

# Modernising the ‘Substance over Form’ Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*

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## 1 Introduction

Taxpayers are entitled to arrange their affairs so as to remain outside the provisions of taxing statutes. However, an attempt that harbours dishonesty can always be challenged by the tax authorities, and the courts will not be deceived by the form of such a transaction. They can examine the true nature of the transaction and attach adequate tax implications to it (*WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300; 11 ATR 752; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530; *Commissioner of Inland Revenue v Saner* 1927 TPD 162; *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369; *Secretary for Inland Revenue v Hartzenberg* 1966 (1) SA 405 (A)). This is the essence of the doctrine of substance over form (‘the doctrine’).

The doctrine is based on a principle that Innes CJ expressed in *Dadoo* (supra at 547) as a ‘branch of the fundamental doctrine that the law regards the substance rather than the form of things – a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur*’. This principle forms an important part of South African law (see *SA Pulp and Paper Industries Ltd v Commissioner for Inland Revenue* 1955 (1) SA 8 (T); *Du Plessis v Joubert* 1968 (1) SA 585 (A); *Bozzone and Others v Secretary for Inland Revenue* 1975 (4) SA 579 (A)). On the adoption of the substance-over-form principle in South Africa, see AG Derksen ‘Should the South African Courts Adopt the English Anti-Tax-Avoidance Rule in *Furniss v. Dawson?*’ (1990) 107 *SALJ* 416; ‘Margo Commission of Inquiry into Certain Aspects of the Tax Structure in South Africa’ (1986) Chapter 27; and ‘The Report of the Katz Commission into Tax Reform’ Chapter 11 (available at <http://www.polity.org.za/polity/govdocs/commissions/katztoc.html>, visited on 10 December 2011).

Traditionally, the doctrine entailed two elements: the label principle and the simulation principle (P Surtees & S Millard ‘Substance, Form and Tax Avoidance’ November/December 2004 *Accountancy SA* 14). Under the first, parties attach a wrong label to a transaction but act in good faith and intend to give effect to the transaction. Under the second, they enter into a sham transaction or a transaction that is in fraudem legis (at 15; see also T Emslie et al *Income Tax: Cases and Materials* 3 ed (2001) at 896–7). The latter type of

transaction is designedly disguised to escape the tax statute while actually falling within its provisions (*Dadoo Ltd v Krugersdorp Municipal Council* supra at 547).

## 2 Case-Law Background

Many South African cases developed the doctrine over more than a century. In 1910 the Appellate Division in *Zandberg v Van Zyl* (1910 AD 302) laid the basis of the doctrine, Innes J ruling as follows (at 309):

‘Not frequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be.’

Just over thirty years later the same Court elaborated in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* (supra at 395–6 (emphasis supplied)) that

‘[a] transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, *if the parties honestly intend it to have effect according to its tenor, is interpreted by the Court according to its tenor*, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax’.

Prior to *Commissioner for the South African Revenue Service v NWK Ltd* (2011 (2) SA 67 (SCA); (2010) 73 SATC 55 (‘NWK’)), the leading case on the doctrine was *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996 (3) SA 942 (A) (‘Ladysmith’)). There the Court held that the anomalous features of certain agreements of lease and sublease were consistent with a wider, unexpressed agreement or tacit understanding. The taxpayer did not prove on a balance of probabilities that the written agreements reflected the parties’ real intention.

The Cape Provincial Division in *Commissioner for the South African Revenue Service v Cape Consumers (Pty) Ltd* (1999 (4) SA 1213 (C)) refused to ignore contracts because the parties in fact and in law intended to give effect to the agreement in question. The Court said (at 1224H-I): ‘The doctrine of the disguised transaction is not a panacea for appellant to ignore agreements where the parties in fact and in law intend that they must be given their legal effect.’

On these criteria, therefore, it was understood and repeatedly held that a transaction cannot be said to be simulated or disguised if the parties intend to give effect to the transaction ‘according to its tenor’; that is to say, in accordance with the provisions of their agreement as expressed by the parties.

### 3 *Commissioner for the South African Revenue Service v NWK Ltd*

#### 3.1 Facts

Slab Trading Company (Pty) Ltd ('Slab'), a subsidiary of First National Bank ('FNB'), was a company that dealt in financial instruments. Slab lent NWK R96 415 776 to be repaid over five years. The capital amount would be repaid by NWK by delivering 109 315 tons of maize to Slab at the end of the five-year period. It was agreed that the interest would be payable on the capital sum at a fixed rate of 15.41 per cent per annum, payable every six months. To this end NWK issued ten promissory notes with a total amount of interest amounting to R74 686 861. To fund the loan, Slab discounted the notes to FNB. Put differently, Slab sold the promissory notes to FNB for an amount less than their face value. NWK would pay FNB on the due date.

Slab sold its rights to take delivery of the maize at the end of the five-year period to First Derivatives, a division of FNB, for the sum of R45 815 776. This forward sale placed FNB in a liquid position to pay the full amount of the loan to NWK. NWK purchased from First Derivatives the right to take delivery of the same quantity of maize for the sum of R46 415 776, payable immediately on the conclusion of the contract, but delivery to take place only five years thereafter. This contract would neutralise the risks associated with delivery in the future. Slab would cede its rights to a trust company to relieve Slab of the 'administrative burden' of the transaction. The latter part of the transaction never took place.

It should be noted (as the Court also did) that before the transactions were concluded, the parties held several meetings to discuss the structure of the transaction. On one occasion Mr Barnard, the NWK financial director, questioned aspects of the proposal, in particular the tax implications. In response FNB sent him an opinion written by senior counsel who had previously commented on similar transactions. Counsel stated his opinion that the transactions described were tax efficient. However, he did caution, in spite of having been advised that the transactions were normal, that there was always the possibility that the Commissioner for the South African Revenue Service ('the Commissioner') might apply the anti-avoidance measures contained in s 103(1) of the Income Tax Act 58 of 1962 ('the Act') to the transactions. Counsel also stated that the transactions might not be regarded as having bona fide business purposes.

After counsel's opinion had been taken, a proposal was sent to NWK, expressly indicating that the series of transactions would enable NWK to deduct the interest paid on the capital sum in the year it was payable under s 11(a) of the Act.

#### 3.2 The Commissioner's Main Arguments

The Commissioner's main argument was that the agreements concluded between NWK and FNB and its subsidiary, Slab, did not reflect the substance

of the real transaction. The Commissioner considered that the transactions were specifically designed to disguise and conceal the fact that the transaction, although ostensibly for a loan amount of R96 415 776, was really a loan of R50 million to NWK by FNB. The additional amount was simulated with a series of purported maize sales which the parties never intended to have any effect.

The Commissioner contended that Slab was interposed as a party solely for reducing or evading liability for income tax. Slab had no real role to play, and its participation was artificially engineered and specifically designed to conceal the fact that the true loan amount was the sum of R50m. Slab's sole purpose was therefore to facilitate the enhanced deduction claimed by NWK in terms of s 11(a) of the Act (par 30).

As for the loan, the Commissioner also noted that the promissory notes covered both the capital and interest. Thus the portion of the notes that constituted repayment of capital was not deductible as interest in terms of s 11(a) of the Act and was also not expended in the course of trade (par 32). The effect of the forward sales and the cessions was that the same maize that NWK would use to discharge its obligation to repay Slab was sold by FNB to NWK (par 26).

In support of this argument, the Commissioner contended that the loan was a 'mere paper exercise and/or simulation' (par 27). Five reasons were given. None of the parties intended to trade in maize before or after the transactions were entered into. The value of the maize at the time of delivery was uncertain. The purchase price for the maize was based on a fictitious value and determined without reference to the value of the maize on the date of conclusion of the contracts (par 27). The risks associated with delivery of maize five years after the conclusion of the sales were great: the market was volatile, yet the parties took no account of the volatility of arrangements for storage after harvest, or the costs of storage or transport. Finally, the description of the maize in all the agreements was inadequate and the grade of the maize was not stipulated although it would materially affect its market value (par 28).

In the alternative, the Commissioner also raised the anti-avoidance mechanism of s 103(1) of the Act. He argued that the series of transactions constituted a transaction, operation or scheme that had the effect of avoiding or reducing NWK's liability for tax, and that the transactions were abnormal and entered into solely or mainly for obtaining a tax benefit (par 33).

### 3.3 NWK's Main Arguments

In reply, NWK contended that the contracts concluded between the parties were performed in accordance with their terms. Five reasons were given. NWK received the amount of R96 million in terms of the loan agreement, and delivered the promissory notes to Slab. NWK paid the price of the maize to First Derivatives in terms of the forward sale agreement. NWK was not party

to the agreements between Slab and FNB. The terms of the loan reflected the intention of NWK and were performed in accordance with their tenor. Finally, there was no tacit understanding or unexpressed agreement on the part of NWK that was not recorded in the contracts to which it was party (par 35).

As regards s 103(1) of the Act, NWK denied that the contracts had the effect of avoiding or postponing liability for tax: they were concluded solely or mainly for securing loan finance. NWK also contended that its tax returns over the years of assessment relating to the contracts in question contained full and accurate information (par 36). NWK further argued that 'if the Commissioner had been satisfied that the loan was simulated and did not have a tax avoidance or reduction effect, he could not, even in the alternative, be satisfied that the transaction was one that had a tax avoidance effect' (par 92). Satisfaction, it was argued, 'is a subjective jurisdictional fact'. The core contention was that the Commissioner could not be satisfied on two apparently conflicting grounds (*ibid*).

### 3.4 The Tax Court's Decision

The Tax Court found in favour of NWK on the basis that it was clear that NWK and FNB at all times intended to fulfil all the contractual terms agreed upon. In other words, this Court seemed less concerned with the actual content and subject-matter of the agreements and focused instead purely on whether the parties in fact carried out what was agreed. Clearly, the Court followed the *Ladysmith* decision on the standard of simulation required to taint the transaction.

### 3.5 The Decision of the Supreme Court of Appeal

Lewis JA giving the judgment of the Court acknowledged the previous relevant decisions but heavily relied on, and substantially quoted, the one in *Ladysmith*.

She asked pertinent questions that the Tax Court did not address, noting that the Tax Court accepted the contracts in issue at face value without questioning their purpose:

- What was the real purpose of the present loan?
- Did it have any commercial substance or make business sense (par 57)?
- Was there any purpose or commercial sense – other than creating a tax advantage to NWK – for the loan by Slab to NWK to be structured as it was?
- Was there any genuine intention to deliver maize to Slab or a cessionary (par 58)?
- Why were two loans agreed on the same day?
- Why was there an agreement to borrow R96 415 776 when NWK did not need it (par 59)?

The Court found that the loan amount was obviously calculated with reference to a factor that did not relate to the amount needed by NWK. The

loan sum was established by taking the interest payable and calculating what capital sum was needed to generate that interest at the rate agreed (par 65).

To determine whether the loan and other transactions were simulated, the appropriate question was whether there was a real and sensible commercial purpose in the transaction other than the opportunity to claim deductions of interest from income tax on a capital amount greater than R50m. The Court could not find any sensible commercial purpose in the transaction. It concluded that what NWK really wished to achieve was a tax advantage, asking: ‘What else could it, or did it, achieve through the transactions in respect of the maize?’ (para 82).

The crux of the decision was stated by Lewis JA as follows (par 55):

‘In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. 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. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.’

Alluding to the circumstances before and during the conclusion of the contracts, the judge continued (par 87):

‘The FNB proposal itself, the transactions concluded between NWK and Slab, and Slab and FNB, with their peculiar features, and Barnard’s inability to give any credible explanation of aspects of the transactions show, I consider, that NWK could not have believed, and did not in fact believe, that the loan was for the sum of R96 415 776. The contract was dressed up in order to create an obligation to pay interest, and consequently a right to claim a tax deduction to which NWK was not entitled. NWK deliberately disguised the true nature of the loan for this purpose. It did not intend, genuinely, to borrow a sum approximating the one it purported to borrow.’

After examining the facts in detail, the judge found that the loan transaction was simulated, for seven reasons:

- the sale of maize by NWK to FNB was dressed up as a loan;
- NWK and FNB concluded two loan contracts on the same day, one for R50 million and the other for R96 million;
- virtually the same amount in excess of what NWK required (R46 million) was paid by FNB to NWK and repaid by NWK to FNB;
- the amount lent was determined by reference not to what was needed but to a capital sum needed to generate a particular sum of interest;
- the maize was vaguely described;
- Slab was afforded no security for repayment of the loan; and
- NWK knew, when the loan was concluded, that Slab would sell FNB both the promissory notes at a discount and its right to delivery of the maize, all on the same day: Slab’s role in the transactions was momentary.

There was never any intention to deliver maize in the future: the agreements in respect of maize were illusory, designed to create a tax benefit for NWK.

Finally, the Court rejected the argument that NWK did not collude with FNB, and indicated that NWK could not have been deceived by FNB. As part

of the concealment of true facts and circumstances, *NWK* did not even lead evidence from the FNB officials who had proposed the transactions. This exposed the numerous extraordinary features of the transactions explicable only by the tax benefits.

## 4 Analysis of the Case

The *NWK* case expands the traditional understanding and application of the doctrine. It focuses on a substance and form different from those in the old cases mentioned above. It also has considerable implications for tax structures and the Commissioner's choice of action against taxpayers who seek to evade tax.

### 4.1 What Substance versus What Form?

Prior to *NWK*, the application of the substance-over-form doctrine focused on the form that the taxpayers projected the transaction to be vis-à-vis the substance that was the real object of the transaction. If the parties intended to carry out what was agreed, the transaction could not be flawed. After *NWK*, the focus falls on the transaction, regardless of what the taxpayers intend to do. This case changes the view of the form that the taxpayers present the transaction to be as well as the substance that it is. If the transaction seeks to achieve a certain objective but is structured so as to achieve it in a different guise, then, unless there is a legitimate or valuable substance to the choice of method, the doctrine could be applied to attach the tax result that would have arisen had the transaction not been given a different guise.

In effect, in *NWK* the Court focused on a different substance and juxtaposed that to a different form distinct from those in prior court decisions. Substance is no longer treated as only what the transaction really is, but also as to whether it has the necessary substance that a transaction of that nature should have. So, in future, substance can be examined for two features: what the transaction is in substance, and whether it has the actual substance that it should have. The form presented could be identical to the substance, but if the substance lacks rational or commercial substance, this deficiency would distinguish the substance of the transaction from its form.

It is submitted that in order to comply with the doctrine, a transaction should therefore have the required substance in all respects. In *NWK* the transactions were seen not to have economic substance. But a transaction that lacks other aspects should also fail the simulation test. Thus, for example, a transaction in which the risk element falls on a party that it normally would not fall on, or which lacks legal force where ordinarily it does, should also fail the test.

### 4.2 Impact of the Case

It might be thought that the Commissioner, armed only with the *NWK* judgment, can attack tax-avoidance schemes purely on the basis of the

avoidance purpose. But this might not necessarily be so. It should be noted that the *NWK* case was essentially about *simulation* and whether one arrangement was disguised or dressed up to look like something else. It could therefore be argued that where there is no suggestion of disguise, a tax-avoidance motive by itself would not be a sufficient basis on which to apply the *NWK* reasoning. In *NWK*, it was emphasised that the parties never intended to deliver the maize. The fact that the agreements in respect of maize were illusory and designed to create a tax benefit for *NWK* accords with the original understanding of the substance-over-form doctrine in that it relies on the disconnected intentions of the parties.

Lewis JA's approach concentrating on the intention of the parties is not a new departure in cases of this nature. In *Skjelbreds Rederi A/S and Others v Hartless (Pty) Ltd* (1982 (2) SA 710 (A)) the Court refused to recognise a cession of rights where it was clear that the cessionary would have to retransfer the rights to the cedent. There was no intention that the cession agreement would result in the rights being transferred to the cessionary. Whilst in *NWK* the intention of the parties came under the spotlight as regards the delivery of the maize, the Court in *Vasco Dry Cleaners v Twycross* (1979 (1) SA 603 (A)) went on to examine all the peculiar features of a contract, ostensibly for the transfer of ownership, in order to determine the real intention of the parties. Intention was also paramount in *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* (1992 (1) SA 867 (A)) where the Court upheld the contracts on the basis that the parties genuinely intended to give effect to what they had apparently agreed on. It was accepted that the doctrine would not apply where the agreement between the parties reflected their true intention (see Lynette Olivier 'Tax Avoidance Options Available to the Commissioner for Inland Revenue' 1997 *Tydskrif vir die Suid-Afrikaanse Reg* 725 at 731). Davis also considered that the actual intention of the parties as opposed to a 'constructed' disguise by means of a written agreement '[was] the key determinant of the nature of the transaction' (D Davis 'Reflections on the Ladysmith Case' (1997) 56 *The Taxpayer* 23 at 26). However, after *NWK*, the focus on the commercial substance of the transaction supersedes the intention of the parties. Thus, even if they intended to perform in terms of the agreed transaction, the transaction or certain steps would still be invalid if they lacked commercial substance.

As the facts in *NWK* show, the transactions devised, some of which were interposed, were extremely contrived and obviously simulated. It is submitted that the decision should not be taken to mean that similar transactions involving convertible loan structures are automatically at risk of attack by the Commissioner as being simulated. Transactions entered into with a genuine commercial rationale remain truly within the letter of the law. As regards these complicated transactions, the *NWK* decision now in effect requires taxpayers to consider the commercial reasons for structures (and each of the steps of those transactions) to determine whether they will withstand the new enquiry.



The *NWK* decision effectively casts doubt on the validity of the principle previously accepted in *Dadoo Ltd v Krugersdorp Municipal Council* (supra) and *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* (supra) that the mere fact that the same result can be achieved through a different route does not imply simulation. The doubt arises because the addition of a step that would be unnecessary if a different route is chosen might place that particular step and therefore the entire transaction in doubt. However, each case is to be considered on its own merits, and it is submitted that the steps together with the principle in *Dadoo* and *Randles* have to be considered against the totality of the facts.

The crux of the *NWK* decision is that a transaction will be regarded as a sham if lacking in commercial sense. The mere fact that a transaction was implemented in accordance with its terms would not preclude a finding that it was a sham. It will be found to be a sham if there was no real commercial reason for it other than the additional tax benefit obtained. As Davis said of *Ladysmith* (supra), 'The test of the commercial rationale for the transaction is perhaps the safest approach for the determination of the tax efficacy of any transaction' (op cit at 26). This approach narrows the distinction between cases where the doctrine applies and those where s 103(1) originally applied. The Court might have been aware of this, also since it explicitly ruled that the doctrine and the anti-avoidance measures of s 103(1) are not exclusive and can be applied in the alternative.

It is not clear how a court would apply the sham doctrine where there was a clear commercial reason for the wider transaction or arrangement but not for a particular step of the arrangement. The new anti-tax avoidance provisions under Part IIA of the Income Tax Act specifically require each step to have a commercial rationale. It could be argued that the new approach established in *NWK* does not specifically provide for an individual test of each step. This is so because, although considerable emphasis was placed on the immaterial interposition of Slab in the transaction, the decision was made on the basis of the whole transaction.

Had the Court not extended the application of the doctrine, could the step involving the maize be disregarded on its own because it is not genuine in the light of the new approach of focusing on each step of the transaction and determining the validity of the step on its own? Depending on the particular facts, a court should be able to apply the sham doctrine to reject a particular step of a transaction if it lacked a clear commercial rationale. In this case a different result would apply if the particular single step were rejected. Unlike the position under statutory anti-avoidance measures in s 103(1), the entire transaction should fail the test, because in its totality, and on the basis of that step, it presented a form which is different from its substance.

Lewis JA's judgment in *NWK* was quoted by Allie J (*ABC, DEF and GHI v The Commissioner for the South African Revenue Service Case* unreported, (Tax Court) WCC case nos 12760, 12828 & 12756, 14 September 2011) in pars 105–7 (available at <http://www.sars.gov.za/Tools/Documents/>

*DocumentDownload.asp?FileID'72428*). Allie J had to consider the tax consequences of so-called deferred delivery share incentive schemes. Under these schemes, the employees of the companies involved were granted options to take up shares. Almost immediately after these options were granted, the employees would exercise them, thus eliminating any gain in the value of the shares for the purposes of s 8A of the Act. The salient provisions of s 8A provide that where an employee obtained the right to acquire any shares from an employer in respect of services rendered, or to be rendered, before 26 October 2004, any gains made by virtue of the exercise, cession or release of that right are taxable. The taxable amount of the gain is equal to the market value of the shares on the date that the right to acquire the shares was exercised by the employee, less any consideration given by the employee.

It was assumed that the tax event giving rise to the tax liability took place on the exercise of the option (or the conclusion of the agreement for the purchase of the shares), and not on the subsequent actual delivery of the shares to the employee: hence the notion of 'deferred delivery'.

Until October 2004, conventional option schemes were taxable under s 8A of the Act and conventional purchase schemes were taxable under par 2(f) of the Seventh Schedule. Quoting *NWK*, Allie J held that the deferred delivery share incentive schemes entered into in 1997 were an attempt to avoid both these provisions. There was nothing sinister in seeking to avoid tax, provided that this was not the only 'real and sensible commercial purpose' of the scheme' (par 171). *NWK* was hailed as the case 'in which guidelines are set out to establish the true substance of a transaction' (par 104).

### 4.3 Interaction with s 103(1)

The *NWK* decision extends the application of the substance-over-form doctrine by introducing a test similar to the anti-avoidance measures contained in the former s 103(1). In effect, the abnormality attribute added by *NWK* implies that the s 103(1) yardstick is imported into the substance-over-form test although it is to apply in addition to the new anti-avoidance provisions in ss 80A to 80L. The new anti-avoidance measures were introduced by s 34(1) of the Revenue Laws Amendment Act 20 of 2006, deemed to have come into operation on 2 November 2006 and applicable to any arrangement (or any steps therein or parts thereof) entered into on or after that date. The new provisions replace s 103(1). Sections 80A to 80L provide the South African Revenue Service with a formidable arsenal against taxpayers who structure their transaction in order to avoid or evade tax. These sections obviate any need that may arise to use legislation to limit the deductibility of interest where tax avoidance is detected.

After *NWK* the opinion of Surtees and Miller (op cit at 16) and Emil Brincker (*Taxation Principles of Interest and Other Financing Transactions* (2004) at ZA-3) remains valid, that it is not necessary or correct to consider

whether s 103(1) of the Act applies if a transaction is found to fall foul of the substance-over-form. The transaction needs to be genuine before s 103(1) or ss 80A to 80L can be applied. So it is submitted that where s 103(1) or ss 80A to 80L are relied on, it is necessary to establish that the form and the substance of the transaction are the same. If the form differs from the substance, the transaction fails the simulation test and the enquiry ends. If form and substance are found to be the same (and the transaction thus passes the simulation test), then it is appropriate to determine whether it breaches s 103(1) or the new ss 80A to 80L. This is the approach that was correctly followed in *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999 (4) SA 1149 (SCA)). Only once the taxpayer passed the simulation test did the Court consider it necessary and proper to measure this genuine transaction against s 103(1).

The extension of the doctrine to attack transactions that are economically abnormal (and therefore simulated because of economic abnormality) means that the abnormality requirement is applicable both to the common law and to statute. It implies that a transaction may be simulated and contravene s 103(1) or ss 80A to 80L, as the case may be. However, it would not be necessary to apply the statutory provisions where the common-law doctrine applies (*Relier (Pty) Ltd v Commissioner for Inland Revenue* 1997 (5) JTLR 119 (SCA); 60 SATC 1). If a transaction is abnormal under both the common law and the statutory provisions, the Commissioner should have a choice of mechanisms to attack the transaction.

Vorster criticises *NWK* because it may render the general anti-avoidance provisions in ss 80A to 80L obsolete (H Vorster 'NWK and Purpose as a Test for Simulation' (2011) 60 *The Taxpayer* 61 at 84):

'As the Court in *NWK* would now have it, the Commissioner can avoid the limitations on his powers in terms of section 80A by simply contending that the avoidance purpose of the transaction results in an irrebuttable presumption of simulation. In addition, he escapes the burden of proof placed upon him in terms of that section'.

Rather more important is to determine whether *NWK* improves our tax law. If *NWK* is correct, then the fact that ss 80A to 80L are rendered obsolete might not be problematic, and might not even be relevant. Perhaps the statutory provisions do not curb avoidance that should be curbed. Furthermore, the criticism ignores the fact that the doctrine as developed by *NWK* is not freely applicable but requires certain requirements to be met. It is also common cause that taxpayers structure their transactions so as to avoid the application of the legislative anti-avoidance provisions. Referring to these in s 103(1) of the Act, Lynette Olivier states that 'it is often difficult for the commissioner to succeed on the basis of this section as taxpayers deliberately structure their schemes in such a way that one or more of the requirements of the section are not met' ('Tax Avoidance and Common Law Principles' 1996 *Tydskrif vir die Suid-Afrikaanse Reg* 378 at 383). The effect of *NWK* is to ease this difficulty on the part of the Commissioner and limit the scope for tax avoidance and evasion. Williams considered that the *Ladysmith* decision would perhaps

encourage courts to seek solutions to cases in common-law principles instead of looking immediately for a statutory provision (RC Williams 'Income Tax: Disguised Transaction: Unexpressed Agreement or Tacit Understanding' (1997) 114 *SALJ* 458 at 461). It is expected that *NWK* will broaden the scope of the common-law principles and intensify the appetite of the courts to seek solutions from them.

The current anti-avoidance provisions in s 80A to 80L contained both a tax-avoidance purpose and an element of impermissibility. Is it therefore easier for the Commissioner to challenge a transaction for failing the substance-over-form test than to prove that it breaches the anti-avoidance provisions? *NWK* itself does not have this effect. *NWK* was decided on the basis of the seven factors outlined in par 3.5 above. The legislative anti-avoidance provisions extend, inter alia, to transactions that are entered into 'by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit' (s 80B(b) of the Act) or that 'created rights and obligations that would not normally be created between persons dealing at arm's length' (s 80B(c)(i)). So the scope of the statutory provisions is wider than the doctrine, even as extended by *NWK*. As a result, the Commissioner should still prefer to apply those provisions rather than the common law, for example, as regards the abnormal conclusion of the transaction and the rights and duties that the transaction creates.

#### 4.4 Conclusion

It may be asked whether this extension of the application of the doctrine surpasses the taxpayer's right to structure transactions so as to attract the least possible tax impact. And how far does the complexity of the transaction in *NWK* affect the potential to apply the doctrine successfully? The Court in *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (supra) found that the terms of the sale and leaseback agreements, even though unusual, made good business sense and were honestly intended to have the effect contended for by the parties. So it should still be possible to pass the simulation test if the transaction is complex but its steps can nevertheless be justified in substance and all other aspects are impeccable.

The *NWK* case modernises the substance-over-form doctrine. This is a necessary development for dealing with the complexity and resourcefulness of tax structuring, and an important step towards ensuring that the common law matches legislative attempts at curbing tax evasion. South African tax statutes have been amended to accord with international practices and secure the equity of tax by making sure that transactions that should be taxable are taxed adequately. Significant additions thus include legislation on capital gains tax and controlled foreign companies (see, respectively, the Eighth Schedule to the Act introduced by s 38 of the Taxation Laws Amendment Act 5 of 2001, and s 9D inserted by s 9(1) of the Income Tax Act 28 of 1997 as substituted by s 14(1) of the Revenue Laws Amendment Act 74 of 2002). The

positive effect of these attempts should continue to be augmented by corresponding development of the common law.

The pertinent point in *Commissioner for the South African Revenue Service v Cape Consumers (Pty) Ltd* (supra at 1224H-I) that '[t]he doctrine of the disguised transaction is not a panacea for appellant to ignore agreements where the parties in fact and in law intend that they must be given their legal effect' remains relevant after *NWK*. However, it is important to note that *NWK* extends this logic: the fact that the actual intention and the legal intention are identical is not a guarantee against attack in terms of the substance-over-form doctrine. Nevertheless, the facts of each case should be carefully considered to determine whether the steps are sufficiently contrived to warrant the application of the doctrine as it now stands. In this regard, Vorster correctly concludes (op cit at 85) that 'the facts considered by the court in *NWK* are most unusual and the reasoning and the remarks of the court in that case must be confined to cases in which its facts are substantially duplicated'.

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