THE IMPACT OF *CSARS v NWK (PTY) LTD* IN DETERMINING WHETHER AN INTEREST FREE LOAN CAN BE REGARDED AS A SIMULATED TRANSACTION.

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ABSTRACT

THE IMPACT OF *CSARS v NWK LTD* IN DETERMINING WHETHER AN INTEREST FREE LOAN CAN BE REGARDED AS A SIMULATED TRANSACTION.

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This research component evaluates the impact that the doctrine of substance over form has on the use of interest free loans. The research process has a two-tiered approach. The first part focuses on the loan concept, its history and development, and current application in South African law. The second part of the process focuses on the development and application of *the doctrine of substance over form* through the common law, with an emphasis on the judgment in *CSARS v NWK Ltd*.[1]

The judgment referred to above, introduced a new concept to *the doctrine of substance over form. Lewis JA* seemingly developing the test to consider what has been coined "commercial purpose" when using the principles of the doctrine to establish whether a transaction has been simulated between parties. The research therefore, in essence, focuses on the following statements by Lewis JA with regards thereto:

1 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA).

> *"…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."*[2]

And:

> *"It 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."*[3]

The purpose of the research is to test *the doctrine of substance over form*, against the concept of an interest free loan, with an emphasis on the impact that the *ratio decidendi,* of *Lewis JA* has on the implementation of the test. The research considers the application of *the doctrine* of a selected set of cases, and the development of *the doctrine* through the common law. In this regard, the research commences with a discussion of the concept of a loan, and its development in South African law. The research then proceeds to focus on the common law of substance over form, prior to the judgment in *CSARS v NWK Ltd*. An in depth analysis is then done on the *CSARS v NWK Ltd* matter, and developments after the judgment, and these are finally compared to some international standards.

The reasoning behind this structure is to focus on, and critically analyse *the doctrine of substance over form*, and the current development and application thereof in South African tax law.

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2 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA) at 360.
3 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA) at 365.

1 INTRODUCTION

1.1 Background

> *"Every man is entitled if he can, to order his affairs so that the tax attaching under the appropriate Acts, is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue, or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."*[4]

This statement by *Lord Tomlin* in *IRC v Duke of Westminster* lays the foundation of what this research intends to address: the structuring or ordering of one's affairs in order to secure a less burdensome taxation result, as well as the application of our common law doctrine of *substance over form* on this.

1.1.1 Background to tax avoidance

Tax avoidance is no new topic to the jurisprudence of taxation. It is predictable that many taxpayers would inevitably seek a means to reduce, postpone or escape a tax liability, and, as such, avoidance schemes take many forms. Often these are difficult to detect.[5] Taxing authorities[6] attempt to curb tax avoidance by imposing anti-avoidance rules which aim at circumventing tax avoidance, with regard not only to specific situations, scenarios or schemes, but also, generally, by the implementation and enforcement of general anti-avoidance doctrines found in legislation and common law.[7]

It is often too difficult to focus on every type of transaction, scenario or scheme when developing specific anti-avoidance rules, and, as a result, The National Treasury, together

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4 *IRC v Duke of Westminster* (1936) AC 1 (19TC490) at 520.

5 Silke, (2014) 19.1.

6 The reference to taxing authorities is made generally, as anti-avoidance is not only bound to South African legislation.

7 Two types of anti-avoidance rules must be distinguished here. Specific anti-avoidance rules (also known as SAARs) are usually aimed at preventing avoidance by imposing rules on specific transactions, entities or scenarios involving the two. General anti-avoidance rules (referred to as GAARs) are broad legal principles contained in legislation. South Africa's GAARs are found in sec 80A-80L of the Income Tax Act 58 of 1962. These are often measures that target transactions that fall through the cracks of the SAARs (see WIrz P *De Schweizer Treuhander* 369). It is important to note that case law and judicial doctrines form part of South Africa's GAARs.

with the South African Revenue Authority, have introduced Section 80A-80L of the Income Tax Act.[8] This section of the Act is what can be regarded as general anti-avoidance rules. General anti-avoidance rules can be regarded as catch clauses and measures aimed at targeting scenarios that fall through the cracks of the specific anti-avoidance rules, and comprise not only of statutory clauses, but also common law doctrines developed over time through court judgments, in order to encompass situations where tax avoidance may take place. Common law principles can often nullify the need to invoke specific statutory anti-avoidance provisions.[9]

More often than not, the first step involved in identifying improper avoidance is to identify whether a scheme or transaction is disguised as something other than what the parties describe it as, or as a sham.[10] With the above in mind, the intended focus of this research will be on: the common law *doctrine of substance over form*[11]; its development and application in our courts; and the application of *the doctrine* to tax avoidance schemes which are alleged and may be regarded as simulated transactions (discussed below).

1.1.2 The doctrine of substance over form and simulated transactions

In order to avoid confusion, it is important to explain that the *doctrine of substance over form* is a common law anti-avoidance rule used to determine whether simulation has occurred, or whether a contract, arrangement or scheme is simulated in order to obtain some undue tax benefit.

The term "*simulated transaction*"[12] primarily finds its place in the realm of commercial law, but its application to taxation is ever increasing and ever relevant. The link between *the doctrine* and a simulated transaction is, however, fairly simple; where it is alleged that a contract or scheme is void based on a result of simulation, the alleged contract or scheme is tested against the principles of the *doctrine of substance over form*.[13]

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8 The Income Tax Act 58 of 1962.

9 Silke (2014) 19.

10 Silke (2014) 19.3.

11 The *doctrine of substance over form* is also referred to as "*the doctrine"*, or *"substance over form*" throughout this chapter.

12 Also referred to as "*simulation*".

13 Reference of this can be seen in various cases, the most recent being *CSARS v NWK*, which will be fully discussed hereunder. It is not relevant to go into complete detail pertaining to claims and

The doctrine has been present in South African common law from as early as 1910[14], in the matter of *Zandberg v Van Zyl.* Although this case was unrelated to the law of taxation, it has had an impact on the concept of *substance over form*, related to both tax law and commercial law for over a century. In this matter, the Court considered the test for simulation by emphasising *the doctrine of substance over form*, and confirming that a court must be satisfied that there exists a real intention to an agreement which is definitely ascertainable, which differs from a simulated intention. The learned *Innes J,* presiding over the matter, then went on further to state that if parties do intend a contract to have effect of its tenor, the situation that the same object or outcome might have been achieved in a different way or manner does not necessarily make the arrangement other than what it purports to be, and stressed that the enquiry in each case should be one of fact.[15]

Over the years, various cases have further dealt with *the doctrine*, and the test for simulation, confirming the same, or similar tests, as that set out in *Zandberg v Van Zyl*. The phrases "real intention" of the parties to a transaction which is "definitely ascertainable" was further confirmed in the latter judgment in *Commissioner of Customs and Excise v Randles Brothers & Hudson*.[16] Here, the Court further confirmed that a transaction is not necessarily disguised because it was devised to avoid a tax liability, but that if parties honestly intend to have effect according to its tenor, and the transaction is interpreted by a Court according to its tenor, the only question that remains is, whether, in this form, it falls within or outside a provision of the relevant Act.[17].

Our Courts were, seemingly, lifting the veil to examine the true nature and substance of transactions, and disregarding the manner in which they were presented, or purported to be.[18] *CIR v Conhage* is a classic example of where the Court set the tone of the judgment

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alternative claims once litigation for collecting taxes has commenced, but it is important to note that if a contract is alleged void as a result of simulation, the *substance over form doctrine* is often at the fore in determining the answer as to whether a scheme or contract is a simulation or not.

14 This is not to say that the doctrine was developed by South African Courts. This doctrine finds its place in many developed jurisdictions, and is also an established principle in International Tax Law.

15 1910 AD 302 at 309. *Innes J* initially referred to a well-known Roman principle of "*plus valet quod agitur quam quod simulate concipitur"* roughly meaning greater value is attached to what is done, than what appears to have been done. The statement above was his qualification (own words) of the maxim. The maxim is also referred to in *BC Plant Hire CC t/a BC Carriers v Grenco (SA) (Pty) Ltd* [2004] 1 All SA 612 (C).

16 *Commissioner of Custom and Excise v Randles Brothers and Hudson* (1941) 33 SATC 48 (alternative reference 1941 AD 369 at 395). See also Kilburn v Estate Kilburn 1931 AD 501.

17 *Supra n116.* (Own emphasis).

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

in its introductory paragraphs, and had focused on the bare element of what the *doctrine of substance over form* entails in matters where simulation is alleged, stating that:

> *"Within the bounds of anti-avoidance provisions in relevant legislation, a taxpayer may minimise his liability by arranging his affairs in a suitable manner. If, for [e.g.] the same commercial result can be achieved in different ways, he may enter into the way that attracts less tax or no tax. But when it comes to considering whether he has succeeded in avoiding or reducing tax, a court will ultimately look at the "true nature and substance of the arrangement and will not be deceived by its form."*[19]

Although the above referenced judgments were premised on different factual settings, the central theme is that if parties intend that an agreement or transaction be performed in a specific manner, and this is in line with the intention of the parties, it would suffice. In *Michau v Maize Board*,[20] the Court further stated that:

> *"What a taxpayer may not do, is to conceal the true nature of their transaction, or as in Zandberg v Van Zyl, call it by a name, or give it a shape, intended not to express, but disguise its true nature. In such an event a court will strip off its ostensible form and give effect to what the transaction really is."*[21]

The *substance over form doctrine* essentially focused on true intention or true purpose, rather than the form of a transaction, and whether the parties had performed in accordance with the tenor of the agreement, and whether this was reflected in their intention.[22] Consequently, common law contribution to tax avoidance was regarded as, that Courts should not be deceived by disguised and sham transactions, but instead give effect to the real transaction between parties, succinctly conveyed as the "woolly principle of substance over form."[23]

The doctrine was, however, further embedded with what the Supreme Court of Appeal phrased as "commercial or business sense" in the judgment of *CSARS v NWK Ltd*

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19 *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA) at para 1; See also *Erf3183/1 Ladysmith (Pty) Ltd and another v CIR 1996 (3) SA 942 (A)* at 950-952.
20 *Michau v Maize Board* 2003 (6) SA 459 (SCA).
21 *Supra* n17 at 464.
22 Brandt *University of Pretoria LLM* 2011 p4.
23 Silke (2014) 19.10.

(hereinafter referred to as CSARS v NWK, or the NWK matter).[24] *Lewis JA* emphasised in this judgement that the investigation into simulation should further delve into the commercial sense of the transaction when determining if simulation had occurred.[25] *The NWK matter* now placed a burden on the taxpayer to show that an actual commercial purpose existed for structuring an agreement, transaction or scheme in a particular way, and that this was to entail more than to obtain an undue tax benefit.

The *CSARS v NWK*[26] case has received much criticism in its commentary as a result of commercial purpose not being a factor when considering the simulation of an avoidance scheme with regards to the *doctrine of substance over form*. The doctrine was unnecessarily stretched, as our common law is least concerned with a transaction lacking "commercial substance" or "commercial purpose", but instead only whether it is a sham, or disguised to be something other than what it is.[27] The distinction now, is that prior to *CSARS v NWK*, a scheme, or transaction, was tested against whether it was disguised or whether it was a sham, and commercial substance had little or no bearing at common law. Post *CSARS v NWK,* however, commercial substance has now become a criterion against which avoidance schemes are tested.[28]

1.1.3 Commercial Purpose

The effect of the commercial purpose element laid down in *CSARS v NWK* may have a seemingly negative impact on many other unintended transactions. The Court, here, seemed to have moved the goalposts, with the introduction of what is termed commercial purpose, or, as the Court phrased it, commercial sense.[29] The problem was, however, that no previous judgments relating to simulated transactions had ever directly dealt with the concept of commercial purpose, nor was any definition or description provided heretofore from the learned *Lewis JA*.

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24 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA). The term "commercial purpose" is used in various forms throughout, and the court also refers to commercial sense.
25 2011 (2) SA 347 (SCA) at 55.
26 *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA).
27 Silke (2014) 19.10 (own emphasis).
28 See Silke (2014) 19-10 for his opinion with regards hereto.
29 2011 (2) SA 347 (SCA) at 55 and 80.

The concept is widely discussed in English common law, and stems from what is referred to as the *Ramsay principle.*[30] The *Ramsay principle* entails that a purposive approach be taken in determining whether simulation has occurred, and testing the transaction against two elements, namely that a transaction or series of transactions should be composite and achieve some commercial purpose, but there should be steps inserted which have no commercial (business) purpose, apart from avoidance of a liability from a taxing statute. If both these elements are met, then the inserted steps should be disregarded for fiscal purposes.[31] Although nothing in the judgment of *CSARS v NWK* makes one believe that *Lewis JA* focused on the English law origination of the principle when handing down judgment, it must be borne in mind that foreign legislation pertaining hereto, especially from the English law, could have unintended effects on the development of our common law, as English tax legislation does not codify general anti-avoidance rules.[32] The problem, it would seem, is what commercial purpose is in terms of South African law, and how it should be interpreted and applied. South African tax legislation is filled with extensive anti-avoidance provisions.

1.2 The *doctrine of substance over form* and interest free loans

With the above kept in mind, it is clear that a seemingly theoretical and practical problem exists with making use of an interest free loan to fund a sale of assets. The premise of this statement is found in the fact that, firstly, there seems no basis in law or in common law (despite anti-avoidance laws contained in section 7 of the Income Tax Act), that places a burden on any individual or entity granting a loan, to charge interest on this loan in his usual course of business. There is, furthermore, no premise indicating that interest is an essential element of a loan agreement.

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30 The *Ramsay principle* was established in the matter of *WT Ramsay Ltd v IRC* [1981] 1 All ER. For purposes hereof, a discussion of the Ramsay principle does not fall within the scope of this research, but will be touched on in chapter 4.

31 *WT Ramsay Ltd v IRC* [1981] 1 All ER 865 (HL). See also Silke (2014) 19-7. It is important to note that the referenced section has been reduced to a very basic understanding, and that the Ramsay principle was developed over four prominent English Court cases. English legislation does not contain general anti-avoidance rules, and the need to develop the common law to this extent is required. The principle deals more with a purposive approach in determining what the legislature in the England intended than mere substance over form, and the common law depicts this.

32 *WT Ramsay Ltd v IRC* [1981] 1 All ER 865 (HL). See also Silke (2014) 19-7 to 19-8.

A further problem which arises is whether, if there is no burden or basis in law, upon a person or entity to charge interest, and a seller allows a purchaser an opportunity to fund his purchase by way of an interest free loan, the transaction could lack commercial purpose or substance for non-charging of interest, and lack profit made from the transaction.

Although media tends to focus on interest free loans to trusts, and the effect of newly introduced anti-avoidance legislation thereon, it is often forgotten that interest free loans can (and are) used in many scenarios ranging from shareholder loans, to sale of an asset by way of an interest free loan to a trust, company or close corporation by the trustee, shareholder/director or member, respectively, and so on. The common practice is for the seller, in whose favour the interest free loan lies, to donate away his loan account with his annual donations tax exclusion, [33] or arrange an exchange of a superfluous, value-less asset or contingent right which has been given an inflated value, essentially resulting in the transfer of an asset without any tax consequences on a loan that does not carry interest to the loaning party. The effect is an erosion of an asset in the hands of the seller, but also the transferring of wealth in a tax-free manner.

The tax consequences of an interest free loan have been examined by our Courts before in *CSARS v Brumerria Renaissance*,[34] but this matter, and judgment of the Court, were on the attribution of income from a loan account to the borrower, to be taxed in the borrower's hands.[35] Unfortunately, the *Brumerria* matter did not shed any light on simulation as tax avoidance in the form of interest free loans. In many instances, the transactions regarded as simulated transactions are complicated and require a thorough knowledge of accounting and legal principles in order to sift through and understand what the true and basic purpose of the transaction is. The intended scope of this research is to focus on interest free loans, and to determine whether these, when tested against the *doctrine of substance over form*, can be regarded as simulated transactions or not.

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33 Income Tax Act 58 of 1962, section 56(2).

34 *CSARS v Brummeria Renaissance* 2007 6 SA 601 (SCA) (Hereinafter referred to as *Brumerria*).

35 *Supra n31.* See also Preston 2014 *North West University LLM (*Secondary source), and also Smit *Stellenbosch University MCom* for further discussion.

1.3 Research object and purpose statement

The primary research objective of this study is to evaluate the *substance over form doctrine*, and determine what effect *the doctrine* has on the sale of assets in exchange for an interest free loan. More specifically, the research will focus on the impact that the judgment in *CSARS v NWK*[36] has on such transactions.

1.4 Research questions

The foremost question to identify in this research is whether interest free loans, as a means to finance a sale of an asset, lacks substance and commercial purpose. In order to do so, the following questions need to be considered and researched, namely:

- What is a simulated transaction?
- What is the *doctrine of substance over form*?
- How was the *doctrine of substance over form* applied before *CSARS v NWK*?
- What is "commercial purpose", and can it be defined with clarity?
- What effect did *CSARS v NWK* have on the *doctrine of substance over form*?
- What is the nature of an interest free loan?
- Is interest an essential element of a loan transaction?
- What effect does the *substance over form doctrine*, and specifically the *NWK* judgment, have on interest free loans?

1.5 Importance of the study

The test for simulated transactions had been developed as part of *the doctrine of substance*

36 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA).

over form in South African law for over a century prior to the *NWK judgment*. The *NWK judgment* called for more than what our common law had provided with regards to the test for simulation, and introduced what is commonly referred to as “commercial purpose” into *the doctrine*.

The importance of this study will be in determining what commercial purpose is, and what effect it will have when applied to a common transaction such as an interest-free loan.

The benefit derived herein will attempt to aid academics and practitioners in identifying what the extent of the application of *the doctrine* may be, while simultaneously focusing on specific aspects of *the doctrine,* such as the newly introduced commercial purpose element, as well as focussing on subsidiary elements of a loan transaction such as interest, or lack thereof.

1.6 Key terms to be used

GAAR	General Anti-Avoidance Rules as contained in Section 80A-80L of the Income Tax Act
SAAR	Special Anti-Avoidance Rules
SARS	South African Revenue Service
C: SARS	Commissioner of the South African Revenue Service
NCA	National Credit Act
ITA	Income Tax Act
SCA	Supreme Court of Appeal
CGT	Capital Gains Tax
FNB	First National Bank
FD	First Derivatives

1.7 Limitations of the study

The study is limited to focusing on the common law approach in determining whether simulation has occurred, and does not consider the effect of any special or general anti-avoidance rules as contained in the Income Tax Act 58 of 1962. Any reference to special and general anti-avoidance rules will be primarily to explain what they may be, and how *the*

doctrine of substance over form, and the concept of *simulation* fit into South African tax law.

1.8 Research design and methodology

1.8.1 Research design

The research design will review and analyse existing case law into the historical development of the term "*simulated transaction*" and *the doctrine of substance over form*, and the development of the concept over the year to date. A further review of the elements of a loan and the application of the concept of interest free loans will be partaken.

Once these concepts have been sufficiently explained, an evaluation of the impact that *the doctrine of substance over form* has on interest free loans, and the result of this evaluation, will be concluded.

1.8.2 Research methodology

The research methodology will be in the form of a literature review on the relevant legislation, case law and published articles affecting the research problem, in order to clarify the current status of the *substance over form doctrine*. It is intended to broaden the research to include a specific type of transaction, namely interest-free loans, in order to define the extent of the application of the term "commercial purpose" as contained in the *substance over form doctrine*.

1.9 Planned Structure of the mini-dissertation

The main outcomes of the present study will be presented in the format of a mini-dissertation. The planned structure of the mini-dissertation is explained and summarised below.

1.9.1 Chapter 1: Introduction

This chapter will provide a background and rationale for the research to take place, and its importance in the area of tax law in South Africa.

1.9.2 Chapter 2: Theoretical analysis of the term "loan" in South African law

This chapter focuses on the concept of the term "loan" and the legal background, development and essential elements of a loan as they apply in South African law, as well as considerations that have been introduced by the National Credit Act which may affect the validity of a loan agreement. It will also look into interest as an element of a loan.

1.9.3 Chapter 3: Historical overview of the substance over form doctrine

This chapter will provide a detailed historical overview of relevant case law which relates to the definition of the concept of *substance over form*, and the development of the term "simulation" as contained in the South African common law. Select cases will be discussed and a deduction will be provided on *the doctrine of substance over form* prior to *CSARS v NWK*.

1.9.4 *Chapter 4: CSARS V NWK LTD* 2011 (2) SA 347 (SCA)

Chapter 4 will focus on a detailed analysis of the *CSARS v NWK* case, which introduced the concept of commercial purpose to *the doctrine of substance over form*, and will attempt to identify a possible definition, or defining factor of what commercial purpose is in South African law. A separate section detailing the development of commercial purpose through foreign cases will be briefly discussed, and a cross analysis with that, as developed in *CSARS v NWK,* will be attempted in order to indicate to the reader what commercial purpose entails in terms of a global context.

1.9.5 Chapter 5: Conclusion

Here a summary of whether interest-free loans can be regarded as simulated transactions, due to lack of commercial purpose, will be discussed and analysed, and will conclude with an analysis on the application of *the doctrine* to the sale of assets where payment is outstanding on an interest free loan account.

2 THEORETICAL ANALYSIS OF THE TERM "LOAN" IN SOUTH AFRICAN LAW

2.1 Introduction

When one thinks of a loan, a picture occurs in the mind of large banks offering hundreds of loans to individual clients for a combination of various needs. The reality, though, is that loans are used in various ways and forms, between various individuals and entities. A few examples of the use of loans are as follows:

- Between a shareholder and a company;
- Inter-company loans;
- Staff loans;
- Common loans from a bank, for a range of reasons from personal loans to mortgaged home loans;
- Business and corporate finance arrangements.

The above is not an exhaustive list. In the modern day, a range of terms and phrases could, and often do, refer to a loan; although, the term "loan" might not be used. Examples of these could be "obtaining financing"; "access to credit"; "line of credit"; "overdraft" and so on. These are all, in essence, loans.

The development and use of loans are age old, as "loans have been around since biblical times."[37] The purpose of this chapter is not to delve into a literary analysis of the use of biblical loans: however, a brief discussion of the history of a loan in South Africa is necessary in order to understand the current concept and workings of South African jurisprudence relating thereto.

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37 Tennant *North West University MCOM* 2010 p12. (See also Preston *North West University LLM* 2014).

2.2 Historical analysis of a "loan"

As stated above, loans have been around since biblical times.[38] The common law surrounding a loan stems from Roman Dutch law.[39] The importance of this is that the Roman Dutch initially differentiated between two types of loans; namely, loans for consumption, known as *mutuum,* and the other a loan for use, known as *commadatum*.[40]

A *loan for consumption* can be described as when a gratuitous loan for use where a borrower agreed "to return a similar object of the same value to the lender."[41] Accordingly, *mutuum* was for the principle only and did not necessarily extend to interest, and it has been stated that "friends do not demand interest from friends."[42] In early agricultural communities during this time, a loan of seed corn to be repaid after the harvest would be common sense. A loan for consumption was, simply put, where someone borrowed something or an amount and used it as if it were his own.[43] If interest was to be charged, or agreed upon, it would have been a separate obligation from the loan, or stipulation (also known as *stipulatio*), and would have to be agreed upon separately, and would be in the form of a verbal contract. The *stipulatio* contract and *mutuum* contract were two separate contracts.[44]

Loans for use on the other hand, were regarded as if a borrower has agreed to return the same object or item to the lender.[45] These were gratuitous loans for use, where one friend might have lent gratuitously to another friend.[46]

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38 *Supra* Tennant *1.*

39 This statement is applicable in as far as it relates to the South African jurisprudence of contracts and loans.

40 Watson A 1984 *Law and History Review* 1-20. Watson's discussion revolves predominantly around the actions an aggrieved party could have taken to enforce these loans, but serves as a good literary source on the development of *mutuum* and *commadatum* as they were applied in Roman Dutch law.

39 Watson *Law* 2. Unfortunately, it seemed far easier in Roman Dutch times, as returning a similar object was sufficiently easier than today. An example would be wine. In Roman Dutch times, wine was wine, whereas in the modern era, the intricacies of wine-making, grape selection, taste, viscosity and so forth would play a role. The question would be whether this application would be sufficient in the modern era. A similar example is grain, with different strains and genetically modified strands of grain. With regards to this example see Thomas *The South African Private Law* discussion from page 288 onwards.

42 Watson *Law* 6.

43 Preston *North West University LLM* 2014 p10.

44 Jansen van Rensburg *Stel LR* 35 at 43.

45 Preston *North West University LLM* 2014 p9.

46 Watson *Law* 12.

It is clear from Watson, and later secondary sources, that these loans were initially of a non-commercial nature, and no interest was borne as part of the agreement. As time went on, charging interest came to issue, and would form part of the agreement.[47]

Although *loans for consumption*, as they are described above during Roman Dutch eras, share a similarity to interest free loans at common law, there are some differences as codification and regulation of these transactions came about. The regulation of loans is furthermore discussed below, whereafter the current common law stance will be further discussed.

2.3 Codification of the "loan" in South African law

2.3.1 Repealed credit legislation

Save to say that an in-depth discussion relating to the law relating to borrowing and credit became codified, the Usury Acts,[48] Hire-Purchase Act[49] and Surety Act came into operation and were repealed over the course of the 1900s. These acts all dealt with loans and credit in South Africa, but were ultimately repealed.

Early credit legislation varied. An example can be seen as in the Law Book of the Orange Free State[50] which pronounced that money trade was to be free, and that every person was entitled to charge as much interest as they deemed fit.[51]

The Usury Act 37 of 1926 was the first consumer regulatory credit legislation, intended to regulate credit agreements where the principle debt was five-hundred thousand Rand or less. The Usury Act[52] aimed to regulate the cost of credit and consumer information disclosure, by capping interest rates, ultimately serving to protect consumers.[53]

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47 Watson *Law* 1-20. (Extremely brief summary of this article). (See also Preston *North West University LLM* 2014 p10).

48 The Usury Act 37 of 1926 as repealed, and The Usury Act 73 of 1968 as repealed.

49 The Hire Purchase Act 36 of 1942 as repealed.

50 Chapter 98. (Secondary source, Moorcroft J *Interest, usury and the bonis mores* Advocate 2014).

51 Moorcroft J *Interest* 2014. He further states that the position was similar in Natal.

52 The Usury Act 37 of 1926 as repealed

53 Rikhotso *University of Pretoria LLM* 21, Renke *LLD* 332-333. (This is an extremely shortened summary of these texts and has only been done to explain the development of credit legislation).

Quite some time after the 1926 Usury Act, The Usury Act 73 of 1968 was introduced and came into effect. This Usury Act of 1968[54] governed credit agreements exceeding five-hundred thousand Rand, and also regulated all financial matters pertaining to purchases and sales, leasing of movable property, and money lending transactions, where credit was involved.[55] The Hire-Purchase Act was also in operation around the same time, and regulated all hire-purchase agreements less than five- hundred thousand Rand.[56]

The above legislation was enacted for consumer protection in their respective applications, but have all been repealed. The gist of the repealed legislation was unified into the National Credit Act.[57]

2.3.2 *The National Credit Act 34 of 2005*[58]

2.3.2.1 The concept of credit in terms of the NCA

The National Credit Act does not specifically define the term "loan", but encompasses "credit". Credit is defined as:

(a) "A deferral of payment of money owed to a person, or a promise to defer such payment; or
(b) A promise to advance or pay money to or at the direction of another person."

Together with this definition, it is furthermore important to consider the term "credit agreement", which is defined in the *NCA* as an agreement that sets out all the criteria set out in section 8 of the Act and, furthermore, lists various different types of credit agreements.

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54 The Usury Act 73 of 1968 as repealed.
55 *Ibid.*
56 Rikhoto *LLM* 2015 p334.
57 It is important to state here that these were not the first and foremost sources of credit legislation. The first consumer credit legislation affecting loans and interest was Act 41 of 1908 (Natal) that regulated loans and interest charged to prevent the exploitation of consumers. The Cape Province also enacted Act 23 of 1908, governing interest rates on loans. This can be noted in Rikhotso *LLM* 2015. See also Renke *LLD* 2012. This serves as a reminder that the extent of a discussion of the history of loans is far too strenuous for this research project.
58 Hereinafter referred to as the "*NCA*" or "the Act".

Section 8 of the *NCA* seems to be an exhaustive list of different forms of credit agreements. On closer inspection of this section, and more specifically section 8(5)[59], it is evident that any agreement, irrespective of form, constitutes a credit guarantee if a person promises to satisfy any obligation upon that agreement and upon demand of another consumer in terms of a credit facility or credit transaction to which the *NCA* applies. Credit guarantees are considered credit agreements in terms of section 8(1)(c) of the *NCA*[60]. A credit guarantee is an agreement that meets all the criteria set out in section 8(5) of this act.

The difficulty with the above is that the *NCA* does not specifically define the term "loan" as with the common law.[61] It does, however, as is evident from above, define credit, and does explain the various forms it may portray.

An interesting element of the above discussion is that the use of the word interest is not found in these definitions, and is also not defined in section 1 of the *NCA*. Section 103 of the *NCA*[62], however, governs interest charges; however, on closer inspection, only governs the amount of interest that may be charged,[63] the time it may be charged,[64] any variation in relation to interest under an agreement[65] and the capping of default interest.[66] Section 103 of the *NCA*[67] does not require, nor stipulates, in any manner or form that interest has to be charged. Any changes in interest rates are governed by Section 104 of the Act[68] which requires notice to the creditor before this may occur.[69]

It is clear from the above discussion that the *NCA* does not in any way prescribe that interest must be charged on a credit agreement.

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59 Sec 8(5) of the National Credit Act 35 0f 2004.
60 Sec 8(1)(c) of the National Credit Act 35 0f 2004.
61 It is important to emphasise that the term "loan" is neither found in the definitions contained in section 1 of the Act, nor referred to elsewhere for clarity.
62 The National Credit Act 35 0f 2004.
63 Sec103 (1) of the National Credit Act 35 0f 2004.
64 Sec 103(2) of the National Credit Act 35 0f 2004.
65 Section 103(3) of the National Credit Act 35 0f 2004.
66 Section 103(4) of the National Credit Act 35 0f 2004.
67 The National Credit Act 35 0f 2004.
68 The National Credit Act 35 0f 2004.
69 Section 104 of the National Credit Act 35 0f 2004. (Own emphasis).

2.3.2.2 Application of the NCA

It is important to note that the extent of the application of the *NCA* to credit agreements. Should it not apply to a credit agreement or credit transaction, the common law principles will have to be considered.

Section 4 of the *NCA*[70] deals with the application of the Act, and states that the Act applies to all credit agreement parties dealing at arm's length made within, or having effect within South Africa. The exception to this is contained in sections 4(1)(a) to (d).[71] These list that:

- Agreements between juristic persons, and associated juristic persons, with an asset value or annual turnover that equals or exceeds the threshold value determined by the Minister;[72]

- The State; [73]

- An organ of state;[74]

- A large agreement where a juristic person and related persons whose asset value or annual turnover is below the threshold value;[75]

- The Reserve bank as credit provider;[76]

- An agreement where the credit provider is located outside South Africa.[77]

The Act does not specifically define what the term "arm's length" entails; however, it does state that the following will be considered non-arm's length transactions:

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70 The National Credit Act 35 0f 2004.
71 The National Credit Act 35 0f 2004.
72 *Supra* sec 4(1)(a)(i).
73 *Supra* sec 4(1)(a)(ii).
74 *Supra* sec 4(1)(a)(iii).
75 *Supra* sec 4(1)(b).
76 *Supra* sec 4(1)(c).
77 *Supra* sec 4(1)(d).

- Shareholder's loans or other credit agreements, where the juristic person is a consumer, and a person who has the controlling interest in such juristic person, the credit provider. This is so even if the credit provider was the juristic person and the consumer held a controlling interest;[78]

- A credit agreement between natural persons in a familial relationship, either co-dependent or one dependent on the other;[79]

- Any other arrangement where the parties are not independent of each other and do not strive to obtain the utmost advantage from a transaction, or a transaction held in law not to be arm's length.[80]

It is clear that the *NCA*[81] is very prescriptive in its application, both to types of credit agreements, and also in the scenarios where the application of the Act may come into play.

2.4 Summary of an interest free loan

To convey the relevance of credit legislation and loans, a brief summary on the purpose of the interest free loans is necessary.

Business funding and business operations funding are two main reasons for loans.[82] In the same light, and with reference to the in exhaustive list of types of loans and funding in the introductory paragraph to this chapter, the following are examples of the use of interest free loans:

- Loans to a family trust, or where capital or growth assets are sold to a family trust via a vendor financing type of arrangement. [83] This can similarly be followed when

78 *Supra* sec 4(2)(b)(i) & (ii).
79 *Supra* sec 4(2)(b)(iii).
80 *Supra* sec 4(2)(b)(iv).
81 The National Credit Act 35 0f 2004.
82 Brinckner *Income Tax* (2010). Reference from Tennant *North West University MCOM* 2010 p19 as secondary source.
83 A vendor financing arrangement is where a seller (usually a trustee and/or beneficiary) transfers a capital asset and ownership to a trust, who is the purchaser. The purchaser has insufficient capital or revenue to fund the purchase, and the seller agrees and accepts that payment remain outstanding on an interest free loan account. The seller, furthermore, agrees to accept payment from proceeds that

a company is involved.[84] This approach is predominantly used in advanced estate planning;

- Loans to employees of a company, for personal or home purchases;

- Inter-company loans to finance operations or running costs, or asset purchases. This could also be the case where a merger or acquisition has occurred in the subsidiary of a holding company.

- Family loans to family members, such as an advance deposit of a new house by a father to his son.

There are many more examples apart from the above, as there are constantly new scenarios where interest free loans are used, or may arise. This said, it is important to note, as explained in the previous sub-chapter, that the *NCA*[85] does not apply to certain credit agreements between connected parties. Most interest free loans occur between connected parties. In this situation, the common law pertaining to loans needs to be addressed.

2.5 Concept of "loan" – a common law perspective

A contract where money is lent was initially considered a loan for consumption.[86] This has been discussed above. The issue is, loans for consumption have evolved and are, to put it plainly, vastly different from the Roman Dutch era they originate from. It can be argued that they are no longer real contracts, but instead, should be regarded as consensual ones.[87] These agreements now give rise to obligations from both the lender and receiver.[88] It is not clear if these should be regarded as the only *essentialia* of the loan agreement.

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the asset may generate (such as dividends from a share portfolio), or decide to donate away the loan account using his R100 000 annual donation exclusion as contained in section 56 of the Income Tax Act 58 of 1962. Good examples of discussions surrounding this specific type of transaction can be found in Van Gijsen *Taxtalk* (online) 2014 and Preston *North West University LLM* 2014.

84 Usually, for a purchase of shares, other mechanisms used are contained in section 42-55 of the Income Tax Act, which are asset for share swaps and share for share swaps where there is usually no loan involved.

85 The National Credit Act 35 0f 2004.

86 Jansen van Rensburg *Stel LR* 42.

87 Jansen van Rensburg *Stel LR* 43.

88 *Supra* Jansen van Rensburg *43.*

2.5.1 Transfer of loan capital

The transfer of loan capital entails the lender to transfer loan capital to the borrower. This obligation puts the lender under a duty to ensure that he gives possession and title to the borrower.[89] This seems self-evident from the type of arrangement a loan is, save to say without transferring loan capital to the borrower, he will have nothing in his possession and a loan could not possibly exist. The borrower, therefore, has an obligation to receive the loan capital.[90]

2.5.2 Return of loan capital

At the expiry of the loan agreement, the borrower is entitled to return the loan capital to the lender, who is in turn obligated to receive it.[91] Again, if this process does not occur, then there is essentially not a loan in existence.

To sum up the above, the lender lends to the borrower, who takes it into his possession. At the expiry of the term, the borrower returns to the lender that which he had borrowed to the lender, who once again obtains possession. If the relationship between borrower and lender did not work in this manner, it would essentially amount to a sale (if the loan capital was given, but never returned).

2.5.3 Interest

There have been many definitions of interest over time so as to try and explain the true nature and relationship that interest has with lending.

Interest gives rise to a third obligation between the contracting parties; namely, the borrower pays interest to the lender, who in turn receives this interest. Interest, however, is not an

89 *Supra* Jansen van Rensburg *43.* See also *LAWSA XV* para 272.
90 *Supra* Jansen van Rensburg *43.*
91 *Ibid.*

essentialia of a loan agreement.[92] Instead, it is regarded by authors as a separate obligation between the parties, should they agree that this obligation exists.[93]

Although not an *essentialia*, interest is commonplace in most agreements pertaining to loan, and the paying of interest often agreed to by the parties at the outset. The paying of interest can take different forms, and can be a fixed percentage of the total sum loaned, or an agreed amount. In some instances, a separate service is rendered by the borrower as payment for the interest.[94] We, furthermore, have precedent that states that the non-charging of interest can be seen as an ongoing donation.[95]

The above is all factually true and correct, but it is clear that parties in a loan transaction are not required to charge interest, should this not be their wishes. This statement is reinforced by the *NBS Boland Bank v One Berg River Drive*[96] matter, where interest is not an essential element of a loan. This dictates that there is no need for a loan agreement to contain interest. This obligation cannot be forced onto the parties.[97]

The second support for this statement is the fact that, as discussed above, all current and historical credit legislation in South Africa places a burden on the lender to not charge excessive interest if so done. None of our repealed credit legislation, nor the *NCA* places an obligation on a lender to charge interest.[98] This coincides with the common law principle that interest is not an essential element of a contract, as mentioned above.

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92 NBS Boland Bank v One Berg River Drive and others, Deeb and another v ABSA Bank Ltd, Friedman v Standard Bank of South Africa Ltd [1999] 4 All SA 183 (A). (See also Jansen van Rensburg *Stel LR* 43).

93 *Supra* Jansen van Rensburg *43.*

94 *The Taxpayer* 2007 187-188.

95 See CSARS v Woulidge (2) SA 199 (A) for a complete discussion hereof. See also Jansen van Rensburg *Stel LR* as secondary source.

96 NBS Boland Bank v One Berg River Drive and others, Deeb and another v ABSA Bank Ltd, Friedman v Standard Bank of South Africa Ltd [1999] 4 All SA 183 (A).

97 NBS Boland Bank v One Berg River Drive and others, Deeb and another v ABSA Bank Ltd, Friedman v Standard Bank of South Africa Ltd [1999] 4 All SA 183 (A).

98 See discussion above in 2.2 regarding the *NCA* and prior legislation.

2.6 Sharia compliant financing agreements

Sharia law is a legal system based on moral and religious laws derived from Islamic religious principles, as opposed to human legislation.[99] Sharia compliant financing arrangements are governed by section 24JA of the Income Tax Act.[100] Under Sharia laws, one may not derive interest from a transaction. The result is that Sharia compliant arrangements are structured in different manners, and these are referred to as *mudaraba, murabaha* and *diminishing musharaka*. Interest income is taxable income in terms of section 24J the Income Tax Act[101], as loans and financing form part of a product suite for these institutions.[102] Sharia law, as explained above, does not recognise interest and one may not derive benefit, in the form of interest, from transactions. Section 24JA of the Act deals with the definition of these transactions and tax treatment of each for income tax purposes.

2.6.1 Types of transactions

As stated, the types of transactions that serve according to Sharia law are defined in section 24JA as follows:

2.6.1.1 Mudaraba

Mudaraba is defined as an agreement whereby a client deposits funds with a bank and the anticipated return is dependent on the amount deposited and duration of the deposit. The bank then proceeds to invest this deposit in other Sharia compliant arrangements, and the returns from this investment are divided between the bank and the client as agreed between them at the outset.[103]

An amount received by, or accrued to, a client in terms of a *mudaraba* transaction is deemed to be interest.[104]

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99 www.bregmans.co.za.
100 58 of 1962.
101 58 of 1962.
102 Interest is further income included in the definition of gross income in section 1 of the Income Tax Act 58 of 1962.
103 Sec 24JA (1) of the Income Tax Act 58 of 1962.
104 Sec 24JA (2). The deeming of interest is in accordance with the definition of interest in section 24J(1)(a) of the Income Tax Act 58 of 1962.

2.6.1.2 Murabaha

Murabaha is defined as an arrangement between a client and a financier. In terms of this arrangement, the financier acquires an asset from a third party, but for the benefit of the client. The client is then to acquire the asset from the financier within 180 days of the purchase from the third party, with the agreement that the purchase price paid by the client exceeds the purchase price paid by the financier to the third party. The purchase price paid by the client is dependent on the duration of the Sharia arrangement and may not exceed the initial amount agreed upon between the client and the financier.[105]

Where a person enters into a *murabaha* transaction, the financier is seen as an indifferent party, and not to have acquired or sold the asset at all.[106] The client is deemed to have acquired the asset from the seller, for an amount equal to that which the financier paid the seller at the time the financier acquired the asset from the seller.[107] In terms of section 24JA of the Act[108], the *murabaha* is deemed to be an instrument, and the difference between the amount paid for the asset by the financier, and the amount paid by the client to the financier to acquire the asset is regarded as a premium payable (or receivable) as per the definition of interest in section 24J(1)(a) of the Act.[109] Section 24J(1) of the Act[110] defines an instrument as an interest bearing arrangement or debt, or the right to receive interest, or pay interest, in terms of any interest-bearing arrangement, repurchase or resale agreement.[111]

2.6.1.3 Diminishing musharaka

Diminishing musharaka is defined in section 24JA(1) of the Income Tax Act[112], as an agreement between a bank and a client, whereby the bank and client jointly acquire an asset from a third party, or the bank acquires an interest in an asset from a third party.[113] The

105 Supra Sec 24JA(2).
106 Sec 24JA(3)(a) of the Income Tax Act 58 of 1962.
107 Sec 24JA(3)(b). of the Income Tax Act 58 of 1962.
108 The Income Tax Act 58 of 1962.
109 The Income Tax Act 58 of 1962.
110 The Income Tax Act 58 of 1962.
111 Sec 24J(1) of the Income Tax Act 58 of 1962.
112 The Income Tax Act 58 of 1962.
113 Sec 24JA(1) of the Income Tax Act 58 of 1962.

client then acquires the asset, or interest in that asset, from the bank for an amount, to be paid over time, as agreed between the client and the bank.[114]

When considering income tax aspects of *diminishing musharaka*, where the bank and client have jointly acquired the asset, the client is deemed to have acquired the bank's interest in the asset for the amount the bank paid for the interest at the same time the bank acquired the interest. Where the bank acquires an interest in an asset from a client, there is no deemed disposal of the asset on behalf of the client, or, similarly, to have acquired the interest from the bank.

Where an instalment is paid by the client, a portion thereof, which is to be determined by Act, is deemed to be interest in terms of the definition of interest in section 24J(1) of the Act.[115] The formula used in determination thereof is as follows:

$$X = A – B$$[116]

- X represents the amount to be determined;[117]
- A represents the total amount of instalment payable by the client;[118] and
- B represents the amount paid by the bank to acquire the interest, in exchange for the instalment payable by the client to the bank.[119]

2.7 Concluding remarks

When one considers the above discussion of the legislative, as well as common law perspectives of the concept of a loan, it is clear that the codified law surrounding credit is aimed at consumer protection. Interest capping and disclosure seem to be important aspects that are mentioned throughout the *NCA*. It would seem clear that the repealed Usury Acts and Hire-Purchase Act were, although briefly mentioned, similar.

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114 Sec 24JA(1) of the Income Tax Act 58 of 1962.
115 The Income tax Act 58 of 1962.
116 Sec 24JA (6) (b) of the Income Tax Act 58 of 1962.
117 Sec 24JA (6)(B)(i) of the Income Tax Act 58 of 1962.
118 Sec 24JA (6)(B)(ii) of the Income Tax Act 58 of 1962.
119 Sec 24JA (6)(B)(iii) of the Income Tax Act 58 of 1962.

The common law approach is somewhat different, as, save for the fact that two important elements must exist, a lender is willing to lend, and a borrower is willing to accept. The concept of interest is synonymous throughout both codified and common law of loans. Interest is not essential. Loans can be entered into without interest forming part of the loan. Interest, it would seem, is a separate *stipulation* and is agreed upon separately, although many times it is incorporated into a loan agreement.

Neither the common law nor legislation dictate that interest be charged. This is solely up to the parties to the agreement. The only aspect governed by law is the capping of interest. It would seem, though, that interest free loans are fully in line with applicable legal principles, and lawfully exist. The effect of Sharia compliant arrangements may bring one to assume that they serve as interest free loans. This assumption is incorrect, as the Income Tax Act specifically deals with the taxing aspects of these arrangements. Sharia compliant arrangements, although they do not reflect interest charged between parties, are taxed in a manner that is compliant with interest income in terms of the Income Tax Act. There is little in case law to assist us in determining otherwise in these instances.

The link between the interest free loans, and non-charging of interest in situations where assets can be transferred interest-free, and without tax consequences for the buyer, seller, and lender, should be considered in the manner used. This is where the use of interest free loans ties in with the concept of simulation and *the doctrine of substance over form*.

3 THE COMMON LAW DOCTRINE OF SUBSTANCE OVER FORM BEFORE THE DECISION OF *CSARS V NWK LTD* 2011 (2) SA 347 (SCA)

3.1 Introduction

The doctrine of substance over form has evolved over decades and is essentially a common law principle which dictates that one must look at the substance of a transaction, and not the form in which it is wrapped.

The discussion on *the doctrine* can only be done successfully through a discussion of case law, in order to understand the stance and view point of the Courts. There is an abundance of case law instances relating to substance over form, much of it within the realm of taxation, but contractual law has simultaneously furthered the jurisprudence of this doctrine. Due to the volume of case law, this chapter will focus on certain cases (predominantly those mentioned in the first chapter). A discussion on all the case law relating to simulation is unwarranted. For ease of reference, the cases will be discussed under separate headings, dealing with the facts, legal questions and onus of proof, judgments given and an analysis of each judgment. The discussion of the judgment will only focus on aspects relating to the *substance over form doctrine* with an in-text analysis. This is so done due to the extensive nature of some of the cases, where some judgments deal comprehensively with unrelated Acts and legal principles.

3.2 *Zandberg v Van Zyl* 1910 AD 302

3.2.1 The Facts

This matter was an appeal in interpleader proceedings. The Appellant (Zandberg) was a creditor of the Respondent (Van Zyl). The Respondent's mother-in-law (also Van Zyl) owed him 50 pounds, due from a promissory note effected between the two, in her favour. The Respondent's mother-in-law could not pay. She, however, owned a wagon and agreed to sell the wagon to the Respondent for 50 pounds. One of the terms of the agreement was that the Respondent's mother-in-law could use the wagon as and when needed.

Zandberg was a creditor of the mother-in-law and had attached the wagon. The Respondent intervened by way of interpleader proceedings. The Respondent claimed that he was the owner of the wagon, and it was not susceptible to interpleader proceedings.

The appeal court had to ultimately determine whether the transaction between the Respondent and his mother-in-law was one of sale, or one of pledge.

3.2.2 Legal question and onus of proof

In this matter, the Court had to consider whether a sale to another person, where the seller remained in possession and retained use of the object of sale, was in actual fact a pledge where the reason for the sale was to secure a debt.

In his judgment, *Solomon J* found that the onus of proof was on the party alleging that the agreement was something other than it purports to be, and that the assumption is that a contract was, *prima facie*, "as it purports to be."[120]

3.2.3 Judgment

Judgment was handed down by three judges; namely, *Lords De Villiers CJ, Innes J* and *Solomon J*. All three assented to the appeal, each in their own judgments.

De Villiers CJ focused his judgment on possession and ownership of the wagon and stated that where the wagon had been sold to the Respondent (to secure a debt), but possession and use remained with his mother-in-law, the Respondent should give a full explanation, and in the absence thereof, the Court is entitled to make certain obvious summaries, namely, that the intention of the parties was to effect a pledge and not a sale.[121] He further held that in the instance that the object sold remains in the possession of the seller for use when pleased, and it manifests that the real object of the parties was not to transfer ownership but, instead, to secure payment for a debt owing to the seller, the obvious Summary was that the parties intended to effect a pledge and not a sale.[122]

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120 *Zandberg v Van Zyl* 1910 AD 302 at 314. (Hereinafter referred to as *Zandberg or the Zandberg case.)*
121 *Zandberg supra* 308.
122 *Zandberg supra* 308.

De Villiers CJ seems to have connected "object" and "intention" and the inference can be drawn that the object of the parties shed light on their intention. The real "object" of the parties was to secure a debt owed to the Respondent by his mother-in-law, while simultaneously allowing her to remain in possession of the wagon, and not to transfer ownership to her. The intention was, therefore, to pledge the wagon to the Respondent to secure the debt, and not sell the wagon to the Respondent.

Innes J took a different approach to his peers. The first sentence of his judgement makes his stance clear, stating that "This dispute turns upon the true nature of the transaction between the Respondent and his mother-in-law."[123]

Innes J subsequently confirmed, as a general rule:

> *"…parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be."*[124]

With this general rule, deemed as the test for simulation in this matter, *Innes J* expressed the maxim *Plus valet quod agitur quam quod simulate concipitu,* and further held that a court must be satisfied that there is a "real intention definitely ascertainable" which occurs from a simulated intention. [125] He held further that if the parties mean a contract to have a particular effect, in accordance with its tenor, circumstances that the same object might have been achieved in other ways do not necessarily make the contract or arrangement other that what it purports to be.[126]

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123 *Zandberg supra* 309.
124 *Zandberg supra* 309.
125 *Zandberg supra* 309. The maxim, when translated, roughly meaning greater value is attached to what is done, than what appears to have been done.
126 *Zandberg supra* 309.

Innes J further stated that there is no general rule that can be used, as each case before a court has its own set of facts and circumstances. The Court must look at the "actual meaning" of the parties.[127] With this, he went on to say 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 creditors*."[128]

The appeal was subsequently allowed to succeed, holding that the Court is bound to deal with the agreement "according to its substance, and not the form purported to be in."[129]

Solomon J, in his judgment confirmed, in line with *Innes J's* thinking, that whether the transaction was one of sale or pledge depended much more on matters of fact, than what it was of law.[130] According to *Solomon J*, it was not uncommon for parties to disguise contracts of pledge as a sale, and in this case, a court will have regard to the real transaction and not what form it assumes.[131]

According to *Solomon J*, circumstances of each case differ and it is impossible to lay down a general rule relating hereto. The object of what the parties had in disguising the transaction was an important aspect to question. *Solomon J* questioned why the contract was disguised as a sale if the real intention was a pledge.[132]

3.2.4 Summary

Although not the first case relating to *the doctrine of substance over form*, this matter was definitely a defining one. It seems as though, from the outset, that the judgment focused on the real object of the parties as an indication of their intentions, and from this point confirmed that the Court looked at the real substance, and not the form it assumed.
On the basis that the parties attempted to conceal what the Court deemed a pledge, the Appeal succeeded. The most important take away was that here, in 1907, our Appeal Court

127 *Zandberg supra* 310.
128 *Zandberg supra* 312.
129 *Zandberg supra* 313.
130 *Zandberg supra* 314.
131 *Zandberg supra* 314.
132 *Zandberg supra* 317.

had already indicated that a transaction purported to be of one type, but disguised as another, would not pass the muster of the Courts when tested.

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

3.3.1 The Facts

The Appellant was a registered company in the Transvaal, which had two shareholders. Dadoo was the main shareholder, and was an Asiatic man (the other shareholder was also Asiatic). Dadoo Ltd was established for the sole purpose of acquiring landed property, trading in such and the conduct of any other business relating to property.

The Appellant purchased two parcels of landed property. One of these was leased to Dadoo for the purpose of business and was where Dadoo resided (or his Asiatic manager in his absence). Dadoo, personally, was prohibited under law from owning property as an Asiatic person.

The Respondent became aware of this and proceeded to have the transfer and registration set aside based on the fact that the law prohibited Dadoo from owning property. The Respondent's contention was that the transaction was *fraudem legis* and, therefore, contrary to law as Asiatic persons were prohibited from owning land in the Transvaal at that stage.

3.3.2 Legal question considered and onus of proof

The Appeal Court had to consider whether the establishment and registration of a company for the purposes of purchasing and holding property, and thus circumventing a statute that prohibited Asiatic persons from owning the property directly, was *fraudem legis,* and, as such, a simulation, and whether the transfer of such property should be set aside.

The Appeal Court did not specifically deal with the onus of proof or give a clear direction as to who this onus rested on. It is contended that the party who alleges *in fraudem legis* of any transaction bears the onus of proving his averment. In this instance, the onus would rest on the Respondent.

For the sake of clarity, *Innes CJ,* at 547, described *fraudem legis* as;

> *'…when it is designedly disguised so as to escape the provisions of the law, but falls in truth within these provisions."*[133]

A further investigation of the term, for sake of completeness, finds that a transaction in *fraudem legis* finds the transaction to be "in circumvention of the rules of the law."[134]

3.3.3 Judgment

There were three separate judgments in this case. The entire judgment dealt with various other aspects, with *Innes CJ* and *De Villiers JA* contributing hereto, and *Solomon JA* writing for the majority. For purposes of this research, the focus is only on the *fraudem legis* aspects which directly relate to *the doctrine of substance over form*.

Firstly, *Solomon JA* discusses interpretation of the legislation prohibiting Asiatic persons from owning land, and in this focus, discusses the Court's role in the interpretation of statute. Here, *Solomon JA* acknowledges that a court cannot only have regard to the language used by the legislature, but should further consider the object and policy of the legislation. He further affirms that the Court cannot accept the literal sense of a word or phrase if it would be inconsistent with the legislature's intention. As *Solomon JA* citing Lord Langdale in support, states: "great confusion arises from not distinguishing the body corporate from its individual members", confirming that this would be true for a "one-man company".[135]

Solomon JA further held that in its interpretation of legislation, the Court has the ability to consider the wording as well and the object of a statute, but cautions that a court cannot legislate the legislation by declaring statutes to have a greater effect than they do, or applying what it seemed were omissions in text.[136] His justification of this statement clarifies the position somewhat, namely[137]:

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133 *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at 547. (Hereinafter referred to as *Dadoo* or the *Dadoo case*.)
134 Merriam-Webster online edition accessed 22 March 2018.
135 *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at 556.
136 *Dadoo supra* 558.
137 *Dadoo supra* 547.

"...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'[138]."

The Court's discussion of interpretation[139] of the manners in which *fraudem legis* may exist leads to *Solomon JA* to further state that:

"…so far as I have been able to investigate them, it seems to me that in principle they can all be brought within the general rule that a statute cannot be evaded or circumvented by doing in an indirect manner that which the law has prohibited, but that in all such cases the Courts will strip off the disguise and exhibit the transaction in its true character."[140]

Solomon JA, at 560, goes further to legitimise, keeping clear of the provisions of a statute by doing something that falls outside the scope of the relevant provisions. In this case, *Dadoo* registering a limited liability company so that the company could hold the property as the provisions of the relevant legislation, only prohibits Asiatic persons from directly owning property in certain areas. In this respect, *Solomon JA* held:

"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.

Now in the present case it does not admit of doubt that the object of Dadoo in floating his business into a limited liability company was to enable it to acquire property which he himself could not as an Asiatic acquire. At the same time, as the holder of 149 out of 150

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138 The maxim *Plus valet quod agitur quam quod simulate concipitur* was defined by *Innes J* in *Zandberg v Van Zyl* 1910 AD 302 at 309 greater value is attached to what is done, than what appears to have been done.

139 *Soloman JA* further discusses examples given in the *Digest* in application of the *Plus valet* doctrine from Roman-Dutch sources. Although interesting, it would serve little purpose in this research as the aim of this chapter is to give an overview of the doctrine as provided in each case, and a discussion of the judgments.

140 *Dadoo supra* 559.

shares he would be in control of the company and could, therefore, deal as effectually with any land registered in its name as if he were himself the owner. In this way he has for all practical purposes succeeded in evading the statutes which prohibit Asiatics from owning fixed property. The question is whether he has achieved this result by doing something which was perfectly legitimate and which was outside of the prohibitions of the law, or whether the registration of the two stands in the name of a company controlled by him is illegal as an act done in fraudem legis. The answer to that question seems to me to depend upon the further question whether the stands though registered in the name of Dadoo, Ltd., really belong to Dadoo himself; or to put it in another way, whether the company is something without substance and a mere mask to hide the features of Dadoo."[141]

In his concluding paragraphs *Solomon JA* confirmed, on behalf of the majority, that the transaction, and the manner Dadoo had structured it, was not *in fraudem legis,* even though the result of the judgment was far from satisfactory. He stated the following in support hereof:

"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. The fact of the matter is that Dadoo has succeeded in keeping outside of the statute prohibiting Asiatics from owning land by taking advantage of the Company Act."[142]

The contention made by the majority in respect hereof was that there was nothing improper with the manner that Dadoo had registered the company, and that no evidence to point out that it was not properly constituted, or that it had a fictitious existence, as the Respondent had cited it in its petition as Dadoo Ltd, and, further, that the memorandum of association was in order. The Court, in this instance, was satisfied that the company was duly incorporated, and that, as a result, it came into existence upon registration with all the rights and obligations which a legal entity of such may enjoy.[143]

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141 *Dadoo supra* 560.
142 *Dadoo supra* 561-562.
143 *Dadoo supra* 561 (own phrasing).

3.3.4 Summary

It is clear from this case that the Court, in its majority judgment, was content with parties keeping clear from a particular statute by deliberately doing something outside the scope of this statute, while equally achieving this purpose. The Court was satisfied that no act *fraudem legis* had been committed by taking advantage of the Company Act at the time.

The facts of this matter differ somewhat from *Zandberg v Van Zyl*, but are important in the evolution of *the doctrine* as the Court clearly stated that, where a party stays clear of a statute by simply doing what the statute is silent on, that party has not disguised the transaction as something that it is not.

3.4 *Kilburn v Estate Kilburn* 1931 AD 501

3.4.1 Facts

This case seems to have intricacies, but for ease of reference, a very short set of facts will be submitted simply, with the essence of the *substance over form doctrine* emphasised.

Kilburn's estate had been sequestrated. Kilburn's wife, the Appellant in the matter, had issued various claims against the estate in the various proceedings relating to the administration of the insolvent estate, which were declined. The Appellant proceeded to institute action against the trustee of her husband's insolvent estate for the release of immovable property, rental and an amount secured by a bond registered in her favour over the immovable property.

3.4.2 Legal Question and Onus of proof

The Court did not specifically deal with the onus of proof in the judgment. Both Appellant and Respondent adduced evidence, both against and for simulation respectively.

The legal question that was considered by the Court was whether the bonding of a property owned by a husband in favour of his wife, to secure an amount due to the wife upon death

or insolvency, and to secure the property in the wife's favour, was a simulated scenario created to protect the property from attachment in the event of insolvency.

3.4.3 Judgment

The Court held that it had never been the intention of Kilburn, nor his wife (Appellant), that the amount secured by the bond was owing to the Appellant, but simply that it was a means for the Appellant to have a secured claim to money in the case of his insolvency or death.[144]

The Court further emphasised that it was Kilburn himself who purchased the property. *Wessels ACJ* stated that:

> *"The money was the husband's money and it was used to buy the land, and he caused the land to be registered in his wife's name with the deliberate intention of defeating the rights of the creditors. 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."*[145]

The appeal was dismissed accordingly.

3.4.4 Summary

Although this judgment is somewhat shorter than those previously discussed, the Court's statement confirming that the veil of a transaction will be rendered and its substance will be examined, is of importance. The Court, here, essentially confirmed that there must be some legal or natural obligation to make the hypothecation (bonding of the property) necessary, and without this the situation would be regarded as simulation.

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144 *Kilburn v Estate Kilburn* 1931 AD 501. (Own emphasis of the judgment summarised into this paragraph).

145 *Kilburn v Estate Kilburn* 1931 AD 501 at 507.

3.5 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48

3.5.1 The Facts

This matter was an appeal from the Durban and Coast local division. The Respondent ran an importing business prior to the enactment of the Customs and Excise Act. As the Respondent was a registered importer, it was entitled to import duty free (under rebate of duty), if the imported goods were transferred to a local manufacturer that, in turn, manufactured the imported goods into certain articles as stipulated in the regulations.

The Respondent required a certificate that the imported goods had been, or were to be, transferred to a registered manufacturer, as well as a receipt of materials by manufacturer and a declaration by the manufacturer that the goods would only be used for purposes for which the rebate was provided. The manufacturer was required to register a bond over the imported goods to ensure that all the goods received would be used solely for the purpose of which the rebate provided was allowed. The manufacturer was not required to become the owner of the stock.

On 1 January 1937, the regulations relating to importations were amended. In terms of these regulations, the class of importers was abolished, but registered manufacturers could still clear imported materials free of duty. The manufacturer was still required to work and manufacture the imported goods, but the only major amendment affecting this was that the manufacturer was to be the owner of the goods for which the rebate was provided.

Due to the new situation created by the introduction of these new regulations, and to avoid any loss of advantage in costing created by the previous rebate regime, the Respondent and registered manufacturers he was doing business with entered into new agreements whereby:

- The Respondent sold imported goods to the manufacturers, and the parties agreed that the purchase would be at a price equal to the landed cost plus the cost of cutting, making and trimming at the previously estimated rates;

- The manufacturers were not required to pay for materials until the garments ordered were delivered. In most cases, there was a simple cross entry scenario in the books. The new agreements, therefore, differed very little from the previous relationship scenario between the Respondent and manufacturers.

The Appellant argued that no transfer of ownership of imported goods had taken place. The Respondent was, therefore, liable to pay full duty on the imported goods. The Appellant made a further alternative claim that the transactions were in *fraudem legis*[146], and they were created and entered into to circumvent the law and regulations placed on the Respondent.

3.5.2 Legal question and onus of proof

The main question the Appeal Court was posed to answer was whether the new contractual relationship created between the Respondent and the manufacturers transferred ownership of the imported goods, or whether the contractual relationship was a simulation intended to create the impression that ownership was transferred.

The further discussion of onus of proof in this matter comes from two different paragraphs in the judgment. One given by *De Wet CJ* for the minority, and the other by *Watermeyer JA* for the majority.

De *Wet CJ* stated, with regards to onus, the following:

> *"The onus is therefore on the Plaintiff to show that these agreements in fact are not what they purport to be."*[147]

Watermayer JA held a similar position for the majority, stating that:

> *"If the Plaintiff is to succeed in this case, he must prove that the goods never became the property of the manufacturer, that the statements to that effect in the document which*

146 See definition of *fraudem legis* at 3.4 above.

147 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48 at 57. (*Randles Brothers*).

procured their release were false. On this assumption the real point at issue is whether or not the ownership of the goods passed to the manufacturers on delivery from the importer's warehouse."[148]

On both the minority and majority, it is clear that the onus of proof was on the Plaintiff, being the Commissioner, to prove that ownership of goods did not pass from importer to manufacturer.

3.5.3 The judgment

In this matter the appeal was dismissed, by a majority judgment, although *De Wet CJ* noted his dissent in his minority judgment. For ease of reference, focus will be on the majority judgment handed down by *Watermeyer JA*, whereafter the minority judgment will be dealt with.

Watermeyer JA focused on the principles of *substance over form* stemming from the judgment of *Dadoo v Krugersdorp Municipality,* explaining that when a statute taxes or forbids a certain tax by name or definition, two principles of "interpretation or construction" arise; namely, it must, firstly, be determined what kind of transaction is forbidden or taxed from the construction of law, and, secondly, the transaction needs to be examined in order to determine whether it falls within the construed law.[149] The Court further noted that interpreting the type of transaction is difficult as parties attempt to conceal the type of transaction between them. The Court, here, went on to quote a passage from *Zandberg v Van Zyl*,[150] and focused on the "a real intention, definitely ascertainable, which differs from the simulated intention". Here, the Court held that just because a transaction is devised for a purpose of evading a prohibition, or avoiding it, does not necessarily mean this transaction is disguised.[151] *Watermeyer JA* went on to say that:

"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

148 *Randles Brothers supra* 68.
149 *Randles Brothers supra* 66. (Own emphasis).
150 *Zandberg v Van Zyl* 1910 AD 302.
151 *Randles Brothers supra* 66.

only question is whether, so interpreted, it falls within or without the prohibition or tax."[152]

The Court's opinion is that a disguised transaction described by the words quoted above was a dishonest transaction as it does not intend to have the legal effect which it has been described as.[153] Here, *Watermeyer JA*, on behalf of the majority, described what the Court felt a disguised transaction was, and, seemingly, touched on what the intention of the parties to such a transaction could be. With regards to this, the Court specifically stated that:

> *"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."*[154]

The Court, at 67, further discussed the above section, and held that, before a finding can be made into whether a transaction is *fraudem legis* or not, it must be satisfied that there is a tacit or underlying understanding between the parties, and in lack thereof, a finding that a transaction was a pretence cannot be made. *Watermeyer JA* stated that the blurring confusion associated with this often leads to the *maxim*[155] being applied incorrectly.[156] With this, the Court then considered the Regulations accompanying the Customs and Excise Act in operation at the time, regarding the importation of goods, and made relevant submissions relating thereto. It was submitted by the Court that there were no express terms that made it a condition that ownership of goods passed from importer to manufacturer before rebate could be granted.[157] With this, it was stated that all that was required was that a form be signed, where the importer declared transfer of the goods to the manufacturer, and where

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152 *Randles Brothers supra* 67.
153 *Randles Brothers supra* 67.
154 *Randles Brothers supra* 67.
155 *Maxim plus valet quod agitur quam quod simulate concipitur. See 3.4 above for the description hereof.*
156 *Randles Brothers supra* 67.
157 *Randles Brothers supra* 67 (b).

the manufacturer declared that the goods were his own property, before a rebate would be granted.[158]

The Court further referred to the Plaintiff's counsel's contention that ownership of material had never passed from importer to manufacturer as there had been "no genuine sale"[159] between the parties. As a result, the Plaintiff's counsel contended that the Court should, therefore, give effect to the true legal effects that the law provides, no matter what the parties had intended. The Court's view was that ownership passed when delivery of possession occurred, and had issue understanding reasons provided by the Plaintiff's counsel. The Court further considered the form of this agreement, and at 68 held;

> *"…form is not a negligible factor from which no inference can be drawn. On the contrary it has considerable value because, if the parties put their contract in the form of a sale on credit, a strong inference can be drawn that they intended a delivery in pursuance of that contract to transfer ownership, whereas if they put their contract in the form of a [locatio operis] an equally strong inference to the contrary can be drawn."*[160]

With this, at 69, the Court discusses "transfer" and finds that this is a matter of fact and not law, and held that the Plaintiff's contention, that there was no genuine sale, could exist only in two possible situations:

(a) The parties were honest in dealings, but the law required more in terms of stipulations for a valid contract of sale; and

(b) The parties were not straightforward with each other, and pretended to enter into a sale agreement but secretly meant something else.[161]

For this, the Court found two possible answers, being that, firstly, form did not determine whether ownership had passed. Here, one has to look into intention. Secondly, the contract was one of sale. In considering the two scenarios, the Court, firstly, followed *Voet's* definition of sale, accepting same. *Voet* defined a sale as "a consensual contract whereby it is agreed

158 *Randles Brothers supra* 67 (c). Own emphasis.
159 *Randles Brothers supra 68.*
160 *Randles Brothers supra* 68 and 69. (Own emphasis).
161 *Randles Brothers supra 69. (Own emphasis).*

that a certain thing shall be exchanged for a certain price, the essentials are the consensus as to the *merx*, the *pretium* and the exchange."[162] The Court was satisfied that the *merx* and *pretium* were set out in the invoices sent from importer to manufacturer, and evidenced by the exchange by one to the other.[163]

At 71, *Watermeyer JA* further stated that ownership and control cannot be mixed, and further considered the second meaning of "genuine sale", and held that the Plaintiff could only succeed with its argument if it was proven that the contract was a pretence. The Court held that a contract could only be a pretence if:

> *"If it was a pretence, it seems to follow that the parties must have had an understanding between themselves that for outward purposes, in order to deceive the customs officials they would dress up their contract as a sale and pretend to have an intention to transfer ownership by delivery, but that in truth they would regard it as a locatio operis and would not pass the ownership on delivery. But there are serious difficulties to be overcome before such a view can be taken."*[164]

The Plaintiff's counsel had referred to several matters which he regarded as indicating that the contracting parties "never honestly intended to transfer ownership"[165], pointing out unusual features in the agreements between the importer and manufacturer. The problem with the Plaintiff's contention is that it asked of the Court to draw an inference that there was never an intention to transfer ownership.[166] Counsel for the Plaintiff, here, referred to *Zandberg v Van Zyl*[167]*,* stating that these types of conditions in a contract would deprive the owner of almost all the benefits attached to ownership, but the Court disagreed with this contention, saying it was misleading and a parallel could not be drawn between the matters.[168] The Court referred to these two unusual conditions referred to in the contract as:

(a) That the price of material sold was fixed at cost price;[169]

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162 *Randles Brothers supra* 70.
163 *Randles Brothers supra* 70.
164 *Randles Brothers supra* 71.
165 *Randles Brothers supra* 71
166 *Randles Brothers supra* 71. The Court referred to the Plaintiff's counsel's use of a selected quotation from *Zandberg v Van Zyl* in support of this. (See 71).
167 *Zandberg v Van Zyl* 1910 AD 302.
168 *Randles Brothers supra* 72. The court went on to discuss the differences at 72.
169 *Randles Brothers supra* 72.

(b) That the price was not to be paid until the garments made out of the material by the manufacturers were delivered to the defendants, and that it was then to be paid by set-off;[170] and

(c) That the price of the garments to be made out of the material was to be determined on the basis of the cost of the material plus cost of making. However, none of these conditions is inconsistent with the transfer of ownership, and there is nothing surprising about them when it is realised that the contracting parties deliberately tried to produce a state of affairs, as nearly as possible, similar to the state of affairs which existed when the defendants employed the services of the manufacturers to make garments on their behalf.[171]

Watermeyer JA countered these contentions by the Plaintiff, saying that the transfer of ownership was much in the party's interest to obtain a rebate, and it would be difficult to think that their intentions were any different from transferring ownership. He pointed out that the one essential difference between this matter and *Zandberg v Van Zyl*[172] was the transfer of ownership and delivery. In further comparing the two matters, *Watermeyer JA* pointed out that, in *Zandberg v Van Zyl*,[173] one party was owed a debt, and the other owned a wagon to be used as security. The learned judge further discusses the *Zandberg* matter and points out the pretence in which the parties in this matter arranged the debt to ensure that use and possession of the wagon remained with them, and in doing so, negating the Appellant's argument that one cannot propose a legal barrier to the transfer of ownership. *Watermeyer JA* further stated that the basis of the decision in *Zandberg* was that the parties did not honestly mean to enter into the terms in which they purported to do. The Court was of the opinion that the pretext that existed in the *Zandberg case* did not exist here."[174]

Watermeyer JA also dismissed the submission from counsel for the Plaintiff viz that the employees still worked as though they were on the old system used prior to this arrangement, saying that this is not inconsistent with transfer of ownership, stating:

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170 *Randles Brothers supra* 72.
171 *Randles Brothers supra* 72.
172 *Randles Brothers supra* 72.
173 *Ibid. Randles Brothers supra* 72.
174 *Randles Brothers supra* 72 – 73.

"None of these entries are [sic] inconsistent with the transfer of ownership, and they are insufficient to lead to the Summary that the contracting parties did not genuinely mean to enter into contracts of sale and to transfer ownership of the material when delivery was made in pursuance of those contracts."[175]

In concluding, *Watermeyer JA* stated the following:

"The inference is almost conclusive that the defendants delivered the goods with the intention of passing ownership. As to the manufacturers, it is difficult to imagine any reason why they should receive the goods with any intention other than that of becoming owners. They were bound to accept them on the terms offered by the defendants, otherwise they would not get them."[176]

Watermeyer JA's reasoning was that customs delivery forms were signed indicating change of ownership, and if they had done this with the intention of not accepting ownership, they were being dishonest. *Watermeyer JA* found that in these circumstances of his judgment, he was satisfied that intention to transfer and accept ownership was present, and accordingly dismissed the appeal with costs.

3.5.4 Summary

It is clear from the above that the Court was satisfied with the manner in which the transactions occurred. The Court considered the actual transfer of ownership of the goods, and the acknowledgment thereof in writing by both parties, and found that it was evident that the intention was to actually pass ownership. The fact that there was an additional agreement allowing the Respondent to re-purchase the goods from the manufacturer, emulated a scenario that was almost alike to the relationship between the parties before the regulations were amended, seems to have made good sense in that there was guaranteed business. This seems to be the ideology followed by the Court.

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175 *Randles Brothers supra* 73.

176 *Randles Brothers supra* 73.

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

3.6.1 The facts

The facts of this case are somewhat more complicated than the previous cases discussed. In order to ensure ease of understanding, the facts will be set out in point form.

Pioneer Seed (Pty) Ltd (Pioneer) and its subsidiary, Pioneer Seed Holdings (Pty) Ltd (Holdings) were intent on setting up a factory in Ladysmith. Both Appellants were wholly owned subsidiaries of Holding, which, as stated above, was wholly owned by Pioneer. The Appellants entered into eight contracts. Two sets of four almost identical contracts were concluded. One set relates to a stand owned by the first Appellant, and the other set to the second Appellant.

In terms of these agreements, the following relationship was created:

- A pension fund leased the land from the Appellant. The fund was entitled, at its own expense, to erect buildings and improvements on the land as they may determine;

- All buildings and improvements erected by the fund shall become the property of the lessor and as a result, the lessee shall have no claim against the lessor for compensation in respect of the buildings and improvements;

- A Sub-lease agreement was entered into between the fund and Pioneer. In terms of this agreement, the fund would erect buildings on the land for Pioneer, and in turn, apart from monthly rental, a premium for the erection of the buildings on date of final completion.

The fund entered into a building contract with Terwell Investments to complete the construction by a determined date, as well as, a variation agreement, whereby the fund only needed to pay rent in as much as it received rental from the sub-lessee.

The Appellants proceeded to include rental income from the fund in their respective income tax returns, but included the land at cost price, and no improvements (factories built on the land) were included. SARS was initially unaware of this, but issued additional assessments as they eventually became aware of the transactions and improvements to the land. The additional improvements included the value of the factories in the gross income of the Appellants in terms of section 1(h) of the definition of gross income contained in the Income Tax Act.[177] Section 1(h) of the Act included the value of improvements effected on land in the gross income of the Appellants, where a right to use or occupy the land was conferred on another party.

The Commissioner submitted that the documents (set of agreements) between the various parties failed to reflect the true intention between the parties and contended that the entire purpose of entering into these agreements, in this way, was the evasion of tax. The Commissioner further submitted that the way the transaction was structured concealed the rights attained by the Appellants by the fund erecting the factories of the land, and that the value of the factories accrued to the Appellants' gross income in terms of section 1(h) of the Act.

The Appellants countered and stated that the Pension Fund was only "entitled" to make improvements or build factories, at its own expense, and, therefore, the Appellants did not acquire these rights as the Commissioner contended.

It is important, here, to state that, in terms of section 10(1)(d) of the Income Tax Act, the fund was exempt from tax. The transactions were structured in such a way that the fund was introduced as a veil between the Appellants and Pioneer.

3.6.2 Legal question and onus of proof

The legal question posed here is somewhat more complicated than a one-liner. This is due to the manner in which the parties entered into these agreements, and the benefit they sought to avoid. One question can be directed at whether the use of a pension fund in the agreement, to erect buildings on behalf of the Appellants, brought about a benefit in the

177 Act 58 of 1962.

Income Tax Act[178], or fell within the scope of the word "accrual" as portrayed in the definition of gross income in the Act.[179]

The Court referred to section 82 of the Income Tax Act[180], and considered the burden of proof it placed on the parties. Here *Hefer JA*, at 240, said the following:

> *"I must also point out that, by virtue of the provisions of section 82 of the Act, the burden to prove that any amount is exempt from tax and the duty to show that the Commissioner's decision to disallow their objection to the assessments was wrong, rest on the appellants.*
>
> *Therefore, unless the appellants have shown on a preponderance of probability that the agreements do indeed reflect the actual intention of the parties thereto, the Commissioner's decision cannot be disturbed."*[181]

3.6.3 Judgment

Hefer JA, writing for the majority, here, began this judgment with a fairly strong statement, saying that:

> *"Since the land on which the factory was to be erected thus belonged to the group (I speak in practical terms), one is immediately struck by the cumbrous arrangements for its construction. Affiliated companies are of course at Liberty to structure their mutual relationships in whichever 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."*[182]

This case has a lengthy judgment, which revolves around the discussion of two main points. Firstly, as set out in the *Westminster case[183],* a taxpayer is entitled to arrange his affairs so

178 58 of 1962.
179 58 of 1962. Section 1 of the act deals with the definition of gross income, among other definitions.
180 58 of 1962.
181 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 229.
182 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue* supra 235-236.
183 *IRC v Duke of Westminster* (1936) AC 1 (19TC490).

as to remain outside the provision of a particular statute.[184] The Court, here, confirmed that when this principle is invoked, the Court will ultimately decide the outcome, which outcome will depend on a question of fact, or on the application of law to the facts.[185]

The second principle is that "courts of law will not to 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."[186]

The reconciliation of these two principles comes into play as a result of *Hefer JA's* reasoning in the quoted introductory section above, indicating that even when there is "no apparent commercial reason" for interception by a third party, a court may seek the motive elsewhere.

Hefer JA went on to say that it is not difficult to apply these principles when only one of them is in question. The English law seemed to provide that they are mutually exclusive principles.[187] South African law seemed to follow this approach in *Dadoo*.[188]

Hefer JA, however, went to say that if both these principles are applied within their own bounds, there is no reason why they cannot be applied in the same case. *Hefer JA,* here referred, to *Zandberg v Van Zyl*, [189] and quoted the introductory paragraph thereto, emphasising a specific phrase therein:

> *"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*

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184 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 230. See also Louw LLM 32 who makes mention of this.

185 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue* supra 238. This was confirmed in *Dadoo v Krugersdopr Municipality*.

186 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue* supra 238. See also 230. This was previously confirmed in *Kilburn v Estate Kilburn* by *Wessels ACJ*.

187 In *IRC v Duke of Westminster* (1936) AC 1 (19TC490) at25, *Lord Russell* of Killowen confirmed this, providing "If all that is meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good . . . If, on the other hand, the doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or nontaxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine."

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

189 *Zandberg v Van Zyl* 1910 AD 302.

have been attained in another way will not necessarily make the arrangement other than it purports to be."[190]

From this, the Court drew attention the fact that the section quoted above was to determine the actual intention of the parties. *Hefer JA* went on to point out what a disguised transaction was by referring to *Commissioner for Customs and Excise v Randles, Brothers and Hudson Ltd*.[191]

Hefer JA, at 240, further held:

"I have quoted the relevant passages from the leading cases in full in order to reveal the fundamental flaw in a submission which tinged the entire argument for the appellants. [T]he parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they had been advised to do. The real question is, however, 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."[192]

He further went on to point out the following important facts presented in this matter, noting:

"Since the same signatories signed the main leases, the sub-leases and the building contracts simultaneously on behalf of the appellants, the Fund, Pioneer and the contractor respectively, we must infer that they signed each agreement with full knowledge of the terms of the others which were either awaiting their signatures or had already been signed." [193]

Hefer JA held that, with regard to the above facts, the agreements cannot be regarded separately, as they were all signed simultaneously and were "plainly interdependent to the extent that none of them would have been concluded unless all the others were also signed."[194]

Hefer JA further considered the relevant clauses of the agreements signed by the parties,

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190 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra 238.*
191 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48 at 57.
192 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 240.
193 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 240.
194 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 241.

pointing out the anomalies in the agreements, and the various clauses which were seemingly pointless between the parties.[195] Here, he commented on the agreements together and remarked that:

> *"So regarded there is a distinct air of unreality about the agreements. Clause 6 of the main leases is to the effect that the Fund would not be entitled to assign the leases or sublet the premises 'without the prior consent of the Lessor which shall not be unreasonably withheld'. Bearing in mind that the subleases were also on the table for signature or might even have been signed already, such a provision was entirely illusory. Bearing in mind further that it was never contemplated that the Fund would occupy the premises, the same goes for clauses 5.2, 11 and 12. (Clause 5.2 is to the effect that the Fund would pay 'all … municipal charges relating to its use and occupation of the premises'; clause 11 is to the effect that the Fund was precluded inter alia from doing or permitting any act 'which may become a nuisance or shall cause any annoyance or discomfort to the Lessor or to any other occupier of the property' and in clause 12 the Fund indemnified the appellants against all claims for damages 'in respect of the use of the premises by the Lessee.') Clause 8 provides that the Fund would 'at its own expense maintain the land and all buildings and other improvements erected on the land, both interior and exterior in a good and proper state of repair and in a neat and tidy condition'; but in point of fact the duty to maintain rested with Pioneer in terms of clause 8.1 of the subleases. Finally there is clause 7.1 which has already been quoted. When the parties signed the main leases they knew full well that the Fund would in actual fact not be entitled to erect 'such buildings and other improvements on the land as it may determine' but was, on the contrary, obliged in terms of the subleases to erect buildings to accommodate Pioneer in accordance with plans which had already been approved by the latter and were in fact annexed to the building contracts."*[196]

Hefer JA found that these anomalies were consistent with a different unexpressed or tacit agreement between the parties. Even though the Appellant's attorney indicated that the accrual, and subsequent rights and obligations of the parties were clearly distinguished in the agreements, and that the transaction still gave a deliberate attempt to give each contract self-sufficiency, which did not actually exist. *Hefer JA* goes further, at 242, that the agreements must be viewed in a broader context, pointing out Pioneer's dominant position

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195 *Ibid*.
196 *Ibid.*

in the transaction, and, further, that the directors involved did not actually negotiate any terms, but were putting this solely on Pioneer. The learned judge further noted that the probability of a tacit unexpressed agreement between the parties existed, and states the following in support thereof:

> *"I mentioned earlier that the agreements cannot merely be regarded as a device aimed at the reduction and avoidance of tax but that they must be viewed in the broader context of an arrangement of the affairs of the companies inter se. There is no evidence of actual negotiations involving the appellants but it is hardly likely, in view of Pioneer's dominant position, that any negotiations in the real sense of the word, were ever conducted."*[197]

Hefer JA considered the probability that the directors sought to have a situation whereby non-enforcement of the obligations was possible as a sole right had been conferred on Pioneer, and considered whether it precluded the Appellants from compliance. The learned judge was of the opinion that the parties to the transaction were aware of the need for the Appellants to protect their own interest. *Hefer JA*, with regards to this, held:

> *"…There is a real likelihood that there was an unexpressed agreement or tacit understanding between the appellants and Pioneer that the appellants would be entitled if need be to enforce compliance with the relevant terms of the subleases.*
>
> *…The evidence does not exclude what is thus a real likelihood that the written agreements do not reflect the true or full intention of the parties."*[198]

The appeal was subsequently dismissed with costs.

3.6.4 Summary

The Court's judgment here was robust and in depth, and, as will be seen later herein, serves as a benchmark for many cases hereafter. The Court, here, considered the principle that a party is entitled to structure his affairs so as to fall out of the governing statute, but further decided that a second principle was to be considered, namely that substance prevails over form.

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197 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 242.

198 *Ibid.*

In its judgment, due consideration was not only given to each individual contract to the transaction, and whether it had effect according to its tenure, but also the relationship each contract played between the parties. What is interesting from this judgment, however, is that the term "commercial reason"[199] was used by the Court in the judgment. The Court stated that when there is no apparent commercial reason for a party to interpose a transaction, the Court may seek this motive elsewhere. The judgment further considers the intention of the directors to these transactions, and the motives behind the transactions, finding that the evidence shows that the agreements do not reflect the real intention of the parties.

3.7 *CIR v Conehage (Pty) Ltd* 61 SATC 391

3.7.1 The facts

The Respondent required capital to expand its business. As a result, the Respondent entered into two sets of similar agreements with Firstcorp Merchant Bank (Firstcorp), whereby certain assets belonging to the Respondent would be sold to Firstcorp, and then leased back to the Respondent by Firstcorp. The Respondent proceeded to claim rentals paid in terms of leaseback agreements as a deduction for expenditure in the production of income under section 11(a) of the Income Tax Act.[200]

The Appellant refused the deductions and invoked section 103 of the Income Tax Act[201], and claimed that the agreements were not what they purported to be, and further submitted that the Respondent did not actually intend to sell and leaseback the assets, but had, in fact, borrowed the purchase price from Firstcorp.

The Respondent initially appealed to the Eastern Cape Special Court, and was successful, whereafter the Applicant appealed directly to the Supreme Court of Appeal (SCA).

An interesting point to remark on here is that the Appellant accepted that the Respondent and Firstcorp did not act in *fraudem legis,* but averred that the agreements lacked the

199 *Erf 3183/1 Ladysmith (pty) Ltd and Another v Commissioner for Inland Revenue supra* 235 – 236.
200 Act 58 of 1962.
201 *Ibid.*

essential elements of a sale and, therefore, the parties had no intention to enter into this type of transaction for the transfer of ownership. The Court, per *Hefer JA*, referred to the taxpayer in this matter as Tycon. [202]This is evident from certain quotations and references made hereunder.

3.7.2 The legal question and onus of proof

The Court focused mainly on two questions. The first was whether the Respondent and Firstcorp entered into a sale and leaseback as a deliberate disguise of the real transaction, which was actually a loan, namely, the nature and substance of the agreements.[203] The second question was whether the Appellant correctly invoked section 103 of the Income Tax Act.

To put the legal questions into perspective, the answer of the first will confirm or deny the answer to the second. Therefore, if the Court found the transaction to be simulated, then the answer as to whether section 103 was correctly invoked will be affirmative.

In his finding*, Hefer JA* never specifically made a finding on the onus of proof. He did, however, at 395(7), confirm the judgment of the Special Court, saying that:

> *"The Special Court found (on the strength of the presumption in s 82 of the Act) that the onus was on Tycon to prove the authenticity of the agreements and that the onus had been discharged. The signatory on Tycon's behalf and two Firstcorp officials who had negotiated the transactions testified that the parties intended to give effect to the transactions according to their terms. The Special Court accepted their evidence on the point."*[204]

202 *CIR v Conehage (Pty) Ltd* 61 SATC 391 *supra* 394 [2]. (*Conehage*).
203 *Ibid.*
204 *Conehage supra* 395 [7].

3.7.3 Judgment

Hefer JA's tone and stance of his judgment can be seen from his introductory quote:

> *"Within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If eg the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax. But, when it comes to considering whether by doing so he has succeeded in avoiding or reducing the tax, the Court will give effect to the true nature and substance of the transaction and will not be deceived by its form."*[205]

The above quote taken from the judgment in *erf 3183/1 Ladysmith v CSARS* by the learned judge*.* He went on further to discuss the element of dishonesty in simulation and pointed out that it was not easy to avoid dishonesty in simulation.[206] He pointed out the submission from the Appellant's counsel, stating that they were in agreement that the Respondent did not act in *fraudem legis.* His view with regard hereto is as follows:

> *"Both in the Special Court and in this court his counsel expressly accepted that the parties did not act in fraudem legis by deliberately disguising their transactions. In the written heads of argument the agreements came under attack solely for lack of what was apparently regarded as essential elements of a sale (cf McAdams v Fiander's Trustee & Bell NO 1919 AD 207 at 2234). On this basis it was submitted that there was no agreement on a verum pretium nor an intention to transfer and acquire ownership";*[207]

And:

> *"…he informed us that he would argue that the agreements should not be applied according to their tenor because, although Tycon and Firstcorp might honestly have believed that it would be sufficient to go through the formality of concluding that kind of*

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205 *Conehage supra* 393 [1] – 394.

206 *Conehage supra* 395 [4]. (own emphasis).

207 Conehage *supra* 394 [3]. The court here did not specifically define the term *verum pretium,* but at face value the term can be defined as *verum* meaning true or truth; and *pretium* meaning price or value. (www.latin-dictionary.org).

agreement in order to procure tax benefits for themselves, they had no real intention to enter into agreements of sale and leaseback."[208]

Hefer JA raised the Appellant's argument that the Respondent and Firstcorp had, and might have had, an "honest belief" and submitted his opinion regarding this as the Appellant contended that the Respondent did not act in *fraudem legis*, but now states that, although the Respondent had an honest belief in concluding these agreements for obtaining a tax benefit, they never actually intended to enter into a sale and leaseback. This was then inadequately stating that the Respondent "dishonestly concealed the true nature of the transactions."[209] The Court referred to various *dicta* in support of this.

The Court considered the Appellant's view and held that a way of testing the Appellant's view was simply to ask how it came about that, if the parties did not intend to deceive, how they entered into agreements that would have no effect as sales and leasebacks. He proceeded to reject the Appellant's view as speculation, finding no support in evidence or probability on the basis of four considerations, namely:

- The consideration given to the advantages and disadvantages by the Respondent's staff, financial director and directors of their affiliated companies of sales and leasebacks;[210]

- The disadvantage which the loss of the ownership of part of Tycon's plant would bring about was expressly mentioned and considered;[211]

- Offers from other banks to make funds available by way of sales and leasebacks were received and considered;[212]

- The extensive negotiations which were conducted at arm's length and the expertise involved in the negotiating and the signing of the agreements.[213]

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208 Conehage *supra* 394 [3].
209 *Conehage supra* 394 [4].
210 *Conehage supra* 396.
211 *Conehage supra* 396.
212 *Conehage supra* 396.
213 *Conehage supra* 396.

Hefer JA further pointed out that the evidence was clear that the parties intended to enter into sale and leasebacks, and were not just going through the motions of merely drafting and concluding the agreements.[214] He further confirmed that asset-based financing transactions, of which a sale and leaseback can be regarded, were notorious for having uncommon clauses and phrases which do not typically appear in usual sale or lease contracts. With this, he stated that even though extension clauses existed in the leaseback agreements, this was not uncommon as these agreements often contain clauses which are not found in usual agreements. *Hefer JA* saw that there was an entitlement to indefinite use of the equipment, but that Tycon had considered and accepted the disadvantages of the loss of ownership, especially when capital generation from the transaction was considered. The transactions made "perfectly good business sense."[215]

For sake of completeness and clarity, reference needs to be made to a section of the judgment relating to the successful invocation of section 103. The relevance hereof is that the Commissioner can invoke this section when he feels simulation has occurred. Here, the Court pointed out the basic determination used when section 103 is invoked, and held:

> *"Broadly speaking the section empowers the Commissioner to determine a taxpayer's liability for income tax and other taxes by disregarding any abnormal transaction which the latter has entered into for the purpose of avoiding or postponing his tax liability or reducing the amount thereof.*
>
> *A transaction is regarded as abnormal if it was entered into or carried out by means, or in a manner, which would not normally be employed in the entering into, or carrying out of, a transaction of the nature of the transaction in question; or has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction of the nature of the transaction in question. An abnormal transaction may be disregarded if it was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax or the reduction of the amount of such liability.*"[216]

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214 *Conehage supra* 396 [9].
215 *Ibid.*
216 *Conehage supra* 397 [11].

In this matter, the Court found that there is no abnormality in Tycon's transactions to warrant the invocation hereof. In this regard, it stated:

> *"The Commissioner's contention is that this is all that counts; the sole purpose of the transaction was to reduce the company's tax liability; and it matters not that Tycon needed the capital to finance its expansion programme. Tycon's argument is precisely the opposite: the purpose of the whole exercise was to obtain capital, not to reduce tax; and if the reduction of its tax liability can be regarded as a purpose of the transactions as envisaged in s 103 at all, it was not the main purpose."*[217]

The Court dismissed the Commissioner's contention that the sole reason for using a sale and leaseback was due to tax advantages that were brought about. The Court noted that this was done for commercial reasons, and in support hereof stated:

> *"…had Tycon not needed capital, there would not have been any transaction at all. Tycon did not approach Firstcorp in order to alleviate its tax burden; it did so because it was in need of capital and this plainly remained the main purpose of the transactions."*[218]

The Appeal Court found that the Special Court correctly found in the Respondent's favour in this regard. The Appeal was subsequently dismissed.

3.7.4 Summary

The Court, here, considered the common law to *the doctrine of substance over form* and the tests laid down therein. The real gist of the judgment, however, was the finding that the buy-and-leaseback transaction entered into made perfectly good business sense. In stating this, the Court looked at the separate transactions and reasoning relating thereto, and noted that when there are multiple agreements to consider, one should have regard for the transaction as a whole.

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217 *Conehage supra* 398 [14].
218 *Conehage supra* 398 [15].

3.8 Conclusion

No set of facts is the same, and finding a transaction to be simulated can be extremely difficult. Above, five cases have been discussed, and, as is evident from these matters, no two cases have the same set of facts. The test for simulation has evolved, and rightly so. Transactions have become increasingly complex, with layers of agreements and indifferent parties involved to achieve necessary results, whatever they may be.

On an evaluation of the case law above, a distinction can be drawn, firstly, between cases where simulation was found, and those where not. A second distinction that can be drawn is of matters where the Courts referred to some form of business purpose or commercial sense. The latter distinction is of importance, as this is the pretence in which we proceed to the next chapter. A final distinction that can be drawn is between those of the six cases that are non-tax law cases, and those that are tax law cases. The problem is that many distinctions can be drawn.

It is important not to attempt to draw a distinction between previous case law, as facts and circumstances of each case differ. Despite a certain commonality in the general tests drawn by the judges in each case, what is evident is that, as case law developed, the factors considered by the Courts have evolved. This can only be seen as natural, as society does not occur in a vacuum, and as society advances, business changes.

In the discussion above, the Courts in *Zandberg, Kilburn and Erf 3183/1* found that simulation had occurred. In the *Zandberg* and *Kilburn* matters, the parties sought to retain possession and use of assets by creating scenarios whereby certain rights remained over assets, attempting to ensure that possession remained. In *Erf 3183/1*, the parties added certain tax indifferent third parties, and structured the agreements in such a way that the third parties held no rights of recourse. The Courts found these transactions to be simulated.

In the judgments in *Dadoo, Randles Brothers* and *Conehage*, the Courts found that no simulation occurred.

A certain point to consider is that, besides the fact of whether simulation was found or not, certain important factors need to be pointed out. Firstly, in *the Kilburn matter*, the Court

found to render the veil and look at the legal and natural obligations. In *Randles Brothers*, the Court looked at the business sense of the transaction, and, similarly, in *Erf 3183/1*, considered commercial reason. Again, in the *Conehage* matter, the Court considered business sense in the transactions. This can indicate that the Courts have, even though possibly inadvertently, considered commercial aspects as a factor when simulation is considered. This is, however, not surprising as most scenarios where simulation may occur, occur around business dealings. The fact that the Courts have considered these factors can, however, assist in further determining situations where simulations have occurred.

It is also somewhat interesting that our anti-avoidance provisions contained in the Income Tax Act[219] now contain that lack of commercial purpose is an avoidance and can, thus, be sanctioned.

219 Act 58 of 1962, sec 80A-80L.

4 *CSARS V NWK LTD* 2011 (2) SA 347 (SCA)

4.1 Introduction

The matter of *CSARS v NWK* has been a decisive case in the jurisprudence of *the doctrine of substance over form.*[220] This matter brought about a change which may have unintended consequences for generations to come. Although this matter is certainly not the latest judgment dealing with simulated transactions, it remains one of the relevant cases, as it sought to introduce a new principle in *the doctrine*. It has been difficult for Courts, as well as for academia, to reconcile the test for simulation in the *NWK matter* with the cases that followed it, as well as with the common law.

This chapter focuses on this case, along with a comparative study of various countries wherein *the doctrine* has place.

4.2 *CSARS v NWK Ltd* 2011 (2) SA 347 (SCA)

4.2.1 The facts

Over a five year period, from 1999 until 2003, NWK claimed deductions in respect of interest paid on a loan from SLAB, which was a subsidiary of First National Bank (FNB). In 2003, CSARS raised additional assessments in which they disallowed these deductions and raised additional interest. The claim by CSARS was that no genuine contracts existed between NWK, FNB and SLAB, and that these transactions were designed to disguise the true nature of the transaction with the intention of reducing NWK's tax liability. The complexity of the transactions can be set out as follows:

- On 1 April 1998, SLAB and NWK entered into a revolving credit facility, whereby SLAB loaned NWK R96 415 776. Loan capital was payable after a period of five years, being 28 February 2003, and payment was to be made by NWK delivering 109315 tons of maize to SLAB.

220 Hereinafter the *substance over form doctrine*, or *substance over form,* or *the doctrine*.

- The maize was duly described as “white maize intended for human consumption”, and was to be delivered in a manner whereby representatives of each party would meet in the presence of a notary, who would sign and deliver silo certificates. This was a known form of constructive delivery in the industry.[221]

- In terms of this agreement, SLAB was entitled to cede its rights or delegate any of its obligations without prior consent to a company within the FNB group.

- Interest was charged at 15,27% (percent) per annum, compounded monthly in arrears. Interest was also payable every six months. For this, NWK issued 10 promissory notes (one for each interest payment to be made), of which the face value totalled R 74 686 861.

- On the same day, SLAB entered into an agreement with FNB whereby they discounted the promissory notes to FNB for a value of R 50 697 518, and simultaneously ceding the rights to FNB.

- On 1 April 1998, SLAB also entered into a sale agreement with First Derivatives (FD) whereby they sold 109 315 tons of maize to FD for R 45 815 776. Delivery was to take place on 28 February 2003. NWK was not a party to this agreement but was aware thereof.

- On 1 April 1998, FD also entered into a forward sale agreement with NWK whereby 109 315 tons of maize were sold to NWK, which was payable in cash on 1 April 1998 for R 46 415 776, and delivery to take place on 28 February 2003. The purpose of this agreement was so that NWK would have possession of the correct quantity of maize for SLAB.

- In June 1998, NWK and SLAB proceeded to cede their respective rights to delivery of maize to FNB. The effect, here, being that NWK no longer had a right to take delivery of the stated quantity of maize from FD, as it was ceded to FNB. FNB was

221 *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA) at 352.

also ceded the right to claim the same quantity of maize from NWK in terms of their loan agreement. Both parties' rights were, therefore, extinguished.

- Despite this, on 28 February 2003, representatives from both FNB and NWK met in Lichtenburg in the presence of a notary. FNB handed silo certificates to NWK in terms of the forward purchase agreements. NWK handed the exact same agreements back to FNB five minutes later, in performance of the obligations of the loan agreement.

The effect of these transactions was that NWK had cash available at its disposal, and, further, had 10 promissory notes that would be settled over a five year period totalling R74 686 861. NWK proceeded to claim the interest deductions against its taxable income in terms of section 11(a) of the Income Tax Act.[222] The total deductions equalled R74 686 861 .

The Commissioner's grounds of assessment for disallowing the interest claimed by NWK against its taxable income, and the raising of additional interest, were based on the contentions that:

- The agreements between NWK, FNB, SLAB and FD were a simulation and did not reflect the true substance of the real transaction in that SLAB was only inserted into transactions as a means, and purpose for NWK to reduce or avoid tax.[223] The loan was for R50 million and not R96 415 766, and the forward sales and cessions between NWK and FNB effectively meant that the same maize was to be delivered by NWK to FNB, and in turn FNB would then deliver that maize back. If one did not perform, it was impossible for the other to;[224]

- The loan from FNB to NWK was, in actual fact, a "mere paper exercise and/or simulation", as none of the parties to any of the transactions intended to trade in maize. Further to this, the value of the maize in 2003 would be considerably higher than in 1999, and, more so, the quality of the maize could not be guaranteed;[225]

222 Act 58 of 1962.
223 CSARS *supra* 354.
224 CSARS *supra* 354.
225 *CSARS supra* 354.

- The commissioner further contended that delivery risks were high due to market volatility, as no storage arrangements or costs of storage had been accounted for, nor transport costs. It was further contended that, as no mention of maize quality was made, the description of the maize was inadequate.[226] Due to all these uncertainties, the Commissioner submitted, in the grounds of assessment, that NWK had no intention of repaying its loan, and SLAB had no intention of acquiring maize or selling it.[227] These contracts were, thus, designed to conceal the reality of the actual loan amount only being R50m.[228]

In the alternative, the Commissioner submitted that the series of transactions between NWK, FNB and SLAB constituted a transaction, operation or scheme as contained in section 103(1) of the Act, and thus avoided and/or reduced NWK's tax liability. The Commissioner contended that these transactions were entered into solely to obtain a tax benefit.[229]

NWK Appealed against the additional assessments to the Tax Court, sitting in Johannesburg, where *Burchowitz J* upheld the appeal. The Commissioner proceeded to appeal to the Supreme Court of Appeal.

4.2.2 Grounds of appeal

NWK, in its grounds of appeal, reiterated that the contracts concluded were in accordance with the terms, and these terms reflected the intention of NWK and were implemented in accordance with their tenor.[230] NWK further submitted in the grounds for appeal that the loans were correctly reflected and that no portion of any payment was for the capital, and further denying that the contracts were effected to avoid or postpone a tax liability.[231] NWK, here, further submitted that the transactions were concluded solely to obtain financing, and that all information pertaining thereto, was contained in a full and frank matter in the returns, contending that it was not liable for the additional interest charged.[232]

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226 *CSARS supra* 354.
227 *CSARS supra* 354.
228 *CSARS supra* 355.
229 *CSARS supra* 355.
230 *CSARS supra* 355.
231 *CSARS supra* 356.
232 *CSARS supra* 356.

4.2.3 Decision of the Tax Court – Court a quo

The Tax Court, per *Burchowitz J,* ruled that NWK had acted in terms of the agreement, and that its witness, Mr Barnard, "genuinely intended to act in accordance with the terms of the loan agreements".[233]

4.2.4 Decision of the Court – Supreme Court of Appeal

The Court, here, per *Lewis JA*, began its consideration by looking into the onus of proof. It was pointed out by the Commissioner, in the Court *a quo,* that NWK bore the burden of proving that the transactions were not simulated as required in terms of section 82(b) of the Act.[234] NWK's opposing submission, was that the burden was on the Commissioner to prove the contention that NWK had simulated the agreements, as the agreements presented *prima facie* proof that the transactions were true.[235]

To this, the Commissioner's counter to NWK's argument was that mere production of the agreements was not a discharge of the onus, and that NWK had to refute that they had a dishonest intention.[236]

The Supreme Court had previously held that the mere production of contracts was not enough to discharge that the parties genuinely intended to have the effect that they appear to have. The Court, here, referred to *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*[237], where *Hefer JA* held:

> *"This is plainly not so. That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they had been advised to do. The real question is, however, 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.*

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233 *CSARS supra* 356. It is important, as mentioned in this matter, to note that the Commissioners contention in the tax court was that NWK intentionally simulated the transactions to obtain the tax benefit provided in the Act.

234 Act 58 of 1962.

235 *CSARS supra* 356.

236 *CSARS supra* 356.

237 *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A).

Therefore, unless the appellants have shown on a preponderance of probability that the agreements do indeed reflect the actual intention of the parties thereto, the Commissioner's decision cannot be disturbed."[238]

Similarly, *Harms JA* confirmed that if agreements were taken at face value, the taxpayer would have to succeed.[239] These agreements, however, had aspects which raised questions regarding the real intentions of the parties, and the Court questioned how it was to examine real intention of parties when the contract appeared to be simulated.[240]

Lewis JA did, however, not make a decision on onus of proof at the outset, but instead found it necessary to consider the real intention and simulation, or *substance over form* of the matter. With this, *Lewis JA* sought to distinguish between remaining outside of statutory provisions, and deception created by a form of a transaction, and held:

"It is trite that a taxpayer may organise 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.[241] *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. However, as Hefer JA said in Ladysmith,*[242] *one must distinguish between the principle that one may arrange one's affairs so as to 'remain outside the provisions of a particular statute', and the principle that a court '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' (per Wessels ACJ in Kilburn v Estate Kilburn,*[243] *cited by Hefer JA in Ladysmith*[244]*)."*[245]

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238 *CSARS supra* 357. See also *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A).

239 *CSARS supra* 357. The court here referred to Harms JA's decision In *Reiler (Pty) Ltd v CIR* 60 SATC 1.

240 *CSARS supra* 357.

241 *IRC v Duke of Westminster* [1936] AC 1 at 19, cited by the court in *Ladysmith*, above. The principle is affirmed by *Hefer JA* in *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA) para 1.

242 *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) at 950H-951D.

243 *Kilburn v Estate Kilburn* 1931 AD 501 at 507.

244 *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) at 951C-D.

245 *CSARS supra* 357.

Lewis JA, at 43, felt no need to engulf the long list of authority on this topic, save for two cases, and quoted these principles derived from *Zandberg v Van Zyl*[246], and *Randles Brothers*[247], and held:

> *"Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is: not what in form it purports to be. The maxim then applies plus valet quod agitur quam quod simulate concipitur. But the words of the rule indicate its limitations. 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 the arrangement other than it purports to be. The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down' (my emphasis)."*[248]

And, at 44, further discussing disguised transactions and intention, and held:

> *"I wish to draw particular attention to the words 'real intention, definitely ascertainable, which differs from the simulated intention', because they indicate clearly what the learned Judge meant by a 'disguised' transaction. 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."*[249]

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246 *Zandberg v Van Zyl* 1910 AD 302.

247 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48.

248 *Zandberg v Van Zyl* 1910 AD 302.(This was directly quoted by the court).

249 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48, but directly quoted from *CSARS v NWK* at 358.

Lewis JA went on to point out that these cases, as referred to, "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 – and she was of the opinion that this warranted some further consideration."[250] The learned Judge then submitted that the correct approach could be found in both the majority and minority judgments in *Randles Brothers*[251]*, and* briefly discussed the matter as follows, stating:

> *"Before 1936 Randles had imported fabric under rebate of customs duty. Various manufacturers made up the fabric into shirts and pyjamas, and returned the items so made up to Randles for sale to retailers. In 1936 the customs regulations changed. In order for Randles to get the rebate the manufacturers had to declare that the material was their property. Randles thus changed its former practice and contracts with the manufacturers. They purported to transfer ownership of the material to the manufacturers, so that the declarations could be made. But the 'right' that the manufacturers acquired was severely restricted. They had to make up the garments in accordance with Randles' instructions and to resell the finished items to Randles at a price equal to that which Randles charged them, plus the cost of making up the garments. Randles bore the risk of loss or damage to the material at all times."*[252]

Lewis JA, then summarised the majority and minority judgments, at 47 to 48, discussing the Court's findings in the matter, as follows:

> *"Watermeyer JA for the majority (Feetham JA concurred and Centlivres JA delivered a separate concurring judgment) found that Randles had so much wanted to transfer ownership of the materials, albeit that the transfer was but a vehicle for achieving another purpose, that they had intended to do so. There was no requirement, he held, that the right transferred had to be untrammelled."*[253]

And:

> "De Wet CJ preferred to look at the substance of what was done: the parties could not possibly have intended sales, pursuant to which ownership of the materials would pass,

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250 *CSARS supra* 358.
251 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48.
252 *CSARS supra* 358 - 359.
253 *CSARS supra* 359.

he considered, since the manufacturers acquired a 'right' devoid of content. Tindall JA too considered that the court should have regard to what was done rather than what was said.[254] In cases that have followed, discussed below, the minority approach has in fact been followed."[255]

Lewis JA went on, referring to *Vasco Dry Cleaners v Twycross*[256], and, more specifically, *Hoexter JA*'s examination of all the peculiar features of a contract to determine the real intention of the parties thereto. *Lewis JA* also considered the matter of *Skjelbreds Rederi A/S v Hartless (Pty) Ltd*[257], and in his consideration of these matters came to the conclusion that, in both matters, dishonesty was not in issue, but rather, that each matter involved a transaction which derived to "achieve a purpose other than that for which it was ostensibly concluded."[258]

After the considerations above, *Lewis JA* focused on a distinction between motive and purpose, with intention, in determining whether simulation had occurred, and in her determination thereof focused on the *Hippo Quarries*[259] matter. Here, she held as follows:

> *"In Hippo Quarries the court drew a distinction between motive and purpose, on the one hand, and intention on the other, in trying to determine the genuineness of a contract, and of the underlying intention to transfer a right, where the transfer was not an end in itself. Nienaber JA said:*
>
> > *'Motive and purpose differ from intention. If the purpose of the parties is unlawful, 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*

254 *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 33 SATC 48.
255 *CSARS supra* at 359.
256 *Vasco Dry Cleaners v Twycross 1979 (1) SA 603 (A).*
257 1982 (2) SA 710 (A).
258 *CSARS supra* 359.
259 *Hippo Quaries (TVL) (Pty) Ltd v* Eardley [1992] 1 All SA 398 (A).

here, the purpose is legitimate and the intention is genuine, such intention, all other things being equal, will be implemented' (my emphasis).'[260] "[261]

After consideration of the above, *Lewis JA* stated the following as to the Court's opinion for the test for simulation:

"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."[262]

The Court, here, then questioned the real purpose of the loan transactions in this matter between FNB, NWK and SLAB, and whether these made commercial substance or business sense, with *Lewis JA* further questioning whether there was any purpose or commercial sense other than the tax advantage created for NWK by the myriad of transactions involved.[263] *Lewis JA* here further questioned whether there was a genuine intention to deliver maize to SLAB, or a cessionary for that matter, as she was of the opinion that the Tax Court did not adequately address these issues, and had accepted the evidence at face value instead of questioning the purpose thereof.[264]

The Court, per *Lewis JA,* further held that to state that a contract where money is paid across, and in return maize is delivered, is a contract of sale and not a loan, and further submitted that the label attached to a contract does not determine its validity.[265] *Lewis JA*

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260 *CSARS supra* 359. Quoted section by *Lewis JA* from *Hippo Quaries (TVL) (Pty) Ltd v* Eardley [1992] 1 All SA 398 (A).
261 At 877C-E.
262 *CSARS supra* 360.
263 *CSARS supra* 360.
264 *CSARS supra* 361.
265 *CSARS supra* 362.

went on further to consider the unusual factors surrounding these contracts, pointing out the following unusual characteristics:

- There was "*round-tripping"* of payments in and out of FNB's bank account, where the exact amounts that came in would go out, save for the bank charges;[266]

- Barnard's concession that NWK had only needed a R50 million loan;[267]

- The quality of maize was determined by an agricultural economist employed by FNB, and was never questioned, nor were the calculations verified by NWK. NWK further accepted the quantity of maize without considering the volatility of the maize market, or market forecasts pertaining thereto.[268]

- The maize description in the contract was poor and vague. The Commissioner contended that there were three types of white maize that could have been referred to. *Lewis JA,* here, also noted that NWK's main witness, Mr Barnard, was evasive when questioned by the Court regarding the quality of maize.[269]

- The absence of security for repayment of the loan was explicable, as per the Commissioner's contention, that FNB and NWK knew that SLAB would cede its rights to FNB, resulting in a situation where FNB and NWK would be relieved of their respective duties. The lack of security was also insufficiently explained by NWK's main witness, Mr Barnard, and his evidence was not seen as credible;[270]

- NWK, as per Mr Barnard's testimony, was aware of the context in which these loans were entered into, and was further aware of the separate agreements between FNB and SLAB. Mr Barnard was similarly aware that SLAB had no real rights in these transactions.[271]

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266 *CSARS supra* 362.
267 *CSARS supra* 362.
268 *CSARS supra* 363.
269 *CSARS supra* 363.
270 *CSARS supra* 363.
271 *CSARS supra* 363.

Lewis JA went on to consider the other agreements, and the delivery of maize between the parties and was of the opinion the other agreements entered into by SLAB were for the same quantity of maize, with the same description, to be delivered on the same day, with the real difference being the amounts were marginally less due to the fee due to each party affecting this. *Lewis JA* then focused on delivery of the maize, and the fact that the cessions by SLAB were done in June 1998, when the other agreements between FNB and NWK were concluded, and stated that Barnard understood the consequences of the cession. The Court further held that this would effectively cancel NWK's obligation to deliver maize. *Lewis JA* further noted the reciprocal discharge of NWK's debts to FNB, by *confusio*,[272] and held that the discharge and delivery by the parties, in the circumstances created by these agreements, made no commercial sense. In this regard, at 74, she stated the following:

> *"...Although NWK argued that set-off would have taken place only when both debts were due (when NWK had to deliver the maize to FNB and FNB had to deliver to NWK on 28 February 2003) in fact Barnard must have appreciated that any delivery would be meaningless. Although silo certificates were exchanged they were in respect of the identical maize, and the exchange and notarial certificates had no purpose. Barnard's protestations that the delivery obligations remained extant are not credible. The entire transaction in respect of the maize was effectively of no significance. At the outset, there was, as the Commissioner has contended, no intention to effect delivery at all. Contrast this result with that in Friedman and like cases: there, although the goods remained with the purchaser when the full amount owed had been paid, there was a genuine change of ownership, delivery being constructive.*
>
> *Similarly, the cession by NWK of its rights to delivery of maize to FNB as security for NWK's obligation to deliver maize pursuant to the cession from Slab to FNB made no commercial sense. The obligation was illusory given that FNB's and NWK's obligations in effect cancelled each other. There were no longer any rights that could be ceded."*[273]

Lewis JA then considered Barnard's evidence, and listed various inconsistencies and inaccuracies therein and found that the Tax Court had erred in finding Barnard a credible

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272 *CSARS supra* 364. Lewis JA here also briefly described *confusio* as the concurrence of a right and obligation in the same person, namely FNB. (Own emphasis).

273 *CSARS supra* 364. (Own emphasis).

witness, citing his explanation of using additional maize as a hedge, and delivery of maize was indicative that "no actual delivery of maize was provided for."[274]

Lewis JA briefly summarised her factual findings relating to the transactions, also considering the role SLAB played in the transaction, dates the agreements were entered into and amounts paid, and the credibility of the witnesses and evidence adduced, and at 77, held:

> *"These aspects all lead to the conclusion that the agreements in respect of maize were illusory: there was never any intention to deliver maize in the future. The loan was a simulated transaction, designed to create a tax benefit for NWK."*[275]

Lewis JA went on to uphold the appeal with costs, essentially confirming that the transaction between NWK, FNB and SLAB was simulated.[276]

4.3 *Discussion of CSARS v NWK*

The judgment delivered by *Lewis JA*, seemingly shocked the tax community, as there was suddenly a new determination, or element, to be considered and met when considering whether a transaction is simulated or not. South African jurisprudence had well-established principles of *substance over form*. These seemed to have some uniformity, as can be seen in Chapter 3 herein, where some of these cases and the principles were discussed in detail, and to which *Lewis JA* referred in detail in his judgment. In order to reduce duplication, these principles will not be redressed here.

What must be considered, however, is the statement by *Lewis JA*, at paragraph 55, where she held:

> *"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*

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274 *CSARS supra* 365.
275 *CSARS supra* 365.
276 *CSARS supra* 365.

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."[277]

And again, at 80, where he held:

"The intention to perform in accordance with the terms of the contract is accordingly questionable, and the Tax Court should have considered this. It 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."[278]

The Court may well have sought to align the principle to certain international standards, or foreign common law principles, as will be discussed hereafter, but what is of concern, firstly, is her confusion of tax avoidance and tax evasion in the judgment handed down by *Lewis JA*. Her comments at paragraph 55 clearly indicate that there should be some form of commercial sense, or real substance and purpose, to ensure that transactions with an objective that allow "tax evasion, or evasion of a peremptory law" fall within the scope.[279] *Lewis JA*, however, later on in her judgment, at paragraph 80, speaks of an arrangement having commercial reason, and not just "an intention to achieve a tax benefit or avoid the application of a law".[280]

Tax evasion and tax avoidance are very different aspects, with the former involving some element of criminality and resulting in criminal sanctions such as fines and imprisonment.

277 *CSARS supra* 360. (Own emphasis.)
278 *CSARS supra* 365. (Own emphasis.)
279 *CSARS supra* 360.
280 *CSARS supra* 365.

Tax avoidance, however, is designed to avoid the application of a law or statute by designing and applying elements or structures to remain outside the scope of a certain taxing provision in fiscal legislation. Clearly, the application of this judgment may create some confusion in that sense.

A further aspect to consider is the phrase by *Lewis JA*, at 55, stating that:

> *"the test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose."*[281]

Here, *Lewis JA* seemingly sought to extend the common law by stating that "the test should go further".[282] She does, however, not qualify this by saying that the test should go further in this matter, or, based on these facts, which can only leave the reader accepting the phrase on face value, that the test for simulation should go further than just the principles laid down in *the doctrine of substance over form*, and that commercial purpose, or commercial reason, or commercial sense of a transaction, should be considered as a deciding factor.

It seems likely that *Lewis JA* sought to extend the common law principles of *the doctrine of substance over form*, although commentary in this regard is divergent on the topic. The fact of the matter is that whether one considers commercial purpose as a factor to consider when determining simulation, or whether the test for simulation has been altered to the effect that a transaction must show commercial purpose in order not to be simulated, seems a matter of argument. No definition or guiding principles have been provided as to what commercial purpose entails. Tax avoidance may very well serve a commercial purpose as it could save money, or in turn, as with the *NWK* matter discussed above, could create a separate stream of income.[283] Furthermore, certain transactions, which may not seem to create any income stream or savings, could serve a completely different commercial purpose, or make different commercial sense, or even be structured for an ulterior commercial reasoning. There remains uncertainty regarding the question whether one should consider commercial

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281 *CSARS supra* 360.

282 *Ibid.*

283 The statement is made is a purely objective sense and should not be considered as an opinion, but purely an observation of a possible reason for parties to simulate a transaction.

purpose with regards to money saving, or profit making, and whether there are various other factors that play a role.

With this said, whether *Lewis JA* really intended to advance the test for simulation or not, commercial purpose is nonetheless a factor that plays a role in the determination of simulation, whether it be the benchmark on which simulation is tested against, or as a guiding factor or element in the determination.

4.4 Developments post *NWK - Roshcon & Another v Anchor Auto Body Builders CC* [2014] JOL 31709 (SCA)

The matter of *CSARS v NWK*[284] created the impression of additional elements to consider when determining whether a transaction had been simulated. The Court's determination that the test should go further, and look into the commercial sense of a transaction, or the real substance and form, created a sense that commercial purpose was the element to look at when determining simulation.

The *NWK matter* was decided in 2011 and created a hype amongst legal practitioners and accountants. In 2014, however, the Supreme Court of Appeal delivered the judgment in *Roshcon v Anchor Auto Body Builders CC.*[285] Now, it has been noted that this was not a tax related case, but the Court found it necessary to qualify certain aspects and impressions which may have been created by NWK. This case will not be discussed in reference as the judgment created no new elements in the test for simulation, but only a qualification of certain paragraphs in the *NWK matter*. As a matter of argument, a brief opinion will be given at the end of this discussion in support of the lack of detail with which this matter is discussed.

284 *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA).
285 *Roshcon v Anchor Auto Body Builders CC* [2014] JOL 31709 (SCA).

4.4.1 The facts

The salient facts are that Nissan Diesel, a manufacturer and supplier of trucks, had a supplier agreement with Wesbank, and Wesbank, in turn, had a floor plan agreement with Toit's Commercial (Pty) Ltd, (an authorised dealer in vehicles). In both agreements, ownership in and to the vehicles was reserved for Wesbank until such time that the dealer had paid for the vehicles.

Toit's had ordered the five trucks from Nissan Diesel for purposes of selling them to Roshcon. Wesbank financed the transaction. The trucks were delivered to Toit's commercial agent, Anchor, which was to modify the trucks on behalf of Roshcon. Roshcon took delivery of two of the trucks and later took delivery of the three trucks; however, they did not remove them from Toit's commercial agent.

Roshcon paid Toit's in full for the trucks. In the interim, Toit's was placed under liquidation before it could pay Wesbank for the trucks. When Roshcon claimed the vehicles from Toit's commercial agent, it refused to part with possession thereof; the reason being that Wesbank instructed them not to release the trucks as it claimed ownership.

Roshcon claimed the trucks as the true owner as it contended that the supplier and floor plan agreements were a disguise or a simulation. It contended that the transaction between Wesbank and Toit's was a loan against the security of the trucks without Wesbank having to take possession thereof. Roshcon contended that Wesbank was securing an advantage which otherwise the law would not allow. Alternatively, Roshcon contended that Wesbank was estopped from claiming ownership.[286]

4.4.2 Judgment

This was a unanimous decision, handed down by *Shongwe JA*, with *Willis JA* feeling the need to add to this judgment. *Willis JA*'s judgment is, out of both, the only one that specifically deals with the elements, and test for *substance over form* contained in *CSARS*

[286] Salient facts summarised from the media summary of the judgment of *Roshcon, accessed from www.saflii.co.za*

v NWK. This is not to say that *Shongwe JA's* judgment is of no relevance, but the fact of the matter is that *Willis JA* specifically dealt with certain paragraphs and statements made by *Lewis JA* in the *NWK matter*. For this reason, focus is placed on this section of the judgment, as an in-depth discussion will bring no furtherance to this research.

In general, this judgment confirmed, or, rather, reaffirmed, the principles of simulation contained in t*he doctrine of substance over form* created through case law. Focusing on *Willis JA*'s comments in his written judgment, the learned Judge considered and discussed the principles of simulation as laid down in common law. *Willis JA*, considering the application of *the doctrine*, at 32, held;

> *"Nothing said subsequently in any of the judgments of this court dealing with simulated transactions alters those original principles in any way or purports to do so. However, in a number of them dealing with income tax, the courts have been called upon to apply these principles in a different context."*[287]

And at 33:

> *"In the income tax cases, the parties seek to take advantage of the complexities of income tax legislation in order to obtain a reduction in their overall liability for income tax."*[288]

After a consideration of the principles laid down in common law, *Willis JA* went on to discuss what he perceived to be *Lewis JA*'s intention in the *NWK matter*, stating that:

> *"The analysis by Lewis JA of the transactions in NWK clearly demonstrated that a range of unrealistic and self-cancelling features had been added to a straightforward loan. They served no commercial purpose, were based on no realistic valuation of the different elements of the transaction and were included solely to disguise the nature of the loan and inflate the deductions that NWK could make against its taxable income. In those circumstances the courts stripped away the unrealistic elements in order to disclose the true underlying transaction."*[289]

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287 *Roshcon supra* 19.
288 *Roshcon supra* 19.
289 *Ibid.*

Willis JA continued to consider *Lewis JA*'s statements in his judgment, specifically at paragraph 55 thereof, wherein reference is made to a statement saying that, where the purpose of a transaction is to achieve an object to avoid a peremptory law or the evasion of tax, it will be regarded as simulated.[290] *Willis JA* holds that certain circles failed to read this paragraph in context of the paragraph written, and judgment as a whole.[291]

Willis JA went on to qualify *Lewis JA*'s judgment as follows, and held:

> *"For those reasons the notion that NWK transforms our law in relation to simulated transactions, or requires more of a court faced with a contention that a transaction is simulated than a careful analysis of all matters surrounding the transaction, including its commercial purpose, if any, is incorrect. The position remains that the court examines the transaction as a whole, including all surrounding circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it, before determining in any particular case whether a transaction is simulated."* [292]

4.4.3 Discussion

Although *Willis JA*'s intentions here were good, his judgment fails to address *Lewis JA*'s submission that the test for simulation must go further, and consider the commercial sense, and real substance and form of a transaction. It is no new feature in the jurisprudence of *the doctrine of substance over form* in South African common law that one should consider all the features and genuineness of a transaction when determining simulation. *Willis JA*, at 37, held that;

> *"the notion that NWK transforms our law in relation to simulated transactions, or requires more of a court faced with a contention that a transaction is simulated than a careful analysis of all matters surrounding the transaction, including its commercial purpose, if any, is incorrect."* [293]

290 *Roshcon supra* 21.
291 *Ibid.*
292 *Roshcon supra* 22.
293 *Ibid*.

In the same breath, *Willis JA* states that the Courts were to consider the transaction as a whole, including surrounding circumstances and unusual features, and the manner that implementation was intended, in order to determine simulation.

Although *Willis JA* has essentially reverted to the position our common law provided for, prior to the *NWK matter*, he failed to address *Lewis JA*'s most important statement, namely that the test should go further, and examine the commercial sense, and real substance and purpose of the transaction. *Lewis JA* clearly sought to extend the test, whereas *Willis JA* has qualified the statement in saying that commercial purpose is an element to consider. There seems no indication in his judgment that *Willis JA* touched on this phrase, and leaves researchers somewhat perplexed, as now, we are to believe that although *Lewis JA* clearly stated one thing, his intention was not so. It is, furthermore, unclear as to *Willis JA*'s reasoning for failure to address *Lewis JA*'s statement that the test should go further.

The effect is that the *Roshcon* matter, despite many authors saying otherwise, fails to assist in determining what *Lewis JA*'s intention was. It, furthermore, fails to give any guidance as to what commercial purpose, commercial reason or commercial sense means. Any business that can structure its affairs solely to avoid the implications of a taxing statute, resulting in money saved, could possibly be regarded as a commercial purpose. Similarly, a transaction whereby an individual, who is also the founder and trustee of a family trust, sells his family assets by way of low interest loan to a family trust, seems perfectly legitimate and has good commercial purpose as the beneficial owner(s) is/are the same family. The failure of the Court to guide us in this sense has created a basis for varied arguments on the topic. *Roshcon* has, therefore, done little to assist in analysing the effects of the *NWK matter*.

4.5 Commercial Purpose – A comparative context

To think that simulation was isolated to South Africa only, is incorrect. With business and familial ties becoming global, businesses and wealthy families are involved in more and more aggressive and complicated planning of business strategies, mergers, acquisitions, share ownership transfers and foreign investment. With this, aggressive tax strategies are designed to reduce double taxation, as well as tax payable in general. For example, a South African company trading in the UK would be burdened to have to pay tax in both jurisdictions, especially when the Rand/Pound exchange is extremely high (or low depending on the

circumstances). There has been a global increase in tax advisory services, and so-called family offices that cater for the investment and management of the global ultra-high net worth clients and families. This is as a result of family members scattered across the globe, and usually having the resources to structure and plan their businesses in the most tax efficient manners. The matter of the term commercial purpose in an international context becomes all the more relevant, as simulated transactions to avoid tax is currently a global phenomenon, with the Organisation for Economic Co-operation and Development (OECD)[294] continuously drafting regulations and model treaties relating to base erosion, profit shifting, anti-avoidance and residence.

With the above in mind, a common counter which is found in almost all countries that have some British influence over legal precedents, the context contained herein is focused around some of the main British cases relating to simulation. This research will proceed on the basis to discuss the evolution of the principle, as a detailed discussion of the case law feeds beyond the parameters of the research proposal. It must be noted that the position in British law is somewhat confusing, and this section serves only as an overview.

As was discussed in the introductory chapter of this research, one of the well-known cases from the United Kingdom is that of *The Commissioners of Inland Revenue v His Grace the Duke of Westminster.* The Court, in this matter, held the following in relation to avoidance:

> *"Every man is entitled if he so can to order his affairs so that the tax attracting under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so to secure this result, then, however unappreciative the Commissioner for Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'The substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally payable. "*[295]

The *Duke of Westminster matter* has been referenced in many South African Court cases since the judgment, as a type of basis, or foundation laid, for the discussion on simulation.

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294 See www.OECD.org. (Hereafter referred to as the OECD).

295 1936 AC 1 (HL). Hereinafter referred to *Duke of Westminster.*

Since this judgment, the House of Lords had decided on a "trilogy of judgments"[296] relating to simulation, and what is termed as "fiscal nullity", also known as *the Ramsay principle*.[297] The first of the three judgments is that of *WT Ramsay Ltd v Inland Revenue Commissioners; Eilbeck (Inspector of Taxes) v Rawling* 1981 1 All ER 865, 1982 AC 300, 1981 2 WLR 449 (HL). Lord Wilberforce held that he was entitled to go beyond what the form of the transactions and consider the substance thereof, stating:

> *"While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine which prevents it being so regarded; to do so is not to prefer form over substance, or substance over form*." [298]

Lord Wilberforce further went on to say:

> *"It does not introduce a new principle; it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process."* [299]

In *Commissioners for Inland Revenue v Burmah Oil Ltd*[300], decided shortly after Ramsay, the House of Lords held that an insertion of steps which had no commercial purpose other than tax avoidance, indicated an interrelated transaction as a whole was artificial.[301] The House of Lords was of the opinion that the judgement by Lord Wilderforce created a

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296 Honiball *International Tax* 514.

297 Honiball *International Tax* 514. (Own Epmphasis added).

298 *WT Ramsay Ltd v Inland Revenue Commissioners; Eilbeck (Inspector of Taxes) v Rawling* 1981 1 All ER 865, 1982 AC 300, 1981 2 WLR 449 (HL) at 871.

299 *Ramsay supra* 873.

300 (1982) STC 30 (HL). See also Honniball *International Tax* 514-516.

301 Honniball *International Tax* 516.

significant change in *the doctrine*; however, warned that this created confusion as *Lord Wilderforce* felt that he had created no new legal principle.[302]

Post Burmah, there was confusion relating to *the doctrine*. In *Furniss v Dawson*,[303] Lord Brightman was of the opinion that the question was not whether any enduring legal consequences existed, but, rather, whether steps that were taken or inserted into a series of transactions have a commercial purpose other than the avoidance of tax liability.[304] He further held that *the doctrine* can be applied to any transaction where two circumstances arise; namely, there must be a pre-ordained series of transactions which may, or may not, include the achievement of a legitimate commercial end.[305] Secondly, certain steps are inserted with no commercial purpose apart from the avoidance of a tax liability. He further went on to say that when these two steps are present, the steps without a commercial purpose may be ignored.[306]

It seems the most recent approach in the United Kingdom is *Barclays Mercantile Business Finance v Mawson (Inspector of Taxes)*[307] where the Court held:

> *"The driving principle in the Ramsay line of cases continues to involve a general rule of statutory provisions, construction and an unblinkered approach to the analysis of facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."*[308]

In other jurisdictions such as the United States of America (USA), Canada and also Japan, *the doctrine* is known as the step-transaction doctrine, and dictates that an intermediate transaction in a series of pre-determined transactions, even if it is *bona fide,* may be disregarded and the several transactions treated as one composite transaction.[309] Australia, Austria, Belgium and Spain make use of the abuse-of-right, or *fraus legis* doctrine, where a

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302 Honniball *International Tax* 516.
303 *Furniss v Dawson* (1984) AC 474. See also Honniball *International Tax* 514-516.
304 *Ibid*.
305 *Ibid.*
306 *Supra Furniss v Dawson* At 166 f-h.
307 *Barclays Mercantile Business Finance v Mawson (Inspector of Taxes)* (2005) 1 ALL ER 97.
308 *Supra Barclays* at 11oc-d.
309 Honiball *International Tax* 525.

court disregards the legal form that a transaction takes if its sole purpose was undertaken to avoid tax with no *bona fide* business purpose.[310]

Similarly, in the Netherlands, the courts have determined that the *fraus legis*, or abuse of right doctrine, has three conditions to meet:

- Sole purpose of the transaction is tax avoidance;

- There is a lack of real and practical effect or purpose other than tax avoidance; and

- The intended consequences are in contravention of Dutch law.[311]

It is clear that *the doctrine of substance over form*, although termed differently, is evident in various jurisdictions. Despite the confusion in the British Courts, what is clear, nonetheless, is that each reference to *the doctrine* above looks at some form of purpose to be met other than just the avoidance of tax, albeit it practical effect or purpose or business or commercial purpose. South African courts are entitled to consider foreign law when deciding on legal principles, and it is certainly only a matter of time before more than just the Westminster case is considered in our judgments**.**

310 *Ibid* 525.
311 *Ibid* 525-526.

5 CONCLUSION

The above research was focused on the influence of *the doctrine of substance over form* on the use of interest free loans, with research focusing on the development of *the doctrine of substance over form* through common law. With this, the conclusion surely has to provide some type of answer to the research question.

It must, from the outset, be stated that, one cannot simply give an outright answer to the research question. *The doctrine of substance over form* stems from areas of tax, commercial and private law. *The doctrine* can, therefore, become fairly complex, but it is also difficult to isolate the test for simulation between the spheres of law (tax, commercial and private). A further issue, as was previously contended, is that as society develops, so do complexities of doing business. This means that simulation is much harder to determine.

The test for simulation pre *CSARS v NWK* was predominantly focused on an assessment of the intention of the parties, and acknowledging that parties to a transaction are within their rights to structure affairs in order to avoid a taxing provision. While case law evolved, the Courts furthered the focus on the intention and motives of the parties to a transaction, with later judgments identifying elements of “business sense” and “commercial reasons” being identified in judgments as a factor considered when identifying whether simulation in transactions has occurred. Further to this, judgements have focused on each contract and the role it plays in the whole transaction to determine whether unnecessary, complicated steps have been inserted. This could lead to simulation.

CSARS v NWK was seen as changing the test for simulation by incorporating what has been deemed by many authors as “commercial purpose”. The Court held that it seemed the test for simulation “should go further”, indicating a possible intention by the Court to expand *the doctrine* to include commercial purpose as part of this test for simulation. The problem with this is that commercial purpose cannot be defined; it cannot be bound to a set of facts or transactions. More so, what may be a transaction between related entities may have a purpose other than for commercial gains, but at the same time, may also not have a simulated intention from the outset. Many such scenarios exist when one considers that family transactions are commonplace globally.

Interest-free and low-interest loans are used in a variety of industries and scenarios. Outside of the scope of this research, a clampdown has begun on the use of interest-free loans with certain amendments and anti-avoidance provisions that have been made. Interest is not an essential element of a loan agreement. This is so neither in common law nor legislation. Without considering the minimum rates of interest and legislative requirements that may be placed on charging on interest, one then has to consider whether not charging interest on a loan can be indicative of a simulated transaction for having no commercial purpose.

As has been stated previously, commercial purpose, or commercial reason or business sense, as has been termed, cannot be viewed in isolation. There is no definition for the term. At best, it is a concept that can only be explained by considering a myriad of aspects such as intention, motive, complexity, purpose and need for the transaction. What may be commercially viable in one scenario may be untenable in another. Again, legal tax avoidance may be commercially viable, and have some commercial purpose in certain scenarios. It can be argued that, every time less tax is paid, or is due, due to legal avoidance schemes and structuring, it could be seen as good business sense, or a good commercial reason. Similarly, a transaction between family members may have far more reasoning behind it than commercial purpose. The arguments can be made for a myriad of scenarios where for example, beneficial owners may be one and the same person, and a scheme has been devised to lawfully hold assets with no sinister intentions.

A loan transaction where no interest is charged is not as complicated as the facts in many cases discussed above may have been. As was seen in the pre *CSARS v NWK* case law, the Courts focused on the true intention of the parties, the motive and purpose for transacting in a particular manner while contemplating the real substance and form of a transaction. Where sales are financed by interest-free loans, and the loan is donated away annually with an individual's annual donations tax exclusion, with actual payments to reduce the loan ever being made, it stands to reason that the real substance and purpose is to disguise a donation as a sale.

If one considers the commercial purpose of this transaction, however, it is clear that it is somewhat of a two-way street. It is efficient only if there are no donations tax payable, and the transfer of assets takes place. On the other hand, if simulation is averred, it is doubtful whether this would pass the test laid down in common law, pre, or post *CSARS v NWK*. This

said, even if the Court in *NWK* sought to extend the test for simulation, it would still be problematic when interest-free loans are at the fore. It is submitted that it would be difficult to extend a test for simulation to include commercial purpose, and that this can only be an element to consider among various other factors. Although the Court possibly sought the test to be extended by including commercial purpose, this would not negate the intention of the parties, the substance and form, the purpose, complexity and motive and purpose of all parties to a transaction where simulation has been averred.

The only reasonable assumption that can be made is that the Court sought that commercial purpose was to be an element to be considered. This would support previous assertions made in other judgments. With this assertion, it can only be so that, when a transaction between two parties involves a form of an interest-free or low-interest loan, the test for simulation must involve an in-depth consideration of more than commercial purpose. In the judgment of *CSARS v NWK*, there affects an interest-free loan or low-interest loan in so far as commercial purpose of the loan may be a factor, considering all other factors that may play a role as mentioned above. With this, the commercial purpose of each transaction will differ and the *NWK* decision can assist further decisions in identifying elements of when such commercial purpose may be a simulated purpose when actual avoidance may have been intended and attempted.

It is, furthermore, important to note that this research has not considered and discussed anti-avoidance provisions contained in law, either in tax legislation or any other law affecting these transactions. Considering this, it is important to note that associated anti-avoidance legislation may have, a drastic impact on a Court's decision.

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