



Pieter van der Zwan
& Associates

Technical Advisory Services
Tax · IFRS

The importance of paying attention to the detail in documents

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Deals are often concluded quickly and within a short period of time as parties negotiate the terms of the transaction. In many cases, the tax implications of all documents relating to the transaction are not considered thoroughly, especially when the parties are unaware of the tax risks that a transaction may involve. These documents include the agreements to implement the transactions but also other documents such as resolutions and announcements.

The judgment laid down in case of ABC (Pty) Ltd v C:SARS (Case No: 13002 heard in the Western Cape Tax Court) reiterates the importance of paying attention to the details contained in documents to ensure these reflect the transaction or deal accurately.

Background to the case

The appellant, ABC (Pty) Ltd (ABC), acquired land with a forest on it from D (Pty) Ltd in 2001. E (Pty) Ltd carried on forestry activities on the land between 2001 and 2003. ABC then sold the land together with the forest to E (Pty) Ltd for an amount, of which R144 700 000 related to the forest.

The question before the court was whether the R144 700 000 should be included in ABC's gross income. The Commissioner contended that it should be included in ABC's gross income on the basis of paragraph 14(1) of the First Schedule to the Income Tax Act which 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." (emphasis added)

The critical question in this case was whether ABC could be said to have been farming (more specifically, whether it was carrying on 'pastoral, agricultural or other farming operations') and therefore fell within the ambit of section 26 and the First Schedule, in which case the amount would be included in gross income.

Grounds for the judgment

The appellant contended that it was a passive investor

in land and acquired the land together with the forest as an investment. It further argued that E (Pty) Ltd was given the right to use the property and the forest; E (Pty) Ltd was therefore carrying on the forestry (farming) operations. E (Pty) Ltd was using the property without paying any consideration, the benefit for ABC being that its asset (forest) was maintained.

SARS however contended that the ABC was conducting farming operations and appointed E (Pty) Ltd to do so on its behalf. SARS based this argument on the following information contained in various documents:

- ✓ The purchase agreement indicated that ABC acquired a **business** from D (Pty) Ltd in 2001.
- ✓ Similarly, the sale agreement indicated that ABC sold a **business** to E (Pty) Ltd in 2003.
- ✓ A resolution indicated that the ABC transferred a going concern and income earning activity to E (Pty) Ltd.
- ✓ An invoice, which was explained as a bonus for good stewardship, indicated that ABC paid E (Pty) Ltd a **management fee**.

Davis J in this case referred to ITC 1185 where the following was held:

"The Court's function is to determine, on an objective overview of all the relevant facts and circumstances, what the motive, purpose and intention of the taxpayer were. 'In other words, whatever a taxpayer may tell the Court has to be analysed through the prism of the objective facts presented to the Court."

Based on the signed documentation, which differed from the evidence of the witnesses, he concluded that ABC was in fact carrying on farming operations and the proceeds fell within the ambit of paragraph 14(1).

Lessons to be learnt

This judgment is a useful reminder of the importance of considering the detail of any agreement or other document relating to a transaction from a tax perspective. This is often neglected in a rush to finalise a deal. A related aspect, of similar importance, is to ensure that agreements and related documents reflect any tax advice obtained accurately. Not doing so is likely to lead to a tax predicament in future.

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