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## Tax of share transactions: The Capstone 556 case

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Wealth accumulated in the form of business owned by the companies in which the shares are held or merely from short-term speculation with shares is realised when shares are disposed of. The tax implications of such disposal of shares, in particular the nature of the proceeds on disposal, is often contentious. Share transactions are often complicated further by the fact that it forms part of complex restructuring arrangements.

The question as to the nature of proceeds from the sale of shares was recently considered in the Western Cape High Court in the case of *Capstone 556 (Pty) Ltd v C:SARS* (Capstone case). This newsletter analyses the factors considered in the judgment in order to highlight potentially important aspects to be taken into account by taxpayer when dealing with the sale of shares.

### Background to the case

The taxpayer in this case, Capstone 556 (Pty) Ltd, acquired JD Group (JDG) shares as part of an arrangement structured through the JD Group to rescue the business of Profurn, an entity in the furniture industry. Following a process of obtaining approvals from the Competition Commission, the JDG shares were acquired by the taxpayer in December 2003. These shares were disposed of by the taxpayer for a significant profit after the recovery business took place in a much shorter period than initially anticipated. Given the short holding time (less than 5 months), SARS assessed the proceeds on the shares to have been received in a scheme of profit-making.

### Factors considered in the Capstone case

The judgment in the High Court however went in favour of the taxpayer. This decision was based on the following factors, some of which may be relevant in other cases relating to share or restructuring transactions, that supported the taxpayer's position:

- ✓ The assessment of the nature of the shares should not be oversimplified by only looking at the apparent facts such as a holding period to draw an inference as to the taxpayer's intention. The full factual matrix must be considered. This is particularly relevant where the position is not clear cut and factors supporting contrary views may exist.

- ✓ Even though the JDG shares were only acquired by the taxpayer on 5 December 2003, activity (agreement between the parties prior to Competition Commission approval) in respect of the acquisition already took place in 2002. Griesel J was of the view that the effective date, being 21 June 2002, as opposed to the date when ownership of the shares was acquired, was the date to take into account when contemplating the taxpayer's intention.
- ✓ The stated purpose of the acquisition, supported by an affidavit submitted to the Competition Commission, was to acquire the shares for strategic purposes (rescue of Profurn business) as opposed to a short-term profit. This point illustrates the importance of ensuring that the intention of the parties in any transaction is evident from the documentation prepared at the time of the transaction. Failure to ensure this may require intention to be inferred from facts that may not reflect the full picture, for example, the short holding period in this case.
- ✓ The taxpayer was able to advance a number of reasons, other than an initial short-term profit objective, for the disposal. These included an unexpected turnaround in the fortunes of Profurn, weakening of the South African economy at the time of sale and evidence that the opportunity that arose was fortuitous.

These factors may give taxpayers an indication of arguments or views that could be relevant in determining the nature of a shareholding. It could be for purposes of determining the inclusion of amounts in gross income, but arguably also in other situations, for example, when dealing with consecutive share transactions in restructuring arrangements.

### Concluding thoughts

Transactions involving the sale of shares are seldom simple, as demonstrated again in the Capstone case. A taxpayer that enters into a transaction where shareholding is disposed or restructured would be well advised to spend some time and ensure that all bases from a tax perspective have been considered and addressed.

If you require technical tax or IFRS assistance or an inhouse seminar please feel free to contact Pieter van der Zwan at 083 417 5904 or [pieter@pvdz.co.za](mailto:pieter@pvdz.co.za) or to visit [www.pvdz.co.za](http://www.pvdz.co.za) and submit a request on the relevant page.

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