 of the First Schedule. In other words, NRV should not be used as a substitute for market value in determining the value of closing stock of produce. More specifically, selling expenses and distribution costs incurred after the end of the year of assessment in disposing of produce must not be taken into account in determining market value.

The value of production costs is determined by considering expenditure allowable for income tax purposes, excluding expenditure deductible under paragraph 12.

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to be part of the soil because they were planted *"pour perpétuelle demeure"*. See also *LAWSA* volume 27 in 336.

28 See *Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241, 8 SATC 13.

29 See the definition of "gross income" in section 1(1).

30 [2018] 4 All SA 289 (SCA), 81 SATC 24.

In ITC 936[31] the Commissioner's decision to value the appellant's produce on the cost of production basis was taken on review. The court noted that the cost of production basis was a recognised and proven method of valuation and the Commissioner's decision to use it could not be said to have been so unreasonable that no reasonable person would have adopted it. Whilst the market value method was open to the Commissioner, the Commissioner was not obliged to use it. The appeal was accordingly dismissed.

The "reasonable man" test does not give preference to one party over the other and both parties are treated on par.[32]

In *Avenant's* case (see **4.3**) the court described as unrealistic the appellant's contention that the pulp from harvested grapes was entirely valueless as work-in-progress.[33] The court cited the following extract from *Richards Bay Iron & Titanium (Pty) Ltd & another v CIR* on the difficulty of valuing work-in-progress:[34]

> "The suggested difficulty in identifying and ascribing a value to things in the process of being manufactured on the last day of the tax year does not entitle the court to disregard the plain language of the definition. Moreover, the difficulty strikes me as being more apparent than real. Certainly in other tax jurisdictions the legislators and the courts have not baulked at the concept of valuing work-in-progress and there is no reason to suppose that the South African Parliament was daunted by the prospect. As has been noted, appellants themselves encountered no great difficulty in doing so when required by respondent to do so."

Having regard to the facts of the case, the court also rejected the appellant's contention that the lower of production cost and market value as specified by SARS involved inexact conjecture rather than a fair and reasonable value.[35]

4.4.2 Value of closing stock

Paragraph 3(1) stipulates that the value of produce held and not disposed of at the end of the year of assessment must be included in income for that year of assessment, and that there shall be allowed as a deduction from this income the value of produce as determined in accordance with paragraph 4, held and not disposed of at the beginning of that year of assessment.

4.4.3 Value of opening stock

The value of produce held and not disposed of at the beginning of a year of assessment by a nursery operator who carried on operations on the last day of the year immediately preceding the year of assessment is deemed to be the sum of –

- the value of produce held and not disposed of at the end of the year immediately preceding the year of assessment [paragraph 4(1)(*a*)(i)], and
- the market value of the produce –
  - acquired during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations [paragraph 4(1)(*a*)(ii)(*aa*)]; or

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31 (1960) 24 SATC 361 (C).

32 *Mutual and Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A) at 435H-I.

33 [2016] JOL 36039 (SCA), 78 SATC 343 at 358.

34 1996 (1) SA 311 (A), 58 SATC 55 at 73.

35 At SATC 358.

- held for purposes other than farming operations, which the nursery operator during the year of assessment commenced to hold for the purpose of farming operations [paragraph 4(1)(*a*)(ii)(*bb*)].

A nursery operator who acquires produce by donation or distribution *in specie* must include the market value of that produce in opening stock under paragraph 4(1)(*a*)(ii)(*aa*) and in that way will secure a deduction for such produce. For the treatment of produce on death see **4.4.6**.

4.4.4 Discontinuation of farming operations

Under section 26(2) some provisions of the First Schedule will continue to apply to a nursery operator still holding produce after farming operations have ceased. These provisions will continue to apply until the last of the produce has been disposed of. Paragraph 3(3) deems produce subject to a similar agreement to a "sheep lease" to be held and not disposed of by the grantor of the lease or agreement (lessor). The value of the produce must be included in the determination of the lessor's taxable income each year until the produce is disposed of.

4.4.5 Commencement or recommencement of farming operations

The value of the opening stock of produce at the commencement or recommencement of farming operations by a nursery operator is deemed to be the sum of –

- the value of any produce held and not disposed of at the end of the day immediately preceding the date of the commencement or recommencement of those operations [paragraph 4(1)(*b*)(i)]; and
- the market value of the produce [other than produce referred to in paragraph 4(1)(*b*)(i)] –
  - acquired during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations [paragraph 4(1)(*b*)(ii)(*aa*)]; or
  - held for purposes other than farming operations, which the nursery operator during the year of assessment commenced to hold for the purpose of farming operations [paragraph 4(1)(*b*)(ii)(*bb*)].

The value (lower of production cost and market value) of produce held at the date of commencement or recommencement of farming operations will accordingly be allowed as a deduction in that year of assessment.

Produce acquired by a nursery operator by donation or distribution *in specie* during the current year of assessment must be included in opening stock at market value.

4.4.6 Death of a nursery operator

Section 9HA provides for the tax treatment of the assets of a person upon death, including the value that such assets are disposed at to the deceased's surviving spouse, heirs and legatees. Section 9HA came into operation on 1 March 2016 and applies to a person who dies on or after this date.[36]

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[36] Section 9HA inserted by section 15(1) of the Taxation Laws Amendment Act 25 of 2015.

Section 25 provides for the tax treatment of the deceased's assets in the deceased estate and also prescribes the values of assets acquired from a deceased estate that should be taken into account by spouses, heirs and legatees. Section 25 came into operation on 1 March 2016 and applies to a person who dies on or after this date.

The income tax and CGT consequences for the deceased person, the deceased estate and the heirs or legatees on the death of a person (including a nursery operator) are discussed in the draft Interpretation Note "Disposal of Assets by Deceased Person, Deceased Estate and Transfer of Assets between Spouses".

4.4.7 Insolvency or liquidation

Section 25C deems the estate of a natural person before sequestration and that person's insolvent estate to be one and the same person for the purpose of determining –

- any allowance, deduction or set off to which that insolvent estate may be entitled;
- any amount which is recovered or recouped by or otherwise required to be included in the income of that insolvent estate; and
- any taxable capital gain or assessed capital loss of that insolvent estate.

The person before sequestration must submit a return of income for the period commencing on the first day of the year of assessment and ending on the date before the date of sequestration[37] and a return commencing on the date of sequestration and ending on the last day of the year of assessment.[38] Produce will have a value equal to the lower of production cost and market value for closing stock purposes at the end of that person's year of assessment in the normal way.

The insolvent estate must submit a return of income for its first year of assessment from the date of sequestration until the end of that year and for all subsequent years of assessment until the estate is wound up.

The insolvent estate will have an opening stock equal to the value included in closing stock of the person before sequestration based on the "one and the same person" principle. Any assessed loss of the person before the date of sequestration will be brought forward into the insolvent estate. Produce must continue to be brought into closing stock at the lower of production cost and market value in the first year of assessment of the insolvent estate and for the purposes of determining future opening and closing stock. Any amount received by or accrued to the insolvent estate from the disposal of produce must be included in the gross income of the insolvent estate.

For CGT purposes there is no deemed disposal on date of sequestration as a result of the "one and the same person" principle in section 25C. Given that produce is floating capital there should be no CGT implications when produce is disposed of by the trustee of the insolvent estate.

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37 Section 66(13)(*a*)(ii)(*aa*).

38 Section 66(13)(*a*)(ii)(*bb*).

A company that is being wound up or liquidated remains the same taxable entity until it is finally dissolved.[39] In practice a company must submit an interim return of income for the period from the beginning of the year of assessment up to the date immediately before the date of liquidation and another return from the date of liquidation until the end of the year of assessment. Produce must be brought to account in opening and closing stock in these interim returns at the lower of production cost and market value.

Any amounts derived by the company after date of liquidation must be included in its gross income.

4.4.8 Transfer of livesetock between spouses

Section 9HB came into operation on 17 January 2019[40] and ensures parity of treatment of all disposals between spouses, including disposals of trading stock and livestock and produce.

For a detailed discussion on the roll-over treatment provided for under section 9HB(3) and (4) with regards to the disposal of, among others, produce between spouses, see the draft Interpretation Note on Disposal of Assets by Deceased Person, Deceased Estate and Transfer of Assets between Spouses.

5. Conclusion

Persons conducting the business of a nursery in the course of which plants or trees are grown for sale are regarded as carrying on farming operations. Persons in this category are taxed in accordance with section 26 subject to the First Schedule. The same tests used to determine whether a person carries on farming operations apply to these nursery operators.

The produce held at the beginning and at the end of the year of assessment of a nursery operator carrying on farming operations is specifically excluded from section 22 and must be dealt with under the First Schedule. The value of the produce held and not disposed of must be brought to account at the beginning and end of the year of assessment. The value to be placed upon the produce on hand is its fair and reasonable value under paragraph 9. The plants or trees grown by a nursery, which are not ready for sale, will fall into the category of growing crops and must not be brought to account when the taxable income from farming operations is determined.

Any trading stock purchased from outside sources and offered for sale is not attributable to farming operations and must be dealt with under section 22.

Special rules apply for income tax and CGT purposes upon the death or sequestration of a nursery operator carrying on farming operations.

Leveraged Legal Products
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39 *Van Zyl NO v CIR* 1997 (1) SA 883 (C), 59 SATC 105.

40 Inserted by section 20 of Taxation Laws Amendment Act 23 of 2018.

Annexure – The law

Section 25C

25C. Income of insolvent estates.—For the purposes of this Act, and subject to any such adjustments as may be necessary the estate of a person prior to sequestration and that person's insolvent estate shall be deemed to be one and the same person for purposes of determining—

(*a*) the amount of any allowance, deduction or set off to which that insolvent estate may be entitled;

(*b*) any amount which is recovered or recouped by or otherwise required to be included in the income of that insolvent estate; and

(*c*) any taxable capital gain or assessed capital loss of that insolvent estate.

Section 26

26. Determination of taxable income derived from farming.—(1) 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.

(2) In the case of any person who has discontinued carrying on pastoral, agricultural or other farming operations and is still in possession of any livestock or produce, or has entered into a "sheep lease" or similar agreement relating to livestock or produce, which has been taken into account and in respect of which expenditure under the provisions of this Act or any previous Income Tax Act has been allowed in the determination of the taxable income derived by such person when such operations were carried on, the provisions of this Act, but subject to the provisions of paragraphs 1, 2, 3, 4, 5, 6, 7, 9, or 11 of the First Schedule, shall continue to be applicable to that person in respect of such livestock or produce, as the case may be, until the year of assessment during which he disposes of the last of such livestock or produce, notwithstanding the fact that such operations have been discontinued.

First Schedule

2. Every farmer shall include in his return rendered for income tax purposes the value of all livestock or produce held and not disposed of by him at the beginning and at the end of each year of assessment.

3. (1) Subject to the provisions of sub-paragraphs (2) and (3), the value of livestock or produce held and not disposed of at the end of the year of assessment shall be included in income for such year of assessment, and there shall be allowed as a deduction from such income the value of livestock or produce, as determined in accordance with the provisions of paragraph 4, held and not disposed of at the beginning of the year of assessment.

(2) For the purposes of subparagraph (1), the value of livestock or produce held and not disposed of at the end of any year of assessment by any person who discontinued farming operations during such year, shall be included in his income for such year and for all subsequent years of assessment so long as such livestock or produce, or any portion thereof, is so held and not disposed of.

(3) Any livestock which is the subject of any "sheep lease" or similar agreement concerning livestock, and any produce which is the subject of a similar agreement, shall be deemed to be held and not disposed of by the grantor of such lease or agreement.

4. (1) The values of livestock and produce held and not disposed of at the beginning of any year of assessment shall, subject to the provisions of sub-paragraph (2), be deemed to be—

(*a*) in the case of a farmer who was carrying on farming operations on the last day of the year immediately preceding the year of assessment, the sum of—

(i) the values of livestock and produce held and not disposed of by him at the end of the year immediately preceding the year of assessment; and

(ii) the market value of livestock or produce—

(*aa*) acquired by such farmer during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or

(*bb*) held by such farmer otherwise than for purposes of pastoral, agricultural or other farming operations, which such farmer during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations; or

(*b*) in the case of any person commencing or recommencing farming operations during the year of assessment, the sum of—

(i) the value of any livestock or produce held and not disposed of by him at the end of the day immediately preceding the date of such commencement or recommencement; and

(ii) the market value of livestock or produce (other than livestock or produce to which sub-item (i) refers)—

(*aa*) acquired by such person during the year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or

(*bb*) held by such person otherwise than for purposes of pastoral, agricultural or other farming operations, which such person during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations.

(2) . . . . . .

(3) . . . . . .

9. The value to be placed upon produce included in any return shall be a fair and reasonable value.