

A CRITICAL ANALYSIS ON SIMULATED TRANSACTIONS

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DECLARATION

I, Alwanduxolo Thembalihle Tshabalala, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites of the degree of Master's in Business Law at the University of KwaZulu-Natal. It has not been submitted before for any degree or examination at any other University.

Alwanduxolo Thembalihle Tshabalala

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ABBREVIATIONS

GAAR - General Anti- Avoidance Rule

SCA - Supreme Court of Appeal

Doctrine - substance over form doctrine

Commissioner - Commissioner of the SARS

CHAPTER ONE

1. INTRODUCTION

It is trite that the principle of simulation is not the fiefdom of the law of taxation only.¹ However, for purposes of this paper, the development of this doctrine within the borders of the law of taxation exclusively, will be examined.

The present economic decline has played a major part in the continued concentration on tax avoidance. The South African Revenue Service (SARS) is continuously trying to decrease the effect of tax avoidance and tax evasion on the tax revenue collections, whilst the taxpayer is stressed to survive financially. Confronted daily with increasing living costs, individuals have become more unwilling to part with their hard-earned money. Understandably, most taxpayers would not voluntarily choose to incur tax liabilities, which with some creative structuring, may possibly be avoidable. Complexities and sophistication is not in itself impermissible.

In *IRC v Duke of Westminster*² Lord Tomlin held that:

‘Every man is entitled, if he can, to so order his affairs so that the tax attaching under the appropriate Acts, is less than it would otherwise be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.’³

The problem arises when intricate and overly complicated tax avoidance transactions and group structures are found to be nothing more than a front to disguise the actual status quo or the actual transaction between parties.⁴ All tax efficient transactions must pass scrutiny in terms of South Africa’s anti-avoidance legislation in the form of General Anti-Avoidance Rules (GAAR). It is important to define simulated transactions and differentiate between tax evasion and tax avoidance.

Disguised transactions may be defined as ‘instances where the parties to a

¹ Christie *The Law of Contract* 4ed (2001) 394.

² *IRC v Duke of Westminster* (1936) A.C 1 490.

³ *Duke of Westminster* supra note 2 at 19.

⁴ *Zandberg v Van Zyl* 1910 AD 302; see also *Dadoo v Krugersdorp Municipal Council* 1920 AD 530 and *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369.

transaction intentionally attempt to conceal the true nature of the transaction and endeavour to create the impression that the agreement is something other than what it is.' This is commonly referred to as the 'simulation principle'.

Tax evasion is the use of illegal means to reduce a tax liability.⁵ It involves the usage of fraud or deceitfulness to decrease a tax liability through the non-disclosure of income and overstatements (this includes the evasion of tax through the use of simulated transactions).⁶ An attempt to evade tax is a criminal offence punishable under section 104(1) of the Income Tax Act 58 of 1962 by a fine, imprisonment or both.⁷ Tax avoidance is where the taxpayer orders his affairs in a legal manner to pay the least amount of tax possible.⁸ In 2010 Lewis JA seemingly created a new requirement for simulated transactions in the case of *Commissioner of the South African Revenue Service v NWK Limited*.⁹

The judgment seems to have parted with the conventional principles in that it encompasses certain unexpected, and perhaps unsettling, dicta concerning the applicable tests for determining whether a transaction constituted a simulated transaction. The court appears to have qualified the test by declaring that, where there is absence of commercial purpose behind the agreement, and the agreement merely enables tax avoidance, the agreement should be regarded as simulated.¹⁰

English law which is accepted in South Africa. It is a Latin noun which literally means to 'stand by things decided'.¹¹ Explained differently it means that Judges are bound by the decisions reached in previous judgments where a set principle has been created. The court in *Commissioner of the South African Revenue Service v NWK Limited* appears to have qualified the test by declaring that, where there is absence of commercial purpose behind the agreement, and the agreement merely enables tax avoidance, the agreement should be regarded as simulated.

It is not so much the court's finding in favour of SARS which has solicited interest in

⁵ P Haupt *Notes on South African Income Tax* (2012) ch 17 at 499.

⁶ K Hauxham & P Haupt *Notes on South African Income Tax* (2007) 350.

⁷ E B Broomberg 'Evasion v avoidance' (2012) 104.

⁸ K Jordaan, A Koekemoer, M Stiglingh, et al *South African Income Tax* (2011) 25.1; see also *Commissioner for Inland Revenue v Conhage (Pty)* 1999 (4) SA 1149 (SCA) at 1.

⁹ *Commissioner of the South African Revenue Service v NWK Limited* 2011 (2) SA 67 (SCA).

¹⁰ *NWK* supra note 9 at 55.

¹¹ Definition available at <http://oxforddictionaries.com/definition/stare+decisis> , accessed on 23 October 2018.

the judgement and the debate and criticism thereto, but rather the courts findings in respect of the established principles. The judgment has been interpreted by many commentators and practitioners to have established a new rule to the effect that any agreement that has as its purpose the avoidance of tax, or a peremptory provision of law, is simulated. The journal articles which have been produced about the decision of the *Commissioner of the South African Revenue Service v NWK Limited* case assist the research by looking at the pros and cons of the judgement and its impact on South African tax law.

The most valid concerns concerning the *Commissioner of the South African Revenue Service v NWK Limited* judgment have been pointed out by Broomberg.¹² His starting point is that the SCA appears to have changed the established principles relating to simulated transactions by introducing a 'new rule'.¹³ He summarises the foundational common law principle, relying on the dictum in the case of *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*,¹⁴ as follows:

'A transaction will not be regarded as simulated if the parties genuinely intended that their contract will have effect in accordance with its tenor, and that rule applies even if the transaction is devised solely for the purpose of avoiding tax.'¹⁵

A further point raised by Broomberg is that the new general anti-avoidance provisions which enable the Commissioner to disregard the transactions that are exclusively aimed at tax avoidance and have no commercial substance.¹⁶ Having a new common law rule together with the general anti-avoidance provisions is detrimental to tax payers as it would permit tax evaluators to use either rule at impulse.¹⁷

The SCA's appreciation of the distinction between 'tax evasion' and 'tax avoidance' is of apprehension as the court undoubtedly conflated these two concepts. Vorster¹⁸ shows that the courts substitutable use of these concepts forms ambiguity as to

¹² E Broomberg 'NWK and Founders Hill' (2011) 60 *The Taxpayer* 183.

¹³ *Ibid.*

¹⁴ *Randles* supra note 4.

¹⁵ This rule had been established by our courts in a string of cases such as *Zandberg* supra note 4 above) *Erf 3183/1 Ladysmith v Commissioner for Inland Revenue 1996 (3) SA 942* and *Commissioner for Inland Revenue v Conhage (Pty) Ltd 61 SATC 391*.

¹⁶ De Koker *SILKE on South African Income Tax* (2011) 27.

¹⁷ *Ibid.*

¹⁸ Vorster 'NWK and purpose as a test for simulation' (2011) 60 *The Taxpayer* 83.

whether the court proposed that the requirement should only be applicable in instances when the transaction sought to evade an existing tax liability or whether it should be applicable where the purpose was to avoid a potential liability. Vorster proclaims that if the court meant for commercial substance requirement to only apply to instances where parties sought to evade taxation, the law of contract renders such a transaction ineffectual.¹⁹ Broomberg contends, however, that by the irrationality to which it would lead if the SCA was using the phrase 'evasion', the court probably really intended to refer to 'tax avoidance'.²⁰

Academics have also criticised the judgement insofar that commercial substance is not a test, but a criterion. What the quote aptly demonstrates is the potentially absurd results a rigid one-criterion test will produce, and therefore that it is to be avoided. Although the criticism is purely semantic and of artificial value, it reveals the vagueness caused by the judgement and the doubt in which it gives rise. To challenge the decision of *Commissioner of the South African Revenue Service v NWK Limited*, the arguments to follow in each chapter are of immeasurable value.

¹⁹ *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A).

²⁰ It is correctly submitted by Broomberg that the words 'evasion' and 'avoidance' are incorrectly used as substitutes since the Income Tax Act itself differentiates between the two concepts. It is therefore assumed that the court intended to use the term avoidance.

CHAPTER TWO

HISTORICAL DEVELOPMENT OF THE SUBSTANCE OVER FORM DOCTRINE

1. INTRODUCTION

As the first point of departure, it is a commonplace that the substance over form doctrine is a universal principle that imputes certain consequences in an agreement, specifically consequences that parties truly intend, rather than the consequences that the parties simulate or aim to simulate. An analysis regarding the background and development thereof will require a study of judicial precedents, not solely handed down by tax courts.

This chapter will analyse the historical basis and application of the doctrine. In this analysis, emphasis will be placed on some of the primary cases in which the doctrine was contemplated and applied. One of the objectives of this chapter is to establish the requirements for the application of the doctrine, as decided and recognized by courts over the years.

2. HISTORICAL DEVELOPMENT OF THE SUBSTANCE OVER FORM DOCTRINE

(a) Common law principles

It is a deep-rooted principle in our common law that a court, in determining which significances to attach to a specific transaction, will neglect the form in which a transaction was discharged and give effect to the substance or true transaction amongst the parties.²¹ Throughout the application of this doctrine, the principle that the true intention of the parties behind the transaction will prevail over the terms contained therein is established.²² Although similar principles such as the plus valet-

²¹ De Koker op cit note 16 at 19.3.

²² Stighling (ed) et al *SILKE: South African Income Tax* (2011) 738; see also Ger 'Supreme Court of

rule²³ and the *fraus legis* principle²⁴ have been developed in our common law and have been significantly recognised by our courts, it was agreed in *Dadoo v Krugersdorp Municipal Council*²⁵ that these principles are just simple branches of the doctrine of substance over form. The doctrine and its numerous branches are particularly applied to extract aside simulated transactions to warrant that the appropriate legal consequences are accredited to the correct essence of a specific transaction, instead of to its form.

The basic composition of a simulated transaction is exemplified through this example. It transpires when the parties pursue to accomplish a certain, predetermined objective on which a particular statute may enforce some system of burden, but through the strategy of their transaction they achieve the anticipated objective by concealing the essentials thereof which is liable to a statutory charge.²⁶ Such concealment may arise either through veiling the true nature of their transaction or through fabricated formation of rights and obligations which diverge from the rights and obligations of which is truly created for between them.²⁷ Such transactions are subject to the application of the doctrine of substance over form.

The doctrine is however not applied indifferently by our courts and entails that certain established criteria are encountered before a court can decide the legal consequences of the transaction premised on its substance rather than its form.

3. SOUTH AFRICAN CASE LAW

a) *General*

To lay a foundation for later analysis of the judgement in *Commissioner for the*

Appeal a- 'maize'-s tax planners with watershed judgement' (2011) *De Rebus* 44.

²³ The full maxim is *plus valet quod agitur quam quod simulate concipitur* which means 'what is actually done is more important than what seems to have been done.' See De Koker op cit note 16 at 46.

²⁴ The principle entails that where an act occurred with the specific intention to avoid the application of a statutory provision, certain legal consequences will follow which would not otherwise have been applicable. In *Dadoo* supra note 4 at 540, the court held that 'a transaction in *fraudem legis* when it is designedly disguised so as to escape the provisions of the law, but in truth falls within these provisions.'

²⁵ *Dadoo* supra note 4.

²⁶ Christie op cit note 1 at 396.

²⁷ *Snook v London & West Riding Investments Ltd* (1967) 2QB 786. Although the court was referring to a 'sham' transaction in this matter, the concept of a 'sham' and 'disguise' or simulated transaction is closely related that, for the purpose of this research it is not necessary to discuss the concepts independently from one another. In this regard, see De Koker op cit note 16 at 19.3.

South African Revenue Service v NWK Limited,²⁸ and specifically to measure whether the Supreme Court of Appeal (SCA) in that case changed any of the principles relating to simulated transactions, or altered the common law in any way, it is essential to navigate some of the more significant cases that have moulded the law in South Africa in this regard.

b) Analysis of Zandberg v Van Zyl 1910 AD 302

The most significant of the primary cases concerning simulated transactions is that of *Zandberg v Van Zyl*.²⁹ The respondent (Van Zyl) was owed 50 pounds by his mother-in-law (Mrs Van Zyl) in terms of a promissory note.³⁰ Mrs Van Zyl could not pay the respondent. However, Mrs Van Zyl had a wagon, and they agreed that the respondent could purchase the wagon for 50 pounds.³¹ It was also understood that Mrs Van Zyl could repurchase the wagon later at the same price and that she could use the wagon in the interim. Subsequently the appellant (Zandberg), another creditor of Mrs Van Zyl, had the wagon attached and the respondent intervened by means of interpleader proceedings, claiming that the wagon belonged to him and was capable of attachment.³² There were three separate judgements, each concluding on the facts that the arrangement constituted a simulated transaction.

De Villiers CJ was of the interpretation that possession advances a belief of ownership and that the respondent was required to yield 'clear and satisfactory' evidence as to why the wagon, which he claims to have bought, remained in the possession of Mrs Van Zyl. This was especially so because he acknowledged that, even though he had bought the wagon, he did not actually require it.³³

Further, De Villiers CJ stated that the transaction that had taken place is more of a pledge due to the fact that the object remained with the seller and thus it is an obvious conclusion that the intention was to effect a pledge and not a sale.³⁴

De Villiers CJ contended that the respondent's objective in making the alleged purchase was to secure debt owing to him by the respondent, whilst allowing the

²⁸ *NWK* supra note 9.

²⁹ *Zandberg* supra note 4 at 309.

³⁰ *Zandberg* supra note 4.

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

³⁴ *Zandberg* supra note 4 at 308.

respondent to use the wagon as if it were her own.³⁵ It is thought-provoking to note that, on the aspect of it, De Villiers CJ considered that the 'object' of the parties shed light on their 'intention' in respect of the agreement.

In respect of laying down the relevant principles relating to simulated transactions, the judgement of Innes J is most noteworthy. His point of departure is that the obvious appearance of a contract, being the words in which it is uttered (or its form), usually harmonies with the agreement arrived at between the parties. There is usually no 'subterfuge' or 'concealment'. However, occasionally, to secure a legal advantage or discharge a legal duty, the true nature of an agreement is concealed by means of a disguise.³⁶ When challenged with such an arrangement, the court will look at the genuineness of the agreement. In consideration Innes J quoted the Latin maxim *plus valet quod qgitur quam quod simulate concipitur*.³⁷

Innes J noted in respect of distinguishing simulation one must not apply a blanket approach, however each case must depend on its own facts, as no general rule can be submitted which will meet them all.³⁸ As to the object of the parties Innes J stated that the parties real objective was not that the respondent should genuinely acquire the use of wagon however, should the Mrs Van Zyl become insolvent therefore Van Zyl could have a claim against it. This transaction was dressed as a sale whereas in fact a pledge had taken place.³⁹

It appears from this passage, as well as the judgement in general, that Innes J took a similar perspective as De Villiers CJ. Innes J made much of the 'object' of the parties in order to achieve the actual character of the agreement in question. Though, it is not always straightforward whether both De Villiers CJ and Innes J strictly kept to the distinction between the object (or purpose) of the parties and their intention in respect of the agreement. Innes J settled the transaction by confirming that the court is bound to deal with the agreement according to its substance, and not its

³⁵ *Zandberg* supra note 4.

³⁶ *Zandberg* supra note 4.

³⁷ This maxim was translated in *B C Plant Hire cc t/a B C Carriers v Grenco (SA) (Pty) Ltd* [2004] All SA 612 (C) at para 33: 'greater value is attached to what is done than to what appears to be done'. In simple language this may be rendered as 'true facts have more value than apparent facts' or 'substance bears more weight than form'.

³⁸ *Zandberg* supra note 4 at 310.

³⁹ *Zandberg* supra note 4 at 312.

form. Hence, in essence it was not a sale, but at most a pledge.⁴⁰

It is intriguing to consider that Innes J did not conclude that the parties acted fraudulently or with mala fides as he did not 'apply any harsh word to the transaction'. This advances the question of whether an 'honest' mistake can ever constitute a simulated agreement. This issue is discussed in more detail below. Solomon J, despite reluctance, arose at a similar decision as Innes J.⁴¹

The decision in this case is not without criticism. It is true that one might ask, if the parties intended a sale, why the respondent did not take possession. However, one might correspondingly ask, if the parties projected a pledge, why the respondent did not take possession, knowing that lack of possession would deny him of his security rights.⁴² Maybe the response is that the parties truthfully believed that they did enter into a sale and thought that the respondent had ownership of the wagon, hence, overlooked the requirements of a pledge.⁴³

It seems from the facts and as the court found, that the object of the parties was to secure the debt owed by the respondent. However, they planned to do so through the transfer of ownership by means of the sale of the wagon. This would provide the respondent security or 'comfort' in that he would be the owner, and therefore have a secure probable real right in the wagon. In addition, it had the benefit of requiring the respondent to be in possession of the wagon and that Mrs Van Zyl could continue to use it.

The court clearly had an issue with this and one might well ask what is so objectionable about obtaining effective security through the transfer of ownership, where the parties intended passing of ownership. Why does the object of securing a debt preclude a sale? The court did not address the lawfulness of such arrangement. Courts, at least at the time of this decision, observed with great suspicion upon sales lacking the concomitant possession by the purchaser of the merx.⁴⁴ This is particularly where the purchase price was settled by means of the extinguishing of a pre-existing debt.

⁴⁰ *Zandberg* supra note 4 at 313.

⁴¹ *Zandberg* supra note 4 at 320.

⁴² *Zandberg* supra note 4 at 308.

⁴³ *Zandberg* supra note 4 at 309.

⁴⁴ See *McAdams v Fiander's Trustee & Bell* NO 1919 AD 207 and *Schneidenberger v Pearce & Allen Ltd* 1927 SWA 93.

Conceivably this is so to protect against manipulation when assets are attached at the reference of other creditors. Nonetheless, these transactions are frowned upon for their motive (although not unlawful), and this possibly gave some incentive for a court to discover that there was a defective agreement, and that the parties intended something else. One should keep in mind that the object of safeguarding an asset in this manner from attachment does not automatically turn a sale into a pledge.

Taking into consideration to the *Zandberg v Van Zyl* case ruling, it is evident that in defining whether the transaction amounted to a simulation, the courts focal point was whether the parties had real intention, which differed from the simulated intention created by their agreement. This was to become the standard test to be used by the judiciary in determining simulation.

c) *Analysis of Goldinger's Trustee v Whitelaw & Son 1917 AD 66*

In this case the trustee (appellant) of the insolvent estate of Goldinger had sold in execution a wagon found in possession of Goldinger. The respondent (Whitelaw & Son) declared the worth of the wagon from the appellant, asserting that the wagon was its property. The wagon was previously sold to Goldinger by the respondent, but Goldinger dishonoured some of the promissory notes that he had issued for the wagons.⁴⁵ It was decided that three wagons would be sold back to the respondent, and Goldinger would be accredited for their value, decreasing his total liability. It was understood that the respondent would not yield possession of the wagons but that Goldinger would sell the wagons for the respondent's account and send the respondent the earnings.⁴⁶ The question to be decided was whether the respondent became the owner of the wagon, while it never took concrete delivery of the wagon.

There were five separate judgments,⁴⁷ but Innes CJ held the parties were mistaken and thus one cannot declare the arrangement as fraudulent; the arrangement was

⁴⁵ *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66 at p50.

⁴⁶ *Goldinger's Trustee* supra note 45 at 62.

⁴⁷ Judgements were delivered by Innes CJ, Maarsdorp JA, De Villier AJA, and Solomon AJ (dissenting).

simply an attempt to obtain the effect of a pledge under the form of a sale.⁴⁸ The importance of this lies in the detail that it was recognised that parties may engage into a simulated transaction short of any deliberate intention to disguise or defraud. Maarsdorp JA noted that: 'it is quite possible that a person may honestly believe in law that he can obtain the security of the pledge by going through the forms of sale'.⁴⁹

De Villiers AJA was, however, not fully persuaded as to the bona fides of the parties as there was no sufficient investigation provided to enable the court to positively assert that the arrangement was not in fraud of the creditors, thus to prove that it was a genuine transaction.⁵⁰

d) Analysis of Dadoo Ltd & others v Krugersdorp Municipal Council 1920 AD 530

This case concerned a statute that prohibited 'coloured persons' from owning certain land. A person by the name of Dadoo was an Asiatic and therefore fell within the class of persons contemplated in the statute.⁵¹ To circumvent this restraint, Dadoo incorporated a company by the name of Dadoo Ltd and attained certain land which Dadoo himself was banned from owning.⁵² The local municipality (respondent) proceeded to apply for an order affirming the transaction to be illegal and set aside the transfer (registration) of land in the name of the appellant. The respondent's argument was that the transaction was in fraudem legis.

There were three separate judgments, but Solomon JA wrote for the majority. In respect of acts done in fraudem legis the court reiterated the substance over form doctrine.⁵³ Solomon JA further indicated that it is perfectly legitimate where a taxpayer orders his affairs in a legal manner to pay the least amount of tax possible.⁵⁴ In holding that the acquisition of the property by Dadoo was not in fraudem legis, Solomon JA further stated that –

'I can see no good ground, therefore; for holding that this is a case in which there has

⁴⁸ *Goldinger's Trustee* supra note 45 at 79.

⁴⁹ *Goldinger's Trustee* supra note 45.

⁵⁰ *Goldinger's Trustee* supra note 45 at 92 - 93.

⁵¹ *Dadoo* supra note 4 at 458.

⁵² *Dadoo* supra note 4 at 460.

⁵³ *Dadoo* supra note 4 at 558.

⁵⁴ *Dadoo* supra note 4 at 560.

been a circumvention of the statute by disguising the real transaction, or which any fraud has been committed upon the law.⁵⁵

The importance of this case is that it was effectively held that a person may intentionally make use of the faults of a statute and transact in a manner to continue outside the realm of that statute. This by itself, or the simple fact that the spirit of a statute has been contravened (as opposed to its language), will not declare a transaction in fraudem legis or simulated. Where the transaction in substance falls outside the statute, then there can be no question of the transaction being in fraudem legis even where it has been purposefully designed to fall outside of the statute.⁵⁶

It is enlightening to compare this case with *Colonial Banking and Trust Co Ltd v Hill's Trustees*.⁵⁷ In the latter case the principles recognized in *Dadoo Ltd & others v Krugersdorp Municipal Council* were confirmed,⁵⁸ but in the facts the transaction was found, in substance, to fall within the language of the relevant statute.

e) *Analysis of Lawson & Kirk v South African Discount & Acceptance Corporation (Pty) Ltd 1938 CPD 273*

Lawson and Kirk (plaintiff) borrowed cash from the defendant. The plaintiff's argument was that the alleged sale by the plaintiff of certain hire purchase contracts to the defendant was in fact the extension of loans by the defendant to the plaintiff and the hire purchase contracts were given in security.⁵⁹ The plaintiff further contended that the defendant charged extreme interest on the loans (in contravention of the Usury Act of 1926) and the plaintiff consequently requested reimbursement of such extreme interest from the defendant. The plaintiff argued that the loans were simply cast in the form of a sale to escape the provisions of the statute.⁶⁰

In view of all the facts, the courts found that there were too many features

⁵⁵ *Dadoo* supra note 4 at 562.

⁵⁶ See also the dicta of Innes CJ in *Dadoo* supra note 4 at 547 – 549; 552).

⁵⁷ *Colonial Banking & Trust Col Ltd v Hill's Trustees* 1927 AD 488.

⁵⁸ *Colonial Banking* supra note 57 at 493.

⁵⁹ *Lawson and Kirk v South African Discount & Acceptance Corporation (Pty) Ltd* 1938 CPD 273 at 278.

⁶⁰ *Lawson and Kirk* supra note 59 at 279.

concerning to the transactions that indicate that, in substance, the transactions constituted a sequence of loans and not sales.⁶¹ In his judgment, Davis J indicated that no person could have consistently and successfully have simulated all the features in a transaction, there is a high possibility that the parties might end up slipping up, and thus that will be of paramount importance.⁶²

The importance of the above statement is that courts will look for irregularities in the activities of the parties to spot simulation. A single irregularity can contradict all the features of the transaction that may have been flawlessly simulated.

f) Analysis of Commissioner of Customs & Excise v Randles brothers & Hudson Ltd 1941 AD 369

The test to determine simulation was further advanced by the court in the *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd* case. Randles was a fabric supplier which traded material to another company which made shirts and pyjamas. Randles attained a documentation showing that this pyjama manufacturer had become the owner, then they were eligible to pay a lower customs duty. So, Randles sold the pyjamas to this company, the company made the pyjamas, after which Randles purchased the material back.⁶³

The Commissioner of Customs and Excise then sued Randles for the remaining customs duty. The question in this case was whether ownership had passed in a batch of imported cloth based on a supposed sale to a clothing manufacturer by the importer under an agreement which provided for the resale to the importer for the price paid plus the costs of production. The agreement was clearly a device to evade the payment of import duties by the defendant. From the position of property law, the parties intended to transfer ownership but that the simulated sale was probably not the true basis on which they wanted to do so.

The majority in the Appellate Division fundamentally adopted the abstract form of conveyance by ruling that ownership had transferred even in the absence of a valid fundamental contractual agreement. Watermeyer JA referred to the *Dadoo Ltd v*

⁶¹ *Lawson and Kirk* supra note 59 at 298.

⁶² *Lawson and Kirk* supra note 59 at 282.

⁶³ *Randles* supra note 4 at 530.

*Krugersdorp Municipality Council*⁶⁴ case and recognized the discussion of following two legal principles.

'Firstly, the law has to be construed to ascertain what kind of transaction is forbidden or taxed.... As to the interpretation of the law, the ordinary recognized principles of statutory interpretation are applied in order to determine what it is that is forbidden or taxed, and in this connection 'the spirit of the law does not operate beyond the limitation of its language, as pointed out by Inness CJ.'⁶⁵

Watermeyer JA then made the judgment an obiter. The court then gave substance to the passage above from Inness JA in the *Zandberg v Van Zyl* case by affirming 'the method of solving it in words which I shall not attempt to improve upon'.⁶⁶ Watermeyer JA held that ownership of movable property does not in our law pass by the making of a contract. It passes when delivery of possession is given accompanied by an intention on the part of the transferor to transfer ownership and on the part of the transferee to receive it.⁶⁷

The heart of the judgement cognisance must be had to true intention of the parties to a transaction, irrespective of the terms of the agreement between them. It is vital to note that according to the case, this principle will only apply where the parties to such a transaction, do not intend the transaction to have, inter partes, the legal effect that the terms thereof convey to third parties.⁶⁸ The conclusion of the court, was clearly dependant on the essential principles pronounced in the *Zandberg v Van Zyl* case, it set the throne concerning determination of simulation by the courts forward.

g) Analysis of Erf 3183/1 Ladysmith (Pty) Ltd & another v Commissioner of Inland revenue 1996 (58 SATC 229)

Two companies, being the appellants, each owned certain immovable property. The appellants were both exclusively owned subsidiaries of another company (Holdings), which in turn was an exclusively owned subsidiary of another company (Pioneer). By means of an organized transaction, the appellants leased their immovable property

⁶⁴ *Dadoo* supra note 4 at 547.

⁶⁵ *Randles* supra note 4 at 533.

⁶⁶ *Zandberg* supra note 4 at 318.

⁶⁷ *Zandberg* supra note 4 at 398.

⁶⁸ M Stighling, A D Koekemoer, L Van Schalkwyk et al *SILKE: South African Income Tax 2012* (2015) 28.5.

to a pension fund. The fund could erect building on the land, but this would become property of the appellants. In turn, the fund sub-let the immovable property to pioneer. The fund was indebted to construct buildings and pioneer would pay consideration to the fund for constructing the buildings in addition to the rental (the fund ensued to claim a tax deduction for the additional amount paid to the fund).⁶⁹

The appellants would only collect rental to the extent that the fund receives rental from pioneer. In terms of the relevant tax legislation, where a taxpayer leases land to a lessee, and obtains a right to have the land upgraded, income is considered to have accumulated to that taxpayer. In respect of the purportedly arranged structure, the appellants did not acquire any such right to have their land improved and demanded that no income accrued to them. The fund did have a right to have the land improved in respect of the lease with pioneer, but since it constituted an exempt entity, it was immaterial. The Commissioner (respondent) overlooked the fund and taxed the appellants on the basis that the interposition of the fund was a sham and that the true transaction was one of lease between the Appellants and Pioneer, and in terms of that transaction a right to have the land upgraded accrued to the appellants.⁷⁰

In delivering the judgement, Hefer JA began by stating the following:

‘Affiliated companies are, of course at liberty to structure their mutual relationships in whatever legal way their directors may prefer, but when a third party is interposed in what might equally well be an arrangement between affiliates, it is not unnatural to seek the motive elsewhere.’⁷¹

This is relevant in that, effectively, the lack of ‘commercial reason’ behind the interposition raised doubt as to the purposes of the parties. In this respect, the court dispensed with two appropriate principles. The first principle is that simplified in the English case of *IRC v Duke of Westminster*⁷² being that every person is entitled to structure his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be.⁷³

Remarkably, the court renowned that ‘in effect it involves the application of more general principles, recognised in *Dadoo Ltd & others v Krugersdorp Municipal*

⁶⁹ *Erf 3183/1 Ladysmith* supra note 15 at 234.

⁷⁰ *Erf 3183/1 Ladysmith* supra note 15 at 7.

⁷¹ *Erf 3183/1 Ladysmith* supra note 15.

⁷² *Duke of Westminster* supra note 2.

⁷³ *Duke of Westminster* supra note 2 at 19.

*Council*⁷⁴ and *Van Heerden v Pienaar*,⁷⁵ which permits parties to arrange their affairs so as to remain outside the provisions of a particular statute.⁷⁶

The court made it clear that the test as to the doctrine of substance over form is not whether it has been established whether the parties truly intended to cast their transaction into a particular form, but the '...real question is...whether they actually intended that each agreement would inter partes have effect according to its tenor. If not, effect must be given to what the transaction really is.'⁷⁷

The weight of the above dicta is that parties may very well reach an agreement as to the form or structure of a transaction, but that is immaterial. The parties must actually intend for the supposed content of the agreement to produce binding legal rights and duties between them.

h) Commissioner of Inland Revenue v Conhage (Pty) Ltd 61 SATC 391

The appellant in this matter had entered into a sale and lease-back transaction with a financial organisation, in terms of which it sold certain equipment for a capital sum and instantly leased the said equipment back. It claimed a tax deduction in respect of the rentals paid on the lease. The Commissioner (respondent) rejected the deductions claimed on the basis that they were not rentals; rather, the transactions were more similar to a loan.⁷⁸ The respondent, contended that even where the parties honestly believed they could obtain a certain result by going through the form of a sale and lease-back, they had no true intention either into such an agreement.⁷⁹

The above proposes that where the bona fides of the parties are not in question, it is more problematic to show that there was indeed a simulation, although the court does not go quite as far as to say that simulation of necessity presupposed dishonesty. The court also noted that where a transaction is considered encompassing numerous agreements, one should have regard to all such agreements as a whole.⁸⁰

A concluding comment by the court was that 'the transactions made perfectly good

⁷⁴ *Dadoo* supra note 4 at 548.

⁷⁵ *Van Heerden v Pienaar* 1987 (1) SA 96 (A) at 107E-F.

⁷⁶ *Erf 3183/1 Ladysmith* supra note 15 at 239.

⁷⁷ *Erf 3183/1 Ladysmith* supra note 15 at 241.

⁷⁸ *Conhage* supra note 15 at 431.

⁷⁹ *Conhage* supra note 15 at 435.

⁸⁰ *Conhage* supra note 15.

business sense⁸¹ in that the appellant received a capital sum for giving up ownership of goods and could keep using the equipment. If the proposal by the court is that 'good business sense' goes a long way in showing the authenticity of agreements, then one may well request security by means of sales,⁸² which makes perfectly good business sense,⁸³ are generally regarded as simulated.

4. HONEST SIMULATION

It is a thought-provoking enquiry whether parties can unknowingly or unintentionally simulate a transaction. In *Zandberg v Van Zyl*⁸⁴ Innes J did not 'apply any harsh words' to the transaction, but still found it to be simulated. Likewise, in *Goldinger's Trustees v Whitelaw & Son*⁸⁵ Innes J found that there was no fraud, but also found the transaction simulated.

In *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*⁸⁶ the court distinguished between an honest transaction formulated not to fall within a statute and a veiled one intended to make it look like it does not fall inside the statute. Watermeyer JA was sceptical about the idea that there can be an honest simulation.⁸⁷

In *Commissioner for Inland Revenue v Conhage (Pty) Ltd*⁸⁸ it was again brought up, and in *ITC 1833*⁸⁹ the court took it as a traditional principle that there can be an honest simulation. It seems that there is no certainty in this regard yet. The bearing of this is in the framework of tax law, is whether a transaction concerning tax avoidance, which can generally be said to constitute an honest transaction in that there is no intention to deceive, can in fact also constitute a simulated transaction. If that is so, would such an honest simulation constitute tax evasion? This matter is discussed further below.

5. DETECTING SIMULATION

⁸¹ *Conhage* supra note 15 at 396.

⁸² Such as in cases like *Hofmeyer v Gous* 10 SC 115 and *Zandberg* supra note 4.

⁸³ See *Nedcor Bank Ltd v ABSA Ltd* 1998 (2) SA 830 (W).

⁸⁴ *Zandberg* supra note 4 at 313.

⁸⁵ *Goldinger's Trustee* supra note 45 at 92-93.

⁸⁶ *Randles* supra note 4 at 396.

⁸⁷ *Randles* supra note 4 at 399.

⁸⁸ *Conhage* supra note 15 at 395.

⁸⁹ *ITC 1833* 70 SATC 238 at para 395.

In *Lawson and Kirk v South African Discount & Acceptance Corporation (Pty) Ltd*⁹⁰ the historical background to the transaction; the court stated that to detect simulation, one should look for where the parties 'slip up' and where their behaviour is uneven with what is alleged. In *Zandberg v Van Zyl*⁹¹ the court made it clear that it is a factual investigation alone that will disclose whether there has been simulation.

In *Michau v Maize Board*⁹² it was emphasised that detecting simulation, in practice is a hurdle. Each case will depend upon its own facts. A court will seek to ascertain the true intention of the parties from all the relevant circumstances, including the way the contract is implemented.⁹³

In *ITC 1638*⁹⁴ the court itemized many of the relevant factors that will be considered, these include the nature of the negotiations between the parties; the purpose which the parties, respectively, sought to achieve by entering into the transaction; the various options available to the parties whereby those purposes could be achieved; the terms of the agreement concluded seen by themselves and in the light of the surrounding circumstances. This list is not exhaustive.⁹⁵

These factors may be referred to as *facta probantia*. It is not always easy to determine the subjective intentions of the parties, and the same complications therefore arise in detection of simulation, as pointed out in *Michau v Maize Board*.⁹⁶ The courts therefore have no choice but to examine the objective facts demonstrated.⁹⁷

6. CONCLUSION

Considering the judgements handed down in the cases discussed above, it is obvious that, in determining whether a transaction is simulated or not, the courts have traditionally looked to the intention of the parties and considering such intention, further investigated whether such intention has been given effect to. At no

⁹⁰ *Lawson and Kirk* supra note 59 at 282.

⁹¹ *Zandberg* supra note 4 at 309.

⁹² *Michau v Maize Board* 66 SATC 288 at 293.

⁹³ *Maize Board* supra note 93 at 293.

⁹⁴ *ITC 1638* 66 SATC 267 at 313.

⁹⁵ *ITC 1638* supra note 95 at 313.

⁹⁶ *Maize Board* supra note 93 at 293.

⁹⁷ C J Pretorius 'Simulated agreements and commercial purpose' 75 *THRHR* 688; 692-694;396.

point did the courts consider it necessary to have regard to the commercial substance of the transaction, which is evidently vastly different from the approach apparently adopted by the court in the *Commissioner of the South African Revenue Services NWK Limited*.⁹⁸

The courts will not just look at the form of the transaction, but as its real nature.⁹⁹ Considering the judgements handed down in the cases set out above, our courts have echoed that where the parties to a transaction legitimately and honestly intend for such a transaction to be given effect in accordance with the nature and meaning thereof, then the courts will, give effect to the transaction in accordance hereto. Conversely, if the parties do not intend to give effect to an agreement, and merely use it to disguise an agreement that they intend to give effect to, the court will give effect to the underlying agreement, not the simulated one. The cases above also show that the courts will focus on whether a transaction is simulated or not, before applying the doctrine. The onus of proof will fall on the taxpayer to prove, on a balance of probability, that the transaction is a precise reflection of actual intention of the parties.

⁹⁸ *NWK* supra note 9.

⁹⁹ *Ochberg v Commissioner for Inland Revenue* 1931 AD 215 at 218.

CHAPTER THREE

1. INTRODUCTION

Companies are continuously overwhelmed with news of reports of multinational businesses downsizing, industries being brought to their knees because of financial complications and forced to retrench thousands of employees.¹⁰⁰ As a result of such an appalling economic environment, parties are seeking to structure their affairs in such a style so as to grasp full advantage of creative organizing opportunities and thus reducing their possible tax obligation as far as is legally permissible.¹⁰¹ One of the principles of the right to avoid tax is the right to elect a transaction that entices the least tax, from a number of alternative transactions.¹⁰²

It is thought-provoking to note that, taxpayers can structure transactions in such a manner to reduce or eliminate a tax liability, on condition that such structuring is bona fide and factually genuine from a commercial perspective, as the courts do not have the directive to unjustifiably 'widen the net of tax liability'.

Furthermore, when determining whether the transaction is simulated or not, the courts will analyse the intention of the parties thereto, and in doing so determine whether they legitimately and honestly intended for the transaction to be implemented in accordance with the nature and meaning thereof. As discussed in the previous chapter, this enquiry has been established in caselaw over many years. In addition, a similar approach is adopted in many jurisdictions, particularly those jurisdictions that already have an existing statutory GAAR.¹⁰³ It is against this backdrop that one must analyse the judgment in the *NWK* case and the perceived significant departure thereof from the existing jurisprudence on the matter of simulation.

2. GENERAL

On the 1st December 2010, the SCA delivered its landmark judgment in the

¹⁰⁰ 'South African Economy Forecast', available at <http://www.oecd.org/economy/south-africa-economic-forecast-summary.htm>, accessed on 20 November 2018.

¹⁰¹ 'Reducing Taxable Income' available at <https://www.entrepreneurmag.co.za/advice/personal-wealth/personal-finance/how-to-reduce-your-taxable-income/>, accessed on 20 November 2018.

¹⁰² This principle was described in *ITC 1638* supra note 95 at 267.

¹⁰³ Please see discussion under chapter four.

*Commissioner, South African Revenue Services v NWK*¹⁰⁴ case, which seemingly reformed the landscape of the doctrine by adding an additional requirement, namely that of commercial substance. The judgment sparked much debate in the tax community amongst commentators and practitioners, as many people thought that the SCA took it upon itself to expand the traditional interpretation of the doctrine.¹⁰⁵

On the other hand, many people were of the understanding that the SCA merely modernised the existing principle forming the basis of the doctrine.¹⁰⁶ As such, what stands to be determined is whether the commercial substance requirement is merely suggestive of simulation or rather is an independent requirement, which must be present before a transaction can be said to be simulated.¹⁰⁷

3. ANALYSIS OF *COMMISSIONER, SOUTH AFRICAN REVENUE SERVICES v NWK LIMITED* 2011 (2) SA 67 (SCA)

NWK entered into a series of agreements through which it obtained a structured finance loan facility in the sum of R50 million from First National Bank ('FNB'). Through structuring their transaction with FNB in the manner which it did, NWK would not only raise the aforesaid amount as a loan,¹⁰⁸ but also generate excessive interest expenses which it would be able to deduct from its taxable income pursuant to section 11 (a) of the Income Tax Act.¹⁰⁹

A loan agreement with a subsidiary of FNB was entered in terms of which the latter would lend a sum of approximately R96 million to NWK on the basis that the capital amount will be repayable in five years' time, partially through the delivery of maize to the subsidiary. To make provision for the interest expense which would be incurred over this time, NWK issued promissory notes to the subsidiary with a value of approximately R75 million. To ensure that NWK had sufficient quantities of maize at

¹⁰⁴ *NWK* supra note 9.

¹⁰⁵ Dachs 'The interpretation of substance over form', available at: http://www.ens.co.za/images/news/14_02_11%2001%2001r1402LAW_AL_2.pdf.

¹⁰⁶ Legwaila 'Modernising the "substance over form" doctrine: Commissioner for the South African Revenue Service v NWK Ltd SA *Mercantile Law Journal* (2012) 24 117.

¹⁰⁷ H Struwig *Simulated Transaction: The Requirement of 'Commercial Substance' to Determine Simulation as Enunciated in the NWK Case – The Established Substance over Form Doctrine Renovated or a Mere Indicator of Concealed Transaction?* (unpublished LLM dissertation University of Pretoria 2013) 27.

¹⁰⁸ *NWK* supra note 9.

¹⁰⁹ Income Tax Act 58 of 1962.

hand to be able to deliver the agreed volume of maize to the subsidiary at the end of the five-year term, another division of FNB entered into a purchase agreement with NWK in terms of which it would sell the same quantity of maize to NWK as which NWK was supposed to deliver in terms of the loan agreement.¹¹⁰

The purchase consideration, which NWK paid on the date of conclusion of this agreement, was approximately R46 million, whilst the delivery of maize to NWK was only to take place on the same date as the date on which NWK had to deliver maize to the FNB subsidiary. On the same terms and on the same date, the FNB subsidiary sold the same quantity of maize to FNB division for approximately R46 million, which maize would also only be delivered some five years later. Finally, and on the same date, the FNB subsidiary relinquished its right to the promissory notes to FNB at a discounted value of approximately R51 million, through which FNB would become entitled to receive interest payments from NWK premised thereon, as and when they become due.¹¹¹ Also, the FNB subsidiary was placed in a position of liquidity to make R96 million loan to NWK by virtue of its sale of maize to the FNB division and the cession of the right to receive interest payments to FNB.¹¹²

Through implementing this transaction, NWK claimed deductions in terms of section 11 (a) of the Income Tax Act to the sum of the face value of the promissory notes over the five-year period in respect of interest payments made to FNB.¹¹³ The issue before both Tax Court, firstly, and thereafter the SCA, was that the loan was effectively only for a sum of R50 million, not the estimated R96 million, and that the transaction was therefore 'specifically designed to conceal the fact that, in reality, the actual loan amount advanced to NWK was R50 million.'¹¹⁴ SARS contended that the interest claimed as a deduction created both a payment of a portion of the actual capital of the loan as well as interest thereon in reality, and therefore sought to disallow the deductions insofar as it related to the repayment of the capital.¹¹⁵ However, it was contended on behalf of NWK that the contracts between the parties were not only intended to be performed in accordance with their tenor, but that this

¹¹⁰ *NWK* supra note 9 at 9.

¹¹¹ *NWK* supra note 9 at 10.

¹¹² Some four months after these transactions, both NWK and the FNB subsidiary ceded their respective right to receive maize under their respective purchase agreements to FNB, where after NWK and FNB concluded short term facility of R50 million.

¹¹³ *NWK* supra note 9 at 11.

¹¹⁴ *NWK* supra note 9 at 30.

¹¹⁵ *NWK* supra note 9.

transpired and that there was no unexpressed agreement between them to which they actually intended to give effect.

The Tax Court¹¹⁶ considered the established principles relating to a taxpayer's right to legitimately minimise his tax liability and the doctrine of substance over form as a common law restriction for simulated transactions¹¹⁷ and settled that NWK successfully satisfied the onus to demonstrate that its true intention was to give effect to the agreements in accordance with their terms. The Tax Court therefore found that simulation was not present in the structure implemented by NWK and set aside the additional assessments raised by SARS. This decision was appealed by SARS and the SCA was approached to finally adjudicate on the matter.

4. THE JUDGEMENT OF THE SCA AND THE INTRODUCTION OF THE COMMERCIAL SUBSTANCE REQUIREMENT

In delivering the judgement, Lewis JA¹¹⁸ firstly confirmed that in tax appeals, the onus of proof rests with the tax payer, by virtue of the Act, and the taxpayer is required to show that the transaction in question is not simulated, i.e. that the parties honestly and lawfully intended for the transaction to be implemented in accordance with the nature and meaning thereof.¹¹⁹ However, as NWK argued that the agreements, which the parties had concluded, served as prima facie evidence of the parties' true intention, the onus thus rested on the Commissioner to disprove NWK's insinuation.

The court then gave recognition to the principle entrenched in our tax law of a taxpayer's entitlement to reduce a potential tax liability¹²⁰ as well as the established requirements to conclude that a transaction is simulated and that it is therefore

¹¹⁶ *ITC 1833* supra note 95; see also S C Emslie *Simulated Transactions* (2010) 59 (6&7) *The Taxpayer*.

¹¹⁷ *Ibid* para 27-35.

¹¹⁸ The remaining judges, Harms DP, Cachalia JA; Shongwe JA and Bertelsmann AJA concurred with the decision.

¹¹⁹ Section 82 (b) of the Income Tax Act.

¹²⁰ See *NWK* supra note 9 para 42 of the judgment in which the court gave recognition to the principle enunciated in *Duke Westminster* supra note 2 above). In this regard, the judge stated that notwithstanding the above principle, a distinction should be made between permitted to 'arranging one's affairs in such a way as to pay the least tax' and the principle that 'a court will not be deceived by the form of a transaction: it will render aside the veil in which the transaction is wrapped and examine its true nature and substance' (as stated by Wessels ACJ in the *Kilburn v Estate Kilburn* 1931 AD 501 at 507).

taxed in accordance with its substance.¹²¹ However, in considering the law on simulation, the court specifically observed the approach followed in the existing authorities but concluded that there had been no consistency in the approach to establish the true intention of the parties to the transaction or, as the court would have it, to establish the 'purpose' which the taxpayer sought to achieve.

Lewis JA then discussed several cases that have contributed to the formation of the principles underlying the doctrine. Of importance, was the decisions handed down in *Zandberg v Van Zyl* and *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd*, where the courts held that the intention of the parties was of paramount importance in establishing whether a transaction is indeed simulated. The court, however, went on to discuss different approaches put forth in each of the majority and the minority judgments of the *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd* case.¹²²

The majority judgment turned on the fact that cognisance must be had to the true intention of the parties to a transaction, regardless of the terms of the agreement between them. In this case, Watermeyer JA considered the subjective intention of the taxpayer and stated that there was no requirement that the right transferred be unrestricted.¹²³ The dissenting judgments were delivered by De Wet CJ and Tindall JA, both placing emphasis on the substance of the transactions as opposed to what the stated intention was.

In addition, the Court also referenced the case of *S v Friedman Motors (Pty) Ltd*¹²⁴ that if two people genuinely agree to achieve a similar result through the sale and repurchase, there is no room for an application of the maxim *plus valet quod agitur quam quod simulate concipitur*. The transaction is intended to be one of sale and repurchase.¹²⁵ The court did not specifically comment on the above referenced case, but presumably the principle was accepted that there is often more than one legal way in which to achieve a particular result, and this depends on the intention of the parties.

¹²¹ See para 43 of *NWK* supra judgment in which the rule laid down in *Zandberg* supra was affirmed by the court.

¹²² *Randles* supra note 4 at 342.

¹²³ *NWK* supra note 9 at 47.

¹²⁴ *S v Friedman Motors (Pty) Ltd* 1972 (1) SA 76 (T).

¹²⁵ *Friedman Motors* supra note 125 at 80.

The court did however make an observation about *S v Friedman Motors (Pty) Ltd*¹²⁶ and *Commissioner for Inland Revenue v Conhage (Pty) Ltd*,¹²⁷ which is central to the debate that was about to ensue. Lewis JA observed¹²⁸ that in both cases the transactions in questions were held not to be simulated, and that it was found that the parties gave effect to their agreement in accordance with its tenor and reasoned that in the aforesaid case, the way the transactions were structured was justified as there were sound commercial reasons for the parties to structure their transaction in the manner they did.¹²⁹ The statement above, regarding sound reasons for structuring an arrangement in a particular manner, gave rise to the crux of the judgment in the *Commissioner for South African Revenue Services v NWK Limited* case. Lewis JA's judgment at paragraph 55 is the basis for the discussion at hand.¹³⁰

The fact that the parties intended to give effect to the transaction in the form that it was cast, as contended for on behalf of NWK as required in terms of the deep-rooted principles, did not satisfy the SCA's enquiry into whether the transaction was simulated or not. As the argument by the Respondent was that the parties intended to perform in accordance with the terms of the contract the court said in addition to the court *aquo* should have asked whether there was actually any purpose in the contract other than tax evasion. The court mentioned that this is not to suggest that a taxpayer should not take advantage of a tax-effective structure. A court should not only look to the outward trappings of a contract; it must consider, when simulation is in issue, what the parties really sought to achieve.¹³¹

Lewis JA therefore seems to say that a commercial transaction, having a commercial purpose, can take advantage of a tax effective structure, but if there is no commercial substance to it, and the transaction does nothing but confer a tax benefit, then pointing to the form of the contract and that the parties followed the steps envisaged, does not assist.

The court therefore insisted that an economically justifiable purpose for the

¹²⁶ *Friedman* supra note 125.

¹²⁷ *Conhage* supra note 15.

¹²⁸ *Friedman Motors* supra note 125 above.

¹²⁹ *NWK* supra note 9 at 54.

¹³⁰ *NWK* supra note 9 at 55.

¹³¹ *NWK* supra note 9 at 80.

transaction must exist and, in the absence of such purpose, it would lead the court to conclude that the transaction is simulated.¹³² On the facts of the matter, the court found that there was no real and sensible commercial purpose in the transaction¹³³ and that the only apparent purpose which the parties sought to achieve was tax benefit ensuing from NWK's ostensible entitlement to claim a deduction from its taxable income in respect of the interest expenses it incurred on an artificially inflated loan amount.¹³⁴ Premised hereon, the SCA found in favour of SARS on the basis that the transaction was simulated and upheld the appeal.

It is not much the court's finding in favour of SARS which has solicited interest in the judgment and the debate and criticism thereto, but rather the court's findings in respect of established law on simulated transactions.¹³⁵ If one had regard to paragraph 55 and paragraph 80 of the judgment, the SCA either departed from the established rules pertaining to simulation by creating a new, independent test to determine simulation, or it broadened the interpretation of the substance over form doctrine by widening the scope of circumstances in which a transaction may potentially be simulated.¹³⁶ Either way, the court endeavoured to introduce a further requirement to the effect that a transaction must have some commercial substance to escape the detrimental consequences of being labelled as a simulated transaction.¹³⁷

The exact application of this requirement – as either an independent criterion for simulation or as De Koker¹³⁸ put it, 'merely as being symptomatic of a transaction that is indeed a pretence or disguise' – remains uncertain and is examined in the remainder of this research.¹³⁹ However, it is necessary to firstly consider the effect of the requirements to better understand the SCA's reasoning.

(a) Deviating from legal principles 'commercial requirement'

¹³² *NWK* supra note 9 at 54 – 55.

¹³³ The court considered various aspects of the transaction to reach a conclusion that the agreements reached in respect of the sale of maize was a charade. See *NWK* supra note 9 at 89 in this regard.

¹³⁴ *NWK* supra note 9 at 86.

¹³⁵ PriceWaterhouseCoopers 'The SCA advanced the law on simulation' (2011) *TaxTalk* 29.

¹³⁶ *NWK* supra note 9 at 55; 80.

¹³⁷ *NWK* supra note 9 at 55.

¹³⁸ De Koker note 16 at 19.3.

¹³⁹ See chapter 5 below.

The doctrine of judicial precedent¹⁴⁰ requires courts to consider judicial decisions handed down in similar instances. Previous judgments create a binding precedent that must be followed.¹⁴¹ This being said, Lewis JA did discuss some of the leading authorities regarding the principle of simulation and how it ought to be determined.¹⁴² Nevertheless, as discussed above, at paragraph 55 of the judgment, Lewis JA essentially put forth that the standard test for simulation is inadequate, thus one should not only investigate and enquire whether parties to a transaction intended to give effect thereto in accordance with its terms; in addition, one must examine 'the commercial sense of the transaction', its 'real substance and purpose'.¹⁴³

Aside from the perceived inclusion of an additional requirement in respect of the test for simulation, what is truly important to determine is whether the controversial paragraphs in the judgment formed part of the obiter dictum or rather the ratio decidendi of the judgment. The difference is vital, as any person in the legal fraternity will confirm, not everything covered in a judgment is binding. Obiter dicta are not binding but may have persuasive value whereas the ratio decidendi of a case is binding and creates a precedent.¹⁴⁴

Many authors, including Vorster, are of the view that the lengthy analysis included in the NWK judgment, had been expressed as an obiter dictum, meaning that it would only hold persuasive value. This view is based on the fact that, as part of the ratio decidendi of the judgment, Lewis JA relied on the established legal principles regarding the test for simulation, to conclude whether the transactions at hand were indeed simulated. Indeed, many share this view, in particular, Broomberg submits that the remarks of the court to effect that, if the purpose of the transaction is only to avoid tax, were made obiter, and are not binding on other courts in the future.¹⁴⁵ Furthermore, this view is echoed by Vorster¹⁴⁶ and Mazansky.¹⁴⁷ Vorster having stated that, in his view the court did adhere to the doctrine of judicial precedent as

¹⁴⁰ This is also known as the stare decisis principle and literally means to 'stand by previous decisions'. See part 5. below.

¹⁴¹ Duard Kleyn *Beginner's Guide for Law Students* 3 ed (2002) 60.

¹⁴² Please see discussion in chapter two.

¹⁴³ Emslie 'Simulated transactions – a new approach?' (2011) 60 *The Taxpayer* 3.

¹⁴⁴ Duard Kleyn op cit note 142 at 60 – 61.

¹⁴⁵ E B Broomberg *The Founders Hill and NWK cases under the spotlight Comment on CSARS v NWK Ltd (27/10) [2011] ZASCA 168, (2011) South African Fiscal Association* 59.

¹⁴⁶ Vorster op cit note 18 at 85.

¹⁴⁷ Mazansky 'And you thought an *obiter dictum* was not binding!' (2012) 61 (3) *The Taxpayer* 45.

the court did not overrule the existing judicial precedent, which was in place prior to the case being heard. This according to him, suggests that the commerciality requirement formed part of an obiter dictum.

Despite the facts the contentious portions of the judgment may, likely, not form part of the ratio decidendi thereof, it is truly doubtful whether a court of lower hierarchy will dare to deviate from any decision, including an obiter dictum, of the SCA.¹⁴⁸ As Mazansky notes,¹⁴⁹ taking this point even further, it does seem quite puzzling that in a relatively short period of time, the SCA handed down several judgments that required analysis of legislative provisions contained in the Income Tax Act, three of which potentially have far-reaching commercial and tax consequences.¹⁵⁰

(b) Relevant criticism

It would be superfluous to traverse the vast amount of criticism published by commentators on the SCA's controversial judgment for the purposes of this research. There are, however, three relevant points of criticism raised against the judgment which warrant mentioning:

First, the paramount enquiry with which a court is tasked when considering transaction of this nature is whether the provision of a taxing statute through which the tax benefit was derived allow for that benefit to ensue, if properly applied to the facts of the case.¹⁵¹ In *NWK*, the general deduction formula contained in section 11(a) of the Income Tax Act¹⁵² is relevant as the interest expenses were claimed as deductions from normal tax through this provision.¹⁵³

¹⁴⁸ Mazansky op cit note 147 at 45.

¹⁴⁹ Ibid.

¹⁵⁰ In addition to the *NWK* judgment, see *Commissioner for South Africa Revenue Service v Sprigg Investment 117 CC t/a Global Investment* 2011 (4) SA 551 (SCA) and *Commissioner for South African Revenue Service v Founders Hill* 2011 (5) SA 112 (SCA).

¹⁵¹ *MacNiven v Westmoreland Investments Ltd* [2003] AC 311 at 320.

¹⁵² Act 58 of 1962.

¹⁵³ See the *NWK* supra note 9 at 12.

In terms of the criteria contained in section 11(a), a taxpayer shall only be entitled to claim a deduction of its interest expenditure in the event that it actually incurred the expense in the course of producing income.¹⁵⁴ De Koker¹⁵⁵ is of the view that *NWK* would not have been able to prove that it had actually incurred all of its claimed deductions by virtue of the true loan amount being only R50 million, and submits that this enquiry of the application of the statutory criteria should have been the starting point and central focus in *NWK*. To do so, however, the true nature of the transaction still had to be established by the court as *NWK* did not concede that the loan was only for R50 million. An enquiry into the actual substance of the transaction would therefore necessarily accompany this suggested approach.

Secondly, the SCA's appreciation of the distinction between 'tax avoidance' and 'tax evasion' is of concern as the court clearly conflated these two concepts.¹⁵⁶ Vorster¹⁵⁷ indicates that the court's substitutable use of these concepts creates uncertainty as to whether the court intended that the requirement should only be applicable in instances where the transaction sought to evade an existing tax liability, or whether it should be applicable where the purpose was to avoid a potential liability, Vorster correctly asserts that if the court meant for commercial substance requirement to only apply to instances where parties sought to evade tax evasion, the law of contract renders such a transaction ineffectual.¹⁵⁸ Logically, an enquiry stops as the moment when the contract is found to be unlawful. The SCA therefore failed to instil any confidence through its reasoning by virtue of the uncertainty caused by it through the interchangeable use of two vastly different concepts. Broomberg¹⁵⁹ contends, however, that by virtue of the absurdity to which it would lead if the SCA was using the phrase 'evasion', the court probably really intended to refer to 'tax avoidance'.

Finally, a further aspect in which the judgment lacks clarity in the SCA's use of the phrase 'simulated'. If one has regard to the judgments in *Zandberg Van Zyl*,¹⁶⁰

¹⁵⁴ Stighling (Ed) et al *SILKE: South African Income Tax* (2011) 110.

¹⁵⁵ De Koker note 16 at 19.3.

¹⁵⁶ J Davis 'Simulated transactions' (2010) 59 (11&12) 204.

¹⁵⁷ Vorster op cit note 18 at 3.

¹⁵⁸ *Hippo Quarries* supra note 19.

¹⁵⁹ Broomberg op cit note 12 at 198.

¹⁶⁰ *Zandberg* supra note 4.

*Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd*¹⁶¹ and *Erf 3183/1 Ladysmith (Pty) Ltd & another v Commissioner of Inland Revenue*,¹⁶² the ordinary meaning of the word 'simulated' connotes a 'pretence' or 'concealment' and therefore implies that there is another, identifiable transaction behind it.¹⁶³ The SCA's use of the term, however, refers to a transaction which lacks commercial substance, notwithstanding the absence of a pretence, disguise or alternate unexpressed transaction.

De Koker¹⁶⁴ therefore considers the SCA's reference to a 'simulated' transaction to be an inappropriate label attributed to the word which differs from the sense in which it had been used by the Appellate Division in previous decisions. The SCA appears to have attached a new meaning to the word to accord with its test for simulation premised on commercial substance. The question the, however, is what the situation would be if a transaction has commercial transaction is 'simulated' in accordance with the meaning attributed to it by the SCA? It would be no surprise to find the judiciary applying the established principles in such a case and correctly referring to a transaction as 'simulated' in the same context as what it was used prior to *NWK*.

Although the criticism is purely semantic and of superficial value, it demonstrates the ambiguity occasioned by the judgment and the uncertainty to which it gives rise. To challenge the independence of the requirements, the arguments to follow are of immeasurable value.

5. UNPACKING THE STARE DECISIS PRINCIPLE

Arguably one of the most debated issues surrounding the *Commissioner, South African Revenue Services v NWK Limited* judgment is the contention that the requirement introduced by the SCA signified a departure from the established and

¹⁶¹ *Randles* supra note 4.

¹⁶² *Erf 3183/1 Ladysmith* supra note 15.

¹⁶³ De Koker note 16 at 19.3.

¹⁶⁴ *Ibid*.

entrenched principles pertaining to simulated transactions in our law. Now, it is a settled principle in our law that courts are obliged, in general, to follow the previous decisions of a higher court or a court of similar stature.¹⁶⁵ Yet, Lewis JA expressed the view that the test to determine simulation cannot simply stop at the enquiry into the intention of the parties, as proposed by the Appellate Division in the *Zandberg v Van Zyl*¹⁶⁶ and *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd*¹⁶⁷ matters. Instead, she suggests that the test for simulation should reach beyond the aforesaid enquiry and requires that the commercial substance of the transaction must be considered.

The effect hereof is simply that although the requirements of the former enquiry may have been satisfied, by not satisfying the latter requirement, the transaction would be regarded as simulated. By implication, the commercial substance requirement therefore supersedes the intention-requirement¹⁶⁸ which is indicative of the intended independence thereof. For this reason, it could be argued that the introduction of the *NWK* requirement was therefore in disregard of the principles embodied in the doctrine of substance over form it is indeed capable of independent application.¹⁶⁹

The pertinent question is whether the SCA properly observed and respected the doctrine of *stare decisis* and the rule of law in its ostensible departure from the established principles. If it can be successfully argued that the SCA failed to do so or that it expanded the established rules under circumstances wherein it failed to fulfil the requirement to do so, it would be equally arguable that the introduction of the requirement was premised on incorrect principles and that it therefore does not constitute a binding precedent about simulation. If this is the case, the commercial substance requirement can simply not be independent.

A necessary requirement for the 'law to rule' is that the law must be reasonably predictable.¹⁷⁰ This does not imply that legislative and policy and policy considerations and rules must be established and adhered to, but also that our judiciary cannot simply depart from its prior decisions without good reason. If this

¹⁶⁵ *Daniels v Campbell & others* 2004 (5) SA 331 (CC) para 94.

¹⁶⁶ *Zandberg* supra note 4.

¹⁶⁷ *Randles* supra note 4.

¹⁶⁸ Legwaile 'Modernising the "substance over form" doctrine: Commissioner for the South African Revenue Service v Nwk Ltd' (2012) 24 *SA Mercantile Law Journal* 122.

¹⁶⁹ Ger 'High Court challenges SCA's interpretation of simulated transactions' (2013) *De Rebus* 63.

¹⁷⁰ *Gcaba v Minister of Safety and Security & others* 2010 (1) SA 238 (CC).

were to happen, it would lead to a result which would be counter-productive to the values envisaged through the rule of law and, for that matter, the Constitution. For this very reason, the doctrine of judicial precedent is applied in our law and has been accepted and affirmed by the constitutional court on various occasions.¹⁷¹

The necessity of this doctrine of the rule of law was confirmed in *Van der Walt v Metcash Trading Ltd*¹⁷² wherein the constitutional court held that the doctrine of judicial precedent is incidental to the rule of law and similarly, in *Gcaba v Minister of Safety & Security & others*,¹⁷³ the constitutional court reiterated that the doctrine is essential for the rule of law. Without a doctrine applicable to the judiciary which gives effect to the supremacy of the law, erratic decision-making would be unavoidable and would abolish the required predictability of the law. Not only would this lead to legal uncertainty, but invariably taxpayers' equality before the judiciary would be jeopardised by the inconsistent decisions in which it would result.

The importance of the nexus of the doctrine of judicial precedent to the rule of law manifests in the consequences that a failure by a court to uphold the previous decisions of the judiciary would amount to the failure of a court to respect the rule of law. If this is the case, the particular judgment should not be followed and cannot be regarded as a binding precedent.

However, the doctrine of legal precedent is not absolute. The tax law, like any other branch of law, continuously evolves with time and necessarily requires new rules, principles and precedent to keep pace with innovative avoidance structures and the public's perception on how it should be dealt with. The doctrine therefore makes provision for a court to deviate from previous decisions, although not lightly.¹⁷⁴

For a court to deviate from a previous decision, the court must be satisfied that the previous decision was either incorrectly decided or that the issues serving before the court are distinguishable from issues which served before the court which gave the precedent-setting decision.¹⁷⁵ Alternatively, the court must be satisfied that the particular point on which it is required to adjudicate was not argued in the previous matter and that it is necessary for a court to explain why it does not share the view

¹⁷¹ *Camps Bay Ratepayers' & Residents' Association v Harrison* (2011) 4 SA 42 (CC) para 28.

¹⁷² *Van der Walt v Metcash Trading Ltd* 2002 (4) SA 317 (CC).

¹⁷³ *Gcaba* supra note 170.

¹⁷⁴ *Camps Bay Ratepayers'* supra note 172 at 30; see also *Gcaba* supra note 170 at 62.

¹⁷⁵ *Daniels* supra note 166 at 95.

expressed in the previous decision and motivate, with good reasons, why a departure from the principles established by the prior decision is necessitated. In my view, the requirement to deviate from judicial precedent should stretch further and requires that the court should formulate its new principle in a manner which is unambiguous, clear and concise. Moreover, the new principle should be reconcilable with the particular law to which the principle relates. If the court fails to do so, its new principle would fail to uphold the strive towards legal certainty and would invite more confusion than clarity.¹⁷⁶

Premised on these principles, the introduction of the commercial substance requirement in *NWK* and its possible infringement on the doctrine of judicial precedent requires analysis.

(a) Observance of the stare decisis principle in Commissioner, South African Revenue Services v NWK Limited

Did the SCA properly observe the established law pertaining to simulated transactions and conclude that it was justified for the court to deviate from these principles and if so, did the SCA clearly and concisely express why such deviation was necessary? For the reasons as set out hereinafter, the quick answer to these questions is in the negative.

It is necessary to pause at this juncture to firstly explain the difficulties already imminent from this extract before considering the SCA's reasoning on the *Randles* matter.

The SCA evidently conflated 'intention' and 'purpose' as part of the same concept, whilst in the *Hippo Quarries* case, the court clearly found that these concepts differ from one another.¹⁷⁷ It should be borne in mind that the SCA also conflated the concepts of 'evasion' and 'avoidance' in its judgment, as already discussed herein, and stated that a purpose to evade tax, as oppose to avoidance of tax, would result in the transaction being simulated.¹⁷⁸ The effect of this line of reasoning by the SCA culminates in the conclusion that a purpose to unlawfully evade taxation would result in simulation, which, in itself, is anomalous in the context of the law of

¹⁷⁶ This view is also expressed by *Waglay J*, as indicative from the minority judgment in *Bosch & another v Commissioner for the South African Revenue Service* 2013 (5) SA 130 (WCC) para 7.

¹⁷⁷ *Hippo Quarries* supra note 19 at 47.

¹⁷⁸ *NWK* supra note 9 at 55.

contract which already provides for the legal consequences where a contract has an unlawful purpose.

Contrary hereto, the court in the *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* case did not decide that an unlawful purpose underlying a transaction would render the transaction as simulated by virtue of the established principle that the law will regard contracts with an immoral or unlawful purpose as ineffectual.¹⁷⁹ PriceWaterCoopers¹⁸⁰ is of the view that the SCA's proposition conflicts the principle established in *Dadoo Ltd v Krugersdorp Municipal Council*, namely that our law does not forbid parties from entering into genuine transactions which are constructed with the purpose to circumvent the operation of legal prohibition.¹⁸¹ This principle is the cornerstone for legitimate tax planning which has been endorsed by our courts on numerous occasions.

The SCA's reasoning appears to depart from a premise which conflicted well established judicial precedent, although it is likely that this conflict was inadvertently occasioned through the SCA's apparent misconception of 'avoidance' and 'evasion' rather than to 'tax evasion' as it did and for this reason, this departure from the judicial precedent pertaining to legitimate tax planning will not be pursued further. It is rather the SCA's reasoning and departure from the principles in the *Randles* matter¹⁸² which is important as the SCA's finding in *Commissioner of South African Services v NWK Limited* conflicts the decision expressed by the court in this case.¹⁸³

The SCA reasoned that the approached followed by Watermeyer JA and De Wet CJ for the majority and minority judgments respectively in the *Randles* case differed. According to Lewis JA, the majority concluded that the taxpayer in casu had such a desire to pass transfer of ownership of the materials to obtain a tax rebate in terms of the relevant customs legislation that the parties invariably intended that the transaction should be given effect to in accordance with its terms. Contrary hereto, according to Lewis JA, the minority judgment rather looked at the substance of the

¹⁷⁹ *Hippo Quarries* supra note 18 at 45.

¹⁸⁰ PriceWaterCoopers 'Tax avoidance: Simulated transactions', available at http://www.saica.co.za/integritax/2011/1966_Simulated_transactions/htm, accessed on 24 November 2018.

¹⁸¹ See also the extract from the judgment in *Randles* supra note 4 at 2.3.3 in which this principle was confirmed by the court.

¹⁸² *Randles* supra note 4.

¹⁸³ *NWK* supra note 9 at 55;80).

transaction than the intention of the parties only. It appears as if the SCA felt that the majority of the court was satisfied that the true intention of the parties was reflected in the wording of the agreement, whilst the minority of the court went beyond the words of the agreement to seek the commercial effect thereof.¹⁸⁴ Of course, the SCA preferred the latter approach and, on the basis, justified its conclusion to depart from the established intention-requirement.

The difficulty with this reasoning, according to both Broomberg¹⁸⁵ and Vorster,¹⁸⁶ is that the SCA misunderstood the difference in conclusions of the majority and minority judgments in the *Randles* case. Vorster¹⁸⁷ correctly points out that both the judges applied the principles established in the *IRC v Duke of Westminster*,¹⁸⁸ *Zandberg v Van Zyl*¹⁸⁹ and *Dadoo v Krugersdorp Municipal Council*¹⁹⁰ judgments but that their different conclusions were premised on their respective interpretations of the charging provisions of the relevant statute and different understandings of the evidence presented to them during the hearing of the matter. Broomberg¹⁹¹ agrees with the contention and states that the difference in conclusions reached by the court in this matter was 'not because of a different in approach to simulated transactions' by the judges, as suggested by Lewis JA in her judgment. In fact, both the majority and minority judgments left the established simulation-principles undistributed.

It appears as if the SCA's eventual decision to introduce a further requirement for simulation was premised predominantly on its interpretation of what the minority judgment held in the *Randles* matter. It should be borne in mind that the court in *Commissioner of Customs & Excise v Randles brothers & Hudson Ltd* expressly followed the principles established in the *Zandberg v Van Zyl* matter¹⁹² and confirmed that the purpose to avoid tax would not amount to simulation if the parties intend to give effect to their transaction in accordance with its terms.

Albeit by virtue of the SCA's misunderstanding of the minority judgment in

¹⁸⁴ Broomberg op cit note 12 at 204.

¹⁸⁵ Ibid.

¹⁸⁶ Vorster op cit note 18 at 84.

¹⁸⁷ Ibid.

¹⁸⁸ *Duke of Westminster* supra note 2.

¹⁸⁹ *Zandberg* supra note 4.

¹⁹⁰ *Dadoo* supra note 4.

¹⁹¹ Broomberg op cit note 12 at 204.

¹⁹² *Zandberg* supra note 4.

Commissioner of Customs & Excise v Randles brothers & Hudson Ltd, the SCA departed from the established principles without adequately motivating why a departure was necessary. It is therefore submitted that the SCA failed to properly observe the doctrine of judicial precedent, especially as the requirements to deviate from a previous decision in order to observe the doctrine of stare decisis, as laid down by the Constitutional Court in the *Daniels v Campbell and Others* matter,¹⁹³ were not satisfied by the SCA. Even if it could be argued that it was justified for the SCA to depart from the established principles as it did, the judgment lacks clarity and contained too many ambiguities to constitute conflation of distinguishable, basic tax concepts in the judgment results in difficulties with the view that its decision should be binding.

6. CONCLUSION

Subsequent to the judgment of the *Commissioner of South African Services v NWK Limited* case being handed down, a clear distinction arose between those authors who were in support of the judgment and those who firmly stood against it. Having considered the historical position about the approach to determining simulation as well as the views of respected such authors as Broomberg, Vorster and Mazansky, it is submitted that the SCA, and notably Lewis JA, indeed deviated from the established and traditional approach to determining simulation by introducing an additional element, namely that of 'commercial substance'. The question to follow is thus whether this deviation can be said to be a justifiable development of the existing principles of the doctrine.

In addition to the SCA's infringement on the doctrine of separation of powers, there are two further consequences occasioned through the conflation of the common law and statutory deterrents which support the view that the commercial substance requirement cannot co-exist with the GAAR.

¹⁹³ *Daniels* supra note 166 at 95.

CHAPTER FOUR

THE PERCEIVED IMPACT OF THE *NWK* JUDGMENT ON THE STATUTORY GENERAL ANTI-AVOIDANCE RULES (GAAR): THE POWERS OF THE LEGISLATOR USURPED?

1. INTRODUCTION

As mentioned previously, as an alternative argument to the allegation of simulation, the Commissioner contended that the arrangements between the parties constituted a transaction, scheme or operation that avoided tax impermissibly and could be challenged in terms of section 103(1) of the Act.¹⁹⁴

In the judgment, Lewis JA correctly noted that the section being relied on had, in fact, been repealed by the anti-avoidance provisions in sections 80A – 80L of the Act.¹⁹⁵ These provisions apply to all the transactions entered into on or after 2 November 2006, but as these transactions occurred between 1999 and 2003, the Commissioner correctly relied on section 103(1) of the Act.

Lewis JA indicated that where a court is content that a transaction has been entered into, which has the consequence of circumventing or plummeting liability for tax and would not typically be active for bona fide business purposes, the Commissioner shall govern accountability for tax as if the transaction has not been entered into.¹⁹⁶

Assuming that the ‘new rule’ regarding commercial substance would be applied going forward, one must ask what would be the need for the statutory anti-avoidance provisions, which empower the Commissioner to attack a transaction that has, as its

¹⁹⁴ In light of the fact that the court found in favour of the Commissioner, on the basis that the transactions were simulated, there was no need for the court to further analyse, in detail, whether a s103 (1) of the Act could have been applied; however, same was briefly touched on, as set out above.

¹⁹⁵ As inserted by section 34(1) of the Revenue Law Amendment Act 20 of 2006.

¹⁹⁶ *NWK supra* note 91 at 91.

sole or core persistence, the avoidance or reduction of tax liability.¹⁹⁷ Given the vastly different consequences, which would arise should a transaction be simulated versus the consequences, which would ensue if the transaction fell foul of the statutory general anti-avoidance provisions,¹⁹⁸ Broomberg notes that it would be utterly undesirable should substantially the same test be applied in both scenarios.¹⁹⁹ In essence, the 'new rule' regarding commercial substance would broaden the scope of the doctrine to such an extent that it would be comparable to a judicially created GAAR.

Consequently, an analysis is necessary to determine the interaction between these provisions and the common law test for simulation as advanced in the *Commissioner of South African Services v NWK Limited* case.

2. ANALYSIS OF THE GAAR

A final argument against the future independent application of the *Commissioner of South African Services v NWK Limited* commercial requirement is that it cannot co-exist with the provisions of the GAAR by the conflation of these respective deterrents to tax avoidance and the undesired consequences which would ensue from it. Moreover, by conflating the test for simulation under the common with a statutory provision which is aimed at combating the same mischief, the constitutional doctrine of separation of powers appears to be infringed which is potentially detrimental to the functions of the legislator and impacts on the independence of the judiciary.

Although an argument premised turns more on the correctness of the approach suggested by the SCA to simulated transactions than the enquiry whether the requirement is independent or not, it is a logical consequence that the *Commissioner of South African Services v NWK Limited* commercial requirement cannot function as a test for simulation if its introduction was bad in law and incorrect. It is for this reason that a discussion hereof is warranted.

¹⁹⁷ Broomberg op cit note 146 at 20.

¹⁹⁸ Section 80B of the Act provides that, in the case of an impermissible avoidance arrangement, the Commissioner may govern the tax consequently by, inter alia, disregard or characterising any steps in or parts of the impermissible avoidance arrangement; characterise any gross income, receipt or accrual of a capital nature or expenditure or treat the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.

¹⁹⁹ Broomberg op cit note 146 at 28.

Failing the applicability of the common law principles on simulated transactions, a secondary deterrent against a transaction through which tax was avoided contained in section 80A to 80L of the Income Tax Act.²⁰⁰ In essence, the statutory GAAR provides that an arrangement through which a tax benefit was derived may attract fiscal consequences, inter alia, as if the transaction had not been entered into between the respective parties.²⁰¹ This relief is only available if the sole or main purpose of the arrangement was for either of the parties to obtain a tax benefit and the arrangement lacked normality, lacked commercial substance, created rights and obligations which would not ordinarily have been created or resulted in an abuse of the provisions of the Act.²⁰² The lack of commercial substance is therefore only one of the so-called 'tainted elements'²⁰³ which must be present along the sole or main purpose of the parties with the transaction to obtain a tax benefit.²⁰⁴

If the coupling between the sole or main purpose requirement and at least one of the tainted elements is absent, the jurisdictional requirements for the invocation of the GAAR will not have been met and the relief provided for under section 80B will not be at SARS' disposal.²⁰⁵ It is therefore to be inferred that the legislator simply did not envisage the lack of commercial substance as capable of being an independent requirement through which avoidance could be combated.

The commercial requirement envisages that any transaction through which a tax benefit is derived will be regarded as simulated if it lacks commercial substance, in which event economic consequences may be applied by regarding the transaction in the same manner as envisaged in section 80B (1) (f) – the actual rights created through the transaction may be regarded as a fiscal nullity. The test postulated by the respective deterrents are almost identical, save for the *Commissioner, South African Revenue Services v NWK Limited* approach to simulation only requiring that a court needs to be satisfied that the transaction lacked commercial substance without having to consider what the intention with the transaction was. It is therefore correctly submitted that the SCA conflated the tests to determine simulation with the

²⁰⁰ Income Tax Act 58 of 1962.

²⁰¹ Section 80B (1)(f).

²⁰² Section 80L (definitions), read with section 80B (consequence) and sections 80A (impermissible tax avoidance arrangements).

²⁰³ Section 80A (a), (b) and (c).

²⁰⁴ De Koker op cit note 16 at 19;35.

²⁰⁵ Ibid.

test envisaged in the GAAR, which is evident from the requirements and consequences of the respective deterrents.²⁰⁶

The immediate problem created by conflating these deterrents is that the decree of the legislator of the requisite coupling between the purpose of the transaction and the tainted elements is rendered redundant through the simplification of the test for simulation by the SCA.²⁰⁷ This conflation created between the concepts renders the requirement susceptible to attack premised on constitutional principles, in particular through the encroachment by the judiciary on the designated functions of the legislative authority. The question which therefore follows is whether the SCA adhered to the doctrine of separation of powers?

In order to prevent excessive governmental powers manifesting in a single body of the state, the doctrine of separation of powers between the executive authority, the legislative authority and the judiciary is recognised in our law and entrenched in the Constitution.²⁰⁸ The doctrine entails that the courts are empowered with the judicial authority and must be independent, subject only to the Constitution and the law, and that it is tasked to perform its functions impartially, without fear, favour or prejudice.²⁰⁹ On the other hand, the legislative authority vests in Parliament²¹⁰ and is tasked with the function of passing legislation. In order for the judiciary to maintain its status as an independent adjudicator of disputes, it is necessary for each of the varying spheres of government to respect this distinction which by implication entails that the judiciary should not embark on the course of law making,²¹¹ nor should it render statutory provisions superfluous contrary to the expressed intention of the legislature, unless the statute stands in conflict with the Constitution.²¹²

It is submitted that the SCA ventured into the domain of the legislative authority by disregarding the legislator's construction of the limits within a court, thus deeming

²⁰⁶ Ger op cit 170 at 62.

²⁰⁷ Vorster op cit note 18 at 84; see also De Koker op cit note 16 at 19;35 in which the author stated that the *NWK* requirement is a duplication of the criteria envisaged in the GAAR, with the only difference its purported independence.

²⁰⁸ Bekink *Principles of South African Constitutional Law* (2007) 4; see ss 43, 85 and 165 of The Constitution of the Republic of South Africa, 1996.

²⁰⁹ Section 165(2) of the Constitution.

²¹⁰ Section 44(1) of the Constitution.

²¹¹ See for example *Coetzee v Government of the Republic of South Africa* 1995 (4) SA 631 (CC) as referred to in *Bekink* op cit note 208.

²¹² Bekink op cit note 208 at 42, submits that the separation is not an absolute separation, especially because of the system of checks-and-balances through which a court is tasked, for example, to review the exercise of powers of the other spheres.

the rights and obligations a nullity. The SCA rendered the GAAR obsolete²¹³ and effectively usurped the functions of the legislature by affording the judiciary a non-statutory power to disregard actual rights and obligations created by the parties to a transaction. The doctrine of separation of powers was therefore not properly observed and adhered to by the SCA, which places a big question mark on the correctness of the SCA's introduction of the commercial substance requirement.²¹⁴

Firstly, Broomberg²¹⁵ submits that it is highly undesirable that a similar test should be applied under both the common law and statutory deterrents to tax avoidance. He contends that unfair discrimination will necessarily ensue where substantially the same test is applied to determine the tax consequences of a transaction under either of the deterrents, especially because different assessors will invariably apply the deterrents unevenly, thereby resulting in differential tax treatment of taxpayers in similar circumstances. It is difficult to argue with Broomberg's logic on this issue. The consequences of invoking common law principles to disregard a concealed transaction differs from the consequences envisaged in the GAAR, albeit slightly. To have substantially the same requirements in order to obtain relief under either of the deterrents is therefore simply not tenable, as SARS would become entitled to elect relief under the common law or statute, depending on what would suit it best. This would not only be a harsh and unfair consequence but would suit it best. This would not only be a harsh and unfair consequence, but invariably taxpayer equality would be neglected through the differential treatment by the fiscus.

Secondly, the observation by the court in *CIR v King*²¹⁶ that it is unthinkable that a singular criterion of a tax avoidance purpose could render a transaction a nullity, as required by the old GAAR,²¹⁷ is of relevance. Where a transaction completely lacks commercial substance, the purpose of the transaction would invariably be to avoid the imposition of a potential tax liability.²¹⁸ As a result of the court's strict interpretation of the old GAAR, the legislator reviewed the provisions and eventually formulated it into the present GAAR. However, *Commissioner, South African*

²¹³ De Koker op cit note 16 at 19.2; see also Broomberg op cit note 12 at 200.

²¹⁴ Broomberg op cit note 12 at 206.

²¹⁵ Ibid 201.

²¹⁶ *CIR v King* 1947 (2) ALL SA 155 (A).

²¹⁷ Section 90 of the Income Tax Act 31 of 1941, postulated that the tax consequences of a transaction may be determined as if such transaction had not been entered into if the purpose with the transaction was to avoid the imposition of tax

²¹⁸ Broomberg op cit note 12 at 206.

Revenue Services v NWK Limited seemingly returns to the positions postulated in the old GAAR by re-introducing essentially the same independent requirement. The objections which it raised in *CIR v King* case may therefore very well be relied on again by taxpayers when they are faced with assessments premised on the *Commissioner of South African Services v NWK Limited* decision.²¹⁹ Moreover, the view that the SCA ventured into the sphere of the legislator by effectively re-introducing an outdated and abolished legislative requirement affirmed.

In concluding, the doctrine of separation of powers is essential to avoid an overconcentration of powers in any single organ of state. It especially requires that the respective authorities should not lightly venture into the sphere of one another. To uphold the principles embodied in this doctrine is of immense importance to respect the independence of each of the authorities and to protect individuals against the arbitrary application of state powers.

The SCA, however, usurped the functions of the legislature for the reasons already advance herein. On this basis alone, the correctness of the *Commissioner, South African Revenue Services v NWK Limited* decision is questionable and casts doubt on whether the commercial substance requirement is capable of independent operation, or at all. Even if the doctrine of separation of powers had been properly observed, the conflation of the respective deterrents against tax avoidance and the consequences which it would ensue from it is simply not tenable. Whereas the established principles pertaining to simulated transaction were capable of co-existence with the statutory GAAR, it is submitted that the principle enunciated in *Commissioner, South African Revenue Services v NWK Limited* is not. The only inference to be drawn from this is that the commercial requirement cannot be regarded as an independent criterion to determine simulation.

3. CONCLUSION

The *Commissioner of South African Services v NWK Limited* commercial requirement has been widely criticised for the undesired consequences and impracticalities it would occasion if it were to be regarded as an independent

²¹⁹ Ibid.

criterion to determine simulation. Admittedly, much of this criticism is attributable to the callousness of the SCA's introduction of a new test for simulation, rather than considering it against defensible legal principles in order to establish its true effect and potential independence. The defensible arguments raised in this chapter support the view that the commercial substance requirement is incapable of application as the sole criterion to determine simulation, as not only does it disregard the established law of simulated transaction and important constitutional principles, it also lacks a common law rule to give it any potential effect and it negated the test postulated in the GAAR. It is therefore submitted that the commercial substance requirement does not establish a satisfactory requirement if applied in isolation and cannot be regarded as the independent criterion to establish simulation.

CHAPTER FIVE

JUDICIAL CLARITY ON THE SUBSTANCE OVER FORM DOCTRINE AFTER *COMMISSIONER, SOUTH AFRICAN REVENUE SERVICES v NWK LIMITED*

1. INTRODUCTION

Amongst all the confusion and discussion regarding the true meaning, and resulting consequences, of the judgment handed down in the *Commissioner of South African Services v NWK Limited* case, the tax community, and apparently the legal fraternity, welcomed the clarification bought about initially by *Commissioner, South African Revenue Services v Bosch*²²⁰ case and finally in the case of *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC & others*.²²¹ This clarification was most necessary, particularly since the court in the *NWK* case deviated substantially from existing principles regarding the determination of simulation and in doing so, introduced an additional element, namely that of 'commercial substance'. Having considered the interplay between the revised principles of the doctrine, as contemplated in the *NWK*

²²⁰ *Commissioner, South African Revenue Services v Bosch* (2014) ZASCA 171.

²²¹ *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC & others* (2014) 2 All SA 654 (SCA).

judgment, and the test for an impermissible tax avoidance arrangement in terms of the GAAR, it would not appear as though one would be able to justify the development of the existing principles of the doctrine to validate the ostensible revision.

2. ANALYSIS OF *COMMISSIONER, SOUTH AFRICAN REVENUE SERVICES v BOSCH* (2014) ZASCA 171.

The Appellants were workers of the Foschini group of companies and participants in an employee's share incentive scheme run by that group. The appellants were assessed by SARS for income tax in respect of the share received in respect of the scheme.

The type of scheme was what is referred to as a 'deferred delivery scheme'. What this means is that they have to exercise within 21 days. Once the option to purchase was exercised, delivery and payment in respect of shares were delayed and would take place in three tranches,²²² each two years' apart, certain restrictions had been placed.²²³

The risk and reimbursements did not pass to the employees until delivery and payment in full for the shares. Furthermore, the employees were also indebted to vend their shares back to the employer for the same contemplation payable on delivery if they ended their services for any reason other than sequestration, death, retirement or ill health. SARS raised the arguments that the scheme was a simulated transaction and that there was 'no real unconditional' sale at the time of the exercise of the option, but that the parties intended that the sale be subject to the suspensive condition that 'the employees remain employed' until the date of delivery and payment. SARS relied on Lewis JA's dictum in *Commissioner, South African Revenue Services v NWK Limited*, where it was stated:

'If the purpose of the transaction is only to achieve an object that allows the evasion of tax...then it will be regarded as simulated.'²²⁴

²²² *Bosch* supra note 221.

²²³ Employees could not dispose of or encumber the share; employees were not entitled to dividends; no voting rights attached to the share.

²²⁴ *NWK* supra note 9 at 55.

The court then took the opportunity to analyse the *Commissioner, South African Revenue Services v NWK Limited* judgement. The court was faced with pure simulated transactions as exemplified by the facts. The parties had not formed genuine rights and obligations but simulated a loan that was for a larger amount than it was, only to allow the taxpayer to get a tax benefit.

In delivering the main judgment, Davis J (Baartman J concurring), seized the opportunity to examine the judgment in the *Commissioner, South African Revenue Services v NWK Limited* case, as the finding therein informed the basis of the Commissioner's argument at present. Davis J indicated that in his view and having had regard to the facts of the case, the SCA was clearly presented with several simulated transactions in the *Commissioner of South African Services v NWK Limited* case. As regards the judgment by Lewis JA, Davis J was not of the view that Lewis JA intended to alter the existing principles of the doctrine.²²⁵

In his view, Davis J stated that the judgment handed down in the *Commissioner of South African Services v NWK Limited* case, and in particular paragraph 55 thereof, must be read within the context of previous judgments regarding the doctrine, such as *Commissioner for Customs & Excise v Randles, Brothers & Hudson Ltd*, *Zandberg v Van Zyl and Erf 3138/ Ladysmith (Pty) Ltd v Commissioner for Inland Revenue*.²²⁶ Essentially, he was of the opinion that the judgment in the *Commissioner, South African Revenue Services v NWK Limited* case and the existing case law on the matter, ought to be read as a whole, rather than interpreting the former in such a manner so as to deviate from the existing jurisprudence.²²⁷

The interpretation put forth by Davis J, as regards the test for simulation considering the judgment in the *Commissioner of South African Services v NWK Limited* case, is that an examination of commercial rationale of a transaction is required,²²⁸ meaning that where a transaction purports to have, as a basis, commercial rationale, yet no such rationale can be established and the single reason for the transaction is to

²²⁵ *Bosch* supra note 221 at 78 '[beyond this finding, there is nothing the careful judgment of Lewis JA which supports the argument that the reasoning as employed in *NWK* supra note 9 above, as intended to alter the settled principles developed over more than a century regarding the determination of a simulated transaction for the purpose of tax.'

²²⁶ See discussion detailed in chapter two.

²²⁷ *Bosch* supra note 221 at 84. Davis J states that '...without an express declaration to that effect, *NWK* should be interpreted to fit within a century of established principle, rather than constituting a dramatic rupture.'

²²⁸ Louw 'High court interprets *NWK* judgment' *DLA Cliffe Dekker Hofmeyr. Tax Alert* (2012) 2.

avoid incurring a tax liability, then the approach adopted by Lewis JA would be defensible.²²⁹

Holding quite the contrary view, Waglay J, writing the dissenting judgment, stated that the SCA did drastically depart from the existing jurisprudence on simulated transaction.²³⁰ Waglay J states:

‘NWK, considered in its entirety, not by extraction of words and phrases out of their real context, does in fact lay down the rule that any transaction that has as its aim tax avoidance will be regarded as simulated transaction irrespective of the fact that the transaction is for all purposes a genuine transaction.’

Notwithstanding, Waglay’s interpretation of the judgment as stated above, he goes on to set out the requirements that are to be met for a precedent to be created, namely that the judgment must be ‘clear and unequivocal, it must be applicable to the facts in the matter before the court confronted with its possible application’.²³¹ In his view, the judgment in the *NWK* case did not expressly depart from previous binding judgments, nor was this intention evident from the reasoning set out therein.

²³²

In addition, Waglay J pointed out the SCA’s confusion regarding the distinct concepts of ‘tax avoidance’ and ‘tax evasion’ and notes that the decision cannot serve as being the authority on the matter of simulated transactions, should the purpose of the transaction be tax evasion as opposed to tax avoidance, the latter being a criminal offence thus resulting in the transaction in question being set aside due to illegality.²³³ For these reasons, Waglay J held the view that the judgment cannot be used as binding precedent on lower courts.

3. ANALYSIS OF *ROSHCON (PTY) LTD v ANCHOR AUTO BODY BUILDERS CC & OTHERS* (2014) 2 ALL SA 654 (SCA).

Despite the attempts by the High Court in *Bosch v Commissioner for the South*

²²⁹ *Bosch* supra note 221 at 86.

²³⁰ *Bosch* supra note 221 at 4.

²³¹ *Bosch* supra note 221 at 7.

²³² Davis J also referred to Broomberg’s analysis of the *Commissioner, South African Revenue Services v NWK* case.

²³³ Louw op cit note 228.

African Revenue Service to settle the controversy arising as a result of the judgment in *NWK* case, a degree of misunderstanding continued. The debate sparked by the *NWK* case was finally put to rest in the SCA judgment of *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC*.

Roshcon (Pty) Ltd was approved a contract in early September 2008, which entailed it to acquire five trucks which were to be tailored with specialized cranes to alter the trucks to suit the specific project. Roshcon ordered the five trucks from Toit's. Toit's in turn ordered the trucks from Nissan Diesel. This transaction was financed by Wesbank. Nissan Diesel supplied the vehicles under a 'supplier agreement' it had concluded with Wesbank in terms of which it sold and Wesbank purchased and paid for the vehicles that authorised Nissan dealers, such as Toit's, wanted for their customers. Toit's had a separate 'floor plan agreement' with Wesbank in terms of which Wesbank provided finance to Toit's for the purchase of motor vehicles. The vehicles acquired by Wesbank from Nissan Diesel would be delivered directly to Toit's or to such person as Toit's may from time to time direct.²³⁴

The five trucks were delivered to Anchor on Toit's' instructions to have modifications undertaken to the sub-frames and load bodies to enable cranes to be fitted to the trucks. On 19 November 2008 two trucks were delivered to Roshcon having been modified. The other three trucks would be delivered on 21 November 2008. A delivery sheet for the two trucks was signed by the representatives of Roshcon and Anchor. On 21 November 2008, Roshcon took delivery of the remaining three trucks, though it did not physically remove them, but only signed the handover sheet. There was seemingly a technical misunderstanding which required the trucks to be improved further, in that the beam supports for the cranes would not fit in the trucks as modified, so that they would require further alteration. This resulted in a further delay in the payment process by Roshcon to Toit's.²³⁵

On 28 November 2008 the credentials constituting proof of delivery, was handed over to Roshcon and Roshcon established payment with Anchor for the modifications; however, by this time, Toit's had commenced with liquidation

²³⁴ *Roshcon* supra note 222 at 9.

²³⁵ *Roshcon* supra note 222.

proceedings and, on instruction from Wesbank, Anchor did not release the trucks, as it claimed ownership of the trucks as Toit's had not yet paid for them.²³⁶

Several months later, Anchor released the trucks to Wesbank, which sold two of the vehicles to Unitransa Supply Chain Solution Proprietary Limited. Roshcon held that the supply and floor plan agreements amounted to a disguise or simulation. According to Wesbank, the onus of proving in respect of a simulated agreement rested with the party alleging simulation (i.e. Roshcon) and in this case at hand, Roshcon failed to discharge the onus.²³⁷

4. FINDINGS OF THE SCA

In a separate judgment, which the full Court concurred, Wallis JA took the opportunity to provide welcome clarification in respect of the judgment in the *Commissioner of South African Services v NWK Limited* case. As a point of first departure, Wallis JA confirmed that the foundation of South African law, regarded simulation, is contained in the statement made by Innes J in the *Zandberg v Van Zyl* case, namely that in determining whether a transaction is simulated, the court must have regard to the real intention of the parties and subsequently determine whether such intention differs from the intention created by their agreement.

After briefly going to discuss the principles established in existing jurisprudence regarding simulation, Wallis JA went on to say that 'nothing said subsequently in any of the judgments of this court dealing with simulated transactions alters original principles in any way or purports to do so'.

Wallis JA emphasised the fact that it would be fundamentally incorrect to attach such an interpretation to the judgment in the *Commissioner, South African Revenue Services v NWK Limited* case to suggest that any transaction,²³⁸ which has the

²³⁶ *Roshcon* supra note 222 at 11.

²³⁷ *Roshcon* supra note 222 at 18.

²³⁸ In his judgment, Wallis JA states with particular reference to paragraph 55 of the judgment delivered by Lewis JS in the *Commissioner, South African Revenue Services v NWK Limited* case, that people have misunderstood the judgment and in particular the statement that 'if the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated' to mean that all contractual arrangements that enable the parties to

avoidance of a tax liability as its sole purpose, is a simulated transaction. Doing so would mean that the interpreter failed to read the judgment in the correct context²³⁹ and would further result in mass condemnation of several suites of transactions, merely since such transactions have the avoidance of a tax liability as their sole purpose.

The SCA's position, as delivered by Wallis JA, regarding the test for simulation is:

'... the notion that NWK transforms our law in relation to simulated transactions or requires more of a court faced with a contention that a transaction is simulated than a careful analysis of all matters surrounding the transaction, including its commercial purpose, if any is incorrect.'

5. CONCLUSION

It is indeed noteworthy that even honourable and experienced judges, having regard to the majority and dissenting judgments in the *Commissioner, South African Revenue Services v Bosch* case differ in their interpretation of the judgment handed down by Lewis JA in the *Commissioner, South African Revenue Services v NWK Limited* case and this illustrates how vitally important clarification regarding the meaning thereof was.

Should the enquiry as per the *Commissioner, South African Revenue Services v NWK Limited* case have prevailed, it would have been an enormous deviation from the established principles forming part of the doctrine, which has been considered and applied in a plethora of different cases. In other words, one can determine conclusively that the court in the *Commissioner, South African Revenue Services v NWK Limited* case did not expand the existing doctrine, but rather sought to revise the traditional understanding of common law principles encompassed in the doctrine. The revision of the doctrine as contemplated in the *Commissioner, South African Revenue Services v NWK Limited* case, would have rendered the doctrine an anti-tax avoidance measure rather than a general doctrine against simulated transactions.

avoid tax will be seen as being simulated. That was not Lewis JA's intention.

²³⁹ Louw op cit note 228 at 3.

Despite those who showed support for the judgment in the *Commissioner, South African Revenue Services v NWK Limited* clarity, the clarity brought about by the *Commissioner, South African Revenue Services v Bosch and Roshcon (Pty) Ltd v Anchor Auto Body Builders CC & others* case, the judiciary can now accept that there are no deviations from the established principles forming part of the doctrine and indeed an enquiry as to simulation will place emphasis on the manner in which the parties to a transaction intend to implement such transaction. In other words, the uncertainty and inconsistencies brought about as a result of the *Commissioner, South African Revenue Services v NWK Limited* case have indeed been relegated to history and the traditional approach to simulation, as set out in the previous cases stand.

CHAPTER SIX

CONCLUSION

1. CONCLUDING REMARKS

As discussed above, the doctrine has been applied to simulated transactions, in general, for over a century and has been repeatedly considered and affirmed by South African courts. By having regard to the three crucial judgments of the SCA, namely the *Zandberg v Van Zyl*, the *Commissioner of Customs & Excise v Randles, Brothers & Hudson Ltd* and the *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* case, it is clear that, in determining whether a transaction is simulated or not, the courts will consider the intention of the parties and, depending on the nature of such intention, possibly further investigate whether such intention has been given effect to. Prior to the SCA judgment in the *Commissioner, South African Revenue Services v NWK Limited*, the courts did not deem it necessary to have regard to the commercial substance of the transaction. Rather, our courts have reiterated that where the parties to a transaction 'legitimately and honestly' intend for such a transaction to be given in accordance with the nature and meaning thereof, then the courts will give effect to the transaction in accordance thereto. One may conclude that emphasis is to be placed on the intention of the parties of a transaction and thus a test as to such parties' intention is required.

In light of the analysis undertaken above, it is apparent that many authors, including Broomberg, held the view, as does the author of this study, that the SCA judgment in the *Commissioner of South African Services v NWK Limited* case ought to revise the enquiry as to whether a transaction is simulated or not, by requiring focus to be placed on the transaction itself rather than having regard to the intention of the parties.

Should this interpretation and ostensible 'new rule' have been given effect, the requirements for simulation under the common law and the test for an impermissible tax avoidance arrangement of the GAAR would have been substantially the same. Importantly, taking into consideration that such a scenario would be addressing the same mischief, and given the different consequences that would apply in each scenario, the Commissioner would possibly have the discretion to choose which route to follow and such a broad discretion would circumvent the limitation of the Commissioner's powers in terms of the GAAR.

The decision in *Commissioner of South African Services v NWK Limited* arguably

lost sight of the point made by previous judgments, as mentioned throughout this discussion.

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