

Proceeds of asset disposal need to be classified

IT IS always a contentious issue as to whether the proceeds from the disposal of an asset can be said to be of a capital nature. In the hands of an individual, it makes a difference of whether the tax rate is 40% compared to 10%.

It is no wonder that most cases in an income tax context deal with the distinction as to whether a receipt is of a capital nature or not.

The question arises whether one should acquire an asset with a view to retain irrespective of the outcome and fortunes. In earlier case law it was, for instance, indicated that proceeds will be of a capital nature if the asset has been acquired for better or for worse (something like marriage) or, relatively speaking, for keeps, only to be disposed of if some unusual, unexpected or special circumstance warranting disposal supervened. It is no wonder that it was described as a formidable burden of proof that needs to be discharged by taxpayers.

In a recent tax case the taxpayer obtained funds under a loan agreement in order to fund the acquisition of certain tank containers. As security for the repayment of the loan, the taxpayer pledged unit trust/collective investment scheme investments towards the financier. It was always anticipated that the unit trusts would not be held indefinitely, but that they would inevitably be sold in order to settle his loan obligation. The investment in the unit trusts lasted for five years, being the duration of the tank container scheme. At the end of the five-year period the taxpayer had the option of retaining the unit trusts or realising them. He chose to realise them as he indicated that he was not a share speculator.

The court applied the general tests to determine the nature of the proceeds, amongst others, whether the intention embarked upon a

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scheme of profit-making. In other words, the question is whether the proceeds are fortuitous or whether they are designedly sought for and worked for. It was indicated that the unit trusts were acquired as security for a loan.

Even though it was contemplated by the taxpayer that the unit trusts would grow in value over the period and that they would hopefully realise sufficient proceeds so as to repay the loan, the scheme was not part of a scheme of profit-making. In other words, there was no intention to make a profit even though that may have been contemplated.

Contemplation is not to be confused with an intention to embark upon a profit making scheme. To the extent that profits may be inevitable, a different conclusion may be reached. In view of the fact that the unit trusts served as security for the loan and that they would most probably have been realised on the expiry of the loan, it was held that the proceeds were of a capital nature.

In a more contentious context, the question arises whether asset managers rebalancing their portfolio would be seen to be embarking upon a profit-making scheme. In this context it has been indicated in case

law that the question would be if the relevant investments are used as stock in trade for sale at a profit. The fact that one may invest in a company whose fortune cannot be predicted with certainty cannot render them a risk investment. It was held that prudence and foresight cannot be equated with an intention to speculate. This would especially be relevant in the current volatile climate that investors face. It was said that dogged adherence to a counter or carelessness in the management of a share portfolio cannot be posited as a prerequisite for qualification as a capital investor.

In this context one should have regard to the nature and character of the investment, the intention with which the investment is acquired and any potential change in such intention. In other words, one cannot necessarily argue that one should hold on to a share counter for five years as that would be the only way in which the proceeds can be seen to be of a capital nature. In a volatile share market one may be required to administer a share portfolio more regularly.

One should also bear in mind that the period of the holding of a share portfolio is not the only requirement that is to be taken into account in determining the nature of the proceeds.

In a situation where the share counter is funded through means of preference share funding or through means of a loan in circumstances where the realisation of the share counter is the only way in which to discharge the obligations in respect of the preference shares and/or the loan, it may well be that the proceeds of such disposal can be seen to be on revenue account.

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