

**A critical analysis of the principles relating to simulated transactions in the
context of the case of *Commissioner for the South African Revenue Service v
NWK Limited* 73 SATC 55**

by

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DECLARATION

I, Heinrich Jacobus Louw, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree Masters in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other university.



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ABSTRACT

The fundamental legal principles in South African law relating to simulated transactions are based on a long line of cases that have been decided in our courts over the past one and a half centuries. The main principle underlying the rule that simulated transactions are void, or that substance prevails over form, is that there can be no contract where there is no true legal intention by the parties. This is simply a necessary consequence of the application of the will theory.

As opposed to the legal intentions of the parties, the purpose of the parties, as another subjective factor, is generally not relevant in determining whether a genuine agreement has been entered into. Purpose may however be taken into account as a factor in determining the true legal intentions of the parties. The existence of an unlawful purpose will also render an agreement unenforceable.

In the case of *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55, Lewis JA has seemingly introduced new considerations into South African law (particularly relevant to tax law), focusing on the presence of an avoidance purpose coupled with the lack of a commercial purpose to determine simulation. This stands somewhat apart from the importance of the true legal intentions of the parties as decisive factor.

This work focuses on the interpretation of these new considerations and the impact of the said judgment on the established principles relating to simulated transactions. In this regard the views of certain critics are discussed. The judgment is also critically analysed in order to draw a conclusion as to what the current legal position is regarding simulation in the context of tax law.

1 INTRODUCTION

1.1 Background

The topic of “simulated transactions” can be properly sorted under the law of contract. However, it is a topic that is particularly relevant in the realm of modern tax law, and specifically in respect of tax avoidance.

Generally, and in the absence of any specific anti-avoidance provisions, the Commissioner for the South African Revenue Service deals with transactions aimed at the impermissible avoidance of tax by applying the general anti-avoidance provisions¹ contained in the Income Tax Act 58 of 1962. The successful application of these provisions usually neutralises the tax benefit that parties involved would have otherwise enjoyed as a result of the transaction.

For various reasons², the general anti-avoidance provisions may be difficult to apply in practice. The Commissioner for the South African Revenue Service therefore often supplements the attack on an impugned transaction by asserting alternative grounds as to why the transaction should be treated as void or otherwise be disregarded.

Our courts have taken note of the fact that “many tax-avoidance schemes can be nullified by the application of common-law principles”³.

The most prominent common-law principle so employed by the Commissioner for the South African Revenue Service is that, where a particular transaction constitutes a simulated transaction, such transaction is void and stands to be disregarded.⁴ The argument in this regard is generally that a particular transaction, which attracts little or no tax (or allows favourable tax treatment), is a sham or a disguise, and that there is some other agreement between the parties, constituting the true transaction, which attracts more tax (or allows for less favourable tax treatment). In other words, the parties did not actually enter into “this” transaction, but they entered into some “other”

¹ Sections 80A to 80L of the Income Tax Act 58 of 1962. Previously the general anti-avoidance provisions were contained in section 103 of the Income Tax Act 58 of 1962.

² See for instance *ITC 1862 75 SATC 34* where the application of the general anti-avoidance provisions were unsuccessful.

³ *Relier (Pty) Ltd v Commissioner for Inland Revenue* 60 SATC 1 at p 6.

⁴ This is evident from a host of cases such as *Randles, Brothers and Hudson Ltd v Commissioner of Customs and Excise* 1941 AD, *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 and *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55.

transaction, and the parties should be taxed based on that “other” transaction.

The Commissioner for the South African Revenue Service therefore regards an attack on a transaction as being a simulated transaction to be a powerful weapon in its arsenal for collecting taxes.

In practice one often finds that, as a first basis of assessment, the Commissioner for the South African Revenue Service would allege that a particular transaction is simulated. Only as a second or alternative basis would the Commissioner for the South African Revenue Service claim that the transaction falls within the scope of the general anti-avoidance provisions.⁵

During the 20th century and the first decade of the 21st century the principles relating to simulated transactions had been firmly established in South African case law, both in respect of the law of contract in general and in the context of tax avoidance.⁶

In 2010 the South African Supreme Court of Appeal gave judgment in the case of *Commissioner for the South African Revenue Service v NWK Limited*⁷. Lewis JA wrote the judgment.

This judgment appears to have parted with established principles in that it contains certain surprising, and perhaps unsettling, *dicta*⁸ relating to the applicable tests for determining whether a transaction constitutes a simulated transaction. Generally, where parties intend to give effect to an agreement in accordance with its terms, it cannot be said that such agreement is simulated. This is so because the parties intend for the agreement to have its stated legal effect between them. However, the court appears to have qualified the test by asserting that, where there is a lack of commercial purpose behind the agreement, and the agreement merely facilitates tax avoidance, the agreement should be regarded as simulated.

It is debatable whether the judgment has in fact parted with established principles, as there are some difficulties in interpreting its content. It is also not clear whether the statements in question form part of the *ratio decidendi* and whether they therefore constitute binding precedent. At the very least it can be said that the judgment has

⁵ This is evident from cases such as *ITC 1625 59 SATC 383* and *Commissioner for the South African Revenue Service v NWK Limited 73 SATC 55*.

⁶ See Chapter 2 below.

⁷ 73 SATC 55.

⁸ *Commissioner for the South African Revenue Service v NWK Limited 73 SATC 55* at para 55.

raised controversy regarding simulated transactions.

The debate as to whether there has been a change in the established principles and what the new position is has been taken up by various authors, most notably Broomberg, author and tax advocate, in his paper entitled “NWK and Founders Hill”⁹.

The debate was also taken up in the South African courts recently in the case of *Bosch and another v Commissioner for the South African Revenue Service*¹⁰.

1.2 Research object

The purpose of this work is to determine the impact of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*¹¹ on the law relating to simulated transactions, specifically in the context of tax avoidance.

This entails a discussion on two very important interrelated issues –

(a) whether a transaction can be said to be a simulated transaction for the mere fact that it has as its aim the avoidance of tax; and

(b) whether a transaction has to bear out some form of commercial sense, failing which it will be regarded as a simulated transaction.

Ultimately the discussion on the impact of the judgment is intended to be useful for purposes of determining the limits in respect of structuring transactions. In a realistic commercial world where parties purposefully and carefully structure their transactions in order to achieve certain outcomes, one such outcome often being the achievement of tax efficiency, the pertinent question is this: at what point does a structured transaction become so contrived that it can no longer be regarded as a genuine transaction, but a simulated transaction?

1.3 Research method

In order to determine the impact of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*¹² on the law relating to simulated transactions, it is necessary to determine what the established principles are in this regard. For this

⁹ *The Taxpayer* 2011 Vol 60 p 187.

¹⁰ 75 SATC 1.

¹¹ 73 SATC 55.

¹² *Ibid.*

reason a chapter follows that deals specifically with established principles.

It is important to appreciate that, when one traverses the rather substantial body of law relating to simulated transactions, and particularly case law, it becomes apparent that the topic is broad and that various themes for discussion can be identified, each dealing with a relevant issue. Some of these themes are as follows –

- the principle that “substance” prevails over “form” and the *plus valet quod agitur* maxim;
- transactions *in fraudem legis*;
- the distinction between the written documents and the legal act of contracting;
- the notion that parties have commercial freedom and freedom to contract and that they may arrange their affairs so as to fall within or outside of a legal provision, such as a taxing provision, and by implication to pay the least amount of tax possible;
- the intention that an agreement will effect in accordance with its tenor or terms;
- the simulated intention and the underlying intention;
- the distinction between consensus and unlawfulness;
- the distinction between tax avoidance and tax evasion;
- honest simulations;
- commercial rationale or commercial purpose;
- the purpose of the transaction and the outcome that the parties wish to achieve;
- indicators of simulation or factors taken into account (evidence); and
- onus or burden of proof.

It is not intended that each of the above themes be discussed in any particular detail or order in this work. It should also be kept in mind that many of these themes overlap and it is often impossible to draw clear distinctions between them or to discuss the one

without the other. Accordingly, this work will not be divided under these themes but will focus in general on an analysis of the relevant principles established in our law, highlighting certain themes more than others, specifically keeping in mind their relevance to the judgment in *Commissioner for the South African Revenue Service v NWK Limited*¹³. To the extent that the analysis of the established principles and the judgment relates to these themes, they will be addressed.

Once a solid foundation has been laid in respect of the established principles, an analysis of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*¹⁴ will follow. The judgment will be discussed and analysed in respect of whether there has been a departure from the established principles.

The judgment will also specifically be discussed in light of its critics, such as Broomberg¹⁵ and other commentators. In addition, the recent decision in the Western Cape High Court in *Bosch and another v Commissioner for the South African Revenue Service*¹⁶ will be discussed and applied.

Finally, a conclusion will be drawn in respect of whether, and to what extent, the judgment in *Commissioner for the South African Revenue Service v NWK Limited*¹⁷ has departed from established principles, and the impact thereof on parties entering into structured transactions in future.

It should be clear from the above that this work is based on the analysis of the legal principles relating to simulated transactions, which mostly entails an analysis of relevant South African case law. The method is therefore analytical and argumentative. The work culminates in a conclusion on the various questions posed as part of the research object outlined above.

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ "NWK and Founders Hill" *The Taxpayer* 2011 Vol 60 p 187.

¹⁶ 75 SATC 1.

¹⁷ 73 SATC 55.

2 ESTABLISHED PRINCIPLES

2.1 Fundamentals of the law of contract in South Africa

2.1.1 General

It is generally accepted that an agreement that has been found to be a “simulated” agreement is void and stands to be disregarded¹⁸. The question arises as to the legal basis on which simulated agreements are regarded as void. This calls for a brief examination of certain fundamental principles in the law of contract.

A contract can be defined as “an agreement ... reached with the intention of creating a legal obligation with resulting rights and duties”.¹⁹

It is also trite that the following requirements²⁰ need to be met before it can be said that a valid contract has come into existence:

- There must be consensus between the parties;
- The parties must have the necessary contractual capacity;
- The agreement must be lawful;
- Performance must be physically possible; and
- Any prescribed formalities must be complied with.

Should any of these requirements not be met, the agreement will be null and void.²¹

Of particular relevance to the discussion on simulated transactions are the requirements of consensus and lawfulness.

¹⁸ Cilliers C “Anti-avoidance” in Brincker TE & De Koker AP (eds) (2010) *Silke on International Tax* Durban: LexisNexis, at para 46.5; See also De Koker AP & Williams RC (2013) *Silke on South African Income Tax* Durban: LexisNexis, at para 19.3.

¹⁹ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.81.

²⁰ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.83.

²¹ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.97.

2.1.2 Consensus

Agreement by consensus is considered to be the fundamental principle on which any contract is based.²² The notion of consensus is also referred to as a “meeting of the minds”²³, a “coincidence of wills”²⁴, “*consensus ad idem*”²⁵ or “wilsooreenstemming”²⁶.

Firstly, consensus entails that the parties intend to perform the legal act of contracting. In other words, it entails that the parties genuinely and seriously intend to be legally bound by the content of their agreement.²⁷ This may be referred to as the *animus contrahendi*.²⁸

The intention of the parties as to their seriousness to be bound is accordingly critical to the establishment of consensus.

Secondly, consensus entails that the parties agree to the content of their agreement. In the law of contract the content of an agreement can be divided into the *essentialia*, *naturalia* and *incidentalia*.²⁹ The *essentialia* are the essential terms of the agreement and indicate whether the parties have entered into a specific nominate contract, such as a sale or lease, or some other *sui generis* contract.³⁰ Specific nominate contracts also consist of *naturalia*, which are terms that, by operation of law, form part of the content of that type of agreement.³¹ Parties may qualify or supplement the agreement by way of introducing further terms, known as *incidentalia*.³²

²² Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 24.

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ Joubert DJ (1987) *General Principles of the Law of Contract* Johannesburg: Juta & Co Ltd, at p 36; Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 24.

²⁶ De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 9.

²⁷ De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 16; Joubert DJ (1987) *General Principles of the Law of Contract* Johannesburg: Juta & Co Ltd, at p 33.

²⁸ Although the term *animus contrahendi* is usually employed in the context of determining whether an offer was a serious offer to contract, as opposed to, for instance, a mere proposal, it is submitted that, in the wide sense, it refers to the intention of a party to be contractually bound.

²⁹ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.94.

³⁰ *Ibid.*

³¹ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.95.

³² Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.96.

In order for true consensus to be reached, parties need to be *ad idem* as to the *essentialia* and *incidentalia*. Consensus as to the *naturalia* is implied where not specifically altered.³³

Consensus, being a product of the corresponding intentions of the parties, is subjective.³⁴ However, when it comes to determining whether the parties have seriously intended to be bound by their agreement (*animus contrahendi*), and what the content of their agreement is, it soon becomes apparent that a practical difficulty arises: intention, being a subjective state of mind, is rather elusive.³⁵ Intention is only ever manifest in objective expressions or acts.³⁶ Christie³⁷ has commented that “in truth, the search is not for agreement by consent but for evidence of such agreement”.

Courts therefore have no option but to examine the objective facts in order to draw any conclusion in respect of the intention of the parties.

The theory outlined above, being that the requirement of consensus will have been met where it is established (through an examination of the objective facts) that the parties had corresponding intentions, is known as the “will theory” or “wilsteorie”.³⁸ Where there are no such corresponding intentions, there is no consensus, and no contract will have come into existence.

Our law also recognises a second theory, known as the “reliance theory”, “vertrouwensteorie” or theory of “quasi-mutual assent”.³⁹ Sometimes, in certain limited circumstances, where there are no corresponding intentions in respect of the parties, and therefore no true consensus, a valid contract can still come into existence. In these circumstances the law will hold the parties bound despite the lack of true consensus.

³³ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 3.95.

³⁴ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 24.

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 4.03; De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 9.

³⁹ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 4.04; De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 13. Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 26.

A third theory, known as the “declaration theory”, is not accepted in our law.⁴⁰ It states that parties will be bound by their stated intentions, even where there has been no meeting of the minds.⁴¹ As mentioned above, the subjective intentions of parties can only be established by an examination of the objective manifestations of those intentions. The stated intentions of the parties are one such objective fact that requires examination and is therefore very important. Also, the existence of the parole evidence rule in our law reinforces the idea that the stated intentions of the parties are very important. Nevertheless, the stated intentions of the parties are not the basis of contractual liability in South African law.⁴² The declaration theory is contrary to the principle in our law that substance prevails over form, which is discussed later in this work.

2.1.3 Unlawfulness

It is important to distinguish between the unenforceability of a contract by reason of “defective consent” (ie lack of consensus) and unenforceability by reason of the “contravention of some rule of law”.⁴³

A contract can be unlawful in that it is contrary to a statutory provision or a common law rule.

A statute may either expressly or by implication render certain agreements unlawful.⁴⁴ Depending on the interpretation of the particular statute, the agreement in question may be void.⁴⁵

Generally, South African tax statutes do not prohibit or outlaw any transactions, but simply provide for the tax consequences relating to transactions. Even the general anti-avoidance provisions contained in sections 80A to 80L of the Income Tax Act⁴⁶ do not make unlawful or render void transactions falling within their ambit, but simply provide for the relevant transactions to be taxed so as to neutralise any tax benefit that the

⁴⁰ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 4.05. De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 13.

⁴¹ *Ibid.*

⁴² *Ibid.*

⁴³ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 351.

⁴⁴ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at pp 351 to 352.

⁴⁵ Nagel CJ (ed) (2006) *Commercial Law* (3rd ed.) Durban: LexisNexis Butterworths, at para 4.06.

⁴⁶ No 58 of 1962.

parties might otherwise have enjoyed.

Of particular relevance here is that there is currently no provisions in our tax statutes that provide that a transaction that has as its purpose the avoidance of tax is unlawful and void.

In terms of South African common law, contracts that are against public policy or that are *contra bonos mores* will not be recognised by our courts and will be unenforceable.⁴⁷

This is so because the law objects to either the “promises” made by the parties, the “purpose” of the parties, or the “reason underlying the promises”.⁴⁸

As far as the “purpose” of the parties are concerned, there is a “general principle that contracts for an illegal purpose are themselves illegal, or to put it another way, contracts the object of which is to achieve something forbidden by law are illegal”.⁴⁹

Where simulated transactions are concerned, the ostensible transactions usually consist of ordinary commercial contracts such as sales⁵⁰, leases⁵¹ and loans⁵² that, ordinarily, are not considered unlawful for being contrary to public policy or *contra bonos mores*. The question is, of course, whether the common law provides that, where the conclusion of an ordinary contract has as its purpose the avoidance of tax, it is against public policy or is *contra bonos mores*, and therefore unenforceable.

If tax avoidance is illegal, then a contract with the purpose of tax avoidance will also be illegal.

If tax avoidance as such is not illegal, the question also arises as to whether tax avoidance implemented by way of an intentionally disguised or simulated transaction, is unlawful (ie constitutes deliberate tax evasion). In other words, where the true contract between the parties fall within the ambit of a taxing statute and attracts tax, but the parties intentionally disguise their contract so that it appears to be a contract that

⁴⁷ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at pp 358, 406 to 410; De Wet JC & Van Wyk AH (1992) *Kontraktereg en Handelsreg* (5th ed.) Durban: Butterworths, at p 89.

⁴⁸ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 399.

⁴⁹ *Ibid.*

⁵⁰ *Zandberg v Van Zyl* 1910 AD 302.

⁵¹ *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 61 SATC 391.

⁵² *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55.

does not fall within the ambit of the taxing statute, have the parties acted unlawfully?⁵³

These issues are discussed in more detail below in the context of *Commissioner for the South African Revenue Service v NWK Limited*⁵⁴.

2.2 Historical foundations of simulation

The notion of a simulated transaction appears to be ancient and the sources of Roman law, such as the *Digest* and *Codex*, make reference to it.⁵⁵ It is unfortunately not within the scope of this work to explore the interesting early history of simulated transactions. In this regard it is instructive to consult the work of Blechner⁵⁶.

Blechner⁵⁷ does however make the following relevant observation –

“The significant contribution of the writers on the later civil law, apart from the insight that they provide into the problems of simulation, is the most clearly expressed in the writings of Donellus, that simulation is a defect of the will – a view commonly held today.”

2.3 South African case law

2.3.1 General

For purposes of laying a foundation for later analysis of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*⁵⁸, and specifically to gauge whether the Supreme Court of Appeal in that case changed any of the principles relating to simulated transactions, or altered the common law in any way, it is necessary to traverse some of the more important cases that have shaped the law in South Africa in this regard.

South African courts have often had to deal with persons claiming that they have entered into an agreement of a certain kind or containing certain terms, whereas in

⁵³ It is important to note that the concept of tax avoidance by way of arranging one's affairs so as to fall outside of the scope of a taxing provision has a corollary. One could equally arrange one's affairs so as to fall within the scope of a provision that provides for a tax benefit. In this work the term tax avoidance should be read as including both scenarios.

⁵⁴ 73 SATC 55.

⁵⁵ Blechner MD “Simulated transactions in the later civil law” *SALJ* 1974 Vol 91 p 358 at pp 358 to 360.

⁵⁶ Blechner MD “Simulated transactions in the later civil law” *SALJ* 1974 Vol 91 p 358.

⁵⁷ Blechner MD “Simulated transactions in the later civil law” *SALJ* 1974 Vol 91 358 at p 380.

⁵⁸ 73 SATC 55.

reality they have entered into another kind of agreement containing different terms, or they have not entered into any agreement at all. Their reasons for doing so are varied – sometimes *bona fide* and sometimes *mala fide*. Sometimes the claim in respect of the transaction is honest, but mistaken, and sometimes it is deliberately false.

One of the earliest cases in this regard is *Fivaz v Boswell*⁵⁹ where the plaintiff claimed that he had bought certain goods from a seller (who was indebted to the plaintiff) and immediately lent the goods back to the seller.⁶⁰ The court found that the transaction was characterised by fraud because in a *bona fide* sale the purchaser takes possession of the goods sold and does not immediately lend it back to the seller at no charge. The court concluded that there was no real sale and the transaction was disregarded for purposes of the proceedings.⁶¹ The court did not elaborate on the purpose behind the transaction (ie what the parties wanted to achieve, or their motive), and whether that was unlawful.

2.3.2 ***Hofmeyer v Gous* 10 SC 115**

In the later case of *Hofmeyer v Gous*⁶² the court dealt with a similar situation. Certain goods, found in possession of a judgment debtor, had been attached in execution at the instance of a judgment creditor. In interpleader proceedings, the respondent (the father of the judgment debtor) claimed that the goods belonged to him as it had been sold to him by his son in satisfaction of a debt. However, he had lent the goods back to his son.

De Villiers CJ remarked that it was a very common device for parties to effect a pledge “*under the guise of a sale*”. The situation usually involves a debtor and a creditor. The debtor purports to sell goods to a creditor in the amount of the debt. The goods may be delivered to the creditor, but are immediately re-delivered to the debtor. Should the goods, being in the debtor’s possession, be attached by other creditors, then the original creditor can step in and claim that the goods belong to him (on the strength of the sale), and fend off the attachment.

⁵⁹ 1 Searle 235.

⁶⁰ Subsequent to the sale, the goods had physically been marked as belonging to the plaintiff.

⁶¹ This case was decided on English law principles. Interestingly, Bell J wrote a dissenting judgment indicating that lack of possession by the purchaser does not necessarily mean that a sale is fraudulent. See also the comments of De Villiers CJ in *Zandberg v Van Zyl* 1910 AD 302 at 308 on this case.

⁶² 10 SC 115.

De Villiers CJ noted specifically that the law treats a transaction for what it really is, and not what it is called. The court found that “*the only object of the parties was to secure the debt due to the father, and at the same time to allow the son to use the goods as his own*”.⁶³ The parties therefore intended a pledge. However, the pledge had to fail because the father gave up possession of the goods.

2.3.3 **Zandberg v Van Zyl 1910 AD 302**

Probably the most significant of the early cases relating to simulated transactions is that of *Zandberg v Van Zyl*⁶⁴. Here the Appellate Division dealt with a factual situation very similar to that described in *Hofmeyer v Gous*⁶⁵.

The Respondent (Van Zyl) was owed 50 pounds by his mother-in-law (Mrs Van Zyl) in terms of a promissory note. 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. 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. The words “*Voldaan door een wagen*” was written on the promissory note. 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 not capable of attachment.

There were three separate judgments, each finding on the facts that the arrangement constituted a simulated transaction.

De Villiers CJ was of the view that possession raises a presumption of ownership and that the Respondent was required to produce “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 in light of the fact that he admitted that, even though he had bought the wagon, he did not actually require it.

Further, De Villiers CJ stated that –

“If the thing is allowed to remain in the possession of the seller, and it is manifest that the real object of the parties was not to transfer the ownership to the

⁶³ *Hofmeyer v Gous* 10 SC 115 at p 117.

⁶⁴ 1910 AD 302.

⁶⁵ 10 SC 115.

*purchaser, but to secure the payment of a debt owing to him by the seller, the obvious conclusion is that the intention of the parties was to effect a pledge, and not a sale.*⁶⁶

De Villiers CJ found that the Respondent's "*object in making the alleged purchase was to secure the debt owing to him by his mother-in-law, and at the same time to allow her to use the wagon as if it were her own*".⁶⁷ He specifically drew a comparison with the facts in *Hofmeyer v Gous*⁶⁸.

It is interesting to note that, on the face 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 judgment of Innes J is most significant. His point of departure is that the outward manifestation of a contract, being the words in which it is expressed (or its form or shape), generally accords with the agreement arrived at between the parties. There is usually no "*subterfuge*" or "*concealment*". However, occasionally, in order to secure a legal benefit or escape a legal obligation, the true nature of an agreement is concealed by means of a disguise.⁶⁹

When confronted with such an agreement, the court will look at the true nature of the agreement. In this regard Innes J quoted the Latin maxim *plus valet quod agitur quam quod simulate concipitur*⁷⁰.

However, Innes J qualified the maxim as follows –

"The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make

⁶⁶ *Zandberg v Van Zyl* 1910 AD 302 at p 308.

⁶⁷ *Ibid.*

⁶⁸ 10 SC 115.

⁶⁹ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

⁷⁰ This maxim was translated in *B C Plant Hire cc t/a B C Carriers v Grenco (SA) (Pty) Ltd* [2004] 1 All SA 612 (C) at para 33: "*This approach accords with the well known Roman legal maxim that plus valet quod agitur quam quod simulate concipitur ('greater value is attached to what is done than to what appears to be done') (see Code 4.22). In simple language this may be rendered as 'true facts have more value than apparent facts' or 'substance bears more weight than form'.*"

the arrangement other than it purports to be.”⁷¹

Innes J also noted in respect of detecting simulation –

“...in considering whether the real nature of any particular contract is different from its ostensible form, we must endeavour from all the circumstances to get at the actual meaning of the parties. Each case must depend on its own facts; no general rule can be propounded which will meet them all.”⁷²

As to the object of the parties Innes J stated that –

“...there is every reason to think that the real object of the parties was not that the respondent should genuinely acquire the wagon, but that he should have a claim against it in case she became insolvent, or was pressed by other creditors. In short, that the real contract was a pledge, and that it was cloaked as a sale in order that she might continue to enjoy the use of the vehicle.”⁷³

It appears from this passage, as well as the judgment in general, that Innes J took a similar approach to that of De Villiers CJ. Innes J made much of the “*object*” of the parties in order to conclude as to the real character of the agreement in question. However, it is not always clear whether both De Villiers CJ and Innes J strictly adhered to the distinction between the object (or purpose) of the parties and their intention in respect of the agreement (consensus).

Innes J concluded as follows –

“I come, therefore, to the conclusion that the facts proved in this case do not establish a genuine contract of sale between Mrs. Van Zyl and the respondent; and that they cannot be taken higher in his favour than as amounting to a pledge of the wagon to him as security for his debt. I do not apply any harsh word to the transaction; I simply say that it was in essence not a sale, but at most a pledge, and that the Court is bound to deal with it according to its substance, and not according to its form.”⁷⁴

⁷¹ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

⁷² *Zandberg v Van Zyl* 1910 AD 302 at p 310.

⁷³ *Zandberg v Van Zyl* 1910 AD 302 at p 312.

⁷⁴ *Zandberg v Van Zyl* 1910 AD 302 at p 313.

Here too, as in *Hofmeyer v Gous*⁷⁵, the “pledge” failed because the Respondent did not have possession.⁷⁶

It is interesting to note 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 raises the issue of whether an “honest” agreement (where there is no dishonesty by the parties) can ever constitute a simulated agreement. This issue is discussed in more detail below.

Solomon J, though with some hesitation, came to the same conclusion as Innes J.⁷⁷

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 equally ask, if the parties intended a pledge, why the Respondent did not take possession, knowing that lack of possession would deprive him of his security rights. Perhaps the answer is that the parties truly believed that they did enter into a sale, and thinking that the Respondent had ownership of the wagon, disregarded the requirements of pledge.

It appears from the facts, and as the court found, that the object of the parties was to secure the debt owed to the Respondent. However, they intended to do so through the transfer of ownership by means of the sale of the wagon. This would give the Respondent security or “comfort” in that he would be the owner, and thus have the strongest possible real right in the wagon. In addition, it had the benefit of not requiring the Respondent be in possession of the wagon and that Mrs Van Zyl could continue to use it.

With this the court clearly had an issue and one might well ask what is so objectionable about procuring effective security through the transfer of ownership, where the parties truly intend the passing of ownership. Why does the object of securing a debt preclude a sale? The court did not address the lawfulness of such an arrangement.

It is clear that courts, at least at the time of this decision, looked with great suspicion

⁷⁵ 10 SC 115.

⁷⁶ *Zandberg v Van Zyl* 1910 AD 302 at p 313 to 314.

⁷⁷ *Zandberg v Van Zyl* 1910 AD 302 at p 320.

upon sales without the concomitant taking possession by the purchaser of the *merx*.⁷⁸ This is especially so where the purchase price was settled by means of the extinguishing of a pre-existing debt.

Perhaps this is so to guard against abuse when assets are attached at the instance of other creditors. But be that as it may, these transactions are frowned upon for their motive (although not unlawful), and this potentially provides some incentive for a court to find that there was defective consensus, and that the parties intended something else. One should keep in mind that the object of securing an asset in this manner from attachment does not necessarily turn a sale into a pledge.

2.3.4 ***Mohamed Abdullah v Levy* 1916 CPD 302**

In this case the trustee (Levy, being the Defendant) of an insolvent estate of one Abbas attached certain property at a shop, the Defendant believing that the property belonged to Abbas. The Plaintiff (Mohamed) sued for the return of the property on the basis that he was the owner of the property and the shop and that he carried on business there. The Plaintiff claimed that Abbas was merely his agent and that the shop and property did not belong to Abbas, but to the Plaintiff. As evidence he provided a power of attorney in favour of Abbas.

On the evidence the court found that the power of attorney formed part of a scheme to allow Abbas to trade without the necessary license. The Plaintiff, who had a certificate, allowed Abbas to use his name and certificate. The power of attorney was to be used if anyone found out that Abbas was not the Plaintiff. Abbas could then say that it was not his business but that it was the Plaintiff's business and that he was merely the agent of the Plaintiff.

De Villiers AJ found that the purported agent-principal relationship between the Plaintiff and Abbas was simulated –

“Holding the view then, that it was never the intention of either plaintiff or Abbas to create the relation of principal and agent between themselves by means of the ostensible power of attorney, or to invest the plaintiff with the ownership of the shop goods, it is unnecessary for me to inquire to what extent the transaction between the plaintiff and Abbas was void as being illegal or contrary to public

⁷⁸ See also the cases of *Mcadams v Fiander's Trustee & Bell* NO 1919 AD 207 and *Schneidenberger v Pearce & Allen Ltd* 1927 SWA 93.

policy. I may, however, express the opinion that the transaction was void on the ground of illegality, its object being, beyond any doubt, to enable Abbas to trade as a general dealer without a licence, which constitutes an offence forbidden by law. It should be clearly understood that, no matter in what form such transactions are cast, the Court will inquire into their real nature and into the real intentions of the contracting parties, and will adjudicate upon them accordingly.”⁷⁹

It is noteworthy that the court clearly distinguished between, firstly, an agreement that is simulated, and therefore non-existent for lack of true consensus, and secondly, an agreement that is void for being illegal. Specifically, once it is determined that the purported transaction is simulated, it is not necessary to enquire as to whether the simulated agreement was unlawful.

2.3.5 ***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 the possession of Goldinger. The Respondent (Whitelaw & Son) claimed the value of the wagon from the Appellant, alleging that the wagon was its property. The wagon (with other wagons) had previously been sold to Goldinger by the Respondent, but Goldinger dishonoured some of the promissory notes that he had issued for the wagons. It was then agreed that three of the wagons (including the wagon in dispute) would be sold back to the Respondent, and Goldinger would be credited for their value, reducing his total debt. It was however understood that the Respondent would not take possession of the wagons but that Goldinger would sell the wagons for the Respondent's account and send the Respondent the proceeds. The question to be decided was whether the Respondent became the owner of the wagon, even though it never took actual delivery of the wagon. However, a similar question arose to that in *Hofmeyer v Gous*⁸⁰ and *Zandberg v Van Zyl*⁸¹, being whether the true nature of the transaction was one of sale or pledge.

There were five separate judgments⁸², but Innes CJ held that –

“The transaction was in essence, therefore, not a sale but a pledge. No doubt the

⁷⁹ *Mohamed Abdullah v Levy* 1916 CPD 302 at p 308.

⁸⁰ 10 SC 115.

⁸¹ 1910 AD 302.

⁸² Judgments were delivered by Innes CJ, Maasdorp JA, De Villiers AJA, Juta AJA and Solomon JA (dissenting).

*parties thought that by going through the form of a sale they could secure the benefits of a pledge. But in that they were mistaken. ...There is no occasion to stigmatise the arrangement as fraudulent; it was simply an attempt to obtain the effect of a pledge under the form of a sale; and though it took place seven months before insolvency, it was, I think, entered into to safeguard the respondents against the possibility of just such a contingency as has actually happened.*⁸³

The significance of this case lies in the fact that it was recognised that parties may enter into a simulated transaction without any deliberate intention to disguise or defraud. Maasdorp JA noted that: *"It is quite possible that a person may honestly believe that in law he can obtain the security of a pledge by going through the forms of a sale."*⁸⁴

Juta AJA noted that: *"The parties may have been perfectly honest and bona fide in trying to come to some arrangement which in law will not entitle the plaintiffs to claim the wagons or its proceeds"*.⁸⁵

De Villiers AJA was, however, not entirely convinced as to the *bona fides* of the parties and stated that –

"The truth of the matter is that the circumstances under which the arrangement was made were not sufficiently investigated to enable the Court to say affirmatively that it was not in fraud of creditors. And I have equal difficulty in saying that the transaction was a genuine one. The plaintiffs (through their agent Taylor) admit it was their object to obtain security. "We wanted the money or some form of security." That is, all they were concerned about was the purchase price of the wagon or some form of security for the purchase price. This strongly points to pledge. They did not wish to obtain the property in the wagon; the wagon for its own sake they did not want.... This again points to a pledge rather than a bona fide resale... Looking at the evidence as a whole, I am not satisfied that the alleged resale was not a pledge, but put in this form to enable the plaintiff in case of insolvency to advance the claim he now sets up. "Simulatio ab uno

⁸³ *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66 at p 79.

⁸⁴ *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66 at p 91.

⁸⁵ *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66 at p 98.

contractu ad alium non valet" (Gothofredus, Ad. C. 4, 22).⁸⁶

2.3.6 ***Dadoo Ltd and others v Krugersdorp Municipal Council 1920 AD 530***

This case concerned a particular statute that prohibited "coloured persons" from owning certain land. A person by the name of Dadoo was an Asiatic and accordingly fell within the category of persons contemplated in the statute. In order to circumvent this restriction, Dadoo incorporated a company by the name of Dadoo Ltd (Appellant) and took up the majority of the shares in it. Subsequently, Dadoo Ltd acquired certain land which Dadoo himself was prohibited from owning. The local municipality (Respondent) proceeded to apply for an order declaring the transaction to be illegal and to set aside the transfer (registration) of the land in the name of the Appellant. The Respondent's contention 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 stated that –

"... where a statute prohibits anything being done, the law cannot be circumvented by the doing of an act in an indirect manner. These rules, indeed, are, in my opinion, merely an application of a general principle, which is as much a part of English as of Roman Jurisprudence, that courts should have regard to the substance rather than to the form of a transaction, and should strip off any disguise which is intended to conceal its real nature. "Plus valet quod agitur quam quod simulate concipitur."⁸⁷

Solomon JA also stated that –

"It is perfectly legitimate; however, for persons to evade a statute by deliberately keeping outside of its provisions and by doing something which effects their purpose equally well; but without bringing themselves within the scope of the law"⁸⁸

⁸⁶ *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66 at p 92 to 93.

⁸⁷ *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at p 558.

⁸⁸ *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at p 560.

In holding that the acquisition of the property by Dadoo Ltd was not *in fraudem legis*, Solomon JA stated that –

*“I can see no good ground, therefore; for holding that this is a case in which there has been a circumvention of the statute by disguising the real transaction, or in which any fraud has been committed upon the law.”*⁸⁹

The relevance of this case is that it was effectively held that a person may deliberately make use of the shortcomings of a statute and transact in a manner so as to remain outside the ambit of that statute. This by itself, or the mere fact that the spirit of a statute has been contravened (as opposed to its language), will not render a transaction *in fraudem legis* or simulated. Where the transaction in substance falls outside of 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.⁹⁰

It is instructive to compare this case with *Colonial Banking and Trust Co Ltd v Hill's Trustees* 1927 AD 488. In the latter case the principles established in *Dadoo Ltd and others v Krugersdorp Municipal Council*⁹¹ were confirmed⁹², but on the facts the transaction was found, in substance, to fall within the language of the relevant statute.

2.3.7 ***Kilburn v Estate Kilburn* 1931 AD 501**

In this case Kilburn's estate had been sequestrated and his wife (Appellant) instituted action against the trustee of the insolvent estate (Respondent) for the release of certain property (as well as rent) and an amount secured by a bond over the insolvent's immovable property.

In respect of the amount secured by the bond the court held it was never the intention of the parties that the amount should be owing to the Appellant but only that she should have a secured claim upon insolvency. There was accordingly no true debt and the security could not operate.

⁸⁹ *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at pp 561 to 562.

⁹⁰ See also the *dicta* of Innes CJ in *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at pp 547 to 549 and 552.

⁹¹ 1920 AD 530.

⁹² *Colonial Banking and Trust Co Ltd v Hill's Trustees* 1927 AD 488 at p 493.

In respect of the property (and rent) the court held that Kilburn had used his money to purchase the property but caused it to be registered in the name of the Appellant with the intention of “*defeating the rights of creditors*”.⁹³ There had been no loan to the Appellant enabling her to purchase the property for her own benefit. Specifically, Wessels ACJ held that –

*“It is a well known principle of our law that Courts of law will not be deceived by the form of a transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance. Plus valeat quod agitur quam quod simulate concipitur.”*⁹⁴

The appeal was accordingly dismissed.

2.3.8 ***Lawson and Kirk v South African Discount and Acceptance Corporation (Pty) Ltd 1938 CPD 273***

Lawson and Kirk (Plaintiff) borrowed money from the Defendant. The Plaintiff’s contention was that the purported sale by the Plaintiff of certain hire purchase contracts to the Defendant was in actual fact the extension of loans by the Defendant to the Plaintiff and the hire purchase contracts were given in security. The Plaintiff further contended that the Defendant levied excessive interest on the loans (in contravention of the Usury Act of 1926) and the Plaintiff accordingly claimed repayment of such excessive interest from the Defendant. In essence, the Plaintiff contended that the loans were merely cast in the form of a sale to escape the provisions of the statute.

After considering all the facts, the court found that there were too many aspects relating to the transactions that indicate that, in substance, the transactions constituted a series of loans and not sales.⁹⁵

In his judgment, Davis J made the following important remark –

“If a man is thought to have been working industriously to make a loan appear to be a sale, it is obvious that not much heed can be paid at any appearances of sale, unless perchance, they be so consistent that it is possible to say: “This must in truth have been a genuine sale: no man could so consistently and so

⁹³ *Kilburn v Estate Kilburn* 1931 AD 501 at p 507.

⁹⁴ *Kilburn v Estate Kilburn* 1931 AD 501 at p 507.

⁹⁵ *Lawson and Kirk v South African Discount and Acceptance Corporation (Pty) Ltd* 1938 CPD 273 at p 298.

*successfully have simulated all its features: he was bound to have slipped up somewhere." But it is the places where he has slipped up which must necessarily be of paramount importance, for if it were a genuine sale, then there was no possible reason why he should ever have slipped up at all. A Parisian cripple is suspected of being a German spy in disguise: that he habitually speaks French and limps on two sticks matters not at all: that he was once heard speaking fluent German and was seen to run may well be conclusive.*⁹⁶

The relevance of the above remark is that courts will look for inconsistencies in the actions of the parties to detect simulation. A single inconsistency can negate all the characteristics of the transaction that may have been perfectly simulated.

2.3.9 ***Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd 1941 AD 369***

In this matter the facts were that Randles, Brothers and Hudson Ltd (Respondent) had always been able to import materials free of customs duty in that it delivered the materials to a registered manufacturer who would produce from the materials clothing items for the Respondent. The prevailing customs regulations allowed the Respondent to do so.

However, new regulations were introduced requiring registered manufacturers to whom imported goods are delivered to declare that the goods were their property, otherwise there would be no rebate of customs duty. The Respondent therefore changed its *modus operandi*. The Respondent would, purportedly, sell the materials to the manufacturer, and agree to purchase from the manufacturer the finished clothing items produced by the manufacturer from the imported materials.

The Commissioner (Appellant) sued the Respondent for customs duty, but the Natal Provincial Division ruled in favour of the Respondent. The Commissioner appealed to the Appellate Division, but Watermeyer JA, Centlivres JA and Feetham JA dismissed the Commissioner's appeal (De Wet CJ and Tindal JA dissenting).

The Commissioner's contention was that ownership never passed to the manufacturer, and in principle, that the sales were not genuine.

⁹⁶ *Lawson and Kirk v South African Discount and Acceptance Corporation (Pty) Ltd 1938 CPD 273 at p 282.*

Watermeyer JA neatly summarised⁹⁷ the procedure adopted in *Dadoo Ltd v Krugersdorp Municipal Council*⁹⁸ for deciding facts similar to that before the court. Firstly, one needs to interpret the statute in order to determine which transactions fall within its scope and which transactions do not. The ordinary principles of statutory interpretation apply. Secondly, the true nature of the transaction before the court needs to be determined in order to decide whether it falls within the ambit of the statute.

In respect of the latter issue, the court noted the *dicta* in *Zandberg v Van Zyl*⁹⁹ that parties may sometimes disguise their transactions, but that such a finding can only be made where it is clear that there is some other “real intention”. In this regard the court noted 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 Courts according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax. A disguised transaction in the sense in which the words are used above is something different. In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, inter partes, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be in fraudem legis, and is interpreted by the Courts in accordance with what is found to be the real agreement or transaction between the parties. Of course, before the Court can find that a transaction is in fraudem legis in the above sense, it must be satisfied that there is some unexpressed agreement or tacit understanding between the parties. If this were not so, it could not find that the ostensible agreement is a pretence. The blurring of this distinction between an honest transaction devised to avoid the provisions of a

⁹⁷ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 394.

⁹⁸ 1920 AD 530.

⁹⁹ 1910 AD 302 at p 309.

*statute and a transaction falling within the prohibitory or taxing provisions of a statute but disguised to make it appear as if it does not, gives rise to much of the confusion which sometimes appears to accompany attempts to apply the maxim quoted above.*¹⁰⁰

The importance of the above passage is that Watermeyer JA made it clear that having a purpose of avoiding the application of a statute does not automatically render a transaction simulated. If there is honest intent that a transaction should have effect as purported, then the only question is whether that transaction falls within the statute or not.

This position was again confirmed by the Appellate Division in the later case of *Du Plessis v Joubert*¹⁰¹ -

“n Transaksie wat bedink is om die betaling van ‘n statutêre belasting te vermy of ‘n statutêre verbod te ontduik, is, soos WATERMEYER, A.R., in Commissioner of Customs and Excise v. Randles, Brothers & Hudson, Ltd., 1941 A.D. 369 op bl. 395, daarop wys, nie noodwendig ‘n verbloemde transaksie in fraudem legis nie. Dit sal afhang van die bedoeling van die partye.”

On the facts it was held that there was a genuine intention by the parties to transfer ownership, and the Commissioner’s appeal failed.

2.3.10 ***Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A)**

Basil Carides sold a business (consisting of certain machines) to Air Capricorn Pty Ltd (the company) and ownership would not pass until payment. The Respondent (Plaintiff) and the company then agreed that the Respondent would pay the company’s debt owed to Carides and as a result the Respondent (Plaintiff) would acquire ownership of the machines (sale). The Respondent would then immediately re-sell the machines to the company (re-sale), but ownership would not pass to the company until payment. The Respondent (Plaintiff) paid Carides and assumed it had become the owner of the machines (re-sale). Subsequently the company sold the machines to the Appellant (Defendant), the company warranting that it was the owner. The Appellant therefore assumed that it was the owner of the machines, after delivery to him. When the

¹⁰⁰ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at pp 395 to 396.

¹⁰¹ [1968] 1 All SA 464 (A) at p 472.

company didn't pay the Respondent (Plaintiff), the Respondent instituted the *rei vindicatio* against Appellant, claim the return of the machines, of which the Appellant was the ostensible owner.

The Appellant's contention was that the sale and re-sale agreement between the company and the Respondent was a loan and pledge, and not a true sale and re-sale. The court agreed that this was the question to be decided. After considering the evidence of the Plaintiff, the court noted that –

“The inquiry cannot be limited to considering what sort of rights the plaintiff intended to acquire and what sort of agreement he imagined he was entering into. The actual meaning of the parties is to be gauged from all the circumstances of the case including an assessment of the probable state of mind of the other party to the contract and an examination of such unusual provisions as are to be found in the contract.”

After examining the “unusual provisions” of the agreement and other surrounding circumstances, Hoexter AJA makes a few interesting observations about the interplay between the *bona fides* or honest beliefs of the parties, and simulated versus genuine transactions.

He noted that, in the prior case of *Mcadams v Fiander's Trustee and Bell* NO¹⁰² De Villiers AJA had remarked that –

“...the question in cases of this kind always is what is the true nature of the transaction, and this is not necessarily determined by what a party may conceive the contract, which he enters into, to be. Parties may honestly think that they are entering into a contract of purchase and sale, which turns out to be one of pledge. Whether it is the former depends upon whether the essential elements of such a contract are present. To go back to first principles. There can be no contract of purchase and sale without the animus emendi on the part of the purchaser, and the animus vendendi on the part of the seller. And it must be a genuine animus of the one to sell and of the other to buy. It is not enough for the parties to think that they have the intention, the intention must be proved as a fact apart from what they thought.”¹⁰³

¹⁰² 1919 AD 207.

¹⁰³ *Mcadams v Fiander's Trustee and Bell* NO 1919 AD 207 at pp 223 to 224.

Hoexter AJA then compares the opposing views of De Wet CJ and Watermeyer JA on the above passage in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*¹⁰⁴. In the said case, De Wet CJ, writing a dissenting judgment, stated that –

*“I think the learned Judge intended to emphasise in the last sentence that, if the Court on a consideration of all the circumstances comes to the conclusion that the transaction was in fact not what it purported to be, it follows that however honestly the parties thought that their intention was in accord with the simulated transaction, that was not their real intention.”*¹⁰⁵

Watermeyer JA, for the majority, commented that –

*“I have some difficulty in appreciating what idea the learned Judge intended to convey by that remark. Whenever an act is voluntarily done, with the expectation that a consequence will follow, that consequence is intended (see Austin’s Jurisprudence, Lecture 19). So when a person makes an agreement thinking that he is buying, he intends to buy, and it is difficult to see how he can think that he has the intention to buy without having it. But whatever was meant by that remark, it is clear that it was an obiter dictum and that it cannot be accepted as derogating from the principles laid down in the following year by the majority of Judges in this Court in Dadoo’s case (supra).”*¹⁰⁶

The relevance of the examination by Hoexter AJA of the above quoted passages is that a problematic situation arises where parties say that they honestly believed to have agreed to something, expecting a particular consequence, and there is nothing in the evidence to cast doubt on their *bona fides*, but at the same time there is a contrary contention that what they thought they agreed to is not what they actually agreed to. It raises the question of whether it can ever be said that one is dealing with a simulated transaction where an honest intention by the parties has been proven.¹⁰⁷ The issue is however reminiscent of the previously quoted comment by Christie¹⁰⁸ regarding consensus that, *“in truth, the search is not for agreement by consent but for evidence*

¹⁰⁴ 1941 AD 369.

¹⁰⁵ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 383.

¹⁰⁶ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 399.

¹⁰⁷ *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A) at p 620.

¹⁰⁸ Christie RH (2011) *The Law of Contract in South Africa* (6th ed.) Durban: LexisNexis, at p 24.

of such agreement”.¹⁰⁹

Hoexter AJA did not take the inquiry further but disposed of the matter before him on the basis that, on all the evidence before the court, and bearing in mind that the onus of proof fell on the Respondent, the Respondent failed to prove that the transaction was genuine and that ownership of the machines was transferred to him.

The Appellate Division held that the Respondent failed to prove ownership passed to him in respect of the purported sale and re-sale.¹¹⁰

2.3.11 ***Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd 1982 (2) SA 710 (A)***

In this matter a foreign company, falling outside the jurisdiction of the South African courts purported to cede a claim to a local company (Respondent) falling within the jurisdiction of the South African courts. This was done for the purpose of enabling the Respondent to bring an application to found jurisdiction in South Africa and institute a claim against Appellants. The Appellants resisted on the basis that the cession was simulated and that the true transaction was that the Respondent would act as agent for the foreign company to recover amounts under the intended suit.

The court held that the mere fact that the claim was ceded to the Respondent in order to allow the Respondent to found jurisdiction did not by itself show that the cession was not genuine.¹¹¹ However, the foreign company and the Respondent had entered into a separate agreement whereby the Respondent was obliged to account to the foreign company for the proceeds of the action. This effectively negated the cession in that the Respondent could not keep the proceeds for its own benefit, despite the fact that the claim had been ceded to it.

Rabie JA held that –

“It may be argued, of course, that as a matter of law the respondent would be entitled to the proceeds of the claim if it succeeds in the action that is to be instituted by it, but that it undertook, in a separate agreement, to account to

¹⁰⁹ It is instructive to consider the *dicta* in *ITC 1185 35 SATC 122* at p 134 in respect of determining the intention of a party in this regard.

¹¹⁰ A later case continuing the string of cases dealing with loans and pledges disguised as sales is *Nedcor Bank Ltd v ABSA Bank Ltd 1998 (2) SA 830 (W)*.

¹¹¹ At p 25.

Freedom Tramping for those proceeds, but to look at the matter in this way would, in my view, be to look at form rather than at the rei veritas, i.e. the truth, or substance, of the matter. The truth of the matter is that the respondent will not be entitled to retain the proceeds of the claim that was purportedly ceded to it out-and-out, and that the claim therefore is, as far as the respondent is concerned, but an empty shell, having no economic content. In the circumstances there seems to be little reason to believe that the respondent was truly intended to be a cessionary that would have the rights suggested by clause 2 of the agreement.”¹¹²

The above emphasises that one has to look at the economic content of a transaction. In this case, two separate agreements, when taken together, negated each other, or cancelled each other out, resulting in no economic effect. For the court, this indicated that there could have been no true cession.

The appeal was accordingly upheld.

2.3.12 **ITC 1618 59 SATC 290**

This matter concerned an Appellant who normally provided services as a draughtsman in his own name to a labour broker, but later it was agreed that he would render his services through a close corporation of which he was the sole member. The Commissioner disregarded the close corporation and assessed the Appellant as if he rendered the services in his own name. Expenditure claimed by the close corporation was also disallowed. The Commissioner’s contention was that in truth, the Appellant was the contracting party, it being a contract of employment, and not the close corporation. It was also to be inferred that the Commissioner regarded the arrangement in respect of the close corporation to be simulated for the purpose of allowing the close corporation to claim deduction which the Appellant himself would not have been entitled to had he rendered the services as an employee.¹¹³

The court held that –

“As against that, however, one must bear in mind that a transaction is not necessarily a simulated or disguised one because it is devised for the purpose of

¹¹² *Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd* 1982 (2) SA 710 (A) at pp 25 to 26.

¹¹³ The facts in this matter can be compared to the facts in the later case of *ITC 1670 62 SATC 34* where the transaction was attacked on the basis of general anti-avoidance provisions.

gaining a tax benefit. If the parties honestly intend a contract to have the effect of its tenor, it is to be interpreted accordingly and then, so interpreted, the question will be whether the benefit in fact accrues – see for eg Commissioner of Customs and Excise v Randles, Bros and Hudson Ltd 1941 AD 369 at 395 – 63 (cited with approval in the Erf 3183/1 case, supra at 952) Thus if a businessman creates a close corporation of which he is the sole member through which he intends to conduct his business in order to obtain a tax benefit, that corporation’s dealings cannot be regarded as disguised or simulated merely because the corporation will receive a benefit on taxation which would not have accrued to the businessman if he had conducted the same business in his own name. If there is a real and genuine intention for the corporation to exist and to do business itself, the courts will give recognition thereto. Thus even if there was some tax benefit which may have accrued in casu by the incorporation of the second appellant, the fact that it may possibly have been entitled to certain deductions which would not have accrued if the first appellant had conducted the business in his personal capacity is no reason to hold that it was not in fact the contracting party.”

The judgment illustrates two very important principles. Firstly, courts do not easily disregard the existence of legal entities such as companies and close corporations.¹¹⁴ Secondly, this case applies the principle established in *Commissioner of Customs and Excise v Randles, Bros and Hudson Ltd*¹¹⁵ that the fact that a transaction has as its purpose the procurement of a tax benefit, it does not automatically imply that such a transaction is disguised or simulated.

2.3.13 ***Hippo Quarries (TVL) (Pty) Ltd v Eardley* [1992] 1 All SA 398 (A)**

In this matter a group company had ceded a claim to another group company (Appellant). The Appellant held a suretyship in respect of the debt from the Respondent and could enforce the claim by calling on the Respondent. The question arose, similar to that in the case of *Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd*¹¹⁶, of whether the cession had been genuine.

The following *dicta* by Nienaber JA is of importance –

“Motive and purpose differ from intention. If the purpose of the parties is unlawful,

¹¹⁴ *ITC 1618 59 SATC 290 at p 297.*

¹¹⁵ 1941 AD 369.

¹¹⁶ 1982 (2) SA 710 (A). The facts were however held to be distinguishable.

immoral or against public policy the transaction will be ineffectual even if the intention to cede is genuine. That is a principle of law. Conversely, if their intention to cede is not genuine because the real purpose of the parties is something other than cession, their ostensible transaction will likewise be ineffectual. That is because the law disregards simulation. But where, as here, the purpose is legitimate and the intention is genuine, such intention, all other things being equal, will be implemented.”¹¹⁷

The above passage draws a clear distinction between an agreement failing by reason of an unlawful purpose being present, and an agreement failing by reason of a lack of genuine intention to contract in light of the fact that there is some other purpose.

2.3.14 ***Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue 58 SATC 229***

The facts in this matter were that two companies, being the Appellants, each owned certain immovable property. The Appellants were both wholly owned subsidiaries of another company (Holdings), which in turn was a wholly owned subsidiary of another company (Pioneer). By means of a structured transaction, the Appellants leased their immovable property to a pension fund (Fund). The Fund could erect buildings on the land, but this would become the property of the Appellants. In turn, the Fund sub-let the immovable property to Pioneer. The Fund was obliged to construct buildings and Pioneer would pay consideration to the Fund for constructing the buildings in addition to the rental (the Fund proceeded to claim a tax deduction for the additional amount paid to the Fund). The Appellants would only receive 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 acquires a right to have the land improved, income is deemed to have accrued to that taxpayer. In respect of the purportedly agreed structure, the Appellants did not acquire any such right to have their land improved, and claimed 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 irrelevant. The Commissioner (Respondent) disregarded 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 improved accrued to the Appellants.

¹¹⁷ *Hippo Quarries (TVL) (Pty) Ltd v Eardley* [1992] 1 All SA 398 (A) at p 398.

The court proceeded from the following initial comment –

*“Affiliated companies are of course at liberty to structure their mutual relationships in whatever legal way their directors may prefer; but when, for no apparent commercial reason, a third party is interposed in what might equally well have been an arrangement between affiliates, it is not unnatural to seek the motive elsewhere.”*¹¹⁸

This is relevant in that, effectively, the lack of a “commercial reason” behind the interposition raised suspicion as to the motive of the parties.

In this regard, the court dealt with two relevant principles.

The first principle is that explained in the English case of *IRC v Duke of Westminster*¹¹⁹ being that “[e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be...”¹²⁰

Interestingly, the court noted that “[i]n effect it involves the application of the more general principle, recognised eg in *Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530 at 548 and *Van Heerden v Pienaar* 1987(1) SA 96(A) at 107E–F, which permits parties to arrange their affairs so as to remain outside the provisions of a particular statute.”¹²¹

In determining whether the taxpayer had been successful in this regard, a second principle comes into play. This is essentially the principle that substance prevails over form¹²², as had been previously formulated by South African courts, such as in *Dadoo Ltd and others v Krugersdorp Municipal Council*¹²³.

As to the interplay between these two principles, Hefer JA held that –

“Provided that each of them is confined to its recognised bounds there is no reason why both principles cannot be applied in the same case. I have indicated

¹¹⁸ *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at pp 235 to 236.

¹¹⁹ [1937] AC 1.

¹²⁰ *IRC v Duke of Westminster* [1937] AC 1 at p 19.

¹²¹ *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 238.

¹²² *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 239.

¹²³ 1920 AD 530 at p 547.

that the court only becomes concerned with the substance rather than the form of a transaction when it has to decide whether the party concerned has succeeded in avoiding the application of a statute by an effective arrangement of his affairs. Thus applied, the two principles do not conflict.”¹²⁴

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 actually 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.*”¹²⁵

The relevance of the above *dicta* is that parties may very well reach consensus as to the form or structure of a transaction, but that is irrelevant. The parties must actually intend for the purported content of the agreement to create binding legal rights and obligations between them.

The court then continued to examine the written agreements comprising the transaction and points to various features that indicate that the parties attempted to give “*each agreement a semblance of self-sufficiency*” and noted that there was a “*distinct air of unreality about the agreements*”.¹²⁶ Specifically, the court noted that the “*anomalies are consisted with a wider, unexpressed or tacit understanding the terms of which have not been divulged*”.

Specifically, the court noted that the “*Fund was not interested in hiring the stands as an ordinary tenant and was prepared to enter into a lease merely because the land would immediately be sublet*”.¹²⁷ This would appear to indicate that the court did take into account whether there had been a commercial rationale for the Fund to participate in the transaction as a lessee and sub-lessor.

However, the court confirmed, although somewhat ambiguously considering the above passage, that “*the agreements cannot merely be regarded as a device aimed at the reduction and avoidance of tax but ...they must be viewed in the broader context of an*

¹²⁴ 229 at p 239.

¹²⁵ *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 240.

¹²⁶ *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 241.

¹²⁷ *Ibid.*

*arrangement of the affairs of the parties inter se.*¹²⁸

This is important in that one should not take a narrow approach and dismiss a transaction as simulated merely because it was aimed at tax avoidance, but rather enquire as to, in the context of the parties being free to arrange their affairs, whether true legal rights and obligations were created between them.

On the evidence, the court found that Appellants could not show that the written agreements reflected the true intentions of the parties, and the appeal was accordingly dismissed.

2.3.15 ***Rellier (Pty) Ltd v Commissioner for Inland Revenue* 60 SATC 1**

In this matter the facts were similar to the facts in the case of *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue*¹²⁹. The Appellant, a company, had acquired a property by means of a structured transaction, leased it to a tax exempt provident fund (Fund), which in turn sub-let the property to another company. The transaction entailed the erecting of buildings on the property, for which sub-lessee would claim a deduction but the Fund, being exempt, would not be liable to tax on the benefit. The Commissioner contended that a right to have improvements effected on the property accrued to the Appellant and assessed it to tax, that being the effect of the true agreement between the parties.

Harms JA aptly summarised the principles espoused in *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue*¹³⁰ as follows –

*“In the main this court concluded that although the law permits people to arrange their affairs so as to remain outside the provisions of a particular statute..., including a taxing provision, the question in the end remains whether the arrangement was one of substance and not one of form... More to the point, it was held that parties cannot arrange their affairs through or with the aid of simulated transactions ... and effect will be given to unexpressed agreements and tacit understandings...”*¹³¹

¹²⁸ *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 242.

¹²⁹ 58 SATC 229.

¹³⁰ 58 SATC 229.

¹³¹ *Rellier (Pty) Ltd v Commissioner for Inland Revenue* 60 SATC 1 at p 6.

On considering the facts the court noted that there had never been an intention by the Fund to use the property. The court took account of the fact that renting a property merely to sub-let it is legitimate, but that usually one would expect such a lessee (such as the Fund) to benefit. In the circumstances the Fund did not stand to benefit at all. This remark by the court can be interpreted as an allusion to there being a lack of commercial rationale by the Fund, and that the claimed intentions of the Fund could not be supported on the facts.

On the facts, the court concluded that the transaction was simulated.

2.3.16 ***ITC 1636 60 SATC 267 and Commissioner for Inland Revenue v Conhage (Pty) Ltd 61 SATC 391***

In this matter the Appellant had entered into a sale and lease-back transaction with a financial institution, in terms of which it sold certain equipment for a capital sum and immediately leased the said equipment back. It claimed a tax deduction in respect of the rentals paid on the lease. The Commissioner (Respondent) disallowed the deductions claimed on the basis that they were not rentals; rather, the transaction was more akin to a loan.

The Respondent did not contend that the parties acted dishonestly. Rather, it contended that even where the parties honestly believed they could procure a certain result by going through the form of a sale and lease-back, they had no true intention to enter into such an agreement.

Hefer JA raised the issue that –

“If the parties did not intend to deceive, how did it come about that they entered into agreements which they knew would have no effect inter se as sales and leaseback? The problem facing the Commissioner is that he has discarded the possibility that the agreements were deliberately disguised. The only explanation which he is able to suggest is that the parties might have believed that the formal instruments would gain them the desired tax benefits. But this is sheer speculation which finds no support in the evidence and is against the

*probabilities.*¹³²

The above suggests that where the *bona fides* of the parties are not in question, it is all the more difficult 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 comprising multiple agreements, one should have regard to all such agreements as a whole.¹³³

A final remark by the court was that “*the transactions made perfectly good business sense*”¹³⁴ in that the Appellant received a capital sum for giving up ownership of the goods, and could keep using the equipment. If the suggestion by the court is that “*good business sense*” goes a long way in showing the genuineness of agreements, then one may well ask why security by means of sales¹³⁵, which makes perfectly good business sense¹³⁶, are generally regarded as simulated.

2.3.17 ***Michau v Maize Board 66 SATC 288***

In this matter the Appellant, a maize farmer, entered into certain agreements with a chicken breeder (Rainbow). In terms of the agreements the Appellant would rent a broiler site from Rainbow. Rainbow would sell to the Appellant its stock of day-old chickens at the broiler site at the beginning of the growing cycle, and at the same time agreed to repurchase the chickens at the end of the cycle at a higher price. In terms of a further agreement the Appellant appointed Rainbow to manage the broiler site. This included the milling and processing of maize to feed the chickens, which maize would be provided by the Appellant. Appellant would virtually only have to deliver maize to Rainbow.

The transaction was admittedly entered into to avoid paying a levy to the Respondent in terms of a particular statute, which levy is generally payable where maize is sold by a maize producer. However, the levy is not payable to the extent that the maize is used by the producer for its own farming operations. The Appellant entered into the said transaction in order to fall inside this exception and avoid the levy.

¹³² *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 61 SATC 391 at p 395.

¹³³ *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 61 SATC 391 at p 395.

¹³⁴ *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 61 SATC 391 at p 396.

¹³⁵ Such as in cases like *Hofmeyer v Gous* 10 SC 115 and *Zandberg v Van Zyl* 1910 AD 302.

¹³⁶ See *Nedcor Bank Ltd v ABSA Bank Ltd* 1998 (2) SA 830 (W).

The Respondent contended that the Appellant had in reality sold maize to Rainbow and that the maize was not truly used in its own farming operations.

On the facts, the Appellant played no real role in the raising of the chickens and only had to deliver maize. However, the court remarked that –

“...this, coupled with an obvious intention to avoid the levies, would not be sufficient in the absence of anything else to justify the respondent’s claim that the agreements were simulated and that the true nature of the contractual relationship between the appellant and Rainbow was one of sale.”¹³⁷

With this the Supreme Court of Appeal emphasised that an avoidance purpose is not, on its own, sufficient to conclude that a transaction is simulated.

Scott JA also further summarised the legal position in respect of simulated transactions as follows –

“It has long since been established in cases such as Zandberg v Van Zyl 1910 AD 302, Dadoo Ltd and Others v Krugersdorp Municipal Council 1920 AD 530, Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd 1941 AD 3691 and more recently affirmed in Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue 1996 (3) SA 942 (A)2 that parties are free to arrange their affairs so as to remain outside the provisions of a particular statute. Merely because those provisions would not have been avoided had the parties structured their transaction in a different and perhaps more convenient way does not render the transaction objectionable. What they may not do is conceal the true nature of their transaction or, in the words of Innes JA in Zandberg’s case supra at 309, ‘call it by a name, or give it a shape, intended not to express but to disguise its true nature’. In such event a court will strip off its ostensible form and give effect to what the transaction really is. But, while the principle is easy enough to state in the abstract, its application in practice may sometimes give rise to considerable difficulty. 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 manner in which the contract is implemented. The onus is upon the party who alleges that the transaction is

¹³⁷ Michau v Maize Board 66 SATC 288.

*simulated.*¹³⁸

On the facts, the Supreme Court of Appeal dismissed the appeal.

2.3.18 ***Mckay v Fey NO and another 2006 (3) SA 182 (SCA)***

In this matter the question was whether a certain Mr Harksen or Mrs Harksen (wife) was the lessee in terms of a written contract of lease, the lessor being the Appellant. The written contract reflected that Mrs Harksen was the lessee, but the Respondent claimed that this was a simulation and that the lessee, in truth, was Mr Harksen.

In considering the applicable legal principles the court noted the following –

*“It has long been recognised that, where parties to a transaction for whatever reason attempt to conceal its true nature by giving it some form different from what they really intend, a court called upon to give effect to the transaction will do so in accordance with its substance, not its form. See generally Erf 3183/1 Ladysmith (Pty) Ltd v Commissioner for Inland Revenue 1996 (3) SA 942 (A) H at 952C - 953A and the cases therein cited. It is important to emphasise that a transaction which is disguised in this way is essentially a dishonest transaction; the object of the disguise, which is common to the parties, is to deceive the outside world.”*¹³⁹

The relevance here is that the court notes that where the true nature of an agreement is concealed, for whatever reason, it is necessarily dishonest. The question raised here is the same question raised in *Commissioner for Inland Revenue v Conhage (Pty) Ltd*¹⁴⁰, whether parties can innocently or honestly enter into a simulated transaction. It would appear from this *dicta* that parties cannot.

A further interesting issue in this judgment is that Scott JA took the approach that it was only the Appellant’s intention that was relevant and not, in this case, Mrs Harksen’s or Mr Harksen’s intention. In other words, if the Respondent’s showed that Mrs Harksen did not have an intention to be the lessee, it would be irrelevant.¹⁴¹ This approach might be open to criticism in light of the fact that, generally, consensus between two parties need to be mutually established in order for rights and obligations to be created.

¹³⁸ *Michau v Maize Board* 66 SATC 288 at p 293.

¹³⁹ *Mckay v Fey NO and another 2006 (3) SA 182 (SCA)* at para 26.

¹⁴⁰ 61 SATC 391 at p 395.

¹⁴¹ *Mckay v Fey NO and another 2006 (3) SA 182 (SCA)* at para 27.

The court allowed the appeal, finding that there had been no simulation, and that, on the facts, Mrs Harksen had always been the person that the Appellant looked at in respect of enforcing the obligations under the lease.

2.3.19 ***Automotive Tooling Systems (Pty) Ltd v Wilkens 2007 2 SA 271***

In this matter the question arose as to whether certain services agreements were in truth contracts of employment. Cachalia AJA made an interesting comment as to the validity of an unsuccessful disguised transaction –

“[6] The Court below held the service agreements unenforceable in their entirety because they had been concluded in fraudem legis, to circumvent the provisions of the Labour Relations Act 66 of 1995 (in particular, those relating to collective bargaining). The grounds for that conclusion were that they purported to create relationships of independent contractors between the appellant and each of the first and second respondents, whereas the substance of the relationship was one of employment. This does not appear to me to be a sound conclusion. The mere fact that a contract is unsuccessfully designed to escape the provisions of the law does not in itself render it unenforceable. It is unenforceable only if the true nature of the relationship is one that the law forbids. Accepting for present purposes that the service agreements were, in truth, contracts of employment, the law does not prohibit them, and the restraints are not forbidden in themselves. In those circumstances the Court below was wrong to declare the service agreement contracts unenforceable merely because they sought to disguise the true relationship between the parties.”¹⁴²

The importance of the above observation illustrates the difference between an agreement that is unlawful and one that is simulated. A true agreement between parties might be dressed up as some other agreement, in order to escape the ambit of a statute (in this matter it was the Labour Relations Act 66 of 1995). Where the disguise is unsuccessful and the true nature of the agreement is uncovered, that true agreement, together with any relevant recorded clauses, will not be unenforceable unless it is unlawful.

¹⁴² *Automotive Tooling Systems (Pty) Ltd v Wilkens 2007 2 SA 271* at para 6.

2.3.20 **ITC 1833 70 SATC 238**

This matter raises two interesting points.

As an *obiter* remark, the court addressed the issue that had been touched on in *Commissioner for Inland Revenue v Conhage (Pty) Ltd*¹⁴³, of whether a *bona fide* transaction, not intended to disguise, can ever be a simulated transaction. In this regard the court noted that –

*“[29] The law on the subject of simulated transactions also includes the principle that notwithstanding that the parties may honestly intend to enter, and may bona fide think that they are entering into a contract of a particular nature and in no way are fraudulent or have an improper claim and the agreement is not designedly disguised, the court may nonetheless, on an analysis of the relevant facts conclude that in fact the agreement is not what it purports to be but that there is some other agreement. See Kroon J in ITC 1636 60 SATC 267 at 313.”*¹⁴⁴

Boruchowitz J was of the view that this is an established principle.

A further interesting issue is that the court agreed with the approach taken by Scott JA in *Mckay v Fey NO and another*¹⁴⁵ that a reciprocal intention on behalf of other parties to the agreement is irrelevant and only the intention of the taxpayer is relevant for purposes of the proceedings.¹⁴⁶

2.4 **Summary of established principles**

2.4.1 **General**

From the basic principles of the law of contract, as well as the cases examined above, it is clear that simulated agreements are void for lack of consensus between the parties. Rather, one must look for some other underlying agreement between the parties in respect of which there is consensus.¹⁴⁷

As mentioned, the so-called “will theory” is the main theory regarding intention and it

¹⁴³ 61 SATC 391.

¹⁴⁴ *ITC 1833 70 SATC 238* at para 29.

¹⁴⁵ 2006 (3) SA 182 (SCA) at para 27.

¹⁴⁶ *ITC 1833 70 SATC 238* at para 34.

¹⁴⁷ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

plays a central role in the South African law of contract. There must be an *animus contrahendi* and a meeting of the minds as to the content of the agreement before contractual rights and duties will be created between the parties.

This accords with the *dicta* in *Zandberg v Van Zyl*¹⁴⁸ and *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*¹⁴⁹ where the courts speak of an intention on the part of the parties that their purported agreement will “*have effect according to its tenor*”.¹⁵⁰

The courts have also made it clear that where disguised transactions are concerned, the parties “*to it do not really intend it to have, inter partes, the legal effect which its terms convey to the outside world*”.¹⁵¹

It is clear then that with the term “*effect*” the courts mean “*legal effect*”. The parties must intend for the agreement to have binding legal effect, or put differently, there must be a true *animus contrahendi*. The term “*intention*” might also properly be referred to as “*legal intention*” in this context.

The notion of simulation therefore goes to the heart of intention as a prerequisite for creating a binding contract. Simulated agreements that are void for lack of consensus should be distinguished from contracts that are unenforceable for being unlawful.¹⁵²

To illustrate the principles gleaned from the preceding cases, the following scenarios are relevant.

2.4.2 Lawful transaction disguised as another lawful transaction

In this scenario parties disguise, for some purpose, a perfectly lawful transaction as some other lawful transaction.

For example, parties could dress up a lawful donation as a sale. Their motivation might, for example, be to not pay donations tax.

¹⁴⁸ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

¹⁴⁹ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at pp 395 to 396.

¹⁵⁰ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

¹⁵¹ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at pp 395.

¹⁵² *Mohammed Abdullah v Levy* 1916 CPD 302 at p 308; *Hippo Quarries (TVL) (Pty) Ltd v Eardley* [1992] 1 All SA 398 (A) at p 398.

Where the parties have truly intended a donation, but have dressed it up to the outside world as a sale, the purported sale will be disregarded for being simulated. Since there would not have been any true consensus between the parties in respect of buying and selling, no legal rights and duties could have been created.

However, the underlying donation, being perfectly lawful, will have created legal rights and duties between the parties given that they have reached true consensus.

The underlying agreement, being the true contract between the parties (substance), will be assessed to determine whether it falls within or outside the ambit of the relevant statutory provision, in this example the provisions relating to donations tax.

The simulated agreement (in this example the sale) is referred to as the “form”. The analogy is however not always apposite and it might be more descriptive to refer to it as the “disguise”.

Even though one is not dealing with an unlawful transaction in this scenario, the very act of intentionally disguising the true transaction could constitute common law fraud. This is so because it involves the intentional making of a false representation. It could also appropriately be called tax evasion, because taxes that are in fact and in law chargeable, are not being paid.

2.4.3 **Unlawful transaction disguised as a lawful transaction**

In certain cases parties may wish to disguise their unlawful transaction as a lawful transaction.

Since unlawful agreements are unenforceable, the benefit that the parties stand to derive is clear.

This scenario was illustrated in *Mohamed Abdullah v Levy*¹⁵³ where the parties agreed that the one would lend the other his name and trading credentials to allow the other to falsely obtain a trading licence. This clearly unlawful transaction was disguised as one of agency and representation.

The court disregarded the agency arrangement as simulated (on the grounds that there had been no true consensus). It was not necessary for the court to deal with the

¹⁵³ 1916 CPD 302.

unlawfulness of the underlying agreement in order to do away with the simulated agreement.¹⁵⁴ Although, the underlying agreement would obviously be unenforceable for being unlawful.

Interestingly, in the case of *Automotive Tooling Systems (Pty) Ltd v Wilkens*,¹⁵⁵ discussed above, the court held that the underlying agreement was lawful and that the mere attempt by the parties to disguise it, which might in itself be unlawful, does not render the underlying true agreement unlawful.

2.4.4 No transaction disguised as a lawful transaction

It is conceivable that a scenario might arise where there is in fact no underlying agreement between the parties, but for some reason they pretend that there is an agreement. This could, for example, be the case where parties fraudulently wish to claim Value-added Tax refunds. Such an agreement would clearly be fictitious and fraudulent.

It appears that the courts have not specifically dealt with such a scenario before. It is clear that in *Zandberg v Van Zyl*,¹⁵⁶ Innes J was adamant that there must be some underlying, definitely ascertainable, true agreement between the parties before it can be said that one is dealing with a simulated transaction.

2.4.5 Transaction not disguised

Once it is established that the parties truly intended their agreement to have the stipulated legal effect (ie where there was consensus) the only question that remains is whether the true agreement is permitted by law (ie whether that agreement is not unenforceable for some other reason, such as unlawfulness).

In the context of tax law, once it is established that the transaction in question is genuine, the transaction might still be assailable on the grounds that it falls within the ambit of general anti-avoidance provisions.

Of particular relevance here is the rule established in *Dadoo Ltd and others v Krugersdorp Municipal Council*¹⁵⁷ and *Commissioner of Customs and Excise v*

¹⁵⁴ *Mohamed Abdullah v Levy* 1916 CPD 302 at p 308.

¹⁵⁵ 2007 2 SA 271.

¹⁵⁶ 1910 AD 302 at p 309.

¹⁵⁷ 1920 AD 530 at p 560.

*Randles, Brothers and Hudson Ltd*¹⁵⁸ that the purpose, motive or objective of avoiding the application of a statute (including a tax statute), does not render a transaction a disguised transaction.

2.4.6 Honest simulation

It is an interesting question whether parties can innocently or unintentionally simulate a transaction.

In *Zandberg v Van Zyl*¹⁵⁹ Innes J did not “apply any harsh words” to the transaction, but still found it to be simulated. Likewise, in *Goldinger's Trustee v Whitelaw & Son*¹⁶⁰ 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*¹⁶¹ the court distinguished between an honest transaction devised not to fall within a statute and a disguised one designed 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.¹⁶²

In *Vasco Dry Cleaners v Twycross*¹⁶³ the court also raised the issue and compared the views of De Wet JA and Watermeyer JA in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*¹⁶⁴.

In *Commissioner for Inland Revenue v Conhage (Pty) Ltd*¹⁶⁵ it was again brought up, and in *ITC 1833*¹⁶⁶ the court took it as an established principle that there can be an honest simulation.

It appears that there is no certainty in this regard yet.

The relevance of this in the context of tax law is whether a transaction involving 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

¹⁵⁸ 1941 AD 369 at p 395.

¹⁵⁹ 1910 AD 302 at p 313.

¹⁶⁰ 1917 AD 66.

¹⁶¹ 1941 AD 369 at p 396.

¹⁶² *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 399.

¹⁶³ 1979 (1) SA 603 (A).

¹⁶⁴ 1941 AD 369 at p 396.

¹⁶⁵ 61 SATC 391 at p 395.

¹⁶⁶ 70 SATC 238 at para 29.

so, would such an honest simulation constitute tax evasion? This matter is discussed further below.

2.4.7 Detecting simulation

In *Lawson and Kirk v South African Discount and Acceptance Corporation (Pty) Ltd*¹⁶⁷ the court used the analogy of the Parisian cripple to the effect that, in order to detect simulation, one should look for where the parties “slip up” and where their behaviour is inconsistent with what is purported.

In *Zandberg v Van Zyl*¹⁶⁸ the court also made it clear that it is a factual enquiry alone that will reveal whether there has been simulation.

In *Michau v Maize Board*¹⁶⁹ it was stated that –

“But, while the principle is easy enough to state in the abstract, its application in practice may sometimes give rise to considerable difficulty. 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 manner in which the contract is implemented.”

In *ITC 1636*¹⁷⁰ the court listed many of the relevant factors that will be taken into account –

“...the court will look to the historical background to the transaction; 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 (eg in the case of a sale the relationship between the purchase price of the goods and the value thereof); the manner of implementation thereof; the subsequent conduct of the parties; the intention of the parties as declared in the agreement or in evidence given by the parties; any indicia that the parties did not intend to implement the agreement as recorded or that the agreement did not reflect their true intention. The list is not exhaustive. It need hardly be added that

¹⁶⁷ 1938 CPD 273 at p 282.

¹⁶⁸ 1910 AD 302 at p 309.

¹⁶⁹ 66 SATC 288 at p 293.

¹⁷⁰ 60 SATC 267 at p 313.

the relevant circumstances must be looked at in their entirety and with regard to their cumulative effect. In doing so the court must further bear in mind the principle that if parties divide a legal transaction into two or more transactions, the true transaction may be one composition transaction embracing all the transactions – in which case that transaction must be recognised as the only one.”

These factors may be referred to as *indicia*, or in the appropriate context, as *facta probantia*.

As mentioned above in respect of the will theory, it is not always easy to determine the subjective intentions of the parties, and the same difficulties therefore arise in the detection of simulation, as pointed out in *Michau v Maize Board*¹⁷¹. The courts therefore have no choice but to examine the objective facts proved.¹⁷²

It is important to note that it is not only the type of transaction that can be simulated, but also the parties to the transaction or the amount involved.

2.4.8 Onus of proof

In ordinary civil matters the onus of proof is generally on the party alleging simulation.¹⁷³ However, in tax appeals the overall onus is on the taxpayer by virtue of statute.¹⁷⁴

¹⁷¹ 66 SATC 288 at p 293.

¹⁷² See also Pretorius CJ “Simulated agreements and commercial purpose” *THRHR* Vol 75 p 688 at pp 688, 692 and 694 to 396.

¹⁷³ *Michau v Maize Board* 66 SATC 288 at p 293.

¹⁷⁴ *ITC 1833* 70 SATC 238 at para 27; Section 82 of the Income Tax Act 58 of 1962; See also section 102 of the Tax Administration Act 28 of 2011.

3 THE CASE OF *COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE V NWK LIMITED* 73 SATC 55

3.1 General

On 1 December 2010 the Supreme Court of Appeal delivered judgment in the case of *Commissioner for the South African Revenue Service v NWK Limited*¹⁷⁵. Lewis JA wrote the judgment and the remaining four judges¹⁷⁶ concurred. As mentioned in Chapter 1 above, the judgment has sparked a debate in that it appears to have departed from some of the fundamental principles relating to simulated transactions, as discussed in Chapter 2.

3.2 Facts

The Respondent was NWK Limited, a public company that traded in maize. Slab Trading Company (Pty) Ltd (Slab) was a wholly owned subsidiary of First National Bank Ltd (FNB). First Derivatives operated as a division of FNB.

The various written agreements comprised the following transactions –

(a) Slab advanced a loan to the Respondent in the amount of R96 415 776, the capital to be repaid by the delivery of 109 315 tonnes of maize by the Respondent to Slab after five years. Delivery would take place through the giving of a silo certificate.

Interest was charged on the capital amount at an annual rate of 15.27%, compounded monthly in arrears and payable every six months. Respondent issued ten promissory notes totalling R74 686 861 for purposes of paying the interest.

(b) First Derivatives sold to the Respondent 109 315 tons of maize by means of a forward sale. Respondent paid First Derivatives R46 415 776 immediately, but First Derivatives only had to deliver the maize five years later. Delivery was also to take place by means of a silo certificate.

(c) Slab sold to First Derivatives 109 315 tons of maize by means of a forward sale. R46 415 776 was immediately payable to Slab, but Slab would only have to deliver the maize five years later. Delivery was also to take place by means of a silo certificate.

¹⁷⁵ 73 SATC 55.

¹⁷⁶ Harms DP, Cachalia JA, Shongwe JA, and Bertelsmann AJA.

(d) Slab discounted (by way of cession) the promissory notes to FNB for R50 697 518 and the Respondent ended up paying FNB on the promissory notes to FNB.

Accordingly, Slab had a right against the Respondent for the delivery of maize in five years in terms of the loan. Respondent had a right against First Derivatives for the delivery of maize in five years in terms of their forward sale. First Derivatives had a right against Slab for the delivery of maize in five years in terms of their forward sale.

The circularity of the arrangement is clear in that that Respondent had to deliver to Slab, Slab had to deliver to First Derivatives, and First Derivatives had to deliver to Respondent. If physical delivery were to take place, the Respondent would simply receive back the same quantity of maize as it delivered.

Slab and the Respondent did however subsequently cede their respective rights to delivery of maize to FNB.

The cession by the Respondent to FNB was *in securitatem debiti* and not an out and out cession and is therefore of lesser importance. On the facts, it did not extinguish any rights.

The relevant cession is Slab's cession to FNB of Slab's right to claim delivery of maize from the Respondent. One should recall that First Derivatives had a right to claim delivery of maize from Slab in terms of their forward sale. First Derivatives and FNB are the same entity, the former being a division of the latter. Accordingly, the cession by Slab to FNB of Slab's right to delivery of maize from the Respondent effectively extinguished Slab's obligation to deliver maize to FNB (First Derivatives) in terms of their forward sale. After this cession, Slab became irrelevant as a party to the transactions. This is so because nobody owed Slab delivery of maize and Slab owed nobody delivery of maize.

What remained was that the Respondent owed FNB delivery of maize because Slab had ceded its right to claim delivery of maize from the Respondent to FNB.

Also, FNB (being one and the same entity as First Derivatives) owed the Respondent delivery of maize in terms of the forward sale between the Respondent and First Derivatives.

On the due date for delivery of the maize, FNB simply handed silo certificates to the

Respondent, and the same silo certificates were nearly simultaneously handed by the Respondent back to FNB.

It is noteworthy that, in terms of the loan between Slab and the Respondent, the capital amount of approximately R96 million would be repaid by means of the delivery of 109 315 tons of maize. However, at the same time, First Derivatives sold 109 315 tons of maize to the Respondent for approximately R46 million in terms of their forward sale. Also, Slab sold 109 315 tons of maize to First Derivatives for approximately R46 million in terms of their forward sale. It would therefore appear that there was a mismatch in the value of the maize of approximately R50 million.

The Respondent, in respect of the five year period concerned, claimed tax deductions in respect of the interest paid to FNB by means of the promissory notes.

The Appellant (being the Commissioner for the South African Revenue Service) later disallowed the deductions, and reversed them, by issuing additional assessments to the Respondent.

The Appellant's grounds were, *inter alia*, that –

- (a) The agreements did not reflect the substance of the underlying real transaction.
- (b) Slab was artificially interposed for “the purpose of reducing or evading tax”.
- (c) The true loan was for R50 million and not R96 million. The amount had been simulated.
- (e) The forward sales and cessions resulted in no maize actually being delivered and there was no true intention to trade in maize. The loan would never be repaid in maize.
- (f) The value attributed to the maize was a “fictitious value”.
- (g) The payments in respect of the promissory notes were comprised of capital and interest payments in respect of a R50 million loan, and were not purely interest payments on a R96 million loan. Only the true interest portion was tax deductible.
- (h) The true transaction was purposefully disguised by the parties to enable the Respondent to claim increased interest deductions.

The Respondent's grounds were that –

- (a) The contracts were performed in accordance with their terms. All the amounts were paid as per the agreements.
- (b) There was no underlying, unexpressed agreement other than that recorded in the documents.
- (c) The payments made by means of the promissory notes did not include capital repayments and were thus deductible as interest.

3.3 Decision

Lewis JA first dealt with the issue of the burden of proof. In tax disputes, the onus generally rests on the taxpayer.¹⁷⁷ However, in this matter the Respondent raised that the documents provide *prima facie* proof of the agreement between the parties. The court confirmed that the mere production of the documents only proves the form of the agreement, as opposed to its substance.¹⁷⁸ The form in which the agreements were cast was not in dispute.

On the issue of simulation, the court started out by confirming the following –

*“It is trite that a taxpayer may organize his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective. But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law.”*¹⁷⁹

After establishing from *Zandberg v Van Zyl*¹⁸⁰ and *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*¹⁸¹ that the intention of the parties is a determining factor in cases dealing with simulation, Lewis JA noted that –

“...the cases do not consistently approach what is really meant by a party’s intention in concluding a contract – what purpose he or she seeks to achieve –

¹⁷⁷ Section 82 of the Income Tax Act 58 of 1962; See also section 102 of the Tax Administration Act 28 of 2011.

¹⁷⁸ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at paras 40 to 41.

¹⁷⁹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 42.

¹⁸⁰ 1910 AD 302.

¹⁸¹ 1941 AD 369.

and this warrants some further consideration.”

Specifically, the court mentioned that two different approaches emerged from *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*¹⁸². Watermeyer JA, for the majority, had focused on the taxpayer’s subjective desire to transfer ownership of the materials, despite the fact that the transfer was a mere means to another end (“*a vehicle for achieving another purpose*”¹⁸³).

De Wet CJ, however, focussed on “*the substance of what was done*”. Because what was transferred was a temporary and empty right¹⁸⁴, there could not really have been an intention to transfer ownership. Lewis JA also referred to the dissenting judgment of Tindall JA. As to purpose, the taxpayer continued to require clothing items manufactured from its material.¹⁸⁵

On a reading of Tindall JA’s judgment, it is clear that he took issue with the fact that the purchase price for the materials would in fact never be paid. The raising of invoices, passing of book entries or “*passing of cheques from each party to the other*”¹⁸⁶ would come to nought. Tindall JA also noted, and Lewis JA referred to this,¹⁸⁷ that “[i]n purchases and sales, as is stated in Digest (18.1.6), what is done is followed more than what is said.”¹⁸⁸ There would effectively be no price and thus there could be no sale. Also, as to purposes, the taxpayer had always wanted the manufacturer to make clothing items for it, and it continued to wish this after the changes in the regulations took effect.

From these dissenting minority judgements it appears that there was allusion to transactions with elements of self-cancellation or that are self-defeating. When all the steps are taken together, and some cancel the other out, nothing has really happened. These transactions come to nought. For example, in that case, the transfer of naked

¹⁸² 1941 AD 369.

¹⁸³ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 47.

¹⁸⁴ *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at p 59.

¹⁸⁵ *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at p 58.

¹⁸⁶ *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at p 76.

¹⁸⁷ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 48.

¹⁸⁸ *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941 AD 369 at p 76.

dominium, or a sale, coupled with a repurchase.

It would then appear that the point Lewis JA tried to emphasise was that, where a “*right devoid of content*” is transferred, or where something is done with no economic effect (or is immediately undone), and is merely a means to an end, it indicates simulation.

In any event, Lewis JA noted that in certain cases the approach of De Wet CJ and Tindall JA had been followed, and not the approach of Watermeyer JA.

Lewis JA then mentioned¹⁸⁹ the cases of *Vasco Dry Cleaners v Twycross*¹⁹⁰ and *Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd*¹⁹¹. In the former the court appears to have looked at the features of the contract and in the latter the court considered that the ceded rights would have been ceded back. She concludes that “*in each a transaction had been concluded that to achieve a purpose other than that for which it was ostensibly concluded*”¹⁹². It appears that the point that Lewis JA tried to make was that the court took an objective approach in these cases to determine the intention of the parties, and looked at what was done.

Lewis JA mentioned¹⁹³ the cases of *Hippo Quarries (TVL) (Pty) Ltd v Eardley*¹⁹⁴ and *Commissioner for Inland Revenue v Conhage (Pty) Ltd*¹⁹⁵. According to Lewis JA, in the former case the court looked at the form and concluded that the parties “*intended to give effect*” to what they agreed and in the latter case the court found that the parties “*honestly intended*” that their agreements “*have the effect*” as contended. In both these cases the court found that there had been no simulation.

Lewis JA also made reference to the case of *S v Friedman Motors (Pty) Ltd*¹⁹⁶ where the parties entered into a sale and re-sale on hire purchase and the question was whether the transaction was simulated and not in actual fact an ordinary loan. Lewis JA

¹⁸⁹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 49.

¹⁹⁰ 1979 (1) SA 603 (A).

¹⁹¹ 1982 (2) SA 710 (A).

¹⁹² *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 59.

¹⁹³ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 50.

¹⁹⁴ [1992] 1 All SA 398 (A).

¹⁹⁵ 61 SATC 391.

¹⁹⁶ 1972 (1) SA 76 (T); Lewis JA noted that this *dicta* was upheld on appeal in *S v Friedman Motors (Pty) Ltd* (3) SA 421 (A), but in fact the appeal failed and the court found it unnecessary to enquire as to the authenticity of the transactions (at p 425) as the matter was decided on another point.

quotes¹⁹⁷ a passage in the judgment by Colman J –

*“If two people, instead of making a contract for a loan of money by one of them to the other, genuinely agree to achieve a similar result through the sale and repurchase of a chattel, 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, and that, at common law, is what it is.”*¹⁹⁸

The court did not specifically comment on the above passage, 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.

The court did however make a particular observation about *S v Friedman Motors (Pty) Ltd*¹⁹⁹ and *Commissioner for Inland Revenue v Conhage (Pty) Ltd*²⁰⁰, which is central to the debate that was to ensue. Lewis JA observed²⁰¹ that in both cases the transactions in question were held not to be simulated, and that the “*parties intended their contracts to be performed in accordance with their tenor*” and that “*there were sound reasons for structuring the transactions as they did*”.

In *S v Friedman Motors (Pty) Ltd*²⁰² the sale and repurchase allowed the seller to continue to possess the vehicle while the bank had ownership as security. In *Commissioner for Inland Revenue v Conhage (Pty) Ltd*²⁰³ the sale and lease-back similarly allowed the seller to retain the property, and this suited the commercial needs of the parties. Lewis JA importantly notes²⁰⁴ that there “*was a commercial reason or purpose for the transactions to be structured as they were*”.

It was further noted²⁰⁵ that there were true transfers of ownership. If there was any default by the sellers they would not have been able to re-acquire the property. The court seems to suggest that this implies that the intention was that true legal rights and

¹⁹⁷ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 53.

¹⁹⁸ *S v Friedman Motors (Pty) Ltd* 1972 (1) SA 76 (T) at p 80.

¹⁹⁹ 1972 (1) SA 76 (T).

²⁰⁰ 61 SATC 391.

²⁰¹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 54.

²⁰² 1972 (1) SA 76 (T).

²⁰³ 61 SATC 391.

²⁰⁴ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 54.

²⁰⁵ *Ibid.*

obligations were created.

Lewis JA then laid down the law as follows –

“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.”²⁰⁶

The above paragraph is discussed in detail below. Suffice it to say that the court proceeded to measure the facts of the case against this statement of the law.

Lewis JA asked –

“What then is the real purpose of the loan in this case? Does it have any commercial substance or make business sense? NWK argued that the loan to it by Slab, like the sales to individuals in Friedman Motors, was genuinely intended to have legal effect in accordance with its tenor. But as I have said, the hire-purchase agreements in that and similar cases made good commercial sense. They allowed the purchasers to raise finance while at the same time retaining possession of the vehicles. And there was a genuine transfer of ownership.

[58] 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 in the way it was? Was there any genuine intention to deliver maize to Slab or a cessionary?”²⁰⁷

As to the contention by the Respondent that the parties intended “to perform in

²⁰⁶ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

²⁰⁷ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at paras 57 to 58.

accordance with the terms of the contract” the court said in addition the court a quo should have asked –

“...whether there was actually any purpose in the contract other than tax evasion. This is not to suggest that a taxpayer should not take advantage of a tax-effective structure. But as I have said, there must be some substance – commercial reason – in the arrangement, not just an intention to achieve a tax benefit or to avoid the application of a law. A court should not look only to the outward trappings of a contract: it must consider, when simulation is in issue, what the parties really sought to achieve.”²⁰⁸

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.

After considering all the unusual features of the transactions, the actual effect of the transactions, and that there was no commercial purpose, the court stated –

“As I have said, the appropriate question to be asked, in order to determine whether the loan and other transactions were simulated, is 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. None is to be found. What NWK really wished to achieve was a tax advantage. What else could it, or did it, achieve through the transactions in respect of the maize? Barnard did not explain any, other than the creation of a hedge which had no effect. He could thus not honestly have believed that the contract was to be performed in accordance with its tenor.”²⁰⁹

Accordingly, the court found that –

“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.

²⁰⁸ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 80.

²⁰⁹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 86.

*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.*²¹⁰

The appeal by the Commissioner for the South African Revenue Service was accordingly upheld.

3.4 Broomberg's criticism

Broomberg's²¹¹ point of departure is that the Supreme Court of Appeal appears to have brought about a change in the established principles relating to simulated transactions by introducing a "new rule".²¹² He summarises the entrenched position, relying on the *dictum* in the case of *Commissioner of Customs and Excise v Randles, Brothers, & Hudson Ltd*²¹³, 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."*²¹⁴

According to Broomberg²¹⁵ the new rule is to be found in the following statement by Lewis JA –

*"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."*²¹⁶

²¹⁰ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 87.

²¹¹ "NWK and Founders Hill" *The Taxpayer* 2011 Vol 60 p 183.

²¹² "NWK and Founders Hill" *The Taxpayer* 2011 Vol 60 p 183 at para 6.

²¹³ 1941 AD 369 at pp 395 to 396.

²¹⁴ Broomberg E "NWK and Founders Hill" *The Taxpayer* 2011 Vol 60 p 183 at para 4.

²¹⁵ "NWK and Founders Hill" *The Taxpayer* 2011 Vol 60 p 183 at para 6.

For Broomberg, it is however not entirely clear what the new rule is because of the problematic use of the words “evasion” and “avoidance”.

He contends that, in the paragraph quoted above, Lewis JA could not have intended to mean that if the object of the transaction is to evade tax, it will be regarded as simulated. In his view, tax evasion is usually achieved by means of a simulated transaction. To state then that where there is an object to evade tax one is dealing with simulation is essentially tautological.²¹⁷

He accordingly assumes that Lewis JA must have meant “avoidance”.²¹⁸ However, if the “new rule” then reads that a transaction will be regarded as simulated where the purpose of the transaction is only to allow tax avoidance, then there is a clear departure from the as stated in *Commissioner of Customs and Excise v Randles, Brothers, & Hudson Ltd*²¹⁹ and this has serious implications for the *stare decisis* principle.²²⁰ This is so specifically in light of the fact that no reasons were explicitly tendered for justifying such a departure.²²¹

It further also has implications for rule of law in that, if legal rights and duties have been created that do not fall with a taxing statute, even after considering any general anti-avoidance provisions, then the transaction does not attract tax and that is how the legislature intended it to be – it is not for the court to tax transaction by declaring them simulated for the mere fact they avoid tax.²²²

Broomberg also mentions a previous practice note from the South African Revenue Service which stated that a “...*taxpayer who has carried out a legitimate tax avoidance scheme, ie who has arranged his affairs so as to minimise his tax liability, in a manner which does not involve fraud, dishonesty, misrepresentation, or other actions designed to mislead the Commissioner, will have met his duties and obligations under the Act...*”²²³

If one compares this statement to the “new rule”, it seems that there has been a move

²¹⁶ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

²¹⁷ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 9.

²¹⁸ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 10.

²¹⁹ 1941 AD 369 at pp 395 to 396.

²²⁰ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 10 to 11.

²²¹ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 13.

²²² Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 17.

²²³ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 15.

away from the idea of there being such a thing as “*legitimate tax avoidance schemes*” towards the idea that all tax avoidance schemes are dishonest simulations.

Broomberg mentions that, to him, it is clear that Lewis JA believes that it is “*unacceptable*” for persons to enter into binding agreements that are aimed solely at tax avoidance.²²⁴

However, according to Broomberg, that is a matter for the legislature to deal with through legislating general anti-avoidance provisions, and it has done so to the extent deemed appropriate – it is not for the courts to intervene where a transaction does not meet the requirements of the general anti-avoidance provisions.²²⁵

A further point raised by Broomberg is that new general anti-avoidance provisions were in any event introduced in 2006 which enables the Commissioner for the South African Revenue Service to disregard transactions that are solely aimed at tax avoidance and have no commercial substance.²²⁶ Having a new common law rule together with the general anti-avoidance provisions is undesirable as it would allow tax assessors to use either rule at their whim.²²⁷

A necessary implication of the “new rule” is that, where genuine rights and duties are disregarded as being simulated for the mere fact that they have a purpose of tax avoidance, it becomes tremendously difficult to establish what the transaction then is on which the parties stand to be taxed.²²⁸ The question that arises is whether the Commissioner for the South African Revenue Service or the court will then have free reign to put forward a transaction which attracts the most tax possible.²²⁹

As mentioned above, Lewis JA in *Commissioner for the South African Revenue Service v NWK Limited*²³⁰ compared the differing views of Watermeyer JA and De Wet CJ in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*²³¹ in respect of the approaches to the question of intention. In this regard Broomberg states that –

²²⁴ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 18.

²²⁵ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 19 to 22.

²²⁶ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 27.

²²⁷ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 28.

²²⁸ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 38.

²²⁹ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 38.

²³⁰ 73 SATC 55 at paras 47 to 48.

²³¹ 1941 AD 369.

“Although not directly expressed by Lewis JA, the intimation seems to be that she understood Watermeyer JA as being willing to accept the form, that is to say, the wording of the contract, as reflecting the true intention of the parties to the transfer of ownership, while De Wet CJ looked beyond the wording to the substance, ie to the commercial effect of the contracts; and she patently preferred the latter approach.”²³²

Broomberg does however not believe²³³ that Lewis JA’s comparison of the opposing judgments is a “fair summation” or “an accurate identification of the root cause of the different conclusions” in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*²³⁴.

Broomberg’s view of the two opposing judgments is as follows. Firstly, De Wet CJ’s view was that a sale was required to transfer ownership to the manufacturers. Watermeyer JA’s view was that a sale was not necessary, but any serious agreement coupled with the intention to transfer ownership was required.²³⁵

Secondly, De Wet CJ’s view was that unfettered ownership had to be passed to the manufacturers. Watermeyer JA’s view was that “legal ownership” had to be passed to the manufacturers and bare *dominium* would therefore suffice.²³⁶

On the issue of intention then, Broomberg concludes that there was no difference in opinion, and in actual fact, the judges concurred that the fact that the sale was entered into to avoid tax was irrelevant for determining the genuineness of the sale.²³⁷

Perhaps the most forceful criticisms that Broomberg launches against the judgment by Lewis JA is as follows.

Firstly, Broomberg notes that Lewis JA infers the “new rule” from a relatively small number of cases namely *Vasco Dry Cleaners v Twycross*²³⁸, *Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd*²³⁹, *Hippo Quarries (TVL) (Pty) Ltd v Eardley*²⁴⁰ and

²³² Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 42.

²³³ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 43.

²³⁴ 1941 AD 369.

²³⁵ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 45.1.

²³⁶ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 45.2.

²³⁷ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 46 to 47.

²³⁸ 1979 (1) SA 603 (A).

²³⁹ 1982 (2) SA 710 (A).

²⁴⁰ [1992] 1 All SA 398 (A).

*Commissioner for Inland Revenue v Conhage (Pty) Ltd*²⁴¹ – the inference being that where there had been a commercial purpose and not just an avoidance purpose, there was no simulation.²⁴²

However, Lewis JA disregarded *Zandberg v Van Zyl*²⁴³, *Dadoo Ltd and others v Krugersdorp Municipal Council*²⁴⁴, and *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*²⁴⁵, which firmly established in no uncertain terms that “a transaction will not be regarded as simulated merely because its only purpose was avoidance of a law”²⁴⁶

Secondly, Lewis JA had found on the facts that the intentions of the parties was only ever to borrow and lend R50 million and not R96 million and it was accordingly wholly unnecessary to introduce the “new rule” – it follows then that the “new rule” was nothing more than an *obiter* remark.²⁴⁷

3.5 ***Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1**

3.5.1 **Facts**

In this matter the Appellants were employees of a company forming part of a group of companies. The Appellants were also participants in and beneficiaries of an employee share incentive scheme that relate to their employment within the group of companies.

In terms of the scheme, options to purchase certain shares were granted to the participants, which they could exercise within 21 days. On exercising the option, delivery of the shares and payment of the purchase price was delayed until a future date. Also, during the intermediate period, even though the shares were considered to have been technically purchased, the participants were contractually restricted from disposing of the shares or dealing with them in any manner. The participants were also not entitled to dividends and voting rights in respect of the shares. Only once delivery and payment took place could the employees deal with the shares in an unrestricted manner.

²⁴¹ 61 SATC 391.

²⁴² Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 48 to 49.

²⁴³ 1910 AD 302.

²⁴⁴ 1920 AD 530.

²⁴⁵ 1941 AD 369.

²⁴⁶ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 50.

²⁴⁷ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 58 to 59.

The scheme managed to circumvent the provisions of section 8A of the Income Tax Act²⁴⁸ by bringing forward the date of the purchase, but deferring actual delivery and payment. This allowed the said section only to capture and tax the growth that the rights would have experienced during the 21 day period and not the potentially much larger growth that the rights would have experienced over the longer period until delivery and payment. The option was also coupled with an obligation on the participants to resell their shares back to the group if they terminated their employment before the time of delivery and payment.

The Respondent, being the Commissioner for the South African Revenue Service raised the issue of simulation. Specifically, it was contended that the exercise of the options in question was not a true unconditional sale, but a sale subject to the suspensive condition that the participants remain in the employ of the group until the time of delivery and payment.

The Respondent specifically relied²⁴⁹ on the decision in *Commissioner for the South African Revenue Service v NWK Limited*²⁵⁰.

It was contended by the Respondent that –

- (a) The resale provision was “*uncommercial for no regard was had to the current value of the shares*”.²⁵¹
- (b) There was no commercial purpose behind the introduction of the resale provision and it was introduced merely to disguise the conditionality of the sale.²⁵²
- (c) The only reason for the introduction of the resale provision was to avoid tax.²⁵³
- (d) The “practical reality” was that the sale would be conditional.²⁵⁴

²⁴⁸ No 58 of 1962.

²⁴⁹ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 71.

²⁵⁰ 73 SATC 55.

²⁵¹ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 75.

²⁵² *Ibid.*

²⁵³ *Ibid.*

²⁵⁴ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 77.

3.5.2 Decision

The matter came to be heard by a full bench in the Western Cape High Court. Davis J²⁵⁵ wrote the majority judgment and Waglay J wrote a separate judgment.

Davis J referred to the controversial paragraph in *Commissioner for the South African Revenue Service v NWK Limited*²⁵⁶, mentioned above, in which Lewis JA laid down the law in respect of simulated transactions. Specifically, Davis J commented as follows –

“[84] In my view, the key paragraph relied upon by respondent in the NWK case needs to be read within this context so as to ensure that the body of precedent is read coherently rather than reading NWK as being an unexplained rupture from more than a century of jurisprudence.... [86] It appears that the intention of this paragraph is to point in the direction which the mandated enquiry must take in such cases namely to examine the real commercial sense of the transaction. If there is no commercial rationale, in circumstances where the form of the agreement seeks to present a commercial rationale, then the avoidance of tax as the sole purpose of the transaction, would represent a powerful justification for approaching the set of transactions in the manner undertaken by the court in NWK. In this way the dictum in a relatively recent case of Scott JA in Mackay v Fey NO and Another 2006 (3) SA 182 (SCA) at para 26 can be reconciled with para [55] of NWK:

‘Before a court will hold a transaction to be simulated or dishonest in this sense it must therefore be satisfied that there is some unexpressed or tacit understanding between the parties to the agreement which has been deliberately concealed.’²⁵⁷

Davis J also referred to Broomberg’s analysis, discussed above, and commented as follows –

“Broomberg thus views NWK as a new and unjustified rule which replaces the previous jurisprudence. In my view, without an express declaration to that effect, NWK should be interpreted to fit within a century of established principle, rather

²⁵⁵ Baardman J concurred with Davis J.

²⁵⁶ 73 SATC 55 at para 55.

²⁵⁷ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at paras 84 to 86.

than constituting a dramatic rupture.”

Also, in the court’s view, the finding by Lewis J that the transaction was simulated was a factual founding –

“In my view, in NWK the court was confronted with a starkly clear set of simulated transactions. The facts of the case illustrated, without doubt, that the parties had not created genuine rights and obligations but had constructed a loan for R95 million as opposed to R50 million, purely to enable the taxpayer to obtain a greater tax benefit. Beyond this finding, there is nothing in the careful judgment of Lewis JA which supports the argument that the reasoning as employed in NWK was intended to alter the settled principles developed over more than a century regarding the determination of a simulated transaction for the purposes of tax.”²⁵⁸

In this regard it would appear that Davis J, without expressly saying so, agreed with the view of Broomberg that Lewis JA decided the matter on the facts without really applying the so-called “new rule”.²⁵⁹

Davis J thus effectively made two important points. Firstly, that Lewis JA’s judgment should be read with in the context of the precedent set by previous decisions and not be interpreted as a departure for such judgment. In other words, it is preferable to interpret the judgment as being consistent with the established body of law.

Secondly, that the test proffered by Lewis JA is really that one should enquire as to whether the agreements purport a commercial rationale, and whether there is in fact such a rationale as purported. If there is no such rationale as purported, but only an avoidance purpose, then, on considering the facts, one might be justified in saying that the transaction is simulated.

It appears then that Davis J was of the view, in interpreting Lewis JA’s judgment, that where there is a disguised purpose (as opposed to a disguised intention as to the contract), one may very well be justified in saying that a certain set of facts bears out a simulated transaction.

On the facts before the court, Davis J found that there was a “clear commercial

²⁵⁸ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 78.

²⁵⁹ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at paras 58 to 59.

purpose”²⁶⁰ and that there was no simulation.²⁶¹ Accordingly, he held in favour of the Appellants.

Waglay J, writing a minority judgment, essentially agreed with Davis J that the appeal should be upheld, but differed in respect of Davis J’s interpretation of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*²⁶²

According to Waglay J, if Lewis JA’s judgment is to be read as being consistent with the established principles, then such an interpretation would be “somewhat strained”.²⁶³

He agrees with Broomberg that –

*“NWK is a dramatic reversal of what has been a consistent view of what constitutes a simulated transaction. 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 which has as its aim tax avoidance will be regarded as a simulated transaction irrespective of the fact that the transaction is for all purposes a genuine transaction.”*²⁶⁴

However, Waglay J was of the view that the new position as expressed by Lewis J cannot constitute binding precedent because her reasoning did not demonstrate a clear and explicit rejection of the preceding authorities.²⁶⁵ Also –

*“This is further compounded by the troubled equivalence in the judgment of the phrases ‘tax avoidance’ and ‘tax evasion’, two very distinct concepts.”*²⁶⁶

Since Lewis JA used the term “tax evasion”²⁶⁷ in the apparent “new rule”, Waglay J noted that it could not find application in the matter before the court because evasion

²⁶⁰ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 89.

²⁶¹ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at para 92.

²⁶² 73 SATC 55.

²⁶³ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 32.

²⁶⁴ *Ibid.*

²⁶⁵ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 33.

²⁶⁶ *Ibid.*

²⁶⁷ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

was not an issue – but only avoidance.²⁶⁸

In a final remark, Waglay J dealt with the difference between tax evasion and tax avoidance and the peculiar use of the terms in Lewis JA's judgment –

“In any event, any transaction which has its purpose tax evasion is unlawful as tax evasion constitutes a criminal offence in terms of the Income Tax Act, NWK cannot therefore be authority for setting aside a transaction as simulated by reason of being a vehicle for tax evasion as this is automatic in terms of the law. On the other hand if the words ‘evasion of tax’ are to be substituted with ‘avoidance of tax’ then the dictum goes against the accepted practice in our Income tax law which permits transactions aimed at tax avoidance. Furthermore the confusion created by the judgment, mitigates against it serving as a precedent binding upon the lower courts.”²⁶⁹

It is clear from the above that Waglay J's reasoning follows that of Broomberg.

²⁶⁸ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 33.

²⁶⁹ *Ibid.*

5 ANALYSIS

5.1 Distinction between intention and purpose

As far as intention is concerned, and as mentioned above, intention is a necessary ingredient for the formation of a contract in South African law.

In this regard, intention involves that the parties have the necessary *animus contrahendi*, and be *ad idem* as to the contents of the agreement.

The theory that the parties are required to have this subjective mental state is described as the will theory. For convenience, one might refer to intention, understood in this particular way, as legal intention.

However, parties can, colloquially speaking, have a common intention regarding a variety of aspects that relate to their agreement. For instance, the parties could intend to use a particular set of documents or record their agreement in particular words (that is, they could agree on the structure or form)²⁷⁰. They could also commonly intend to carry out certain steps, such as delivery. Also, they could commonly intend to achieve a particular object or outcome. The latter is generally referred to as motive or purpose.

It is important that intention relating to these aspects be distinguished from legal intention. It is the legal intention of the parties that are fundamental to the creation of contractual rights and obligations between the parties.

Purpose, as mentioned, is something different from legal intention. There might be a variety of purposes or motives for a party to want to contract, and there may be a variety of objects that a party might want to achieve.

A party may also have a direct and indirect purpose. For example, a party's direct purpose might be to acquire ownership of an item by purchasing it, but his indirect purpose might be to immediately on-sell it, to let it out, to use it, to not use it, to donate it to someone else, or even to commit a crime with it.

It stands to reason that parties do not need to have a common purpose. For example, a seller might want to sell an item for a particular reason, but the purchaser might want to

²⁷⁰ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 40; *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 240.

purchase the item for another reason.

Purpose is generally relevant in the context of unlawfulness. Where a contract is concluded for an unlawful purpose, it will generally be unenforceable.

In my view, the courts appreciate the above exposition, and particularly in *Hippo Quarries (TVL) (Pty) Ltd v Eardley*²⁷¹ the court took note of the important distinction to be drawn between intention and purpose.

It is noteworthy that Lewis JA referred to this distinction in her judgment,²⁷² but she also inexplicably conflates the two terms.²⁷³

Lewis JA placed much emphasis on the purpose of the parties, as opposed to their legal intention. This is evidenced by the two factors (or tests) that she seemingly introduces²⁷⁴ –

- (a) the lack of a commercial purpose; and
- (b) the presence of an avoidance (or evasion) purpose.

5.2 Commercial purpose

5.2.1 Distinction between “having effect” and “giving effect”

An issue that, in my view, could explain much of the controversy surrounding the judgment of Lewis JA is the following.

In *Zandberg v Van Zyl*²⁷⁵ and *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*²⁷⁶ the courts referred to an intention of the parties that their purported agreement should “have effect according to its tenor”.²⁷⁷

Also, courts have stated that, where disguised transactions are concerned, the parties

²⁷¹ [1992] 1 All SA 398 (A) at p 398.

²⁷² *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 51.

²⁷³ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 45.

²⁷⁴ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

²⁷⁵ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

²⁷⁶ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at pp 395 to 396.

²⁷⁷ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

“to it do not really intend it to have, *inter partes*, the legal effect which its terms convey to the outside world”.²⁷⁸

In my view, it is clear then that with the term “*have effect*” the courts mean having “*legal effect*”. The parties must intend for the agreement to have binding legal effect. There must be a true *animus contrahendi*. They must truly intend that legal rights and obligation arise and be binding as between them, as purported.

However, in *Commissioner for the South African Revenue Service v NWK Limited*²⁷⁹ it was contended on behalf of the Respondent that the agreements “*were performed in accordance with their terms*”²⁸⁰ and the court *a quo* found that the Respondent “*acted in terms of the agreements*”²⁸¹.

The court also noted that in *Hippo Quarries (TVL) (Pty) Ltd v Eardley*²⁸² the court concluded that parties “*intended to give effect to that which they apparently agreed*” and in *Commissioner for Inland Revenue v Conhage (Pty) Ltd*²⁸³ that the agreements were “*intended to have the effect contended for by the parties*”.²⁸⁴

In respect of *S v Friedman Motors (Pty) Ltd*²⁸⁵ and *Commissioner for Inland Revenue v Conhage (Pty) Ltd*²⁸⁶ the court also noted that “*the parties intended their contracts to be performed in accordance with their tenor*”.²⁸⁷

Lewis JA then stated that –

“*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*

²⁷⁸ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 395; *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 58 SATC 229 at p 240.

²⁷⁹ 73 SATC 55.

²⁸⁰ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 35.

²⁸¹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 37.

²⁸² [1992] 1 All SA 398 (A).

²⁸³ 61 SATC 391.

²⁸⁴ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 50.

²⁸⁵ 1972 (1) SA 76 (T).

²⁸⁶ 61 SATC 391.

²⁸⁷ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 54.

*ostensibly achieved they will intend to give effect to the transaction on the terms agreed.*²⁸⁸

It is clear that there is a fundamental distinction between parties intending an agreement to have legal effect in accordance with its tenor or terms, and parties intending to simply perform or act in accordance with the tenor or terms of their purported agreement. The latter simply means that parties agree to carry out the steps envisaged by the documents and has nothing to do with legal intention.

It is however not certain whether Lewis JA appreciated this fundamental distinction.²⁸⁹

Lewis JA stated that “*the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms*”. Taken at face value, she is partly correct, because that has never been the test for determining simulation. It has never been an established principle in South African law that the performance of an agreement as envisaged by the terms (ie carrying out the steps as recorded) proves authenticity and excludes simulation.

The decisive factor in respect of simulation has always been the legal intention (consensus) of the parties, as per the judgments in *Zandberg v Van Zyl*,²⁹⁰ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*²⁹¹ and *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue*²⁹².

If all Lewis JA meant to convey was that the fact that parties agree to act out the steps in their agreement is not sufficient to exclude simulation, then it can hardly be argued that she has altered the established principles.

However, if the court believed that the test had always been whether the parties intended to “give effect” to their agreement (ie carry out the steps), as opposed to intending that their agreement will “have effect” (ie have legal effect *inter partes*), then the proposed extension of the test is based on a false premise.

²⁸⁸ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

²⁸⁹ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 50.

²⁹⁰ *Zandberg v Van Zyl* 1910 AD 302 at p 309.

²⁹¹ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at pp 395 to 396.

²⁹² 58 SATC 229 at p 240.

Due to the practical difficulties in detecting simulation, the fact that parties have performed the steps envisaged by their agreements has always been a factor that should be considered, as indicated in *ITC 1636*²⁹³. Perhaps the only change that Lewis JA did introduce is that she pointed out that, in respect of this factor, “*the charade of performance is generally meant to give credence to their simulation*”²⁹⁴ and that performance does not necessarily indicate authenticity.

In my view, the position is that carrying out the steps as envisaged or recorded in respect of an agreement, is not, on its own, conclusive in either establishing or excluding legal intention.

5.2.2 Relevance of commercial purpose

On the assumption then, and as argued above, that Lewis JA dealt with a “test” that was never the true test in the first place, it is difficult to appreciate the value of the further statements regarding commercial purpose. Having held that the test cannot simply be whether the parties intended to perform in accordance with the tenor of their agreement, she proposed that the test should also involve “*an examination of the commercial sense of the transaction: of its real substance and purpose*”.²⁹⁵

This too, on the face of it, cannot really be faulted because courts are entitled to look at all relevant factors, and the commercial sense of a transaction (and perhaps its purpose, or lack thereof) may very well be a relevant factor to consider in appropriate circumstances to determine the actual legal intention of the parties.

However, a commercial purpose cannot be a prerequisite for entering into a genuine transaction. A party may have a variety of purposes, which may or may not be commercial in nature, and the parties to the transaction may not even share the same purpose. The purpose must however not be unlawful.

What then is the relevance of introducing commercial purpose as a determining factor?

Lewis JA stated that “*where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction*

²⁹³ 60 SATC 267 at p 313.

²⁹⁴ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

²⁹⁵ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

*on the terms agreed.”*²⁹⁶

The suggestion here is that there is an ostensible objective, disguising some other objective. That is, there is a simulated purpose and an underlying purpose.

This suggestion is highly problematic. The idea of a simulated purpose (as opposed to simulated legal intention) is unheard of in the cases dealing with simulation. Simulation is never a question of purpose. A so-called hidden agenda or disguised purpose is irrelevant in the formation of binding contracts. Only true legal intention is relevant.

The only explanation for the apparent convoluted is perhaps to be found in the context of the facts of the case.

There was an ostensible purpose on the part of the Respondent to borrow R96 million because they needed finance for their business. The real purpose was only to borrow R50 million because they needed finance in their business, and claim interest deductions as if the capital amount of the loan was R96 million.

The ostensible legal intention was to lend R96 million, and pay the capital back by means of the delivery of maize. The real legal intention, as found by the court, was only to borrow R50 million, and presumably, to pay it back by means of the promissory notes.

There was some similarity between the Respondent's purpose and its legal intention.

However, one might also observe that there is certainly not a lack of commercial purpose for the Respondent to borrow money. The only issue is the amount. There was not a commercial purpose for the Respondent to borrow the additional R46 million apart from the purpose of claiming higher interest deductions.

In addition, the purpose in respect of the structure, or the design of the transactions, was that certain elements should cancel each other out. Whereas the Respondent would receive R96 million, it would immediately use the R46 million to buy maize from FNB (First Derivatives) – the same quantity that it would need to deliver in order to settle the R96 million debt. The “substance” or net effect of this transaction would be that, on the effective date, the Respondent would only actually have R50 million of capital to use in its business.

²⁹⁶ *Ibid.*

It should also be kept in mind that in the case of *Dadoo Ltd and others v Krugersdorp Municipal Council*²⁹⁷ there was no commercial purpose in interposing the company. It merely served as a means to allow a person to control a property that he by law could not own.

Also in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*²⁹⁸ the sale to the manufacturer had no commercial purpose as such. The clothing items made from the textile was simply to be bought back. At best there was an indirect commercial purpose in that the clothing items were required for business purposes, but the direct purpose of the transaction was only to avoid taxation.

Again, in *Vasco Dry Cleaners v Twycross*²⁹⁹ there was a clear commercial purpose. The ownership of the assets was to serve as a form of security for the purchaser, even though he did not require the assets himself. The same might be said about other cases such as *Zandberg v Van Zyl*³⁰⁰. Yet, here the courts found that there had been simulation.

Also in *Skjelbreds Rederi A/S and others v Hartless (Pty) Ltd*³⁰¹ there was a clear commercial purpose – the cession allowed the foreign company to enforce a claim that it would otherwise not have been able to enforce. Here too the court found that there had been simulation.

One way of interpreting the “commercial purpose” test is to see it in the exact manner that Lewis JA described it: an examination of the transaction’s “*real substance and purpose*”.

A stated purpose for a transaction can be exposed as false when an examination reveals that the transaction has, in substance, no commercial effect (ie has no commercial purpose). Where there is such a falsely stated purpose for a transaction it may indicate a lack of legal intention and legal substance in respect of that transaction.

Pretorius³⁰² makes the point that the various objective considerations that courts take into account should be seen as supplementary criteria in light of the difficulty in

²⁹⁷ 1920 AD 530.

²⁹⁸ 1941 AD 369.

²⁹⁹ 1979 (1) SA 603 (A).

³⁰⁰ 1910 AD 302.

³⁰¹ 1982 (2) SA 710 (A).

³⁰² Pretorius CJ “Simulated agreements and commercial purpose” *THRHR* 2012 Vol 75 p 688 at p 692.

determining intention in the abstract. He notes that commercial purpose is one such supplementary criterion.³⁰³

In other words, when parties carry out the steps envisaged by their purported agreement, the steps may end up negating each other, and in some respects the parties may very well end up in the same position they started in. It might be difficult to conceive of a reason why a party would enter into a transaction in the first place where the net effect of the steps is the same as if no steps were taken at all. One might then very well ask whether an agreement that comes to nought is not merely a charade. Such a situation could indicate a defect in the legal intention of the parties.

5.2.3 English law and self-cancelling transactions

Olivier³⁰⁴ has discussed some of the major English cases dealing with the doctrine of substance over form.

She specifically deals³⁰⁵ with a string of English cases in favour of a “commercial purpose” test, namely *WT Ramsay Ltd v Inland Revenue Commissioners*,³⁰⁶ *Commissioner of Inland Revenue v Burmah Oil Co Ltd*³⁰⁷, and *Furniss (Inspector of Taxes) v Dawson*³⁰⁸.

These cases all dealt with transactions containing self-cancelling steps – these steps having no commercial purpose and indicating simulation.

In *Commissioner for the South African Revenue Service v NWK Limited*³⁰⁹ Lewis JA accepted the submission by the Appellant that “to ascertain the true intention of NWK one had to ignore entirely all the rights and obligations in respect of the maize”.

This indicates clearly that Lewis JA was faced with a transaction containing self-cancelling steps, and that the court’s approach was to ignore those steps as being simulated, to uncover the “true intention” of the Respondent.

³⁰³ Pretorius CJ “Simulated agreements and commercial purpose” *THRHR* 2012 Vol 75 p 688 at p 695.

³⁰⁴ Olivier L “Tax avoidance: options available to the commissioner for inland revenue” *TSAR* 1997 Vol 4 p 725.

³⁰⁵ ³⁰⁵ Olivier L “Tax avoidance: options available to the commissioner for inland revenue” *TSAR* 1997 Vol 4 p 725 at pp 732 to 736.

³⁰⁶ 1981 1 All ER 865, 1982 AC 300, 1981 2 WLR 449 (HL).

³⁰⁷ 1982 STC 30 (HL).

³⁰⁸ 1984 1 All ER 530, 1984 AC 474, 1984 2 WLR 266 (HL).

³⁰⁹ 73 SATC 55 at para 85.

In respect of *Furniss (Inspector of Taxes) v Dawson*³¹⁰ Olivier comments –

*“On appeal from the house of lords ... [the court] ... held that the distinguishing feature between schemes which will be upheld and those which will not, is not whether any enduring legal consequences exist, but whether the different steps inserted into a pre-ordained series of transactions have a commercial purpose other than the avoidance of tax. The doctrine of substance over form was not limited to a series of transactions which were circular and self-cancelling, aimed solely at the achievement of a fiscally beneficial purpose. The doctrine can be applied in any composite transaction as long as the following two requirements are present: First, there must be a preordained series of transactions, which may or may not include the achievement of a legitimate commercial end. Secondly, certain steps are inserted with no commercial purpose apart from the avoidance of a liability for tax. When these two requirements are present, the steps without a commercial purpose may be ignored.”*³¹¹

The above interpretation by Olivier of *Furniss (Inspector of Taxes) v Dawson*³¹² seems remarkably similar to the logic employed by Lewis JA. The resemblance is so striking, that it appears as if Lewis JA has imported the English law principles relating to simulation into South African law, and specifically those principles in respect of cases where there are self-cancelling steps, which have no commercial purpose and are aimed at avoidance.

After considering another English case, Olivier remarks that –

*“The presence of the motive of avoiding tax is thus not sufficient reason to disregard a transaction. The absence of a commercial purpose could, however, indicate that the transaction was artificial.”*³¹³

If this comment captures what Lewis JA’s judgment was intended to convey, then I certainly agree. Unfortunately Lewis JA’s judgment was not as articulate.

³¹⁰ 1984 1 All ER 530, 1984 AC 474, 1984 2 WLR 266 (HL).

³¹¹ Olivier L “Tax avoidance: options available to the commissioner for inland revenue” TSAR 1997 Vol 4 p 725 at p 735.

³¹² 1984 1 All ER 530, 1984 AC 474, 1984 2 WLR 266 (HL).

³¹³ Olivier L “Tax avoidance: options available to the commissioner for inland revenue” TSAR 1997 Vol 4 p 725 at p 736.

5.3 Avoidance (or evasion) purpose

5.3.1 Distinction between tax avoidance and tax evasion

Tax evasion, simply put, is where a transaction, as a matter of fact and law, attracts tax, but through non-disclosure or simulation, the parties escape taxation.

Simulation aimed at escaping tax constitutes tax evasion. Simulation is a means of tax evasion.

Where a genuine transaction, in fact and in law, does not attract tax, then, even where it is aimed solely at not paying tax, then it cannot be subject to tax, even though it may be termed a transaction for the avoidance of tax.³¹⁴

However, Lewis JA proposed a test to the effect that: “[i]f the purpose of the transaction is only to achieve the evasion of tax, or of a preemptory law, then it will be regarded as simulated.”³¹⁵

As pointed out by Broomberg,³¹⁶ and by Wagaly J,³¹⁷ there appears to be a lack of appreciation on the part of the court for the difference between tax evasion and tax avoidance, the former being unlawful and the latter being perfectly legitimate.

If the purpose of a transaction is tax evasion, then as pointed out by Broomberg³¹⁸ and Waglay J,³¹⁹ it is in any event unlawful. It is not necessary to enquire as to whether it is simulated.³²⁰ Broomberg assumed then that Lewis JA meant “avoidance”.³²¹

However, that would, proverbially speaking, put the cart before the horse. Just because there is a purpose (object, goal or motive) to avoid tax does not mean there is an intention to disguise or simulate anything in order to evade tax.

³¹⁴ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 395.

³¹⁵ *Commissioner for the South African Revenue Service v NWK Limited* 73 SATC 55 at para 55.

³¹⁶ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 9.

³¹⁷ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 33.

³¹⁸ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 9.

³¹⁹ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 33.

³²⁰ One should however take note of the judgment in *Mohamed Abdullah v Levy* 1916 CPD 302 where the court first enquired as to whether there was simulation, even though the underlying transaction was unenforceable for unlawfulness.

³²¹ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 10.

I would not go so far as to put words in the mouth of the court and replace the word “evasion” with “avoidance”, as Broomberg and Waglay J did. If what was stated is tautological and nonsensical, then so be it. I would however agree with Waglay J³²² that the controversial *dictum* should rather be left as a non-binding remark, not meeting the standard of clarity required to constitute binding precedent.

Accordingly, in my view, it cannot be determined with any measure of certainty whether Lewis JA meant that, if the parties to a transaction have a tax avoidance motive, then that is the end of the enquiry and simulation is established.

5.3.2 Honesty and dishonesty

In any event, in my view, an avoidance purpose cannot and does not by itself conclusively establish simulation.

This is so because the mere fact that a transaction has an avoidance purpose does not mean that there is anything dishonest about the transaction or the parties.

In my view, dishonesty is a *sine qua non* for simulation. There must be a deliberate intention to disguise.

South African courts have had opportunity to discuss the issue of “honest simulation” before, but unfortunately it appears that there has been conflicting decisions.

In *Zandberg v Van Zyl*³²³ Innes J indicated that in cases of simulation there is calculated or purposeful “*subterfuge*”, “*concealment*” or “*disguise*”.³²⁴ However, it is ironic that Innes J found against the Respondent even after implying that there was no *mala fides*.³²⁵

In *Goldinger's Trustee v Whitelaw & Son*³²⁶ the court found that there was no fraud, but still found that the transaction was simulated.

In *Mcadams v Fiander's Trustee and Bell NO*³²⁷ De Villiers AJA specifically held that

³²² *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 33.

³²³ 1910 AD 302 at p 309.

³²⁴ However, it is ironic that Innes J found against the Respondent even after implying that there was no *mala fides*.

³²⁵ *Zandberg v Van Zyl* 1910 AD 302 at p 313.

³²⁶ 1917 AD 66 at p 79.

³²⁷ 1919 AD 207 at pp 223 to 224.

parties may honestly believe they are entering into an agreement which is in actual fact another.

In *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*,³²⁸ Watermeyer JA expressed his difficulty with the statement of De Villiers AJA above by arguing that if a party thinks he is entering into an agreement, then he intends to do so, and it would be unreasonable to then say that he intends something else. In his view the remark by De Villiers AJA was *obiter*. De Wet CJ differed from Watermeyer JA.³²⁹

This issue was also later examined by Hoexter AJA in *Vasco Dry Cleaners v Twycross*.³³⁰

In *Commissioner for Inland Revenue v Conhage (Pty) Ltd*³³¹ the Supreme Court of Appeal briefly discussed the issue, and seemed to indicate that simulation may be honest or dishonest, “*depending on the use the parties want to make of it*”. However, the Commissioner for Inland Revenue failed in this case precisely because he abandoned the argument that the parties acted dishonestly.³³²

In *ITC 1833*³³³ the court took it as an established principle that honest transactions can be simulated transactions.

However, I agree with Watermeyer JA in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*³³⁴ that it is difficult to see how a party can at the same time honestly intend something but at the same time intend something else.

In my view, the cases in favour of honest simulations used as a basis those cases dealing with sales that were in fact pledges. Strangely, courts have traditionally looked with great suspicion at such sales, specifically where the purchase price is settled by the extinguishing of a pre-existing debt. In such cases there might not have been sufficient evidence to make a finding as to the dishonesty of the parties, but probably, in order to protect creditors, the courts found it justified, on the facts, to not give effect to the purported sales.

³²⁸ 1941 AD 369 at p 399.

³²⁹ *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd* 1941 AD 369 at p 383.

³³⁰ 1979 (1) SA 603 (A).

³³¹ 61 SATC 391 at para 4.

³³² *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 61 SATC 391 at para 8.

³³³ 70 SATC 238 at para 29.

³³⁴ 1941 AD 369 at p 399.

In this regard then, and in my view, an avoidance motive, in the absence of dishonesty (in the sense of a deliberate, intentional dishonest disguise) is insufficient to establish simulation.

The idea that an honest transaction, having a purpose of avoiding tax, can be regarded as a simulation, which constitutes tax evasion, cannot be sustained.

5.3.3 The sense of justice

Joubert³³⁵ has addressed the *dictum* in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*³³⁶ dealing with the principle that an avoidance purpose does not automatically render a transaction simulated.

Joubert specifically notes that –

*“Although the above dictum is, with respect, strictly logically speaking correct, it may be difficult for a court to apply in instances where circumvention of legal rules violates the court’s subconscious sense of justice. In such circumstances a court may be tempted to conclude that the parties in reality intended to enter into the type of contract to which the adverse legal rule applies directly. Although not strictly logically speaking correct, such conclusion may appear to be plausible in view of the atypical object, structure or terms of the contract which the parties entered into. For this reason it may not be possible to predict with complete confidence whether a court will conclude that a specific contract is a simulated one or not.”*³³⁷

The notion is conveyed that it is conceivable that courts may be tempted, because the purpose of a transaction was to avoid the application of an act (eg avoid tax), to say that the agreement is simulated. In other words, where a transaction is not within the spirit of a law, and is on the verge of being unlawful or falling within the ambit of a statute, a court may frown upon such transaction and may be inclined to find a way to do away with that transaction – one such way being simulation.

Broomberg has observed this violation of the court’s “*subconscious sense of justice*” in

³³⁵ Joubert NL “Asset-based financing, contracts of purchase and sale, and simulated transactions” SALJ 1992 Vol 109 p 707 at p 712.

³³⁶ 1941 AD 369.

³³⁷ Joubert NL “Asset-based financing, contracts of purchase and sale, and simulated transactions” SALJ 1992 Vol 109 p 707 at p 712.

Lewis JA's judgment –

“One can understand, of course, that Lewis JA evidently considers it unacceptable that members of the public should be permitted to enter into transactions which create binding rights and obligations, for the sole purpose of avoiding tax; and many may agree with the sentiment. That, however, does not justify the court in overriding the basic common law principle, and in creating a new common law rule to counter such tax-avoidance”³³⁸

In my view, courts should guard against this temptation as it has the potential to taint established legal principles. The blurring and straining of a legal principle and applying it in a matter where the facts do not support its application, hampers the development of law, even though, when looked at in isolation, it may appear that the law has been developed for the better.

³³⁸ Broomberg E “NWK and Founders Hill” *The Taxpayer* 2011 Vol 60 p 183 at para 18.

6 CONCLUSION

At the outset of this work it is stated that the object of the research is to determine the impact of the judgment in *Commissioner for the South African Revenue Service v NWK Limited*³³⁹ on the law relating to simulated transactions, specifically in the context of tax avoidance.

This appears to be a very difficult question. On whether there has been a change in our law at all, there are contrary views, as is clear from the two judgments in *Bosch and another v Commissioner for the South African Revenue Service*³⁴⁰.

If there has been a change, the nature of the change is by no means clear, and may come down to an introduction of English law principles into South Africa.

The specific questions relating to the broader enquiry are these –

(a) can a transaction be said to be a simulated transaction for the mere fact that it has as its aim the avoidance of tax; and

(b) does a transaction have to bear out some form of commercial sense, failing which it will be regarded as a simulated transaction.

These questions are interrelated, and concentrate on purpose, as opposed to intention, the latter being at the heart of the creation of genuine agreements.

In this regard I defer to the view³⁴¹ of Davis J, to the effect that there has not been a departure from established principles, but that an avoidance purpose, coupled with a commercially empty transaction, may in appropriate circumstances strongly suggest simulation. However, in my view, neither an avoidance purpose nor a lack of commercial rationale is, on its own, sufficient to conclude that an agreement is simulated.

In the meantime, it is perhaps best to let Lewis JA's judgment be, and allow the courts to deal with its interpretation in the future. Davis J's judgment has already taken some of the sting out of *Commissioner for the South African Revenue Service v NWK*

³³⁹ 73 SATC 55.

³⁴⁰ 75 SATC 1.

³⁴¹ *Bosch and another v Commissioner for the South African Revenue Service* 75 SATC 1 at p 27.

*Limited*³⁴², by requiring it to be interpreted consistently with the established body of law, as set out in Chapter 2. It would however be interesting to see what the Supreme Court of Appeal does in future, should the opportunity arise.

For now, when parties structure their agreements, it is important to note that, if anything, *Commissioner for the South African Revenue Service v NWK Limited*³⁴³ has emphasised that carrying out the steps alone does not prove legal intention. That has never been the test and there is thus no departure from *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*³⁴⁴.

Having said that, one should always bear in mind that in tax matters the onus of proving that a transaction is genuine, is on the taxpayer, and this may be a very difficult task. The fact that a transaction has an avoidance purpose and contains self-cancelling steps which appear to lack commercial sense does not make this task any easier for the taxpayer.

Word count: 25 396 (excluding abstract and list of resources)

³⁴² 73 SATC 55.

³⁴³ 73 SATC 55.

³⁴⁴ 1941 AD 369.

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