A common law view of "carrying on a trade"

A thesis submitted in partial fulfilment of the

requirements for the degree of

MASTER OF COMMERCE (TAXATION)

of

Rhodes University

by

Qhinga Aidan Mkonza

November 2017

Abstract

The term “trade” is defined in very wide terms in the Income Tax Act and includes a “business” and a “venture”. For a taxpayer to claim certain deductions in arriving at taxable income, the taxpayer must be carrying on a trade. The expression “carrying on a trade” is not defined in the Income Tax Act. Whether or not a taxpayer is carrying on a trade is a matter of fact. Case law has established certain principles and tests to be applied in determining whether a taxpayer is carrying on a trade. The goal of the thesis was to determine to what extent an activity can be considered as carrying on a trade. This research focused on the letting of property, money-lending, or farming operations in relation to carrying on a trade or business or engaging in a venture. The thesis also discussed at what stage a taxpayer ceases to carry on a trade and what the tax consequences are of ceasing to trade.

An interpretative research approach was used in the research as it sought to understand and describe. No interviews conducted for this research and the data used for the research are publicly available.

It was established that “carrying on a trade”, including a business, requires an active step taken by the taxpayer to trade. It involves regularity of buying and selling or rendering of services. The intention to trade is important but it is a subjective matter and cannot be persuasive in determining whether a taxpayer is carrying on a trade; objective factors are also considered. If the stated intention to trade matches the actions of the taxpayer, the taxpayer will be considered to be carrying on a trade. In determining whether a taxpayer is carrying on a trade each case must be considered with its own merits.

Key words: Income tax; trade; carrying on a trade; carrying on a business; engaging in a venture; farming operations; letting of property; money-lending; assessed losses

Table of contents

Chapter 1: Introduction 5

1.1 Context of the research 5

1.2 Goals of the research 9

1.3 Methods, procedures and techniques 9

1.4 Overview of the chapters 10

Chapter 2: Carrying on a trade or business 11

2.1 Introduction 11

2.2 The law 11

2.3 The term “trade” 12

2.4 The term venture 13

2.5 The profit motive 15

2.6 Carrying on a business 15

2.7 Conclusion 17

Chapter 3: Farming Operations 19

3.1 Introduction 19

3.2 “Carrying on” a farming venture 19

3.3 Farming with a profit prospect 21

3.4 Intention to farm – subjective and objective factors 26

3.5 Buying and selling of farm produce 33

3.6 Rendering of farming services for a fee 34

3.7 An active step taken to farm 35

3.8 Conclusion 39

Chapter 4: Letting of property 41

4.1 Introduction 41

4.2 The law 41

4.3 Intention 42

4.4 Profit motive 45

4.5 Evidence of regularity and continuity 47

4.6 Conclusion 51

Chapter 5: Money-lending 53
5.1 Introduction 53
5.2 The law 54
5.3 Profit Motive 55
5.4 Intention to lend at market value 56
5.5 System or plan disclosing a degree of continuity 58
5.6 Money lending within the same group of companies 62
5.8 SARS guide on money-lending 66
5.9 Conclusion 66
Chapter 6: Assessed losses and carrying on a trade or business 68
6.1 Introduction 68
6.2 The Law 68
6.3 Ceasing to trade 69
6.4 Endeavouring to earn income 70
6.5 The income requirement - failing to earn trade income 72
6.6 Post liquidation income 75
6.8 Conclusion 80
Chapter 7: Summary and findings 81
7.1 Introduction 81
7.2 Findings 81
7.3 Conclusion 84
List of references 85

Chapter 1: Introduction

1.1 Context of the research

The term “trade” is defined in section 1 of the Income Tax Act, 58 of 1962 (referred to as the Income Tax Act) as follows:

> *includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trademark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of similar nature…*

Section 23(g) of the Income Tax Act provides negatively for expenditure and losses that may not be allowed as a deduction, whereas section 11(a) allows as a deduction, expenditure and losses actually incurred by the taxpayer in the production of income, excluding expenditure and losses that are capital in nature. For expenditure to qualify under section 11(a), however, the taxpayer must, in terms of the preamble to section 11, be “carrying on a trade”. While the term “trade” is defined in the Income Tax Act, the expression “carrying on a trade” is not defined. To determine, therefore, whether a taxpayer is carrying on a trade is a matter of fact. A person receiving income in the form of remuneration does not “carry on a trade”. According to de Koker and Williams (2015: para.7.2) deductions and allowances available to a person whose income is derived in the form of remuneration as defined in paragraph 1 of the Fourth Schedule, other than an agent whose remuneration is normally derived in the form of commission on sales or turnover, has been radically restricted by section 23(m) of the Income Tax Act.

In **Burgess v Commissioner for Inland Revenue, (1993) 55 SATC 185(A),** the court held that the term “trade” must be given a wide meaning. It was held that the meaning must include any “venture” in which a risk is being undertaken with the purpose of making profit. As the definition of “trade” includes a “business”, “carrying on business” falls within the concept of “carrying on a trade”. Therefore, if a taxpayer is carrying on a business, the taxpayer will also be “carrying on a trade”. There have been many Income Tax cases where the court was required to determine whether a taxpayer was carrying on a trade or a business.

Farming, for instance, constitutes an “occupation” or “venture”, and therefore “carrying on farming operations” is part of “carrying on a trade”. Whether or not a taxpayer is “carrying on farming operations" is determined by the scale of activities of the taxpayer. Oliver (2010:193) states that both subjective and objective factors must be considered to determine whether a taxpayer is "carrying on farming operations". Haupt (2015:792) states that, for farming provisions in section 26 of the Income Tax Act to apply, the farmer must not only be earning farming income, but must be "carrying on farming operations". In **Income Tax Case No 1319, (1980) 42 SATC 263 (EC)**, it was held that for a taxpayer to be "carrying on farming operations" there must be the intention to farm, coupled with the reasonable prospect that profit will be derived. Also, in **Income Tax Case No 586, (1945) 14 SATC 123 (U)**, it was held that acquiring and grazing cattle on a leased farm with the intention to sell at profit constitutes "carrying on farming operations".

Taxpayers can be engaged in transactions such as the letting of property and can incur expenses such as interest on a mortgage bond, property rates, water and electricity. To qualify for a deduction in terms of section 11(a), the taxpayer must be "carrying on a trade" which can be determined by the scale of activities. Repairs and maintenance and treatment against beetles in respect of the property would also be deductible in terms of section 11(d) if the taxpayer is "carrying on a trade". Rental income accrues to a landlord, and in terms of the gross income definition in section 1 of the Income Tax Act, the landlord must include the rental income on the earlier of the dates when it is received by the taxpayer or when it accrues. If the landlord fails to recover the rental income due from a tenant but unpaid, the landlord can write off the debt and claim a deduction in terms of section 11(i), which provides for a deduction of bad debts that have been included in the person's income. However, to qualify for the deduction, the taxpayer must also be carrying on a trade.

According to Haupt (2015:115), rental income earned from the letting of property might not require an active involvement by the lessor as the letting of property is specifically included in the definition of trade. However, in **Commissioner of Taxes v G's Estate, (1965) (1) SA 780 (SRAD),** the court stated that "carrying on a business" of letting of property requires a degree of continuity or regularity. In **Income Tax Case No 1529, (1991) 54 SATC 252 (C)**, the court held that rental income received as a benefit from certain investments does not render that investment a business. Similarly, **Income Tax Case No 883, (1959) 23 SATC 328 (T),** established that rental income received from the letting of an inherited property does not constitute "carrying on a business". Although the definition of "trade" includes the letting of property, the expenses in relation to the letting of property qualify for a deduction only if the taxpayer is letting the property in "carrying on a trade".

A taxpayer may be involved in money-lending and may have borrowed money at interest in order to provide loans. The interest incurred will qualify for a section 24J(2) deduction if the taxpayer is involved in "carrying on a trade" as a moneylender. When a debt constituting unpaid interest on a loan becomes irrecoverable, the taxpayer may wish to claim a write-off in terms of section 11(i) of the Income Tax Act and can only do so if the taxpayer is "carrying on a business" as a moneylender. This is demonstrated in the case of **Solaglass Finance Company (Pty) (Ltd) v Commissioner for Inland Revenue 53 SATC 1, (1991) (2) SA 257 (A),** in which the court held that lending money to companies in the same group of companies, staff members and clients of the group does not constitute the business of money lending. The reason for this judgement was because such activities were not normally found in an ordinary, commercial business. **Secretary for Inland Revenue v Crane, 39 SATC 191, (1977) (4) SA 761 (T),** determined that transactions not concluded in a system or plan disclosing a degree of continuity in acquiring capital for future use does not constitute "carrying on a business" as a moneylender. According to **Income Tax Case No 1138, (1969) 32 SATC 3(R),** a person lending money to a small number of companies in which that person is interested, is insufficient to identify that the person as a money lender. The court required that there must be evidence of a systematic business of lending for a taxpayer to be "carrying on a business" as a moneylender. Moreover, in **Income Tax Case No 1275, (1978) 40 SATC 197(C),** the court stated that holding investments does not constitute "carrying on a trade" and that expenditure incurred to watch investments, does not qualify for a section 11(a) deduction. The South African Revenue Service (SARS), in their Practice Note 31 (SARS.1994:1), state that a taxpayer not practising as a money-lender can set off an interest expense against funds borrowed to the extent that it does not exceed the interest earned on the loan. Although the Practice Note sets out the practice of SARS this is not supported by legislation or the common law and may therefore not be upheld if the matter is heard by the courts.

Section 20 of the Income Tax Act allows taxpayers to set off assessed losses from trade against income derived from a South African source, including assessed losses from "carrying on farming operations". Section 20 also allows taxpayers to set off assessed losses from earlier years of assessment from income earned in the current year of assessment, if the taxpayer is "carrying on a trade". However, should a taxpayer, other than a natural person, have ceased "carrying on a trade", assessed losses brought forward from the previous years will not be set off against income earned. Certain tests have been established by the courts determining when a trade ceases, that are relevant to the present research. In **SA Bazaars (Pty) Ltd v Commissioner for Inland Revenue, 18 SATC 240, (1952) (4) SA 505 (A),** it was held that for a company to set off assessed losses carried forward from previous years of assessment against the current year's income, the company must have been trading during the past 12 months. The decision was followed in **Commissioner for South African Revenue Services v Megs Investments (Pty) (Ltd) and Another, (2004) 66 SATC 175.** A company in liquidation receiving interest income from investing surplus funds cannot set off assessed losses against the interest income if these are carried forward from previous assessments. Further, in **Income Tax Case No 957, (1960) 24 SATC 637 (0),** the court held that losses incurred by a taxpayer prior starting to trade, cannot be set off against income earned after the taxpayer has started trading.

Section 20A prohibits losses incurred from certain trades carried on by a natural person from being set off against other income. Trades carried on as a hobby are referred to as "suspect trades" in terms of the section. Such trades include animal showing, sports, farming, gambling and betting, and rental of residential accommodation, aircraft, or vehicles to relatives, unless persons who are not relatives of the taxpayer occupy at least 80 percent of the property for at least half of the year of assessment. Losses incurred from each of these specific activities can only be set off against income from that specific trade. Section 20(A)(3) of the Income Tax Act, however, states that the "ring fencing" of assessed losses from suspect trades does not apply if the trade constitutes a business in respect of which there is a reasonable prospect of deriving taxable income, within a reasonable period. According to Stiglingh, Koekemoer, van Schalkwyk, Wilcocks and de Swardt (2015:210), section 20(A)(3) provides an escape route if the taxpayer can prove that the activity at issue is a legitimate trade, despite classification as a suspect trade.

While the definition of "trade" in section 1 of the Income Tax Act is very broad, excluding only certain classes of passive income, the requirement that a person must be "carrying on a trade" for the purpose of claiming deductions has given rise to a great deal of case law. It is therefore important to determine whether the nature and scale of activities carried on by a taxpayer will qualify as "carrying on trade" for Income Tax purposes. The question this thesis addresses is: what precisely constitutes "carrying on a trade" for Income Tax purposes?

1.2 Goals of the research

The goal of the research is to consider the nature of the transactions and the structure and extent of activities carried out by taxpayers to determine whether a person is "carrying on a trade" or "carrying on a business" for tax purposes. In addressing this goal, the following sub-goals will be addressed:

- assessing the scale of activities carried on by farmers in determining whether it constitutes "carrying on farming operations";
- determining whether taxpayers engaged in a venture like money-lending or the rental of property would qualify as "carrying on a trade";
- discussing the circumstances under which taxpayers will be allowed set off assessed losses against income; and
- discussing the activities carried out by natural persons that are regarded as "suspect trades" according to section 20A of the Income Tax Act and the "business" considerations that would provide an escape from the tax consequence of disallowing the loss.

The discussion focuses on the trades of farming, the letting of property and money-lending, as well as satisfying the requirement of "carrying on a trade" to be entitled to set off assessed losses, to illustrate the issues that arise in determining whether a trade is being carried on, and the broad spectrum of tests that have been established by the courts in this regard. This defines the scope of the present research.

1.3 Methods, procedures and techniques

An interpretative research approach is adopted for the present research as it seeks to understand and describe (Babbie & Mouton: 2009). The research methodology applied can be described as a doctrinal research methodology. This methodology provides a systematic exposition of the rules governing a particular legal theory (in the present case the legal rules relating to "carrying on a trade" which is a requirement for claiming certain deductions in terms of the Income Tax Act), analyses the relationship between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2014).

The documentary data to be used for research consist of:

i. The Income Tax Act, including Practice Notes
ii. Case law
iii. Other writings.

The research is conducted in the form of extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions is promoted by:

- adhering to the rules of statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent, or which is of persuasive value (primary data) and the writings of acknowledged experts in the field;
- discussing, opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

As all the data are publicly available, no ethical considerations arise in relation to their use. Interviews will not be conducted; opinions will be considered in their written form.

1.4 Overview of the chapters

Chapter 2 of the research discusses the definition of "trade" in terms of the Income Tax Act. It also provides an overview of the term "carrying on a business", business being included in the definition of "trade". Chapter 3 is based on farming operations. Carrying on farming operations is part of carrying on a trade. The chapter determines the nature and extent of farming activities that constitute carrying on farming operations in terms of the First Schedule to the Income Tax Act. Chapter 4 determines the extent of the letting of property that will be considered as carrying on a trade or business. In chapter 5, the research discusses money-lending activities that constitute the carrying on of a trade. Chapter 6 assesses at what stage a taxpayer ceases to carry on a trade. Chapter 7 provides a conclusion to the thesis.

Chapter 2: Carrying on a trade or business

2.1 Introduction

The goal of the research is to consider the nature of the transactions and the structure and extent of activities carried out by taxpayers to determine whether a person is "carrying on a trade" or "carrying on a business" for tax purposes.

This chapter explores the term "trade", as defined in section 1 of the Income Tax Act, and "carrying on a trade", as required by the preamble to section 11 of the Income Tax Act. The term "trade" is defined, but the expression "carrying on a trade" is not, even though it is a requirement for taxpayers to claim certain deductions. In addressing the goal of the research, the chapter discusses the following:

- the definition of trade;
- the definition of a venture;
- the meaning of "carrying on a business"; and
- the requirement of a profit motive.

Taxpayers carrying on a trade are entitled to claim certain deductions for Income Tax purposes. Whether or not a taxpayer carries on a trade is a matter of fact and case law and other writings will provide an explanation of the principles applying to determine whether a person is carrying on a trade.

2.2 The law

The term "trade" is defined in terms of section 1 of the Income Tax Act as follows:

> *... includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trademark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of similar nature ...*

Section 11(a) of the Income Tax Act provides for a deduction of expenditure and losses actually incurred in the production of income, excluding expenditure and losses that are capital in nature. For expenditure to qualify in terms of section 11(a) the taxpayer must, in terms of the preamble to section 11, be “carrying on a trade”. Section 23(g) of the Income Tax Act prohibits deductions from income to the extent that moneys were not expended for the purpose of trade.

2.3 The term “trade”

The term “trade” includes a venture where a taxpayer enters into the venture with the intention of making a profit. The term trade can be given a wide interpretation, as was confirmed in **Income Tax Case No 770, (1953) 19 SATC 216 (T).** The appellant company was engaged in three different types of business, namely coal-mining, investment, and share jobbing. During the year ended 30th of June 1951, the appellant derived income from its mining activities. Its investments consisted of shares in private companies, and apportionments were made to it from income (interest and dividends) derived in respect of its investments. A loss, however, was sustained in respect to its share jobbing activities.

In assessing the taxpayer at year end the Commissioner for Inland Revenue apportioned the loss incurred from share jobbing in proportion to the income from share investments. The taxpayer objected to the assessment on the grounds that the Commissioner should set off the loss from share jobbing against the income from coal mining. On appeal, the court held that investment in shares was a well-established occupation that fell under the definition of “trade”, which embraces every profitable activity, and therefore must be given a wide interpretation. Consequently, the appeal was allowed, and the taxpayer was able to set off the losses from share jobbing against income from coal-mining activities.

Trade also includes a venture, where a taxpayer risks something with the intention of earning a profit. This was confirmed in **Burgess v Commissioner for Inland Revenue, (1993) 55 SATC 185 (A).** The appellant had entered into a share investment scheme that involved the risk that, if the company invested in failed to perform, the investors would not only not earn a profit, but would have an obligation to repay the loan to the bank at interest amounting to 12 percent per annum. The transactions were not concluded only by individual taxpayers, but with a partnership of which the taxpayer was member. The cost of providing the bank with a guarantee was the only outlay on the part of the individual investors and the amount of the guarantee was the most that could be lost from the transaction, in terms of the partnership deed.

The gains realised from the investment qualified for inclusion in gross income in terms of the definition in section 1 of the Income Tax Act. Also, the scheme proposers pointed out that the interest payable to the bank would qualify as a deduction in terms of the Income Tax Act. When the appellant was introduced to the scheme high returns were expected because stock markets were booming. The appellant agreed, obtained a bank guarantee of R425 000, entered into a partnership with Fenton, and the transactions were concluded that day. In October 1987, there was a crash on the Johannesburg Stock Exchange and the value of the investment plummeted. It became evident after the first anniversary of the policy that the insurance company would not pay more than the minimum guaranteed. The accounts of the partnership for the year ended 29 February 1988, showed a loss of R477 740 in respect of the taxpayer's investment, being interest incurred in the 1988 financial year.

In his tax return, the appellant claimed R477 740 as a deduction that resulted in a net loss that year. In determining the appellant's taxable income, the Commissioner for Inland Revenue disallowed the deduction of R477 740, stating that the activities carried on by the taxpayer did not constitute "carrying on a trade". Dissatisfied with the Commissioner's decision, the appellant appealed. Allowing the appeal, the court held that the definition of trade must be given a wide interpretation and includes a "venture", being a transaction in which a person risks something with the object of making a profit.

A venture, according to the court decision, includes a transaction in which a person takes a risk with the aim of making a profit. The appellant in the case invested in shares and there was no guarantee that there would be profits. The investment therefore carried a risk of losing the capital investment and repaying the loan to the bank, together with interest.

2.4 The term venture

The definition of "trade" includes a venture. If a taxpayer enters into a transaction involving risk with the aim of earning returns, that transaction will constitute a venture in terms of the definition. The Income Tax Act does not provide a definition of the term "venture". As shown above, the term venture has been defined as a transaction entered into by a taxpayer with the intention of earning a profit. It then follows that if a taxpayer enters into a transaction without the intention of earning profit, the transaction cannot be considered to be a venture. If a transaction does not qualify as a venture it cannot therefore be classified as a trade. This was confirmed in **Income Tax Case No 368, (1936) 9 SATC 211(U).** The appellant, an attorney, was approached by a client who suggested he should join with him in making an advance to a third party who needed the sum to secure certain mining rights. In return for this advance, the third party was prepared to account to the appellant and his client for 25% of any profit that was to be made by the exploitation of the rights.

The appellant agreed to join the scheme without an expectation of realising profits and little expectation of recovering the amount advanced. During the year of assessment under review, the person to whom the advance was made succeeded in realising the property and the appellant received a substantial block of shares in the company that had been formed to acquire the property, as his share of the profit that was realised.

In assessing the appellant, the Commissioner for Inland Revenue included in taxable income the value of the shares received as a profit of the investment. Dissatisfied with the Commissioner's decision, the appellant lodged an objection stating that the amount so received represented a capital appreciation derived from a speculation that was outside the scope of income earned by the appellant. Allowing the appeal, the court held that the advance was made by the appellant without any expectation of profit and therefore did not qualify as a venture within the definition of "trade" as set out in the Income Tax Act. The court further stated that the profit was to be regarded as a windfall and was capital in nature. A "venture" was therefore defined by the court as a transaction in which a person risks something with an object of making a profit.

The case provides a limit to the meaning of a venture in terms of the definition of "trade" in the Income Tax Act. The appellant having advanced a sum without expecting any profit or return, this did not constitute a venture. It then appears that for a venture to be considered as a "trade" there must be a risk involved with the aim of making a profit. In this case, the appellant appeared not to have been involved in risk because there was no expectation of profit and little expectation of a return in capital.

2.5 The profit motive

A venture must have a risk element and must be carried out with the intention of making profit. The definition of "trade" usually requires transactions to be entered into by a taxpayer with the intention of realising gains. In certain circumstances a taxpayer can enter into transactions without the intention of earning a profit. The question to be considered is whether the intention to earn a profit is decisive in determining whether this constitutes a trade.

The term trade includes the letting of property. If the taxpayer lets a property without the intention of earning profit, the question is whether the taxpayer will be considered to be involved in a trade. The profit motive was not considered to be decisive in **Income Tax Case No 615, (1949) 14 SATC 399 (U)**. The appellant taxpayer, from the year 1935, carried on business in leased premises. During the year 1937, the appellant floated a company and transferred the business carried by him in the leased premises to the company. At the end of the lease, the appellant renewed the lease agreement for the premises under his name and sub-let the premises to the company. The rental payment by the company to the appellant was the same as the amount paid by the appellant to the owner of the premises. In assessing the appellant at year end, the Commissioner disallowed as a deduction the losses incurred by the taxpayer as a result of sub-letting, holding that the taxpayer did not carry on a trade. The taxpayer objected to the decision of the Commissioner and appealed to the Tax Court. Allowing the appeal, the court held that the sub-letting of the property by the appellant constituted carrying on a trade. It was further stated that a lease agreement constituted carrying on a trade, and the lack of a profit motive in the lease cannot be regarded as decisive.

2.6 Carrying on a business

The definition of "trade" in section 1 of the Income Tax Act includes a "business". The expression "carrying on a trade", referred to in the preamble to section 11, therefore includes the expression "carrying on a business". The phrase "carrying on a business" is not defined in the Income Tax Act, but was defined in **Cape Town Municipality v Clarensville (Pty) Ltd, (1974) (2) All SA 346 (C),** where Baker J stated (at 357) that "carrying on business activities" means:

> *an act of selling or supplying goods or services and an intention to continue selling or supplying such goods or services as and when the opportunity arises for as long as it is thought desirable; a series of acts of selling or supplying goods or services in circumstances from which this intention can be inferred.*

According to the definition by the court, carrying on a business requires a degree of continuity. A taxpayer will therefore be considered as carrying on a business if there is regularity and continuity of selling or rendering of services for as long as there is an opportunity to do so.

A similar definition of carrying on a business was recently stated in **Income Tax Case No 1529, (1991) 54 SATC 252(C)**. Section 10(1)(k)(ii) of the Income Tax Act previously provided an exemption for dividends accruing to a non-resident, provided the taxpayer did not carry on a business in the Republic. The appellant taxpayer was a resident in the United States of America. He derived income from the Republic in the form of interest on investments, dividends from shares and rental income from properties. In assessing the appellant during the year under review, the Commissioner for Inland Revenue refused to grant an exemption for the dividends from the Republic, stating that the appellant was carrying on a business of letting property in the Republic. The taxpayer objected to the assessment and it was overruled and he appealed to the tax court. Quoting an English case, Modderfontein Deep Levels Ltd v Feinstein 1920 TPD 288, the court stated (at 291):

> *To constitute a business there must either be a definite intention at the first act to carry on similar acts from time to time if opportunity offers, or the acts must be done not once or twice but successively, with the intention of carrying it on, so long as it is thought desirable.*

Allowing the appeal, the court was of the view that the appellant had a single lease for a number of years and made no decisions with regard to the administration of the property and had no actions to take except to wait for the bank to remit rental to him. The court therefore stated that such circumstances cannot fall in the parameters of carrying on a business.

The decision taken by the court indicates that carrying on a business requires an active step with an intention to do so from time to time. There must be a series of acts to carry on a business and must be carried as long as the opportunity arises. Earning income from the property in this case was therefore incidental.

Section 20A(3) of the Income Tax Act provides an indication of what the legislature considers to be indicators of when a business is being carried on. According to the sub-section, there must be a reasonable prospect of deriving taxable income within a reasonable period. The taxable income that can be derived must exclude a taxable capital gain. The Income Tax Act does not provide a definition of a "reasonable prospect" or "reasonable period". It is only objective factors that can be used in the "facts and circumstances test" to support the definition. Assessed losses suffered by natural persons resulting from "suspect trades", where they earn a certain level of income from another trade, are normally ring-fenced in terms of section 20A of the Income Tax Act. "Suspect trades" are normally trade activities regarded as a hobby. Accordingly, section 20(A)(3) provides the following indicators of the "facts and circumstances" that will indicate that there is a reasonable prospect of deriving taxable income include:

- the proportion of gross income in relation to deductions;
- the level of activities or expenses in relation to advertising, promotion or selling;
- whether the trade is carried on in a commercial manner, including the number of full-time employees, the commercial setting of the premises, the extent of the equipment and the time the person spends conducting the business.

It is submitted that, together with the profit motive, these are probably the most comprehensive and relevant indicators of when a business is being carried on.

2.7 Conclusion

Section 1 of the Income Tax Act provides a definition of "trade". Common Law principles, however, confirm that the term "trade" must always be given a wide interpretation. A taxpayer involved in a "trade" must include all receipts in gross income in terms of section 1 of the Income Tax Act. However, for the taxpayer to claim certain deductions from income, the taxpayer must be "carrying on a trade". It can therefore be concluded that the expression carrying on a trade requires a taxpayer to enter into transactions that involve a measure of risk with the intention of making a profit.

The term "trade" includes a "venture". It is not every "venture," seemingly, that can be considered to be "carrying on a trade". For a "venture" to constitute "carrying on a trade", it appears that there must also be a risk involved with the aim of making a profit. The taxpayer must have been involved in a transaction that does not guarantee a return. It then follows that engaging in a "venture" that does not bear a risk with the objective of making a profit, cannot be considered as "trade".

The expression “carrying on a business” is the equivalent of “carrying on a trade”. The Income Tax Act does not provide a definition of “carrying on a business”. Case law therefore provides a definition for the expression. For a taxpayer to be “carrying on a business”, there must be an intention of the taxpayer to buy and sell or render services on a regular basis as long as the opportunity arises to do so. Section 20(A)(3) of the Income Tax Act, in determining where a business is being carried on, confirms that there must be a reasonable prospect of deriving taxable income within a reasonable period and provides certain indicators to be considered in establishing this reasonable prospect of profit and therefore what constitutes carrying on a business.

Carrying on farming operations may also constitute “carrying on a trade”. The term “carrying on farming operations” is not defined in the Income Tax Act. Taxpayers “carrying on farming operations” are subject to the provisions of section 26 and First Schedule of the Income Tax Act. To determine whether a taxpayer is “carrying on farming operations” is a matter of fact. Each case must be considered on its own merits. The next chapter will focus on activities carried on by taxpayers that constitute “carrying on farming operations”.

Chapter 3: Farming Operations

3.1 Introduction

The previous chapter explored the definition of "trade" in section 1 of the Income Tax Act and "carrying on a trade" as required by the preamble to section 11 of the Income Tax Act. Farming constitutes an "occupation" or "venture" and therefore "carrying on farming operations" may constitute "carrying on a trade". For a farming venture to be considered as "carrying on" a trade, the taxpayer must be involved in carrying on a business as a farmer.

The goal of the research is to consider the nature of the transactions and the structure and extent of activities carried out by taxpayers to determine whether a person is "carrying on a trade" or "carrying on a business" for tax purposes. In addressing this goal, the following sub-goal (amongst others) will be addressed: the scale of activities carried on by farmers to determine whether it constitutes "carrying on farming operations".

In addressing the sub-goal, this chapter will explain the extent of activities carried on by a taxpayer that will constitute "carrying on farming operations". Legislation, case law and other writings will be used to provide an explanation of the tests and principles that are used to determine whether activities carried on by taxpayer constitute carrying on a trade or business as a farmer. The chapter will consider the following factors: farming as a venture, the profit prospect in a farming venture, buying and selling farm produce, rendering of farming services for a fee, the intention to farm, and active steps taken to farm.

3.2 "Carrying on" a farming venture

Farmers carrying on farming operations are subject to the provisions of section 26 and the First Schedule to the Income Tax Act. As discussed below, taxpayers earning regular farming income can be considered to be carrying on farming operations. Case law has established that the farming venture must be carried on with the intention to earn profits; the profits need not be realised immediately, but there must be evidence of significant amount of capital invested towards the farming venture for it to be subject to the farming provisions of the Income Tax Act. Case law also confirmed that the activities of the farmer are considered in determining whether a taxpayer intends to farm at a profit. The term farming "venture" was considered in **Income Tax Case No 1177,**

(1972) 34 SATC 147 (R). The appellant had been a farmer and gave up farming when the venture became unprofitable and the appellant took up full time employment. Some five years later the appellant and his wife purchased a dilapidated small holding with the intention of making it a habitable home. In addition, the appellant planned to develop the property into a small farming venture that would help them earn an income after retirement. At the time of purchasing the property, the appellant owned 58 sheep, which he brought to the property and developed grazing for them; he then acquired jersey heifers and some poultry. Further, he planted fruit trees and vines. For up to three years while improvements were being made the income derived was negligible, mainly from selling sheepskins. He claimed that over these three years, his farming operations were subject to the farming provisions in the Income Tax Act and he sought to deduct the expenditure undertaken to improve the property.

In assessing the taxpayer for the year ended 31st March 1976, the Commissioner of Taxes disallowed the deduction of the losses being of the view that the appellant was not trading as a farmer but had merely improved a dwelling for accommodation purposes. The taxpayer appealed to the Rhodesian Special Court against the decision of the Commissioner. Allowing the appeal, the court held that the appellant was involved in a "venture" and subsequently had incurred expenditure in the process of carrying on a trade, regardless of the fact that the taxpayer derived only small amounts of income. The court relied on the fact that regular farming income was earned by the taxpayer, even though it was negligible; the regularity of activities meant that the taxpayer was trading as a farmer.

The appellant expressed an intention to carry on farming operations. The actions may have also shown that there was an intention to farm. Developing a farming proposition to generate income after retirement reflects an intention to farm at a profit in the future. The time the appellant devoted in making the property habitable proved that he intended to live and farm on the property. Cutting back bush in the property to provide grazing land for the animals and putting fences around the property, showed an intention to farm. He also planted two acres of lucerne and three acres of star grass to supplement the feed for the animals and this also indicated that the taxpayer intended to farm at a profit. The intention of the taxpayer, together with his activities on the property, indicated that he intended to carry on a trade or business as a farmer.

It can be concluded that for a taxpayer to be considered as carrying on a trade there must be intention to make a profit and a reasonable prospect of deriving profit. Both subjective factors and objective factors must therefore be considered in determining whether this is so. Importantly the profit motive can be persuasive but not decisive in most cases.

3.3 Farming with a profit prospect

Taxpayers owning a farm and engaging in a farming "venture", may intend to both consume the produce and sell surplus stock. The question to be considered is whether the taxpayer's venture can be regarded as carrying on farming operations. It is submitted that a farmer can have a full-time job and maintain a farm part-time, and still be considered as carrying on business as a farmer, provided there is an intention to farm at a profit. A farmer can incur excess expenditure initially, but if the scale of farming has the potential of deriving ultimate profit, the farmer will be considered to be carrying on a trade as a farmer. The court was called upon to decide whether consuming farm produce and selling the surplus constituted farming operations in **Income Tax Case No 208, (1931) 6 SATC 55 (U)**. The appellant, a full-time teacher, held 25 morgen of land on which he grew crops of oats, mealies, potatoes, and other vegetables; he also planted and cultivated fruit trees. During a specific year the taxpayer disposed of a small amount of vegetables and fruit to a local market and, in his own household, consumed surplus vegetables, milk, and butter. The appellant had been advanced a loan to acquire the land for farming. Subsequently, the expenditure on cultivation and maintenance, together with the interest on the capital borrowed, exceeded the value of the produce sold and consumed. A loss was incurred and in calculating taxable income for that year he sought a deduction against other income, contending that the loss had been incurred while carrying on business as a farmer.

In assessing the appellant, the Commissioner for Inland Revenue disallowed as a deduction the loss incurred from the "venture", contending that the taxpayer did not carry on trade as a farmer. Dissatisfied with the Commissioner's decision, the appellant appealed to the Income Tax Court, arguing that he did carry on farming operations. Allowing the appeal, the court held that even though the appellant was not engaged in profitable production, his operations would ultimately yield good profits; further that even though the taxpayer was not making a profit at present, there was a genuine intention to farm with the hope of making a profit in the future.

In reaching the decision, the court considered subjective factors in determining whether the taxpayer was carrying on farming operations. There must be a genuine intention to farm. Considering the objective factors, however, it may have appeared that the taxpayer was farming as a hobby to consume produce and to sell the surplus. As he was not farming on a full-time basis and had a full-time job as a teacher, it could be argued that farming was his hobby.

A part-time farmer consuming and selling surplus produce will be subject to the provisions of section 26 and the First Schedule of the Income Tax Act if there is an intention to farm and to realise profit from the farming venture. A farmer consuming farm produce and selling surplus produce was not considered to be carrying on farming operations in **Income Tax Case No 1324 (1980), 42 SATC 288 (Z)**. During the years 1977 and 1978 the appellant had sustained losses in conducting farming activities and had sought to deduct the losses incurred amounting to $3 468 and $5 499 respectively from his income. Neither the appellant nor his wife had farming experience and had been advised that the land was unsuitable for crops like maize but was suitable for pyrethrum and small stock. In 1972, the appellant acquired a farming licence and purchased some pyrethrum seeds and irrigation materials. During that year, the appellant responded to an enquiry from the tax department stating that he did not intend to carry on trade as a farmer and that the property was his residence and accommodation for his dogs. The appellant's pyrethrum venture was not successful.

During October 1972, he purchased two jersey heifers and in June 1973 four calves. Towards the end of 1973, the appellant acquired chickens and later added rabbits. In addition, to accommodate the needs of the animals, the appellant laid water pipes and conduits from a borehole to troughs at different points on the property. An elderly man was responsible for cleaning the property and two occasional temporary labourers helped to maintain the property. The taxpayer consumed some of the produce and disposed of the surplus realising income amounting to $687 and $995 in 1977 and 1978 respectively. There was no evidence to substantiate income derived from the sale of rabbits in these years. In 1979 the taxpayer started selling eggs, chickens, and rabbits on a regular basis.

In assessing the appellant, the Commissioner contended that the activities carried on by the taxpayer between 1977 and 1978 did not constitute carrying on a trade as a farmer and disallowed as a deduction the losses incurred. The Commissioner further stated that it was only after 1978 that the taxpayer started carrying on a trade as a farmer. The appellant was dissatisfied with the

Commissioner's decision and objected to the Special Court. Dismissing the appeal, the court held that the Income Tax Act is designed to assist taxpayers who pursue farming to earn an income. It was further argued that a farmer earning income from selling surplus produce, if available, cannot be considered to be carrying on a trade as a farmer in terms of the Income Tax Act. Further, that the taxpayer had failed to discharge the onus that he carried on trade as a farmer in 1977 and 1978 respectively.

In the above case, there was a change in intention by the taxpayer. The taxpayer initially farmed the property as a hobby. Initially the primary objective of the taxpayer was to farm for domestic purposes and realize excess produce. The written letter he sent in reply to the tax department's enquiry reflected an intention not to carry on trade as a farmer. When he purchased livestock, chickens, and rabbits, this still did not constitute carrying on a trade as a farmer. Even the laying of pipes and conduits from a borehole to troughs, was not enough to be considered as carrying on a trade as a farmer. There was no regularity of buying and selling farm produce for a profit in 1977 and 1978; this only became evident in 1979. In reaching its decision, the court considered both subjective and objective factors.

Section 20A of the Income Tax Act ring-fences losses arising from certain trades, where a natural person earns income otherwise from carrying on that trade, exceeding the amount at which the maximum marginal rate of tax is levied. Section 20A(2)(b) deals with the so-called suspect trades in respect of which ring-fencing applies and sub-paragraph (vi) refers to "farming or animal breeding, unless that person carries on farming, animal breeding or activities of a similar nature on a full-time basis". Section 20A(3), however, provides an "escape clause", where the trade constitutes a business and "there is a reasonable prospect of deriving taxable income (other than taxable capital gain) within a reasonable period", considering certain indicators that support this prospect. Part-time farmers earning income from another trade and incurring farming losses would therefore have to satisfy the requirement that the farming operations constitute a business with a reasonable prospect of making a profit.

The activities of a farmer must reflect an intention to farm at a profit. Where a taxpayer is farming produce for which there is no market, this will not automatically determine that the taxpayer is not carrying on farming operations with the intention of making profit. If the venture is carried out on land that renders farming impossible, however, the venture cannot be considered as carrying on a business as a farmer. This was confirmed in **Income Tax Case No 1319 (1980), 42 SATC 263 (EC)**. The appellant taxpayer was a medical specialist who resided on a small holding of approximately 30 hectares, which he purchased in 1967. At the time of purchase the property was heavily bushed virgin coastal land. With the intention to engage in livestock farming, particularly jersey cattle and goats, the appellant began clearing the bush. However, at that time, there was no market for registered jersey bulls and, in addition the soil rendered the breeding of small stock impracticable. Consequently, during 1969, 1970 and 1971 the taxpayer reflected substantial net farming losses. In 1972 the appellant wrote to the divisional council stating that the property was no longer viable agricultural land and requested subdivision into two-morgen lots.

During the tax years ended during 1976 and 1977 the taxpayer recorded net losses of R7 809 and R7 558 respectively and sought to deduct the losses from other income. During those years the taxpayer made no purchases of stock, nor did he institute any developments; only one animal was sold for R203.00. In assessing the appellant, the Commissioner for Inland Revenue disallowed the deduction of net losses incurred during the 1976 and 1977 tax years, stating that the appellant was not carrying on farming operations. The appellant objected, but the objection was overruled. Dissatisfied, he appealed to the tax court contending that he was genuinely engaged in farming despite the losses suffered and that he had injected sufficient capital to make the property viable for farming. Dismissing the appeal, the court held that whether a person is carrying on farming operations is a matter of fact and that there must be an intention to farm coupled with a reasonable prospect of profit. The venture had been unprofitable from the beginning.

The profit motive was also considered in **Income Tax Case No 1644, (1995) 61 SATC 23** in which the appellant was a graphic designer who lived in a house on a farm which was 242 hectares in size and situated near a dam. In 1985 the appellant started livestock farming, primarily cattle and sheep. In 1986, the appellant bought mares and stallions with the intention of breeding horses. In 1990, the taxpayer had between six and seven mares and two stallions.

In 1987, the appellant, together with his neighbour who was also a farmer, began a joint project. The neighbour used part of the appellant's farm to cultivate tomatoes. According to the agreement, the appellant would pack and market the tomatoes, but because the property was situated in a hail belt, a storm destroyed the entire crop in that year, after which the appellant focused on cattle farming and feed production. In 1990 the appellant, who had farmed Bonsmara cattle, sold his cows. The intention of the taxpayer was to buy equipment and cattle of good quality, which he did. His expenditure of R6 000 was for machinery and R4 000 for purchasing cattle. He also planted four hectares of lucerne, which is fast-growing and hail resistant. As a result of drought, the taxpayer began sowing feed in 1994 and installed an irrigation system, and at the time of the hearing, the appellant had four hectares lucerne under irrigation.

In 1990 the taxpayer derived an income of R10 708, which he used to buy cattle and equipment, but in 1991 and 1992 there were only significant expenses and no income. He testified that he had installed comprehensive irrigation systems but that the water level had fallen because of drought conditions; he further stated that he had acted pro-actively by developing the farm despite realizing that he would not make a profit. The property was suitable for farming and his research and exertions were not in dispute. The Commissioner for Inland Revenue had allowed the taxpayer to set off losses incurred from 1985 to 1989. The issue was to determine whether the taxpayer carried on farming operations in the years of assessment 1990, 1991, and 1992, when no income was earned. The Commissioner contended that the taxpayer had not carried on farming operations in terms of section 26 of the Income Tax Act because there was no reasonable prospect of profiting from his activities. The taxpayer appealed to the Income Tax Court against the decision of the Commissioner.

Allowing the appeal, the court held that as long as there is a genuine intention to develop land as a farming proposition with the aim of deriving profit, the taxpayer will be considered to be carrying on farming operations. The court mentioned that the taxpayer had not anticipated that he would make a profit in that specific year, but that intention was subjective. and it was difficult to ascertain its genuineness. To determine whether intention was genuine, objective factors must be considered. A person’s stated intention cannot be decisive if his activities are irreconcilable with his stated intention, in which case, his stated intention cannot be accepted.

As was discussed above, the stated intention of the taxpayer in ITC 1319 was to farm. The appellant cleared a heavily bushed area to make livestock farming possible, which showed a real intention to farm. The land, after clearance, however, proved unsuitable for livestock. Also, the taxpayer planned to farm livestock that was not selling at that time. Having proceeded to farm on land that was unsuitable for livestock farming and, in addition, farming livestock that did not sell in the market at that time indicated that the taxpayer did not have a profit motive from the activity.

If the taxpayer was intending to farm for profit, it was not worth investing in unsuitable land. The court therefore considered the objective factors to determine whether the taxpayer was carrying on farming operations. The stated intention to farm at a profit by the taxpayer did not match the actions that were carried out (objective factors).

The decision of the court in ITC 1644 was based on the actions of the taxpayer and his stated intention. The taxpayer carried on livestock farming and crop farming which proved to be impossible because the property was situated in a hail belt and this ended the partnership between the taxpayer and his neighbour. As the appellant was eager to be involved in a venture that was profitable, he only focused on livestock farming. Eager to invest more, he sold cattle to buy farming equipment and more cattle of better quality. The appellant cultivated the land and installed a complete irrigation system so that he could supply water for the livestock and the grass he cultivated. It is evident that the activities of the taxpayer showed an intention to farm and make a profit in the future. The only problem was that the appellant was not at that time making a profit. Considering these actions, it is clear that there was an intention to farm for profit. The stated intention to farm at a profit matched the objective factors and the courts therefore correctly allowed the appeal.

Olivier (2010:193) states that both subjective and objective factors must be considered to determine whether a taxpayer is "carrying on farming operations". This means that the taxpayer's stated intention in carrying on a farming "venture" must be considered together with the activities carried on. For a farmer to be subject to the provisions of section 26 and the First Schedule of the Income Tax Act, it therefore appears that the activities must be in line with the farmer's stated intention to farm.

3.4 Intention to farm – subjective and objective factors

A taxpayer's stated intention to farm will not be decisive if it does not match the activities carried on by that taxpayer. There must be evidence reflecting an effort by the farmer to carry on a business as a farmer. The scale of cultivation, capital invested in acquiring the farm and the infrastructure laid down by the taxpayer will reflect the intention to carry on business as a farmer. A farmer investing retirement income, cultivating and planting the land on a large scale and erecting an irrigation system to water the farm, shows a genuine intention to carry on a business as a farmer.

The activities of a farmer were considered in **Income Tax Case No 937, (1960) 24 SATC 374 (T)**. The appellant was employed as a bank clerk and resided on a small holding near the town in which he was employed. The property he purchased had fruit trees and he planted additional trees. He purchased another stand to acquire additional water and he erected a spray irrigation system. The taxpayer's activities included the cultivation of fruit trees, the planting of cattle feed and lucerne, and the growing of vegetables. The purchase price of the property was secured by personal insurance policies.

In determining his taxable income at year end, the appellant disclosed, in addition to the salary earned, income and expenditure described as farm income and expenditure, resulting in a net loss of £940. The appellant sought to set off the loss against income earned as a bank clerk. In assessing the taxpayer, the Commissioner for Inland Revenue was of the opinion that the taxpayer was not a *bona fide* farmer and consequently ignored the loss incurred. The taxpayer objected to the Commissioner's assessment. The objection was disallowed, and the appellant appealed to the tax court.

Allowing the appeal, the court held that the taxpayer acquired the property with a genuine intention to farm. The court noted that the taxpayer had purchased the property four years before retirement. The house on the property when purchased was dilapidated and the property was neglected because it was owned by an estate agent. The taxpayer had raised money and improved the house after acquiring the property and had dealt with the neglect. When the water failed he was persuaded to buy the adjoining stand, which had an ample water supply. Further, the taxpayer had spent money on a pumping outfit, planting of additional fruit trees, and erected a spray irrigation system. The court therefore decided that the circumstances weighed heavily in favour of the taxpayer's having purchased the farm with a genuine intention to yield a profit, as, apart from the mortgage bond acquired for the purchase, the personal insurance policies reflected a serious intention.

In reaching the above judgement, it seems that the court considered the intention of the taxpayer. Taking active steps by the taxpayer to farm for a profit were taken into account. Even though the taxpayer was employed full time as a bank clerk, he was, however, intending to farm. On acquiring the land which already had growing fruit trees, additional trees were planted by the taxpayer. There was insufficient water to sustain the venture, and consequently, he purchased a neighbouring plot to supplement the water supply. He acquired a loan to finance the acquisition of the farm. He also purchased cattle and planted grass for feed. His actions demonstrated an intention to farm. The subjective stated intention by the taxpayer was borne out by the objective factors.

A farmer can invest in a farm, but if natural circumstances result in poor yield, the taxpayer cannot be considered not to be carrying on a business as a farmer. A poor farm yield can result in losses suffered from a farming venture that can be set off against income and be carried forward to be utilised in subsequent years if the taxpayer carries on business as a farmer. This was considered in **Income Tax Case No 1258, (1976) 39 SATC 58 (R)**. The appellant was born in South Africa and resided in Johannesburg. The appellant's family regularly visited a farm owned by his father during school holidays. In 1957 the appellant emigrated from South Africa to Rhodesia where he established a company that manufactured diamond crowns. In 1969 the appellant purchased a dwelling in the Salisbury suburb of Greendale. The farm property comprised ten acres of land, eight of which were arable land on which maize and oats grew. The stand was equipped with irrigation pumps, piping, a reservoir, and a borehole yielding 1 000 gallons of water per hour. The appellant realized that the property was suitable for cultivation. It also had fruit-trees, stables, chicken-runs, and pig-pens and the added advantage of proximity to his business premises.

Consequently, the appellant purchased the property for $56 475 and named it "The Ranch". He then sold his Greendale residence for $40 000. Prior to occupation the appellant ploughed a portion of the land and planted maize. Upon occupation he planted potatoes. He also cultivated one-quarter of an acre on which he prepared a vegetable garden. Expenses of $56 on fertiliser, $14 on seeds, and $183 on farm tools were incurred, and labourers were hired at $12 each per month, including food. During the year ended 1973, the appellant did not reap any crops because of drought and uncertain availability of water from his borehole. He then abandoned the crops. For the year ended 31 March 1974, he planted maize and potatoes, and grew vegetables on one-quarter of an acre. The cost of fertiliser and seed amounted to $61 and $56 respectively and maize meal $21. He also purchased two tractors at $746. Excessive rain fell that year and the potatoes were water logged and rotted in the ground. Maize and vegetables were sold for only $170. The appellant's father-in-law came to live at "The Ranch" to run the farming operations.

During the year ended 31 March 1975, the appellant planted maize, cultivated vegetables on a large scale, and started growing granadillas. During the year ended 31 March 1976, the appellant's sales of maize, vegetables, and granadillas amounted to $839. There was a substantial improvement in sales compared to previous years.

In assessing the appellant for the years ended 31 March 1974 and 1975, the Commissioner for Taxes disallowed, as a deduction, losses of $3 392 and $7 433 respectively, expressing the view that the appellant did not carry on trade in farming on the ten-acre stand. Dissatisfied with the Commissioner's decision, the appellant appealed to the Tax Court. Allowing the appeal, the court held that the conduct of activities that can be classified as farming operations does not necessarily constitute the "trade" of farming, but that the important thing to be ascertained was the intention of the taxpayer in carrying out the activities. Further there was proof of a genuine intention to farm for profit, even though the income derived was small; also, even though the taxpayer left eight acres of land uncultivated, the appellant's evidence on balance of probabilities showed that there was a genuine intention to carry on farming operations.

It is evident that the above decision considered the intention of the taxpayer together with his actions. The appellant was a full-time engineer who acquired property equipped with farming infrastructure. The intention on acquisition was to farm. His actions supported his intention. It can be deduced that the argument of the Commissioner that the venture was small scale was rejected because the taxpayer's actions reflected his intention.

In general, a farming venture is not likely always to be profitable. If the intention to farm at a profit is evident, the unprofitable venture can still be considered as farming operations. The amount of capital invested, the number of employees employed by the farmer and the willingness of the farmer to farm on a full-time basis, can reflect an intention to carry on a business as a farmer. The intention to farm was considered in **Income Tax Case No 1424 (1986), 49 SATC 99 (Z).** The appellant, a qualified agricultural engineer, worked for the government Institute of Agricultural Engineering. In June 1980 the appellant purchased a farm of about 40.5 hectares outside Harare. The purchase price of the farm was $37 000. The appellant paid $10 000 in cash and acquired a bond to cover the balance. The appellant intended to produce eggs, poultry, and grow vegetables. After 25 years of service with the government the appellant resigned in September 1980. The intention was to pursue his farming operations on a full-time basis. The appellant received his pension and used $10 000 to pay for the farm and to purchase livestock and capital assets. In

August 1980 the appellant commenced farming operations and by June 1982 had nine full-time and four casual employees.

The appellant's venture, however, was under-capitalised: cash flow became an issue because of lack of water due to drought. The appellant therefore resumed his employment in August 1981 as a result of the financial difficulties. His employment income from the Institute of Agricultural Engineering resulted in the continuance of his farming operations. The appellant's wife, an experienced secretary, took a paid part-time job to supervise the farm operations in the absence of the appellant, who ploughed back much of the income from the government into the farm.

For the year ended 31 March 1981, the amount reinvested in the farm was $14 276, and for the following two years $26 211 and $15 232 respectively. The taxpayer realized income amounting to $4 861 from the sale of eggs and vegetables for the year ended 31 March 1981. The overall net loss for that year was $3 370. During the year ended 31 March 1982, the taxpayer received $15 696 from poultry and eggs, and $2 884 from the sale of vegetables, sustaining a net loss. For the year ended 31 March 1983, the appellant received a salary amounting to $14 555 and his wife earned $5 535. During that year, the farming operations made a gross profit of $5 229 from the sale of poultry and eggs. Because of water scarcity, the income from the sale of vegetables decreased to $1 394 and the full-time labour force also decreased to six. In determining taxable income for the year ended 31 March 1983 the appellant recorded a net loss of $14 948.

In assessing his taxable income for that year, the Commissioner for Inland Revenue disallowed certain deductions, contending that the taxpayer's activities were a hobby and not a trade as a farmer in terms of the Income Tax Act. Dissatisfied with the decision the taxpayer appealed to the Special Court. Allowing the appeal, the court held that to determine whether the taxpayer carried on farming operations, actions as well as intentions must be considered. There must be a genuine intention to develop land as a farming proposition and there must be reasonable grounds for assuming that ultimately a profit will be derived. It was stated that if the aforementioned requirements are met, the taxpayer can be regarded as carrying on farming operations. The court stated that the actions of the appellant showed a genuine intention to farm at a profit.

In deciding whether the taxpayer is carrying on a trade as a farmer, the court held that the stated intention to farm, together with the activities of the taxpayer must be considered. The actions of the taxpayer showed that he had an intention to farm at a profit at some stage. It then appears that it is therefore not necessary that the taxpayer makes profit at the commencement of farming, but there must be a genuine intention to farm. The activities carried on by the taxpayer reflected a genuine intention to farm at a profit.

It has been confirmed in court decisions that both objective and subjective factors must be considered to determine whether a taxpayer carries on farming operations in terms of section 26 and the First Schedule of the Income Tax Act.

In **Income Tax Case No 1698, (2000) 63 SATC 161,** the appellant taxpayer was a full-time medical practitioner and for several years conducted operations on a farm. The appellant had purchased farm B between the years 1982 and 1983 for R130 000 intending to engage in stock farming, particularly angora goats, which were then flourishing in the livestock industry. To finance his operations, he acquired a loan of R80 000 from a bank and used part of his inheritance. The appellant continued to practise medicine and only utilised his weekends for farming. Due to the collapse of the mohair industry and other negative factors, he considered game farming as an alternative, to which he systematically converted between 1987 and 1988, believing that the venture had a real prospect of economic viability. However, game farming required further capital for fences that complied with game reserve standards, extra boreholes, windmills, dams, and water tanks. He increased the game on the farm but realised that it would take a considerable time to make a profit. Drought, health problems, and other challenges set in and in 1993 the appellant sold the farm.

After recovering from his health problems, the appellant purchased farm C in 1994 near to his home and spent a considerable amount of money on improvements and developments. Initially engaged in ordinary farming and livestock, his main objective was to develop a game farm for breeding game to increase his herd. Due to a dispute with his neighbour, however, he sold farm C in a relatively short time. Because there was a considerable amount of game on the property, the purchaser was able to start farming from December 1996.

Evidence revealed that the taxpayer had accumulated a loss amounting to R600 000 and the R130 000, which had been spent on developments and improvements. Net losses per annum amounted to approximately R60 000 and there was no indication that the operation was going to break even. It was evident that the taxpayer could not service the interest on the bank loan. The operations had been unproductive and had no prospect of generating profit in the foreseeable future.

In assessing the taxpayer appellant, the Commissioner disallowed the deduction of the losses holding that the losses had been incurred since 1985 and the appellant had to show that a reasonable prospect of an ultimate profit existed to be considered as carrying on farming operations. Dissatisfied, the taxpayer appealed to the tax court. Allowing the appeal, on the grounds that both subjective and objective factors must be considered, that the intention to generate profit was genuine, and that farming was not a hobby as witnessed from the activities on farm B, where the nature of farming demonstrated a genuine intention to generate profit. There was no evidence suggesting any other intention than profit.

It then follows that the facts of the case show that the taxpayer's intention was to farm. The loan acquired from the bank was evidence of a genuine commercial intent because the taxpayer would be required to repay the loan and the relevant interest.

In addition, as the mohair industry was collapsing, the taxpayer responsibly converted to game farming. It can therefore be concluded that if the taxpayer had been pursuing a hobby, he would be unlikely to convert to game farming, with a further injection of capital needed to comply with the standards of game farming. In addition, it is natural that a farm cannot be profitable under drought conditions and selling a farm during those conditions showed that the taxpayer was avoiding an unprofitable "venture". After recovering from poor health, the taxpayer purchased another farm which was subsequently sold. The loss incurred by the taxpayer from the game farm appeared to be incurred from farming operations. The court therefore considered the taxpayer's stated intention together with the objective factors carried on by the taxpayer. The Commissioner appealed unsuccessfully against the decision of the tax court.

This case was heard post-1994 and the decision was confirmed by the Supreme Court in **Commissioner for South African Revenue Services v Smith, (2002) (6) SA 621 SCA, 65 SATC 6.** The court dismissed the Commissioner's appeal holding that the respondent had a genuine intention of carrying on farming operations profitably. It is important that the appellant incurred the loss in question prior to, and not after, disposing of the farm, otherwise he would not be subject to the farming provisions in the Income Tax Act. Trading is a requirement for section 26 of the Income Tax Act to apply.

A taxpayer can be involved in buying and selling farm produce for profit. Alternatively, some farmers provide farming services to other farmers for a fee. The question is whether such ventures constitute farming operations in terms of section 26 of the Income Tax Act.

3.5 Buying and selling of farm produce

Farmers speculating in livestock are considered to be carrying on a trade as a farmer. Speculation in livestock is a venture that involves a high risk with the intention of earning profit. Carrying on a business for Income Tax purposes requires a transaction to have a risk element that is entered into by a taxpayer with the intention of earning a profit. The buying and selling of farm produce for a profit was considered to be carrying on a business as a farmer in **Income Tax Case No 586, (1945) 14 SATC 123 (U)**. The taxpayer leased a farm and was involved in the acquisition of cattle to graze them on the farm for periods varying between six weeks and six months and selling them thereafter. The Commissioner was of the view that the taxpayer was involved in speculation with livestock and not regular farming operations. In assessing the taxpayer at year end the Commissioner declined to apply the farming provisions in the Income Tax Act. The appellant taxpayer objected to the Commissioner's decision and appealed to the tax court.

Allowing the appeal, the court held that the activities carried on by the taxpayer constituted the business of a farmer. The court was of the view that as long as the taxpayer intended to sell at a profit, he carried on farming operations in terms of the Income Tax Act; further, the taxpayer was a speculator involved in the marketing of animals and therefore likely to be speculating in other commodities. A speculator in animals was therefore like a speculator in any other commodity. The court stated that the transformation of products from one state to another is emphatically the business of the farmer: the acquisition of a specific asset, working that asset through farming methods, and then realising it at a profit constitutes carrying on a business as a farmer.

Taxpayers are sometimes involved in the rendering of farming services to other farmers for a fee. The question is whether these activities constitute "carrying on a business" as a farmer.

3.6 Rendering of farming services for a fee

The term "farming" is not defined in the Income Tax Act and therefore must be given its ordinary meaning. Reference is made in the First Schedule to the Act to livestock and produce, thus indicating that farming relates to the rearing of livestock and the growing produce. Case law has established that it extends to farm activities carried on by farmers for a profit. The question that remains unanswered is whether ownership or right to land is a requirement for a farmer to be considered as carrying on a business as a farmer. A taxpayer can render farming services to other farmers for a fee. According to the wide definition of farming, a taxpayer rendering services for a fee qualifies as carrying on farming operations. The courts were called upon to determine whether rendering farming services to other farmers for a fee constituted carrying on farming operations in **Income Tax Case No 1548, (1991) 55 SATC 26 (C).**

The appellant earned income from shearing, harvesting, and transportation activities for other farmers, for which purpose he purchased harvesting and shearing machines. These activities were not, however, extensive enough to justify the purchase of the machines with the purpose of earning additional farming income of rendering (shearing and harvesting) services to other farmers for a fee. In the year of assessment, the appellant had earned income from providing harvesting and shearing services to other farmers and contended that those services constituted farming operations and were therefore subject to the provisions of section 26 of the Income Tax Act. He asserted that if the activities are carried out by a farmer on his own land, they would constitute farming operations and therefore, if the same activities are carried out by a farmer on another farmer's land, they retain the character of farming operations. The appellant contended further that there was no difference whether a farmer earned income from planting, sowing, and breeding cattle for himself, or being remunerated for carrying out those activities for other farmers.

In assessing the appellant at tax year end, the Commissioner was of the view that the expenditure incurred by the taxpayer to acquire the shearing and harvesting machines was not incurred to carry on farming operations and refused to apply section 26 of the Income Tax in respect of the income earned from shearing and harvesting. Dissatisfied with the Commissioner's decision, the appellant appealed to the Tax court. Dismissing the appeal, the court held that the expression "farming operations" used in the Income Tax Act is capable of encompassing the appellant's shearing and harvesting services for others. In Afrikaans, however, the term "boerdery" does not extended to a farmer who shears and harvests for other farmers. It was further stated that the term farming operations used in the Income Tax Act, on a restricted interpretation, only includes activities carried out by a farmer on his own land from which he derives income. However, the court held that a farmer need not be the owner of the land but must have the right to the land and to its yield, and only then will the farmer be subject to the provisions of the First Schedule.

In reaching the above decision, it appears that the court took a literal approach in deciding whether the taxpayer was carrying on farming operations. The court defined farming according to the Afrikaans term "boerdery", which does not cover supplementary activities that a farmer can carry out and does not extend to activities over and above direct farming activities. The case was heard in 1991 and the ownership or right of ownership of the farm was taken into account. The approach to interpreting tax legislation has, however, changed post-1994. A purposive, rather than a literal interpretation is adopted. It can be argued that the decision might have been different if the case had been heard post-1994.

The provisions of section 26 and the First Schedule to the Income Tax Act will only apply to a taxpayer involved in carrying on farming operations. A taxpayer owning a farm will not be considered to be carrying on farming operations if no active step is taken to farm. Haupt (2015:792) states that for farming provisions in section 26 of the Income Tax Act to apply, the farmer must not only be earning farming income but must be "carrying on farming operations".

3.7 An active step taken to farm

Carrying on a business as a farmer requires an active step to be taken by the farmer to farm the land. Having a right to farm without actively being involved in farming, does not constitute carrying on a business as a farmer.

This was considered in **Commissioner for Inland Revenue v D & N Promotions (Pty) Limited, (1995) (2) SA 296, 57 SATC 178**. The respondent was a private company with registered offices situated in Pietermaritzburg in KwaZulu-Natal. The respondent derived income mainly from farming operations and was involved in the growing and marketing of sugar cane. During the tax year ended on the 30th of April 1985, the respondent received R12 035, being retention interest paid by a miller as the difference between final price per ton of sugar and the provisional price thereof for that year. Also, the respondent received R71 025 for the loss of certain rights and the burden imposed for the transport and delivery of sugar cane to sugar mills.

A farmer carrying on farming operations would include farming receipts in taxable income in terms of section 26 of the Income Tax Act. If a farmer is carrying on farming operations, in determining taxable income, he can submit farming receipts and can claim certain deductions for expenditure, in terms of paragraph 12 of the First Schedule of Income Tax Act. In assessing the taxpayer for the tax year ended in 1985 the Commissioner for Inland Revenue treated such receipts as income not derived from farming operations in accordance with section 26 of the Income Tax Act. The respondent objected to the assessment and appealed to the Natal Special Court for hearing Income Tax Appeals.

The Special Court allowed the appeal, but the Commissioner, dissatisfied with the decision, appealed to the Natal Provincial Division. The court pointed out that the Income Tax Act does not provide a definition of "farming operations" and whether a person's economic activity constitutes carrying on farming operations is essentially a matter of fact. Further, that the income and farming operations which comprises of numerous agricultural activities must be directly connected. The amount of R12 035 was therefore considered to be income derived from farming operations. The R71 025, however, was considered not to be income derived from farming operations because it was received for the loss of a right and not for carrying on a business as a farmer.

A taxpayer who owns a farm without taking an active step to farm the land will not be considered to be carrying on farming operations. Acquiring a farm and holding it without farming is like holding a property for investment. The subsequent disposal of such property will not be subject to the provisions of section 26 and the First Schedule but will be subject to the Eighth Schedule of the Income Tax Act. In yet another recent case: **Commissioner of South African Revenue v Kluh Investments (Pty) Limited, (2016) ZASCA**, the courts were called on to define the term "carrying on farming operations". The Thesen group of companies owned a property in Knysna on which they conducted forestry, timber-growing, and a plywood manufacturing business. During May 2001 Steinhoff Southern Cape (Pty) Limited (Steinhoff) concluded a written agreement with Thesen Company (Pty) Limited and Thesen Properties (Pty) Limited (collectively referred to as Thesen). The agreement was that Steinhoff would acquire all the assets as a going concern from Thesen for a purchase price of R45 million, including the land and plantation. However, the board of Steinhoff stopped the acquisition of land and plantation because their policy at that time did not allow the company to acquire fixed property situated in South Africa. As a result of Steinhoff's policy, the agreement was renegotiated so that Steinhoff acquired only the forestry, equipment, and staff members. Kluh Investment (Pty) Limited (Kluh), a special purpose subsidiary of a Swiss company unrelated to either Thesen or Steinhoff, purchased the land and growing trees from Thesen for R29.5 million. Consequently, on 29 June 2001, Kluh took possession of the land and plantation.

In terms of the written agreement executed on 3 October 2001, the purchase price of R29.5 million was apportioned to R11 596 121 for the plantation and R12 528 459 for the land and the remaining balance to the other assets, including an erf, the plywood business, and certain trademarks. Early in 2003, prompted partly by escalating timber prices and the scarcity of plantation resources, Steinhoff opted to acquire the plantation and land that was purchased by Kluh from Thesens during 2001. As a result, on the 21st February 2003 Steinhoff and Kluh entered into 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, equipment, and plantation contracts carried on by Kluh at the plantations and the plantation immovable property 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 valuator provided that the value of the standing timber and plantation stocks as at 30 June 2003 will not be more than R98 million and the value of the immovable land will not be less than R10.5 million.*

However, certain disputes arose between the parties to the agreement. The disputes were then concluded on the 29th of July 2004. In terms of the settlement agreement which had an effective date of 1 June 2004, the final purchase price of the combined assets was R159.7 million of which R144.7 million was in respect of the plantation.

In assessing Kluh at year end the Commissioner for the South African Revenue Service included in gross income the proceeds of the sale in terms of section 26(1) of the Income Tax Act, read with paragraph 14(1) of the First Schedule. The appellant, however, appealed against the decision made by the Commissioner to the Tax Court that it did not "carry on farming operations" in terms of section 26 of the Income Tax Act. The Tax Court, however, dismissed the appeal holding that the appellant did "carry on farming operations" in terms of section 26 of the Income Tax Act. The court relied on agreements and other documentation in deciding that Kluh had been carrying on forestry operations through the agency, as it were, of Steinhoff. The court was of the view that paragraph 14 of the First Schedule to the Income Tax Act applied, as the appellant was disposing of a timber plantation. Paragraph 14(1) of the First Schedule to the Income Tax states:

> *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.*

Dissatisfied with the Tax Court's decision, the appellant appealed to the Supreme Court of Appeal. On appeal, the court stated that the Tax Court failed to consider the evidence provided by Kluh's Chief Executive Officer and other witnesses that the appellant carried out no farming activities whatever on the land. The court stated that the provisions of paragraph 14(1) of the First Schedule and section 26 of the Income Tax Act cannot be used alone or together to create a presumption that the disposal of a farming operation means that the seller was "carrying on farming operations". The court further held that Kluh did not earn any income from the plantation and cannot be considered as a farmer or to be farming in terms of paragraph 14(1) of the First Schedule of the Income Tax Act.

For the provisions of the First Schedule to apply, the taxpayer must be carrying on farming operations. Section 26(1) of the Income Tax Act states: "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 this Act but subject to the provisions of the First Schedule". Paragraph 14(1) of the First Schedule of the Income Tax Act states: "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 capital in nature and shall form part of such farmer's gross income". It is therefore important to link a receipt to the purpose of the taxpayer. If a taxpayer received income that is directly linked with farming operations, the taxpayer will be subject to the provisions of section 26 of the Income Tax Act read with the First Schedule.

The key issue in the case was that Kluh acquired and held a plantation and then subsequently disposed of it. It follows that the plantation, even though it was used for farming purposes by Steinhoff, was held by Kluh only as an investment. Kluh did not “carry on farming operations”, even though it held a farming plantation. It is evident that “carrying on farming operations” requires a taxpayer to farm rather than just to own a farm. Kluh took no active steps to farm the land, so there were no actions to show that the taxpayer was intending to farm.

The CIR v D & N Promotions and the Kluh Investment cases provide evidence that illustrates the difference between a taxpayer holding a farm and a taxpayer carrying on farming operations.

3.8 Conclusion

Court rulings have indicated that, for a person to be considered to be carrying on farming operations in terms of section 26 and the First Schedule to the Income Tax Act active steps must be taken to farm. The activities of the taxpayer determine whether farming operations are carried on. It appears that taxpayers involved in farming for consumption purposes and selling surplus produce are not considered to be carrying on farming operations. Only taxpayers who farm with the objective of selling the produce for profit will be considered to be carrying on farming operations. If the activities of the taxpayer indicate that there can be no profit, the venture will not be subject to the farming provisions in the Income Tax Act. Farmers speculating with livestock that results in profit are considered to be carrying on farming operations. A taxpayer carrying on farming operations for other farmers for a fee, however, was not considered to be subject to the provisions of section 26 and the First Schedule to the Income Tax Act. The reason is that the taxpayer must be carrying on farming operations on a property to which he has a right.

The intention of a farmer is also important: the stated intention of a farmer will not be decisive if it is not in line with the objective factors. It can therefore be deduced that there must be a genuine intention to farm, but if the stated intention does not match the actions of the taxpayer the stated intention will not be considered.

Letting of property is included in the definition of “trade” in section 1. For a taxpayer to claim certain deductions, however, that taxpayer must be carrying on a trade. The next chapter will therefore focus on the extent to which the letting of a property is considered to be carrying on a trade in order to claim certain deductions in terms of the Income Tax Act.

Chapter 4: Letting of property

4.1 Introduction

Chapter 3 examined the nature of the activities of farmers that constitute "carrying on a trade" or a business as a farmer. Not every farming activity constitutes "carrying on a trade". A farmer must be farming with an intention of making a profit and there must be a reasonable prospect of profit being derived to be considered to be carrying on a trade or a business as a farmer.

The goal of the research is to consider the nature of transactions and the structure and extent of activities carried out by taxpayers to determine for tax purposes whether a person is "carrying on a trade" or "carrying on a business", including the question whether taxpayers engaged in a venture of letting of property qualify as "carrying on a trade".

The definition of "trade" includes the letting of property but for the deductions to be claimed under section 11(a), the taxpayer must be "carrying on a trade" of letting property. This chapter will consider to what extent the letting of property constitutes "carrying on trade" in terms of the Income Tax Act. Legislation, case law, and other writings will be used to provide an explanation of whether the letting of property constitutes "carrying on a trade". The chapter will consider the following factors: intention, profit motive, property held as investment and evidence of regularity and continuity.

Taxpayers involved in the letting of property incur expenses for repairs and maintenance, water and electricity, among others. To claim expenditure in relation to the letting of property, the taxpayer must be carrying on the business of letting property. This chapter will focus on the factors considered by the courts in determining whether a taxpayer is carrying on the trade of letting property.

4.2 The law

The preamble to section 11 and section 11(a) of the Income Tax Act states:

> *For the purpose of determining the taxable income derived by any person from carrying on a trade, there shall be allowed as deductions from the income of such person so derived-*
>
> *a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital in nature*

Taxpayers may be involved in a venture of letting property to tenants. The taxpayer would normally incur expenditure such as the cost of water, electricity, cleaning and gardening services. In determining the taxable income, the taxpayer can deduct the expenditure only if carrying on the trade of letting property, to qualify for a deduction in terms of section 11(a). Taxpayers would incur expenditure as a result of repairing and maintaining properties. Section 11(d) of the Income Tax Act allows as a deduction, expenditure incurred by the taxpayer in repairing and maintaining property occupied for trade or property from which income is receivable. To qualify for a deduction in terms of section 11(d) the taxpayer must be carrying on the trade of letting property. Section 11(d) of the Income Tax Act states that:

> *For the purpose of determining the taxable income derived by any person from carrying on a trade, there shall be allowed as deductions from the income of such person so derived-*
>
> *d) expenditure actually incurred during the year of assessment on repairs of property occupied for the purposes of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sum expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade.*

The expression “carrying on a trade” is not defined in the Income Tax Act. Case law has considered various factors that will result in a taxpayer being regarded as “carrying on a trade”. The intention to let property has been used by the courts in determining whether this does constitute a trade.

4.3 Intention

The courts have considered that the intention of a taxpayer to let a property is important in determining whether a taxpayer is carrying on the business of letting property. A taxpayer intending to let a property for income can be considered to be carrying on trade, taking certain factors into consideration.

The intention of the taxpayer was considered in **Income Tax Case No 136, (1928) 4 SATC 203 (U)**. The appellant resided outside the Union and derived income from Government and municipality stock in the Union. The income derived by the taxpayer was subject to full exemption from normal tax if the taxpayer did not carry on a trade in the Union. The appellant had previously carried on a business in the Union. The premises in which the appellant carried on business were let for a period of 8 years. The intention of the taxpayer was to sell the premises when the last lease ended. In assessing the appellant, the Commissioner for Inland Revenue refused to grant full exemption on the interest accruing to the appellant on investments from the Union. The Commissioner contended that the appellant carried on the business of letting property from the old property that was used by his company. The appellant appealed to the Income Tax Court. Allowing the appeal, the court held that letting a property while waiting for a favourable opportunity for disposal did not constitute carrying on a business.

It is evident that the court relied on the intention of the taxpayer. The taxpayer intended to dispose of the property and not to carry on a business of letting property. The rental income derived from the property therefore appeared to be incidental.

The intention to carry on a business of letting property must always match the actions and the decisions of the taxpayer to let the property. A taxpayer earning incidental rental income from property cannot be considered to be carrying on a trade of letting property. The intention of the taxpayer was also taken into account in **Income Tax Case No 258 (1932), 7 SATC (U)**. The appellant, a non-resident of the Union, owned assets under a joint estate of her deceased husband. A farm property situated in the Union was part of the estate. The deceased's son was supposed to exercise his option to purchase the property after attaining the age of 18 years. The appellant continued her half ownership of the farms until her son attained 18 years. Meanwhile interest from the government stock accrued to the appellant. After attaining the age of 18, the son, a resident of England, enrolled at Cambridge University in an Agriculture course with the intention of taking advantage of his father's will. The appellant in the meantime leased the farms and derived rental income over many years.

Interest from the Union accruing to non-residents was exempt on condition that the taxpayer did not carry on a trade in the Union. In assessing the appellant, the Commissioner denied the exemption and subjected the interest to tax, holding that the appellant was carrying on a business by letting property in the Union. Objection was lodged contending that the Commissioner's assessment did not take into account the circumstances that led to the retaining and letting of the property. The objection was not allowed, and the appellant appealed to the Income Tax Court, which held that on the facts disclosed there was no evidence of an intention to hold the farms to make an income by letting them. The court stated that the circumstance that led to the rental of the farm was to hold the property in undivided shares with the trustees under the will until the son had made a decision as determined by the will.

Regularity and continuity are factors applied to determine whether the letting of property constitutes carrying on a trade. It is also evident, however, that there must be an intention on the part of the taxpayer to carry on a business. The taxpayer's intention in this case was to fulfil her husband's wishes; his will stipulated that she should hold the property until their son attained the age of 18 years and exercised his option. The intention was to hold the property until that time. The intention was not to engage in the business of letting property. It can therefore be concluded that rental income derived during the years was incidental.

Earning rental income from a single building is not always enough for a taxpayer to be considered to be carrying on trade of letting property for Income Tax purposes. Carrying on a trade of letting property requires regularity and a degree of continuity of letting property at a profit. In **Income Tax Case No 883, (1959) 23 SATC 328 (T)**, the appellant taxpayer resided outside the Union of South Africa. After his father died, the appellant inherited certain properties from his father's estate. One of the assets was a stand in Johannesburg upon which a building was erected. The appellant's brother was granted the authority to conduct transactions. The brother let the property to tenants and effected repairs and renovations when necessary. The appellant's brother, on behalf of the appellant, invested a significant amount of money in shares and in loans to South African companies. Dividends were received by the appellant from the shares held by him. According to section 30 of the Income Tax Act 31 of 1941, dividends accruing to a non-resident were exempt from Super Tax, provided that the taxpayer did not carry on business in the Union.

The Commissioner raised an assessment on the dividends received by the taxpayer holding that exemption cannot apply because the taxpayer was carrying on a business in the Union. The Commissioner was of the view that the letting of property and repairs and renovations to the property constituted carrying on a business. Objection was raised against the assessment on the grounds that the appellant must be exempted from Super Tax because he was not carrying on a business in the Union, and his appeal to the Income Tax Court was successful. The court held that the appellant was not carrying on a business in the Union but was merely receiving a benefit from his father's inheritance which entitled him to full exemption.

It can therefore be deduced that the decision of the courts was again based on the intention of the taxpayer. The appellant inherited a property and the brother, on behalf of the appellant, effected repairs and improvements. The earning of rental income in this case was incidental. Even the improvements to the property did not mean that the taxpayer's intention was to carry on the business of letting property. Not every letting of property constitutes carrying on a trade in terms of the Income Tax Act. The court viewed the income as a benefit from an inheritance. The scale of activities by the appellant did not amount to an altered intention.

The courts have also considered the likelihood of a venture to make a profit. The letting of property with no hope of making a profit can indicate that a taxpayer does not carry on the trade of letting property.

4.4 Profit motive

The letting of property with the ultimate prospect of deriving a profit can be an indication that a taxpayer is involved in the carrying on of a business of letting property. Taxpayers earning rental income can claim certain deductions only if they are carrying on the business of letting property. It was confirmed in **Income Tax Case No 561, (1944) 13 SATC 313 (U)** that a taxpayer must be earning income with the ultimate prospect of making a profit from letting property to qualify for certain deductions. The appellants had inherited a large country residence and two farms. The property was let on one occasion for three to four months and on other occasions. The lessee was required to maintain the property instead of paying rent. The appellants struggled to find a lessee willing to pay rent, so the property produced no income for seven years. The appellants had incurred expenditure for repairs and sought a deduction in determining taxable income for that year.

In assessing the appellants, the Commissioner for Inland Revenue refused to grant as a deduction the expenditure incurred contending that the taxpayer was not carrying on a trade. The appellant objected to the assessment and appealed to the Income Tax Court. The court dismissed the appeal holding that the property stood empty with no income derived and therefore the appellant could not be entitled to deduction in terms of the Income Tax Act because there was no trading. The lease agreement entered into by the appellant with a tenant was to pay for the maintenance of the premises, as was further held by the court. With such an agreement there was no gain or profit that could be derived by the taxpayer. Even though the taxpayer's intention was to lease the property, no fixed term lease agreement was concluded. The lease agreements concluded were only for short periods. The property remained unleased and so derived no income for a long time, concluded the court.

It then follows that the court considered the facts submitted and found that they did not match the stated intention of the taxpayer. Furthermore, the appellant could not provide evidence that there was a reasonable prospect of ultimately deriving profits from the property. The previous lease agreements only required the tenants to maintain the premises without having to pay a rental on the property. This was evidence that the appellant had no intention of deriving profit but was rather reducing domestic expenditure.

There is evidence supporting the conclusion that the letting of a vacation residence with the intention of minimizing cost does not qualify as carrying on a trade of letting property. The income derived from letting of vacation residence is incidental and therefore the taxpayer cannot claim certain deductions. In **Income Tax No 1292, (1979) 41 SATC 163 (T)**, the appellant taxpayer, a commercial manager, built a residence and incurred costs amounting to R45 135. The taxpayer had obtained a bond of R22 000 and paid the balance in cash. During the years ended 1974 and 1975 the taxpayer had occupied the house as a vacation residence. When not in occupation the appellant would let it to private individuals. At a later stage the appellant entered into a contract with an employer for a consideration amounting to R1 100 per annum to use the residence when he himself was not using it. During the years ended 29 February 1976 and 28 February 1977 the appellant sought to deduct the respective sums of R2 905 and R3 250 as losses incurred in the carrying on a trade of letting property. The Commissioner disallowed the deduction of the losses contending that the taxpayer was not carrying on a trade of letting property. Dissatisfied with the Commissioner's decision the taxpayer appealed to the Income Tax Court.

Dismissing the appeal, the court held that for a venture to qualify for deductions in terms of the Income Tax Act there must be a reasonable possibility of earning a profit and not fanciful expectations. There was no hope that the taxpayer would earn a profit from the letting of the property. The court therefore concluded that the appellant did not carry on the business of letting property but was minimizing the cost of a vacation residence.

The courts have also considered the regularity and continuity of activities in letting of property. It therefore appears that a taxpayer who rents out property on a regular basis and has a history of such transactions is likely to be considered as "carrying on a trade" of letting property in terms of the Income Tax Act.

4.5 Evidence of regularity and continuity

Another factor evident from past court cases that influences a decision on whether a taxpayer is involved in the carrying on the trade of letting property is the degree of continuity or regularity of transactions. Also, another factor that was raised in past cases, is that a plan and structure of letting property can prove that the taxpayer is a professional landlord.

In **Income Tax Case No 615, (1946) 14 SATC 399 (U)** the court considered the regularity or continuity of transactions by the taxpayer. The appellant taxpayer occupied premises under a lease agreement during the year 1935. In October 1937 the appellant floated a company and transferred to it the premises he previously occupied and leased. After the lease expired the owner of the premises refused to grant a lease to the company owned by the appellant. The owner was prepared to grant, however, a renewed lease agreement to the appellant. The lease was renewed accordingly under the name of the appellant, and, with the consent of the owner, the appellant sublet the premises to his company at the same rental that had been paid. The arrangement subsisted until the year ending on the 30th of June 1940. The appellant carried on no business operations from the 11th of January 1940 to the 1st of May 1940.

In assessing the taxpayer for the year ended 30th of June 1940, the Commissioner for Inland Revenue denied deduction of losses incurred from the 11th of January until year end. The Commissioner was of the view that the sub-letting by the appellant to the company did not constitute carrying on a trade. Dissatisfied with the Commissioner's decision, the appellant objected arguing that he had carried on a trade for the entire year under review and appealed to the Income Tax Court. Allowing the appeal, the court held that the sub-letting to the company by the appellant constituted carrying on a trade. The court considered the regularity of the transactions – the appellant had to pay monthly rent, receiving it from the company and paying it over to the landlord. The court stated that the transaction would not yield profits because the appellant received rental income which was equal to the rental expense that he paid to the landlord. The intention of entering into the transaction was because the landlord wanted to contract with the appellant and not the company and therefore the monthly rental payments by the appellant constituted carrying on the trade of the letting of property. The decision taken by the court was influenced by the intention of the taxpayer and the circumstances that led him to enter into the lease agreement. The intention was to let property to the company and the appellant had to make regular monthly payments to the lessor. The court concluded that because there was a lease and continuity of payments, the taxpayer was carrying on a business of letting property and was entitled to claim deductions.

Holding a property as an investment with the intention of benefiting from capital accretion does not constitute carrying on a trade of letting property. To be considered as carrying on a trade of letting property, there must be a system or plan in place that discloses a degree of regularity and continuity of transactions. In **Commissioner of Taxes v G's Estate, (1965) (1) SA 780 (SRAD)** the court stated that "carrying on a business" of letting property requires a degree of continuity or regularity. The deceased taxpayer was ordinarily a resident of the Union of South Africa. The deceased had formed four private companies in Southern Rhodesia (now Zimbabwe) and became chairman and managing director with a large shareholding. To enable the companies to subscribe for the shares and earn dividends in a company carrying on a business of letting property owned by the deceased and his sons in the Republic, the deceased advanced a large loan for which the companies had paid interest to the deceased. The deceased had no office or place of business in Southern Rhodesia, but in 1959 when he was 75 years old he visited the territory. During this visit he was interested in property there, and two years after his visit he purchased two stands in Bulawayo which he thought would produce a capital accretion in value for his grandchildren. Then occupied by tenants, the property provided rental income until his death in 1961.

According to the Income Tax Act of the Federation of Rhodesia and Nyasaland 1959 (Act 35 of 1959) interest received from sources within the Federation by persons not ordinarily resident, nor carrying on business in the Federation, was exempted from Income Tax. The Commissioner assessed the deceased taxpayer on the interest received by him during the years of assessments ended on the 31st of March 1960 and 1961. The Commissioner stated that the letting of property by the deceased constituted carrying on a business and therefore the interest exemption did not apply. The executors of the deceased's estate objected to this assessment stating that the deceased's letting of property in the Federation did not constitute carrying on business. Dismissing the appeal, the Income Tax Appeals Special Court contended that the deceased was carrying on business in the Federation.

This decision of the Income Tax Appeals Special Court was reversed by the High Court of Southern Rhodesia, which stated that the interest received by the deceased must be exempt because the purchase of property by the deceased did not constitute carrying on a business. The court held that the intention of the deceased to acquire the properties was a capital investment and that the rental income was incidental. It was further held that there was no evidence showing a degree of continuity or regularity of letting of property by the deceased to prove that he was indeed a professional landlord.

It is evident that the deceased purchased the properties as a long-term investment hoping that their increase in value would benefit his grandchildren. This makes it clear that the main intention of acquiring the property was for capital investment and that the rental that accrued was incidental. In addition, there was no evidence that the deceased had a history of letting property.

It can be concluded, however, that based on the fact that the deceased had a history of holding properties for rental income, the acquisition of his properties may have qualified as carrying on a business because there was regularity or continuity of letting. Also, there was no evidence of a structured plan to carry on business as a professional landlord. The intention of the taxpayer to hold the property as a capital investment was therefore in line with his actions. He only derived rental income and took no active steps that would make it a professional venture.

In **Income Tax Case No 1529, (1991) 54 SATC 252 (C)**, the appellant taxpayer, a metallurgical engineer specialising in maximum recovery of coal and gold, was a resident of the United States of America. The appellant was the founder of company B which manufactured beneficiating equipment for the mining industry. Company B, however, operated in premises which had proved to be inadequate during 1971 to 1978 and the company subsequently moved to stand C. The stand was acquired by a company in which the appellant held all the shares. Company B expanded, whereupon stand C became too small. An adjoining stand D was acquired by the company in which the appellant held all the shares.

The company owning stand C had entered into a lease agreement with company B prior to developing stand C. There was also a lease agreement between the appellant and the company in respect of stands C and D, and the appellant had received rent with regard to those agreements. Stands C and D were transferred from the company in whose name they were previously registered into the name of the appellant. Consequently, rent was received by the appellant himself. There had been only one tenant in stands C and D from 1980 until the lease expired in 1988, after which the appellant entered into a new lease agreement with firm R who became the new tenants.

In 1980 the appellant emigrated from South Africa to take up citizenship in the United States of America. He left his affairs in South Africa in the hands of a firm of accountants, S, which received the rental payments in respect of stands C and D. After 1980 the appellant had various investments and received dividends from shares, interest from securities and rental income from properties. Prior to emigrating from South Africa, the appellant had been carrying on business but left all his assets behind, having been advised to retain his stands because they would increase in value. As the family of the appellant and his wife remained in South Africa, the appellant visited from time to time.

In assessing the appellant at year end the Commissioner contended that the taxpayer was carrying on a business in South Africa as he was receiving rent from stands C and D and therefore was not entitled to a full dividend exemption. The Commissioner was of the view that the fact that the stands in question were ultimately transferred into the appellant's own name from the two companies in which he was a sole shareholder changed the nature of the appellant's activities from receiving dividends from an investment in property-owning companies to a taxpayer carrying on the business of letting property. The appellant objected to the assessment and appealed to the Income Tax Court. Allowing the appeal, the court held that not every letting of property constituted carrying on a business. The court further stated that to carry on a business as a professional landlord there must be a degree of continuity or regularity and that the circumstances and activities relating to stands C and D indicate nothing other than investment in property with rentals being incidental.

It is evident from the court decision that, even though "trade" as defined in section 1 of the Income Tax Act includes the letting of property not every letting constitutes carrying on a trade or business. It appears that a system or plan must exist in order for a taxpayer to be considered to be carrying on the business of letting property. There must also be a degree of regularity or continuity in the activities of the taxpayer. It then follows that taxpayers receiving rental income on properties held as an investment cannot always be considered to be carrying on a business. A taxpayer can hold a property for speculation and rental income received can be incidental, in which case the taxpayer cannot be considered as carrying on a business of letting property.

Section 20A of the Income Tax Act provides for the ring fencing of losses from a trade, including suspect trades, to income from that trade. The ring fencing applies to natural persons earning taxable income exceeding the amount that is subject to the maximum marginal rate of tax. The letting of property is listed as a "suspect trade" in terms of section 20A(2)(b) of the Income Tax Act, unless the residential accommodation is occupied to the extent of 80 per cent or more by persons who are not relatives of the taxpayer for at least half of the year of assessment. This includes the rental of holiday homes, bed and breakfast establishments, guest houses and dwelling houses. If the taxpayer proves to the Commissioner in terms of section 20(A)(3) of the Income Tax Act that there is a reasonable prospect that the business will derive taxable income (excluding taxable capital gains) within a reasonable time, the ring-fencing will not apply.

4.6 Conclusion

It is clear that the courts have considered the intention of the taxpayer in determining whether the taxpayer is carrying on a trade of letting property. If a taxpayer's intention is to hold a property for a reason other than to make a profit from the letting of the property, the taxpayer cannot be considered to be carrying on the business of letting property. A taxpayer will be considered to be carrying on a business if his intentions, together with his actions, show that he aims to make a profit from the letting of property.

It is therefore submitted that if the intention of a taxpayer is to carry on the business of letting property, there must be a reasonable prospect that ultimate profits will be derived. The intention alone may not be decisive in considering whether letting of property is carried on as a business venture. It can also be concluded that in determining whether a taxpayer can make a profit from the letting of property, the structure in place to carry on the business as a commercial venture will be considered. If there is no structured plan to ensure profits from letting the property, the taxpayer will not be considered to be carrying on a letting business.

In addition, there must be evidence of regularity or continuity of transactions in determining whether the letting of property can be considered as carrying on a trade. The history of transactions, such as the involvement of estate agents and the number of properties that are let, can provide evidence of regularity or continuity in letting property. In that case the taxpayer will be considered to be carrying on the trade of letting property and can claim certain deductions from the rental earned on the property.

Taxpayers are sometimes involved in moneylending and may have borrowed at interest to provide loans. The interest incurred will qualify for a section 24J(2) deduction if the taxpayer is involved in "carrying on a trade" as a moneylender. When a debt constituting unpaid interest on a loan becomes irrecoverable the taxpayer may wish to claim a write-off in terms of section 11(i) of the Income Tax Act but can only do so if the taxpayer is "carrying on a business" as a moneylender. The next chapter will consider activities and transactions entered into by taxpayers in the lending of money that will qualify as carrying on a business or a trade.

Chapter 5: Money-lending

5.1 Introduction

The nature of transactions and the structure and extent of activities carried out by taxpayers is relevant in determining for tax purposes whether a person is "carrying on a trade" or "carrying on a business". The sub-goal of the thesis, whether taxpayers engaged in money-lending qualify as "carrying on a trade", will be addressed in this chapter. The expression "carrying on a trade" is not defined in the Income Tax Act. Case law has established various factors that determine whether a venture of money-lending constitutes carrying on a trade. These factors or tests include the requirement that there must be a profit motive, an intention to lend at market value and a system or plan disclosing a degree of continuity in the making of loans.

Taxpayers may be involved in money-lending and may have borrowed at interest to provide loans. The interest incurred will qualify for the section 24J(2) deduction if the taxpayer is "carrying on a trade" and therefore is engaged in the business of a money-lender. When a debt constituting unpaid interest on a loan becomes irrecoverable the taxpayer may wish to claim a bad debt write-off in terms of section 11(i) of the Income Tax Act but can only do so if the taxpayer is "carrying on a trade" or business as a money-lender. In addressing the sub–goal referred to above, this chapter will therefore consider to what extent money-lending constitutes "carrying on a trade" for Income Tax purposes. The chapter will consider the following factors:

- the profit motive;
- an intention to lend at market value;
- a system or plan disclosing a degree of continuity;
- money-lending within the same group of companies; and
- plans for recovering money lent to clients.

Taxpayers carrying on the business of money-lending will incur certain expenditures. To qualify for a deduction of these expenditures the taxpayer must be carrying on a trade as a money-lender. This chapter will focus on factors considered by the courts which constitute carrying on the business of money-lending.

5.2 The law

Taxpayers involved in a money-lending venture are required to include in gross income any interest amounts that were received or accrued to them in that year of assessment. Section 1 of the Income Tax Act defines "gross income" as follows:

> *In relation to any year or period of assessment, means-*
>
> *i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or*
>
> *ii) in the case of any person other than a resident, the total amount in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic*
>
> *during any year or period of assessment, excluding receipts or accruals of a capital nature...*

The definition of "gross income" in section 1 is important because it states that the taxpayer need not actually have received a receipt but must have accrued to the taxpayer. The accrual of interest is calculated in terms of section 24J.

A taxpayer may be involved in money-lending and may have borrowed money at interest to provide loans. The interest incurred will qualify for a section 24J(2) deduction if the taxpayer is involved in "carrying on a trade" as a money-lender. Section 24J(2) of the Income Tax states:

> *Where any person is the issuer in relation to an instrument during any year of assessment such person shall for the purposes of this Act be deemed to have incurred an amount of interest during such year of assessment, which is equal to-*
>
> *a) the sum of all accrual amounts in relation to all accrual periods falling, whether in whole or in part, within such year of assessment in respect of such instrument; or*
>
> *b) an amount determined in accordance with an alternative method in relation to such year of assessment in respect of such instrument,*
>
> *which must be deducted from the income of that person derived from carrying on any trade, if the amount is incurred in the production of income.*

Having included the interest in "gross income" when it accrued in terms of section 24J, the taxpayer may fail subsequently to recover the amount accrued to him or her and may therefore seek a section 11(i) deduction in terms of the Income Tax Act. The preamble to section 11 and section 11(i) of the Income Tax Act state:

For the purpose of determining the taxable income derived by any person from carrying on a trade, there shall be allowed as deductions from the income of such person so derived -

(i) the amount of any debt due to the taxpayer which has during the year become bad, provided such amount is included in the current year of assessment or was included in the previous years of assessments in the taxpayer's income . . .

To qualify for that the bad debt deduction, therefore, the taxpayer must be involved in carrying on a trade as a money-lender. The courts have established various tests in this regard.

5.3 Profit Motive

A taxpayer that borrowed money at a certain rate of interest and lends it out at a lower interest rate will not realise profit from that venture. The profit motive was considered by the courts in **Income Tax Case No 112, (1928) 4 SATC 61 (U).** The appellant company owned a building from which it derived rentals. Under the memorandum of association, the company had the power to borrow and lend money. The appellant engaged in a large number of transactions in which it lent money on first mortgage. The appellant was a private company with two shareholders who were also directors. One of the directors held all the shares, except for one share held by the other director.

During the year of assessment, the company borrowed a large sum at six percent interest. As security for the mortgage loan the company used the building owned by the company from which it derived the sole income of the business. At the same time the company lent the same amount borrowed to the principal shareholder at one per cent, without security, and no terms were stated as to how the loan would be repaid.

In determining its taxable income for that year, the appellant sought, as a deduction, the expenses incurred on the borrowed amount, contending that it was an expense laid out for the purpose of trade. The Commissioner for Inland Revenue denied the deduction stating that the expense was not incurred for the purposes of trade, nor was it incurred in the production of income. Dissatisfied with the Commissioner's decision the appellant appealed to the Income Tax Court. Dismissing the appeal, the court held that the expenditure was not incurred for the purposes of trade. The court stated that if a taxpayer is carrying on a trade as a money-lender the sole purpose is for gain. Regarding the appellant's transactions, the court held that even though the company was a trader, there was no possibility of deriving any profit from the loan.

If a taxpayer lends money at a market-related interest rate, this can be persuasive in determining whether the taxpayer carries on a business of money lending. Lending money at market-related interest rates reflects an intention to earn profits.

5.4 Intention to lend at market value

For a taxpayer to be carrying on a business of money-lending, it must lend at an interest rate calculated to a earn profit and must also lend to independent parties. These two factors can be persuasive in determining whether a taxpayer is carrying on a business of a money-lender. This was confirmed in **Income Tax Case No 979, (1962) 25 SATC 44 (F)**. The appellant company was formed in 1951 with the purpose of acquiring certain immovable properties. The appellant borrowed money to finance the purchase of the properties. In a directors' meeting, the company opted to embark on a business of short-term money-lending to suitable clients to best advantage. The memorandum was therefore amended to include money-lending. The appellant embarked on the money-lending venture temporarily and profits were likely to be yielded.

Over a period of two years between 1956 and 1958 the appellant concluded seven transactions of money-lending. The transactions were concluded with various independent firms not connected to the appellant. The loans were made at a favourable interest rate and security was provided by the clients of the appellant. In the year ended 31st March 1959 an amount of £7 000 owing to the appellant became irrecoverable. In filing returns for that year end the appellant sought to deduct the amount as irrecoverable. The Commissioner of Taxes, in assessing the appellant, denied the deduction contending that the appellant was not carrying on the business of money-lending. The appellant objected to the assessment and the objection was overruled. The appellant then appealed to the tax court. Allowing the appeal, the court held that the appellant's intention was to embark on money-lending and that the appellant had incurred the loss in carrying on a business as a money-lender.

In reaching the decision, it is evident that the court considered the number of transactions concluded by the taxpayer, the interest charged by the taxpayer to the clients, the relationship of the clients with the appellant, and the security provided by clients to the appellant. The market-related interest of ten percent that was charged showed that there was an intention to yield a profit on the transaction. The granting of security by the clients to the appellant showed that there was a system or plan in place designed to help the appellant recover its loans.

A taxpayer carrying on a business of money-lending should have security in place that will ensure recovery of capital borrowed by clients, which is an indication of a system or plan to lend. The money should also be lent at market related interest rate and be made available to the general public. In **Income Tax Case No 999, (1962) 25 SATC 183 (F)**, the appellant company was formed in 1959 by a professional man and his wife. On the 31st of March 1959, six weeks after incorporation, the company had made loans amounting to £7 400. For the year ended 31st March 1960 and 31st March 1961 the loans made due to the appellant amounted to £11 400 and £10 400 respectively. Of the loans made between those years, £2 600 was permanent in nature and convertible to shares, £2 000 was over ten years and secured by a mortgage, and £2 500 was over four years and secured by a mortgage. Another loan of £2 500 over a year was secured by a pledge of shares and eight loans were made to tobacco farmers for a short period under stop-order on their tobacco crops.

In 1959 a loan amounting to £1 000 was made to an individual to finance a chicken-farming venture. The loan was secured by a bond repayable by monthly instalments of £100 from the 31st of December 1959. No capital repayments were made by the individual and it was discovered that he had left the country leaving no assets behind. In filing tax returns for the year ended 31st March 1960 the appellant sought to deduct the £1 000 as a loss incurred in the carrying on a business of money-lending. In assessing the appellant, the Commissioner of Taxes refused to grant the deduction arguing that the appellant was not carrying on trade as a money-lender. The taxpayer appealed to the tax court against this decision. Allowing the appeal, the court held that the appellant had established the fact that he was carrying on a business as a money-lender. The court further stated that the objects of the company gave the appellant power to lend money; also, evidence showed that the company on formation had the intention of lending money to tobacco farmers at ten percent interest. The interest charged by the taxpayer showed that there was an intention to make a profit from the venture. The court also stated that there existed a system or plan disclosing some degree of continuity in laying out and getting back the money, which involved a frequent turnover of a considerable sum of money.

It follows that for a venture to be considered as carrying on a trade as a money-lender the taxpayer should be lending at a market-related interest rate. Lending at market-related rates shows an intention to lend at profit. The courts have further stated that there must be a system or plan disclosing a degree of continuity regarding money-lending transactions to be considered as carrying on the business (and therefore the trade) of a money-lender.

5.5 System or plan disclosing a degree of continuity

A taxpayer who lends money without a system or plan in place and without a degree of regularity that discloses continuity of transactions, cannot be considered as carrying on a business as a money lender for Income Tax purposes. The court confirmed that there must be a system or plan disclosing continuity of transactions for a money-lending venture to be considered as carrying on a business in **Income Tax Case No 812, (1955) 20 SATC 496 (T)**. The appellant derived rental income on property owned by him, interest on mortgages and interest on loans that were secured by promissory notes. The appellant had sought to deduct amounts of £800 and £183 in determining his taxable income for the 1954 tax year. The Commissioner for Inland Revenue refused to grant a deduction contending that the appellant was not carrying on a business of money-lending.

The appellant objected to the Commissioner's assessment and the objection was overruled. The appellant appealed to the tax court and the appeal was dismissed. The court held that there was no evidence provided by the appellant to show that he carried on a business as a money-lender. The court further stated that there was no evidence of a degree of continuity or system or plan involved in the use of his capital.

A company with a Memorandum of Association covering money-lending can be considered to be carrying on a trade of money-lending if there is evidence of regularity and continuity of transactions. There must be a system or plan that will ensure the recovery of capital lent to clients. The system or plan disclosing a degree of continuity was also considered in **Income Tax Case No 1003, (1963) 25 SATC 237 (F)**. The appellant company was formed by one S.Z who, as a result of the successful operation of a manufacturing company in which he and his wife owned the shares, had accumulated a large amount of capital. The primary object of the company was to acquire property in Bulawayo. In 1951 S.Z considered a purchase of a property in a certain town, as it constituted a readily marketable commodity. The property on which stood a cottage that provided a low return was purchased by the appellant.

The objects set out in the company's Memorandum of Association were extensive and covered money-lending and acting as agents. In 1955 S.Z was approached by an agent on behalf of the borrower, who sought a short-term loan of £2 500. The appellant agreed to advance the loan for 8% interest. In 1956 the appellant made eight loans from £300 to £7 500 for periods ranging from three to twelve months at interest varying from eight to ten percent. In the year 1957 the appellant renewed four short loans previously made and in April 1958 the loan of £7 500 was renewed for a further three months.

Among the loans made was a renewal in 1956 of a loan amounting to £2 500 originally made in 1955. The loan was due in 1957, repayment was sought, and a portion of the amount owing was repaid eventually. In January 1958 a further amount was paid leaving the capital and accumulated interest amounting to £1 137, which proved to be irrecoverable. In determining the taxable income for the year ended 31st March 1959 the appellant sought to deduct the capital lost from its money-lending business. The Commissioner refused to grant the deduction stating that the appellant was not carrying on a business of money-lending. The appellant, dissatisfied with the Commissioner's assessment, appealed to the Tax Court. Dismissing the appeal, the court held that the original intention of the taxpayer was to invest in fixed property.

The appellant could not discharge onus that the intention had changed to engage in money-lending but had rather engaged in a temporary venture to make use of available capital. The court further held that the appellant did not show consistency in starting a business with a system or plan in place and degree of continuity in the turn-over of money. The court also stated that there was no evidence of a director's resolution to reflect a change in intention of the company that the appellant was ready to embark on a money-lending venture.

Even though the taxpayer was lending at market related rates, the court decision was based on the fact that there was no structure or plan with regularity of transactions to show that the money-lending venture was being carried on as a business. There was no evidence of a change in intention from property investment to money-lending in terms of a director's resolution.

A similar decision was made in **Income Tax Case No 1138, (1969) 32 SATC 3 (R)**. The appellant taxpayer company was formed with the principal objective to manufacture, to produce merchandise, to trade, deal, and supply, and, up to March 1964, its activities had been confined to these types of activities. In March 1964 the appellant company sold the business to a company that had recently been formed but retained the premises on which it had carried on the business. The sale was concluded by the issue of shares to the appellant and the remainder was a loan payable to the appellant.

After the sale the appellant's income was in the form of dividends from the shares, interest income from the loan to the newly formed company, and rental income on the premises it retained after disposing of the business. Later, in 1965, the appellant expanded the business by purchasing shares in other companies and granting loans to the companies in which it held direct or indirect shares. The income derived by the appellant from these loans formed an insignificant amount of the total income that had been derived in the specific year of appeal.

In March 1966 the appellant company lent £1 500 to one of the companies and a promissory note for £1 540 was issued by that company. The repayment of the loan was guaranteed by three directors of the borrowing company. The guarantee was the promissory note signed by the directors. At a later stage the promissory note was withdrawn, and six cheques were issued in substitution. Five of the cheques were for £300 each and one was for £30. The cheques issued were, however, not endorsed with a guarantee from the directors and two of the cheques for £300 each were dishonoured on presentation. The appellant did not take any steps to recover the amounts of these cheques from the directors under the original guarantee.

In submitting returns for the year ended 31st of March 1968 the appellant company claimed a £600 deduction of the dishonoured cheques as a bad debt expense incurred in the course of carrying on business as a money-lender. The Commissioner for Taxes refused to grant the deduction contending that the loan in question had not been made in the course of carrying on a business as a money-lender. The Commissioner further stated that there was lack of evidence that a loss had actually been incurred.

Dissatisfied with the Commissioner's decision, the appellant company appealed to the Tax Court. Dismissing the appeal, the court held that for money-lending to be considered as carrying on a business there must be a system or plan that discloses a degree of continuity in laying out and getting back capital for further use, which involves a frequent turnover of capital. The money must be lent to make a profit and there must be a form of security for loans made by the business.

It appears that the court also considered a form of security on lending as part of the system, plan or structure to determine whether a money-lending venture constitutes carrying on a business as a money-lender.

Carrying on a business of money-lending requires a taxpayer to lend money to independent clients and there must be security in place of recovering the capital amount. In **Secretary for Inland Revenue v Crane, 39 SATC 191, (1977) (4) SA 761 (T)**, the respondent, a retired stockbroker, lent Antelope Construction (Pty) Ltd the sum of R44 000 in June 1973. The loan was advanced in two amounts of R30 000 on the 8th of June 1973 and R14 000 on the 20th of June 1973 respectively. The loans were for a period of three months and both amounts bore an interest rate of 12 percent per annum. As security for the loan the respondent was given the borrower company's acknowledgement of debt and the personal guarantee of its director. Between June and July various amounts were paid to the respondent. Then the borrower company was liquidated, the director of the company was sequestrated, and the amount of R24 940 owed to the respondent remained irrecoverable.

The respondent sought to deduct the amount of R24 940 on its tax return as a bad debt, but the Secretary for Inland Revenue denied the deduction, contending that the taxpayer was not carrying on a business as a money-lender. Dissatisfied with the Secretary's decision the respondent appealed to the Special Court, which allowed the appeal maintaining that the respondent was carrying on a business as a money-lender. The Secretary, dissatisfied with the Special Court decision, appealed to the Provincial Division. Allowing the appeal, the Provincial Division held that there was no clear evidence in the taxpayer's activities to show that there was an intention of carrying on a business as a money-lender. The court further stated that the transactions of the taxpayer were not determined by a system or plan disclosing a degree of continuity in laying out and getting back capital for further use. It was further stated that there was no frequent turnover of capital, which would characterise floating capital. In this case, although the taxpayer had obtained security for the loans, the regularity of transactions under a system or plan was not evident.

Often companies in the same group of companies advance loans within the group. It is therefore important to consider whether loans within a group of companies can constitute carrying on a business as a money-lender for Income Tax purposes.

5.6 Money lending within the same group of companies

Advancing loans within the same group of companies was discussed in **Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue, (1991) (2) SA 257 (A)**. The appellant was a private company and a wholly owned subsidiary of Plate Glass Shatterprufe Industries Limited (PGSI), a public company listed on the Johannesburg Stock Exchange. In 1973 PGSI decided that the finance of the group must be managed by a finance company. The finance company would arrange for and secure funds required by all companies in the group and monitor the use of funds by the subsidiaries. A dormant subsidiary named Plate Glass and Shatterprufe Industries Finance Company (Pty) Ltd was granted the responsibility for finance and the name of the company was subsequently changed to Solaglass Finance Company (Pty) Ltd (Solaglass).

One of the objectives of Solaglass in the Memorandum of Association was to lend money to any person or company and to borrow such money as it deemed fit. Subsidiary companies requiring funds would apply to the appellant and the appellant would grant funds in the form of a loan. No security was required for this kind of loan granted to the subsidiaries that were, however, required to pay interest on the loans advanced by the appellant, and the interest varied according to the financial position of each company. The appellant charged interest at one percent higher than that at which it had been borrowed. Surplus funds from subsidiaries were required to be placed with the appellant on a daily basis. The appellant did not rely on the surplus funds it received from the subsidiaries but borrowed moneys from PGSI as well as from commercial banks. Loans obtained from commercial banks were guaranteed by PGSI.

Initially the appellant's borrowing and lending was confined within PGSI and companies in the group. Subsequently appellant's activities were extended. Loans were made to staff members, and bills were discounted with customers trading with subsidiaries in the group. The appellant also deposited money with building societies to enable staff members to obtain mortgage bonds. The appellant did not obtain any form of security for the loans it advanced and the loans were not structured to maximise profits. The appellant's business was mainly to grant loans only to companies within the group, customers trading with the group, and staff members of the group.

In submitting its tax returns for the year ended 31^{st} of March 1978 the appellant sought to deduct a loss amounting to R4 545 922, being a disposal of a debtor, plus a major portion that was a loan granted to PG Environment Systems (Pty) Ltd. In respect of the year ended 31^{st} of March 1979 the appellant sought to deduct an amount of R55 153 being losses sustained on loans that were irrecoverable from bills discounted to customers trading with subsidiaries of the group and loans made to employees and ex-employees. The Commissioner denied the deduction of the debts written off by the appellant holding that the appellant was not carrying on a business as a money-lender. The appellant objected and when the objection was not allowed, appealed to the court.

Dismissing the appeal, the court held that the trading activities were geared to achieve a dual purpose of furthering the interest of the Group's subsidiaries and of the group itself, and of making a profit. In this situation it is evident that Solaglass's initial objective was to serve the interests of members of the group. At a later stage it served the interests of its employees and customers by trading specifically with subsidiaries of the group. At the time, section 23(g) of the Income Tax Act stated:

> *no deductions shall in any case be made in respect of the following matters, namely-*
>
> *any moneys claimed as a deduction from income derived from trade, which are not wholly or exclusively laid out or expended for the purposes of trade . . .*

The dual purpose therefore made it possible for section 23(g) of the Income Tax Act to be applicable to deny the deduction of the losses. As much as the venture carried on qualified as "carrying on a money-lending business" the expenditures incurred were not wholly or exclusively laid out for the purposes of trade.

5.7 Plan or system to recover money lent to clients

A system or plan disclosing repayment terms of the capital borrowed must be in place for a venture to be considered as carrying on a business of money-lending. The money must also be made available to the general public. The system or plan that provides for security in order to recover loans advanced was discussed in **Income Tax Act Case No 957, (1960) 24 SATC 637 (0)**. The appellant company had been formed as a private company with the main object of taking over a firm of building contractors as a going concern. The objects of the company further empowered it to invest and deal with the moneys of the company not immediately required in such a manner as may be required for the use of the company from time to time and to lend and advance money to such companies or persons on terms that were expedient.

The only income derived by the appellant during the year of assessment ended 30th of June 1959 was from interest on certain loans made to shareholders or to the relatives of shareholders. The appellant sought to set off assessed losses in respect of the year ended 30th June 1958 against income derived during the year ended 30th of June 1959. Being of the opinion that the appellant did not carry on trading operations during the 1959 year of assessment in accordance with the **SA Bazaars (Pty) Ltd v Commissioner for Inland Revenue, (1952) (4) SA 505 (A), 18 SATC 240**, the Commissioner denied the set-off claim.

Dissatisfied with the Commissioner's decision the appellant appealed to the Income Tax Court contending that it had carried on business as a money-lender during the year in question and was consequently entitled to the deduction. Dismissing the appeal, the court stated that there were no payment terms and regular repayments of capital were not made to ensure frequency of turnover. The court also stated that there was no evidence of any system or plan in laying out and recovering loans, which is essential to a money-lending business. The court compared the taxpayer with a taxpayer like a bank, which advances money to clients for profit. A form of security for money lent to clients is a factor in considering whether a taxpayer is carrying on a business as a money-lender.

A similar case was heard in **Income Tax Case No 933, (1960) 24 SATC 347 (C)**. The appellant derived income from employment as a manager and, in addition, from rents, interest, and dividends. The appellant made a loan to H which was made up of a capital sum of £4 240 and interest of £106. The appellant had sought to claim as a deduction the loan as a bad debt that was irrecoverable in determining his taxable income at year end. In assessing the appellant, the Commissioner refused to grant the deduction contending that the appellant was not involved in carrying on a business as a money-lender. The appellant objected to the assessment arguing that he had made a practise of borrowing and lending money, that for many years the major portion of his income had been derived from lending money, and therefore the bad debt had been incurred in the carrying on a business as a money-lender.

Dismissing the appeal, the court held that the appellant had made only one loan for the year under review ended on the 30th of June 1955. The interest earned by the appellant was interest from investments. The court then reviewed the transactions from 1951 from when the appellant claimed to be carrying on a business of money-lending. There was no evidence of terms of repayment for the loans, the amounts of the loans were not reflected in returns, and there was no indication of the circumstances that led to the issue of the loans. Most of the interest earned by the appellant was from investments. There was no structure or plan of advancing loans to show that he carried on business as a money-lender.

It then follows that money lent without a system or plan of security in place, and without regularity and continuity of transactions with the general public, will not constitute carrying on a business as a money-lender. Carrying on a trade as a money-lender with security was recently discussed in **Income Tax Case No 1771, (2004) 66 SATC 205**. The appellant was a registered limited liability company and had conducted the business of an investment and financing company. The appellant had made loans to company A with which it shared common directors; 90% of the shares were held by C and the remaining 10% by an individual. Company A had conducted a business of manufacturing and shipping containers overseas. The appellant had conducted the business of an investment and financing to C. The appellant held a number of shares in companies registered on the Johannesburg Stock Exchange and had made loans to companies, but mainly C. The terms and conditions of the loans differed from debtor to debtor. For several years, the appellant had advanced various monies to A up until April 1997 when A ceased trading. There was no written agreement between the appellant and A regarding the money lent, but the loan was subject to certain conditions. They agreed that the appellant would advance monies to A from time to time when the latter needed such monies to enable it to continue with business activities. When the appellant had money to advance, interest on the advanced loans would be calculated at market-related rates and capitalised monthly. There were, however, no fixed dates of payment and A was only obliged to make repayments when in a financial position to do so. In addition, there was no differentiation of interest and capital repayment. No security was provided by A to the appellant for the loan.

In April 1996 the directors of A decided to close the company because it was losing money. The amount owing to the appellant at that date amounted to R24 064 626 and the directors could not repay any portion of this amount to the appellant. In determining taxable income for the year ended 28 February 1997 the appellant sought to deduct the amount owed as an irrecoverable debt incurred from carrying on a trade as a money-lender. In the assessment of the appellant the Commissioner for the South African Revenue Service disallowed the deduction and contended that the appellant did not carry on a trade as a money-lender. The appellant objected to the assessment, but the objection was overruled, whereupon the appellant appealed to the Income Tax Court for hearing Tax Appeals. Dismissing the appeal, the court held that there was no system for the appellant to recover money it lent from time to time, nor was interest payable on such money and there was no method of recovering the monies lent. The only manner to recover the money lent was if A was able to afford the payment, which would be contrary to what one would expect in a relationship of money-lender and borrower.

It is therefore evident from the court decisions above that for a taxpayer to be considered to be carrying on a business as a money-lender there must be some form of security in place to ensure that an amount advanced is recovered by the taxpayer.

5.8 SARS guide on money-lending

The South African Revenue Service (SARS), in their Practice Note 31 (SARS, 1994: 1), state that a taxpayer not practising as a money-lender can set off an interest expense against funds borrowed to the extent that it does not exceed the interest earned on the loan. Although the Practice Note sets out the practice of SARS this is not supported by legislation or common law and may therefore not be upheld if the matter is heard by courts.

5.9 Conclusion

For a taxpayer to be considered to be carrying on a business as a money-lender there must be an intention to make a profit. A money-lender will lend money at market-related interest rates to ensure that a profit is derived from the venture. The taxpayer must have a system or plan disclosing a degree of regularity and continuity of transactions. A taxpayer company must make it clear in its Memorandum of Association that the company is carrying on the trade of money-lending. If this is not reflected in the Memorandum, there must be evidence of directors' meetings that makes it clear that the company will carry on the business of money-lending. A structure must be in place to acquire the funds to be lent and the loans must be made to the general public. Loans advanced by a company to a specific target group other than the general public will not be considered as money advanced in the carrying on of a business as a money-lender. Also, a taxpayer must have a form of security that will ensure that money advanced to clients is recovered.

The discussion in this and the previous chapters discussed the transactions of various classes of taxpayer in on-going operations, and whether they were carrying on a trade or business. The next chapter will discuss at what stage a taxpayer ceases to carry on a trade and what the tax consequences are of ceasing to trade.

Chapter 6: Assessed losses and carrying on a trade or business

6.1 Introduction

The previous chapter discussed the nature and extent of money-lending carried out by a taxpayer, to constitute carrying on a trade as a money-lender for Income Tax purposes. The goal of the research is to consider the nature of the transactions, structure, and extent of activities carried out by taxpayers in order to determine whether or not a person is "carrying on a trade" or "carrying on a business" for tax purposes, including a sub-goal relating to circumstances in which taxpayers that have ceased to trade will be allowed to set off assessed losses against income.

Section 20 of the Income Tax Act allows taxpayers to set off assessed losses from income derived from a South African source. If the taxpayer is "carrying on a trade", section 20(1) also allows taxpayers to set off assessed losses from earlier years of assessment from South African source taxable income earned in the current year of assessment. If a company should cease to trade, however, the balance of assessed losses available from previous years of assessments may not be carried forward and utilised in subsequent years, when the company again commences to trade. Natural persons, however, are permitted to set off assessed losses from previous years against other income (other than losses ring-fenced in terms of section 20A) derived from a South African source. This chapter will discuss ceasing to trade and will consider the following factors: ceasing to trade, endeavouring to earn income, post-liquidation income and the income requirement.

6.2 The Law

Section 20(1) of the Income Tax Act states:

> *For the purpose of determining the taxable income derived by any person from carrying on a trade, there shall, subject to section 20A, be set off against the income so derived by such person-*
>
> *a) Any balance of assessed loss incurred by that person in any previous year which has been carried forward from the preceding year of assessment: provided that no person whose estate has been voluntarily or compulsorily sequestrated shall be entitled to carry forward any assessed loss incurred prior to the date of sequestration, unless the order of sequestration has been set aside, in which case the amount to be so carried forward shall be reduced by an amount which was allowed to be set off against the income of the insolvent estate of such person from the carrying on an of any trade.*

There are various issues that arise in relation to the requirement that the person should be carrying on a trade to be entitled to set off a balance of assessed loss, including endeavouring to earn trade income, when a trade ceases and the effects of liquidation. These issues are discussed below.

The provisions of section 20(1) of the Income Tax Act will not apply, however, to the set off of the balance of assessed losses in carrying on a trade outside the Republic against income from a South African source. According to Stiglingh, Koekemoer, van Schalkwyk, Wilcocks and de Swardt (2017:218), foreign losses are fully ring-fenced and can only be set off against foreign income. This aspect is discussed below.

Section 20A of the Income Tax Act prohibits the setting-off of assessed losses incurred by a natural person earning income equal to or exceeding the maximum marginal rate of tax, against other income derived by him from another trade or non-trade activity. This section was discussed in earlier chapters, in relation to the ring-fencing of the losses incurred in carrying on a "suspect trade" and the evidence to be considered in determining whether there is a reasonable prospect of deriving income from this trade in the future. This evidence illustrates the legislature's interpretation of indicators of trade.

6.3 Ceasing to trade

When a company ceases to trade it cannot carry forward assessed losses when it resumes trading in subsequent years. A company must be carrying on a trade and must earn income from that trade to be able to set off assessed losses from trade income. This was confirmed in **SA Bazaars (Pty) Ltd v Commissioner for Inland Revenue, 1952 (4) SA 505 (A), 18 SATC 240**. The appellant company had carried on business as a general dealer for several years. The appellant had incurred losses on the 16th of November 1941. During succeeding years, up to the year ended the 30th of June 1947, the company maintained its existence, retained its bank accounts, obtained the transfer of its operations to other premises, paid its company tax, and complied with all the requirements of the Income Tax and Companies Act, but it did not carry on ordinary trading operations.

During the year of assessment ended 30th of June 1948, the company resumed trading activities and made a profit from operations in that year and the following year. The company claimed that it was entitled to carry forward the accumulated losses incurred prior to its closing down. Therefore, the appellant set off assessed losses against profits. In assessing the appellant, the

Commissioner for Inland Revenue refused the deduction contending that the loss carried forward from the previous years of trading operations was nil.

The appellant appealed against the Commissioner's decision to the Special Court for hearing Tax Appeals, but the appeal was dismissed. Dissatisfied with the decision the taxpayer appealed to the Appellate Division and the appeal was dismissed again. It was held that in the year following the closing down of the business the company had not carried on any trade. The court further stated that the company had derived no income in that year from a trade against which a set-off of any loss incurred could be made. Therefore, in the case of a company that has ceased to trade in a specific year of assessment, the assessed loss accumulated up to the end of that year of assessment may not be utilised against income in subsequent years of assessment, should the company commence trading again.

6.4 Endeavouring to earn income

A taxpayer must earn income from carrying on a trade to be able to set off assessed losses from previous years of assessment against the income. If a taxpayer does not derive income from carrying on a trade, there must be evidence that reflects an effort to earn income from that trade. The taxpayer can only set off previous assessed losses from income if had endeavoured to earn income from carrying on a trade. This fact was confirmed in **Income Tax Case No 777, (1953) 19 SATC 320 (T)**. The appellant company was registered in 1941, and for the years of assessment ended 30th of June 1942 and 1943, carried on a manufacturing business. The business was not successful and incurred losses. During the 1944 tax year the manufacturing business was discontinued, and the company name was changed. The company acquired certain properties and shares as income-producing investments. As of the 30th of June 1947, evidence by the Commissioner for Inland Revenue showed that the company had incurred losses amounting to £1 616. During the year ended on the 30th of June 1948 dividend income accrued to the company. In addition, certain shareholdings were sold by the company, some at a profit and some at a loss. The losses exceeded the profits on disposal. During that year the company owned property but did not derive any rental income from it, although it tried to let its property.

In assessing the appellant for the year ended on the 30th of June 1948 the Commissioner declined to set off assessed losses brought forward from the 1947 tax year contending that the appellant did not carry on a trade in that year. The appellant objected to the assessment, but it was overruled. Dissatisfied with the Commissioner's decision, the appellant appealed to the Tax Court. Allowing the appeal, the court held that, as the appellant had endeavoured to let its fixed property, it had carried on a trade during the year ended 30th of June 1948 and was entitled to carry forward assessed losses incurred up to the 30th of June 1947 to be set off against 1948 income.

Therefore, it appears that, should the taxpayer not earn income from carrying on a trade, there must at least be evidence of efforts to earn income from carrying on a trade for a company to utilise previous assessed losses. An effort to earn income was also considered in **Income Tax Case No 1476, (1989) 52 SATC 141 (T)**. The appellant company was incorporated on the 13th of March 1969. The subscribers for its shares were Messrs A and B. The company had incurred losses and was not earning income. Up to and including 1987 the appellant had invested approximately R693 000 and did not attempt to recover or to dispose of the investments. Interest and dividends accrued from the investments. For the year under consideration the appellant did not receive any dividends or interest from the investments.

In filing returns for the year ended 1987 the appellant had sought to set off income for that year against the assessed losses brought forward from 1986. In assessing the appellant, the Commissioner disallowed the set-off of the assessed losses because the appellant did not carry on a trade. The Commissioner further contended that the appellant was merely holding inactive investments and that holding investments does not constitute carrying on a trade. The appellant objected to the assessment, the objection was overruled, and an appeal was made to the Tax Court. Dismissing the appeal, the court held that during a year in which a company did not carry on a trade, it cannot be permitted to carry forward to that year any balance of assessed loss. The carrying on a trade requires an active step to trade, something more than watching over investments. The appellant had investments in shares that required little supervision, the court further held. Therefore, the company had failed to provide evidence that it was carrying on a trade in the year in question. The court also stated that the appellant had failed to establish that it endeavoured any activity in that year that would have constituted carrying on a trade.

While endeavouring to earn income may mean that trading has not ceased, determining when trading is not being carried on or has ceased, is discussed in the next section.

6.5 The income requirement - failing to earn trade income

A company must be earning trade income to be able to set off assessed losses from previous years. If a company does not earn trade income in that year it cannot be considered to be carrying on a trade. A company will be considered not to have carried on a trade when it ceases earning income from that trade. The courts considered the facts stated in **Income Tax Case No 664, (1948) 16 SATC 125 (U)**. The appellant had carried on trade for some years up to and including the year ended the 30th of June 1929. The assessed losses at that date as determined by the Commissioner for Inland Revenue amounted to £37 179. From that date up to and including the year of assessment ended on the 30th of June 1945, the appellant derived no income from trade. From the year ending on the 30th of June 1930 to that ending on the 30th June 1945, the Commissioner had determined the assessed loss of the appellant to be nil. The appellant objected to the Commissioner's assessment contending that it was entitled to carry forward the assessed losses up to 1945. Dismissing the appeal, the court held that the appellant was not entitled to carry forward its assessed losses because it did not earn any trade income. The court further stated that there must be some form of trade income derived by the company from which it can set off assessed losses.

A company earning investment income may seek to set-off assessed losses from this passive income. Carrying on a trade requires an active step to be taken by a company to trade and earn income from that trade. Assessed losses incurred by a company can only be carried forward and set-off against trade income. In **Income Tax Case No 1679, (1999) 62 SATC 294**, the appellant had traded as a shop and in 1994 converted to tourism consultancy. The appellant consulted for both national and international tourists. Evidence revealed that the sole member of the company, together with his secretary, had undertaken a trip to the United States of America to recruit clients. He had a list of the people he intended to see and had prepared and printed letter-heads, business cards, and business brochures to use on this trip. The member had also prepared CDs and tapes for the American market. The recruiting process included contacting and meeting different people and conducting exhibitions where the videos were played. The member distributed the business cards, business brochures, and other advertising material to potential clients.

In calculating taxable income for the year of assessment ended in 1995 the appellant company derived no income, but incurred expenditure amounting to R36 006. The appellant had incurred an assessed loss of R91 382 in the 1994 tax year and the Commissioner for Inland Revenue issued a revised assessment to reverse the assessed loss brought forward in the 1995 tax year from the previous year. The Commissioner was of the view that the appellant did not generate any income for the 1995 year of assessment and therefore did not carry on a trade in that year. As the company was not carrying on trade in the 1995 year of assessment, it did not qualify to set off assessed losses from the previous year. The appellant objected to the assessment and appealed to the Tax Court contending that it carried on a trade in the year 1995 even though it derived no income. Dismissing the appeal, the court held that for an assessed loss to be brought forward from one year of assessment to the next, the taxpayer must be deriving income from trade against which the assessed losses from previous year can be set off. The court argued that evidence showed that the appellant's only income in 1995 was interest amounting to R4 708, and that income was not derived from the appellant's normal trade. The court then decided that because the appellant company did not carry on a trade in 1995 the 1994 assessed losses were not available.

A company earning passive income must prove that it is an investment company to be considered as carrying on a trade. It is only then that a company can set off assessed losses against investment income. This was confirmed in **Commissioner for South African Revenue Services v Megs Investment (Pty) Limited and Another, (2004) 66 SATC 175**. The respondent company had carried on their business from the same premises, with the same staff in the same manner. The respondent carried on the business of arranging and managing discounts for a chain of wholesale, retail, supermarket, and grocery outlets. On the 1st of January 1996 the respondent sold the entire business as a going concern to Shoprite Checkers (Pty) Ltd for R21 000 000. The respondent did not carry on the normal trading activity of recovering a portion of the discounts for their own account during the 1996 tax year. During that tax year the respondent received interest from the purchase price of R21 000 000 while it was held in trust pending payments on certain conditions being fulfilled. In June the respondent received interest from ABSA bank on a portion of the purchase price amounting to R6 000 000. The balance of the purchase price of R6 000 000 was distributed to shareholders as a dividend and R9 000 000 was invested free of interest in three Namibian companies, with the view to the possible development of similar chain store organizations in Angola with their Namibian associates. The respondent directors expended considerable money, time, and effort to these ends, but no contracts were concluded.

The respondent had traded at a profit in the 1995 tax year but had accumulated a sizeable assessed loss which had been brought forward from previous tax years and which was set off against profits. The respondent had sought to deduct the remainder of the assessed loss against interest earned during 1996. The Commissioner was of the view that the respondents were not entitled to set off the balance of assessed losses because the taxpayers did not carry on trade and did not generate income from trade in 1996. The Commissioner's decision, however, was reversed by the Bloemfontein Tax Court.

Dissatisfied with the Tax Court decision the Commissioner appealed to the Supreme Court of Appeal. Allowing the appeal, the court held that even though the respondent companies derived interest income, that amount was not actually derived from carrying on a trade. The court further stated that the respondent failed to prove that it was an investment company, after investing proceeds from the sale of the business in interest-bearing instruments.

It is important to note that section 20(1) of the Income Tax Act requires a company to trade, as opposed to earning income. The South African Revenue Services, however, apply an income test instead of a trade test to determine whether a company can set off assessed losses from income. The courts have recently criticised the Commissioner's practice in **Income Tax Case No 1830, (2007) 70 SATC 123**. The company carried on a business of awarding licences to the security industry for the use of a computer programme that it had developed. For the appellant's year of assessment ended 2003 it had accumulated assessed losses amounting to R3 338 742 from the development expenditure of its programme. During 2004, which was the year in question, the appellant incurred further losses of R424 057 and the only income derived by the appellant was interest of R12 302 and sundry income unrelated to the appellant's trading activities.

In submitting returns for the tax year ended in 2004, the appellant sought to set off the balance of assessed losses against income. In assessing the appellant, the Commissioner for South African Revenue Service disallowed the set-off of the losses from income contending that the appellant carried on no trade in that year and had not derived trade income to set off the losses brought forward. Dismissing the appeal, the court held that the derivation of income was only part of the requirement for a company to carry forward assessed losses in carrying on a trade. The court further stated that South African Revenue Services Interpretation Note 33 must consider that the legislation requirement for section 20(1) to apply was the "trade requirement" and not "income from trade" as contended by SARS.

The South African Revenue Service (SARS), in their Interpretation Note 33 (SARS.2010:1) that was criticised by the court, state that the taxpayer must actually be carrying on trading activities, and it does not accept that the mere receipt of interest and dividends constitute the carrying on of a trade. SARS also does not accept that the taxpayer's intention to earn income from carrying on a trade will result in the taxpayer's setting off assessed losses against such income. The taxpayer must have carried on a trade and the income must have accrued to the taxpayer for assessed losses to be set off against income.

A company is considered to have ceased carrying on trade on the date of liquidation. Any assessed losses from previous assessments fall away after the date of liquidation. The company may not set off the assessed losses against post-liquidation income in subsequent years because it is considered to have ceased carrying on a trade. This is discussed below.

6.6 Post liquidation income

A company in liquidation will be considered to have ceased carrying on trade on the day it is liquidated. A company may have incurred assessed losses in previous years and will not be able to carry forward the losses after the date of liquidation. Income can accrue to a company after liquidation, such as the collection of debts owing to the liquidated company. It can be deduced that income accruing post liquidation will not be considered as income earned from carrying on a trade and can therefore not be set off against previous assessed losses. This was confirmed in **Timberfellers (Pty) Limited v Commissioner of Inland Revenue, (1994) 59 SATC 153**. The appellant at that time was a subsidiary of a company called Sharon Air (Pty) Limited, which was wholly owned by Mr MB McCarthy. During the year 1982, the appellant company was in financial difficulties, was provisionally placed under liquidation, and this was made final on the 20th of September 1982. On the 5th of October 1983 the appellant was discharged from liquidation. When the company was placed under liquidation the appellant company had lost all its franchises and had no stock of any value. It also had no salaried employees or equipment of any significance. The only assets the company had were pre-liquidation debts and an assessed loss which dated prior to liquidation. The only liability the company had was a loan owing to Sharon Air limited, which was

Mr McCarthy's loan account. On the 25th February 1985 the appellant's shares were acquired by Mr Northam and the company effected sales thereafter.

In submitting the tax returns for the year ended on the 5th of October 1985, the appellant sought to set off against income the balance of assessed losses amounting to R2 336 568. In assessing the appellant, the Commissioner for Inland Revenue refused to allow the assessed losses to be carried forward from the 1983 tax year to 1984, contending that the appellant did not carry on a trade. The appellant objected to the assessment and appealed unsuccessfully to the Natal Special Court for hearing Income Tax Appeals. The appellant then applied to the Natal Provisional Division. Dismissing the appeal, the court held that the collection of outstanding debts after liquidation did not constitute carrying on a trade. The company ceased carrying on a trade on the day it was liquidated.

A company disposing of trading stock that remained after liquidation cannot be considered to have earned income from carrying on a trade. The company ceases carrying on a trade on the date of liquidation. The company can therefore not set off previous assessed losses from income accruing as a result of selling remaining trading stock after liquidation. This was considered in **Robinson Consolidated Industries Limited v Commissioner for Inland Revenue, (1997) (2) All SA 195(A), 59 SATC 199**. The appellant was a manufacturer, wholesaler, and retailer of stationery and associated products. The appellant operated across the country through subsidiary companies. During the year 1986 the company had become insolvent and was trading at a loss. On the 16th of September the company was placed under provisional liquidation. The powers of the liquidators included carrying on business in so far as it might be necessary for the beneficial winding up of the company. The creditors were of the view that it would be beneficial for the company to carry on trading and to be sold as a going concern. Therefore, the company carried on trading from the 6th of September 1986 up to the 30th of September 1986, the effective date of the sale. The sale effectively took place on the 3rd of October 1986. The sale was made to Sassari Investment (Pty) Ltd, a subsidiary of a major competitor known as Walton.

The sale was a lock, stock, and barrel sale, although some assets were excluded from the sale. Stock on hand was included in the sale as a going concern, however, stock in transit as at the 1st of October 1986 had to remain with the appellant. The business passed into the buyer's hands as at the relevant date. While the appellant was in state of limbo, between 1st of October 1986 and

15th March 1988, the company made two sales. The appellant contended that the sales were made from trading. The sale constituted stock that was in transit and which was excluded from the sale of the business as a going concern. The first sale amounting to R6 000 was made in April 1987 and the other of R3 000 was made in July 1987. The proceeds of the sales were deposited in the liquidation account of the company and were described as “sale of shipments” under the heading “Realisations”.

In assessing the appellant, the Commissioner for Inland Revenue refused to grant as a deduction the assessed losses incurred by the appellant, contending that the appellant did not carry on a trade during the 1988 year of assessment. The Commissioner stated that the appellant would not qualify to set off assessed losses accumulated prior to the 1988 year of assessment against income of succeeding years. The appellant objected to the Commissioner’s assessment and appealed unsuccessfully to the Transvaal Special Court for Hearing Income Tax Appeals. Dissatisfied with the Tax Court decision the appellant appealed to the Appellate Division. The appellant was of the view that the sales made were proceeds realised from carrying on a trade. Dismissing the appeal the court held that the appellant did not carry on trade by realising the stock that was not sold during liquidation; further, it held that even though section 20(1) of the Income Tax Act allows a taxpayer to carry forward and set off assessed losses against income in subsequent years, a company can only do so if it is actively trading, but the company had ceased trading on the day it was liquidated.

The day a company is placed in final liquidation, it is considered to have ceased carrying on a trade and can therefore not carry forward any previous assessed losses from that trade. It was conformed that income accruing to the company after liquidation cannot be set-off against previous assessed losses in **Commissioner for South African Revenue Services v Contour Engineering (Pty) Limited, (1999) 61 SATC 447**. The respondent company had carried on business as a steel construction company. The respondent had run into financial difficulties and was subsequently placed in provisional liquidation on the 2nd of September 1987. It was later placed in final liquidation on the 19th of November 1987. The respondent, prior to liquidation, had accumulated losses for several years amounting to R813 364. Sometime after the provisional liquidation a certain Venter and Engele attempted to purchase the fixed assets of the respondent to take over the business as a going concern. They succeeded and continued the business from the premises previously owned by the respondent. Venter negotiated a purchase of the shares and made a compromise offer to the creditors of the respondent.

In submitting returns for the year ended on the 31st of December 1988, the respondent sought to set off income against the assessed losses carried forward from the previous year. The Commissioner for South African Revenue Service disallowed the set-off of assessed losses from 1987. The respondent objected to the assessment and appealed successfully to the Special Court for Hearing Income Tax Appeals. The court relied on a Mr Cohen, who testified that the respondent had embarked on new commercial activities immediately after being discharged from liquidation, which included selling engineering equipment for a commission and had commenced before 1988 tax year. Cohen further testified that Venter had attended to that side of the business and had gone out to conclude some deals on behalf of the respondent before 14 December 1988 and had continued to do so after that date. The Commissioner was dissatisfied with the decision and appealed to the Appellate Division. Allowing the appeal, the court held that the liquidation of the company meant winding up the company. The court further stated that the respondent had not been carrying on a trade for the year ended in 1988.

In another case liquidators of a company attempted to maximise income for the company in liquidation. For a company registered as an investment company, income earned by the company can be considered to be income earned from carrying on a trade. This fact was considered in **Income Tax Case No 1751, (2002) 65 SATC 294**. The appellant was a company in liquidation and, prior to liquidation the appellant had carried on a business in investments, trust management, and property development. The essential business of the appellant was as a money-lender. It borrowed money and advanced it to borrowers engaged in speculative ventures and such money yielded interest.

When the liquidators of the appellant assumed control of the company they did not obtain any loans, nor did they make fresh advances of money. The liquidators, however, allowed the appellant to collect monies owing to it and to repay its lenders. The liquidators had prepared thirteen liquidation and distribution accounts in which no provisions were made for tax on post liquidation income, as the balance of assessed losses had been brought forward to be set off against income. The Commissioner did not raise any objection regarding thirteen accounts, but objected to the fourteenth, a liquidation and distribution account, on the grounds that the appellant had not carried on trade post liquidation. The Commissioner contended that the assessed losses of the appellant had fallen away as of October 1994 when the company ceased trading after disposing of the last of its property. The Commissioner further stated that the appellant was merely earning interest but did not carry on a trade after the 1st of March 1996 and, post liquidation, would be taxed as from the 1997 year of assessment. The Commissioner therefore issued assessments each year reflecting post liquidation income and did not set off assessed losses against the income. Evidence, however, showed that the appellant and the Commissioner had reached an agreement that the appellant would be allowed to carry forward assessed losses which would be used to set off post liquidation income. There was a letter of agreement between the liquidators and the Commissioner dated 12 August 1993 allowing the liquidators to set off assessed losses amounting to R16 435 111 against post liquidation income. The appellant stated that the liquidators collecting money owing to the appellant constituted carrying on a trade as a money-lender. The appellant further contended that the Commissioner had agreed to utilise the assessed losses against post liquidation income.

Allowing the appeal, the court held that almost a decade after the appellant had been placed in liquidation, the company was still operating, and the liquidators were collecting interest payments. Furthermore, the court stated that money-lending was the business of the appellant and its capital was trading stock. Therefore, the appellant carried on a trade each year and could set off post liquidation income against the assessed losses incurred.

It is therefore submitted that for a company to be considered as carrying on a trade and to be able to set off assessed losses from income, the company must be earning income from that trade.

6.7 Foreign Assessed losses

Section 20(1) proviso (b) states that foreign losses incurred by residents of the Republic can only be set off against foreign income and not income derived from the Republic. The court decision in **Income Tax Case No 11156, (2004) ZATC 3** may have taken a different approach. The appellant, a South African citizen ordinarily residing in Panorama, Cape Town, was a full-time employee of company X at the time of hearing. In his spare time the appellant carried on trade as a foreign exchange dealer. In his income tax returns for the 2002 year of assessment the appellant sought to set off against income a loss of R158 964 arising from foreign exchange dealings. The respondent (SARS), however, issued a revised assessment and disallowed the set-off against other income on the grounds that the appellant did not carry on such trade in South Africa. The respondent objected to the assessment, the objection was dismissed, and an appeal was made to the Income Tax Court. Allowing the appeal, the court held that the wits and labour that played a role in his trading were exercised by him in the Republic. The court stated that even though the appellant was investing in a foreign country, he was making his own decisions on his trade in the Republic. The court clearly considered the source of the loss to be the activities carried on in the Republic and not the foreign investments.

6.8 Conclusion

It is clear that when a company ceases to trade, the assessed losses incurred in prior years may not be carried forward to be utilised in subsequent years should the company resume trading. If a company maintains its existence only with administrative work, it will not be considered to be carrying on a trade. It is evident that there must be active steps to carry out trade operations taken by the company. A company failing to derive trade income must at least exert an effort to earn income, because if the company does not earn income it cannot be considered as carrying on a trade and may not utilise assessed losses from previous years. A company ceases to carry on a trade on the day of liquidation. It appears that income accruing post liquidation may not be set off against previous assessed losses because a company must be earning trade income to utilise assessed losses from previous years. Earning passive income does not constitute trade income.

The next chapter will discuss the findings of the research.

Chapter 7: Summary and findings

7.1 Introduction

The term "trade" is defined in the Income Tax Act. A taxpayer involved in a trade must include receipts and accruals in "gross income" in terms of section 1 of the Income Tax Act. However, to claim certain expenditure against income, the taxpayer must be "carrying on a trade". The term "carrying on a trade" is not defined in the Income Tax Act. If definition is not provided in the Income Tax Act, case law therefore provides the definition. Therefore, the goal of the research was to consider the nature of the transactions and the structure and extent of activities carried out by taxpayers to determine whether a person is "carrying on a trade" or "carrying on a business" for tax purposes. In addressing this goal, the following sub-goals were addressed:

- assessing the scale of activities carried on by farmers in determining whether it constitutes "carrying on farming operations";
- determining whether taxpayers engaged in a venture like money-lending or the rental of property would qualify as "carrying on a trade";
- discussing the circumstances under which taxpayers will be allowed set off assessed losses against income; and
- discussing the activities carried out by natural persons that are regarded as "suspect trades" according to section 20A of the Income Tax Act and the "business" considerations that would provide an escape from the tax consequence of disallowing the loss.

7.2 Findings

Chapter 2 provided a definition of "trade" and "carrying on business", which constitutes "carrying on a trade". Trade is defined in section 1 of the Income Tax Act. Trade must however not be limited to the definition provided in the Income Tax Act but must be given a wide meaning. The definition of "trade" includes a venture wherein a taxpayer enters into a risky transaction with the intention of earning a return. There must be an intention to earn a profit from the risky venture for it to be considered as a trade. A taxpayer may incur certain expenditures and may seek a deduction on these expenditures. To qualify for a deduction of expenditure, in terms of the preamble to section 11 of the Income Tax Act, a taxpayer must be carrying on a trade. The term "carrying on a trade" is not defined in the Income Tax Act. If a term or expression is not defined in the Income

Tax Act, case law principles are applied in determining the meaning of the expression, and the principles established in case law have determined that carrying on a business requires the intention to carry on a trade or business, together with a degree of continuity and regularity of selling something or of rendering services over a period of time. In deciding whether the taxpayer is carrying on a trade or a business, the profit motive is important but not decisive.

Chapter 3 focused on "carrying on farming operations". Carrying on farming operations may constitute carrying on a trade or business for Income Tax purposes. Farming income is taxed in terms of section 26 and the First Schedule to the Income Tax Act. The expression "carrying on farming operations" is not defined in the Income Tax Act. Farming as a venture is a trade. Farmers carrying on a farming venture are considered to be "carrying on a trade" or business of farming. If a farmer's intention is to farm, his or her actions and efforts must demonstrate an intention to farm, and there must be a reasonable prospect of making a profit from these farming operations, to be carrying on a trade or business of farming. If a farmer works only to consume produce and then sell the surplus, the provisions of section 26 and the First Schedule to the Income Tax Act will not apply to this operation. The provisions are applicable only to farmers who are farming to sell produce at a profit. It is, however, not clear when a farmer is rendering farming services for a fee, whether this venture constitutes carrying on farming operations. It has been established that there must be an intention to farm for a venture to be regarded as a farming operation. Intention is, however, subjective, and therefore there must be objective factors that match the taxpayer's stated intention to farm. The intention to farm alone is not decisive but can only be persuasive. There must also be an active step taken by the farmer to farm for the venture to be considered as carrying on farming operations. If a taxpayer owns a farm but does not take any active steps to cultivate and farm the land, it means that the farm will be a capital asset and the provisions of section 26 and First Schedule to the Income Tax Act will not apply; that farm will be subject to the provisions of the Eighth Schedule. The provisions of section 26 and the First Schedule to the Income Tax Act cease to apply the day a farmer stops farming.

In chapter 4 the thesis discussed what constitutes "carrying on a trade" of the letting of property. Taxpayers involved in the letting of property can incur certain expenditure such as the mortgage interest on the property, repairs and maintenance, water bills, etc. The rental income accruing to the taxpayer is included in gross income in terms of section 1 of the Income Tax Act. For the taxpayer to claim the expenditures as a deduction, the taxpayer must be carrying on the trade of letting property. To be considered as carrying on the trade of letting property, there must be the intention of letting property for profit. The intention to let must be supported by objective factors. A taxpayer that lets a vacation home to reduce the cost is not considered to be carrying on the trade of letting property. The trade of letting property requires regularity and a degree of continuity. The taxpayer must be letting the property for profit on a regular basis and must continue to let the property for as long as there is an opportunity to do so.

Chapter 5 assessed the extent on which money-lending can constitute “carrying on a trade”. Money-lending is a venture entered into by taxpayers to lend money to persons in order to earn interest. Taxpayers may have borrowed the money at interest to lend at a higher rate to gain profit. A taxpayer may fail to recover a portion of money that was lent and may seek to write off that amount. To claim the deduction, the taxpayer must be carrying on the trade of money-lending. The taxpayer must carry out the moneylending venture with the intention of making a profit. The taxpayer must also lend money to the general public and must not limit the trade to a specific group of people or to persons connected to that taxpayer. There must be a system or plan in place as well, which discloses a degree of regularity and continuity in the transactions. There must be a plan in place that will provide security for the money lent to the clients and to recover the capital amount and the interest on the money lent. The South African Revenue Service, in Practice Note 31 sanctions the deduction by persons who are not moneylenders of interest paid on money borrowed, but the deduction is limited to the interest income on money lent.

In chapter 6, the thesis focused on when a taxpayer ceases to carry on a trade. Individuals and companies are permitted to carry forward assessed losses from previous years and set them off against trade income from a South Africa source. If a company ceases to trade, however, the assessed loss falls away on that day. Should the company resume trading in subsequent years, it may not claim the assessed losses from previous years. A company that does not earn income must exert a certain effort to show that there is the intention to earn income for it to be in a position to carry forward previous assessed losses. On the day a company is liquidated, it will cease trading on that day and previous assessed losses fall away from that day. Any income accruing to the appellant after liquidation may not be set off against previous assessed losses. The South African Revenue Service in their Interpretation Note 33, declare that income is required to accrue to the company from carrying on a trade before the company can utilise previous assessed losses. Section 20(1) of the Income Tax Act however requires that the company must be trading to enable it to carry forward assessed losses. The practice of the South African Revenue Service has been criticised by the court, where it was emphasised that section 20 refers to carrying on a trade and not to the earning of income from that trade.

7.3 Conclusion

Although much of the case law analysed in the thesis dates back many years, the principles and tests established by the courts have stood the test of time. From the research carried out it is clear that these principles and tests used by the courts to determine whether a taxpayer is "carrying on a trade" or a business are very similar as they apply to different types of activities. The subjective intention to carry on a trade or business, coupled with objective facts that support the intention, the continuity and regularity of transactions, taking active steps to carry on the business and the intention to make a profit in return for undertaking business risk, are referred to in the majority of court decisions. Although the Income Tax Act does not define "carrying on a trade" or a business, the indicators provided by the legislature in section 20A(3) of the Act of a business with a reasonable prospect of success, contain some useful guidelines. These indicators include the proportion of gross income in relation to allowable deductions, the level of advertising, promotion or selling, the commercial manner in which the business is carried on, including the number of full-time employees, the commercial setting of the business premises, the extent of equipment used and the time the person spends conducting the business, together with the business plans. In future litigation relating to "carrying on a trade" or business, these indicators are likely to provide the courts with further tests and principles.

List of references

Legislation

Federation of Rhodesia and Nyasaland: Income Tax Act, 35 of 1959

South Africa: Income Tax Act, 58 of 1962

Books and articles

Babbie, E. & Mouton, J. 2009. **The practice of social research**. Cape Town: Oxford University Press Southern Africa.

De Koker, A. and Williams, R.C. 2015. **Silke on South African Income Tax - Volume 2**. Durban: LexisNexis.

Haupt, P. 2015. **Notes on South African Income Tax.** Cape Town: Hedron.

McKerchar, M. 2014. **Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation**. eJournal of tax Research. p5 – 22. [Online] Available: https://www.business.unsw.edu.au/research-site/publications-site/ejournaloftaxresearch-site/Documents/paper1_v6n1.pdf [accessed 27/09/2016].

Nolo's Plain-English Law Dictionary. [Online] Available: https://www.nolo.com/dictionary/carrying-on-business-term.html [accessed 26/07/2016].

Oliver, L. 2009. **The "trade" requirement for income tax purposes: A re-appraisal – CSARS v Smith, 65 SATC 6**. [Online] Available at: http://0-eds.b.ebscohost.com.wam.seals.ac.za/eds/detail/detail?sid=0eec570c-7a7d-4e88-9fb5-183e8a87b748%40sessionmgr101&vid=0&hid=111&bdata=JnNpdGU9ZWRzLWxpdmU%3d#AN=edssas.jefs.v3.n2.a6&db=edssas [accessed 27/09/2016].

Stiglingh, M., Koekemoer, A.D., Van Schalkwyk, L., Wilcocks, J.S., De Swardt, R.D. and Jordaan, K. Updated annually. **Silke: South African Income Tax.** Durban: LexisNexis.

South African Revenue Service. 1994. **Practice Note 31 Income Tax: Interest paid on moneys borrowed**. [Online] Available: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-PrN-2012-21%20-%20Income%20Tax%20Practice%20Note%2031%20of%201994.pdf [accessed 27/09/2016].

South African Revenue Service. 2010. Interpretation Note 33: Assessed losses: Companies: The trade and income from trade requirements. [Online] Available: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-33-Arc-36%20-%20IN33%20Issue%201%20Archived%20on%2030%20June%202010.pdf [accessed 10/09/2017].

Case law

Burgess v Commissioner for Inland Revenue, (1993) 55 SATC 185(A)

Cape Town Municipality v Clarensville (Pty) Ltd, (1974) All SA 346 (C)

Commissioner for Inland Revenue v D & N Promotions (Pty) Limited, (1995) (2) SA 296, 57 SATC 178

Commissioner for South African Revenue Services v Contour Engineering (Pty) Limited, (1999) 61 SATC 447

Commissioner for South African Revenue Services v Smith, (2002) (6) SA 621 SCA, 65 SATC 6

Commissioner for South African Revenue Service v Megs Investments (Pty) (Ltd) and Another, (2004) 66 SATC 175

Commissioner for South African Revenue Services v Kluh Investments (Pty) Limited, (2016) ZASCA

Commissioner of Taxes v G's Estate, (1965) (1) SA 780(SRAD)

Income Tax Case No 112, (1928) 4 SATC 61

Income Tax Case No 136, (1928) 4 SATC 203

Income Tax Case No 208, (1931) 6 SATC 55

Income Tax Case No 258, (1932) 7 SATC 67

Income Tax Case No 368, (1936) 9 SATC 211

Income Tax Case No 561, (1944) 13 SATC 313

Income Tax Case No 586, (1945) 14 SATC 123

Income Tax Case No 615, (1949) 14 SATC 399

Income Tax Case No 664, (1948) 16 SATC 125

Income Tax Case No 770, (1953) 19 SATC 216

Income Tax Case No 777, (1953) 19 SATC 320

Income Tax Case No 812, (1955) 20 SATC 496

Income Tax Case No 883, (1959) 23 SATC 328

Income Tax Case No 933, (1960) 24 SATC 347

Income Tax Case No 937, (1960) 24 SATC 374

Income Tax Case No 957, (1960) 24 SATC 637

Income Tax Case No 979, (1962) 25 SATC 44

Income Tax Case No 999, (1962) 25 SATC 183

Income Tax Case No 1003, (1963) 25 SATC 237

Income Tax Case No 1138, (1969) 32 SATC 3

Income Tax Case No 1177, (1972) 34 SATC 147

Income Tax Case No 1258, (1976) 39 SATC 58

Income Tax Case No 1275, (1978) 40 SATC 197

Income Tax Case No 1292, (1979) 41 SATC 163

Income Tax Case No 1319, (1980) 42 SATC 263

Income Tax Case No 1324, (1980) 42 SATC 288

Income Tax Case No 1424, (1986) 49 SATC 99

Income Tax Case No 1476, (1989) 52 SATC 141

Income Tax Case No 1529, (1991) 54 SATC 252

Income Tax Case No 1548, (1991) 55 SATC 26

Income Tax Case No 1644, (1995) 61 SATC 23

Income Tax Case No 1679, (1999) 62 SATC 294

Income Tax Case No 1698, (2000) 63 SATC 161

Income Tax Case No 1751, (2002) 65 SATC 294

Income Tax Case No 1771, (2004) 66 SATC 205

Income Tax Case No 1830, (2007) 70 SATC 123

Income Tax Case No 11156, (2004) ZATC 3

Robinson Consolidated Industries Limited v Commissioner for Inland Revenue, (1997) (2) All SA 195(A), 59 SATC 199

SA Bazaars (Pty) Ltd v Commissioner for Inland Revenue, 18 SATC 240, (1952) (4) SA 505(A)

Secretary for Inland Revenue v Crane, 39 SATC 191, (1977) (4) SA 761(T)

Solaglass Finance Company (Pty) (Ltd) v Commissioner for Inland Revenue 53 SATC 1, (1991) (2) SA 257(A)

Timberfellers (Pty) Limited v Commissioner of Inland Revenue, (1994) 59 SATC 153