

# THE DEVELOPMENT OF THE SIMULATED TRANSACTIONS DOCTRINE AS MEANS OF COMBATTING IMPERMISSIBLE TAX AVOIDANCE

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By

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## **ABSTRACT**

Tax avoidance may be an inevitable consequence of taxation; however, it remains a great drain on the fiscus. There are many ways in which the Commissioner may attack avoidance arrangements in order to lessen the drain on the fiscus. One manner in which the Commissioner may attack avoidance arrangements is through the doctrine of simulated transactions. Given that the simulated transactions doctrine is ordinarily a contract law doctrine and not strictly speaking a tax law mechanism one might wonder how this area of law might develop into an anti-avoidance mechanism. This contribution sought to understand how the doctrine may develop as an anti-avoidance mechanism through an analysis of the development of the case law in regards to the development of the doctrine in order to ascertain how it has developed into a common-law anti-avoidance rule. In this regard selected cases were discussed which highlighted firstly the genesis of the simulated transactions doctrine in our law (Chapter 2) and selected cases were discussed that highlighted the simulated transactions doctrine's development and use as an anti-avoidance mechanism (Chapter 3) and finally the courts acceptance and treatment of this development and how this development was discussed in the literature was also discussed (Chapter 4) It was concluded that whilst the doctrine can be developed quite extensively as an anti-avoidance mechanism the courts are unlikely to develop same into a broad common-law General Anti-Avoidance Rule.

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## CHAPTER 1: INTRODUCTION

Broadly speaking, the substance over form principle is the principle that allows the court to strip away or disregard the outward form of a transaction and give effect to what the court determines is the actual, substantive transaction; the principle is expressed in the maxim *plus valet quod agitur quam quod simulate concipitur* meaning “(‘greater value is attached to what is done than to what appears to be done’)...in simple language this may be rendered as ‘true facts have more value than apparent facts’ or ‘substance bears more weight than form’.”<sup>1</sup> Secondly, the term *in fraudem legis* refers to acts done that comply with the letter of the law but are designed to nevertheless defeat the spirit or purpose of the law.<sup>2</sup> This of course then begs the question as to whether a person may ever remain outside of the purview of legislation, can a person ever arrange their affairs so as not to fall within the wording of a statute? Relatedly, a simulated transaction may be said to be one that is entered into without any intention to give effect to the agreement, or to some of its terms, and the parties have some other real agreement that will give effect to, despite the purported agreement.<sup>3</sup> A simulated transaction, then, is one in which the authenticity of the parties intentions to contract on the terms of the supposed agreement is called into question.<sup>4</sup> Thus it may be said then that the simulated transactions doctrine enjoins a court to set aside a supposed transaction and uphold or apply what is found to be the real transaction between the parties; the jurisdictional fact that allows the court to disregard the form of the agreement being the dissonance between what is seen as the real intentions of the parties which must differ from the supposed intention. Thus understood it seems that simulated transactions principle and the *fraudem legis* principle both have their genesis in the *plus valet* maxim, both being concerned with the substance of a transaction as opposed to merely the form or wording in which it is couched. The two principles differ however in that simulated transactions the parties do not really intend the

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<sup>1</sup> B C Plant Hire cc t/a B C Carriers v Grenco (SA) (Pty) Ltd [2004] 1 All SA 612 (C) at para 33

<sup>2</sup> Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) at pg648

<sup>3</sup> Williams, R.C. *Income Tax in South Africa Cases and Materials* (2009) 3<sup>rd</sup> ed LexisNexis: South Africa at p. 562

<sup>4</sup> Hutchison, A & Hutchison, D “Simulated Transactions and the Fraus Legis Doctrine” 131 *South African Law Journal* 69 (2014) at pg. 70

outward appearance of the agreement whereas arguably the very nature of transactions in *fraudem legis* are intended to be what in form they purport to be, simulated agreements then are ineffective for lack of serious intent whereas agreements in *fraudem legis* are ineffective or invalid due to their outward effects – circumventing the spirit of the law. However, as will be shown in the chapters below the two principles of simulation and *fraudem legis* have become somewhat jurisprudentially entwined.

Further, The South African Revenue Services defines impermissible tax avoidance as arrangements that are artificially contrived such that they have no or negligible economic value.<sup>5</sup> It may also be said that tax avoidance exists on some spectrum from permissible to impermissible tax avoidance, the exact delineating point at which tax avoidance becomes impermissible may not be precisely defined.<sup>6</sup> Whilst there may be certain factors that are indicative of impermissible tax avoidance the only definitional element, that is to say the only necessary feature of impermissible tax avoidance is that it is an arrangement that is seen as inconsistent with the statutory purpose of the taxing legislation.<sup>7</sup>

Given the above then this thesis looks to answer the question as to how the simulated transactions doctrine was developed in the common law as a means of combatting impermissible tax avoidance. The question to be discussed and which this paper attempts to answer then is how the courts have used the principles of substance over form and *fraus legis* to combat tax avoidance which is inconsistent with the Income Tax Act's<sup>8</sup> purpose? The purpose of answering this question is to provide a principled historical account of the above principles' development in our law as means of combatting impermissible tax avoidance in order to highlight potential weaknesses that the simulated transactions doctrine might have as a mechanism for curbing impermissible tax avoidance, the role it has played, and might continue to play, in combatting such abusive arrangements and to provide a principled foundation from which any further development of the doctrine might

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<sup>5</sup> SARS Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) (2005) pg. 4

<sup>6</sup> Benjamin T Kujinga 'Factors that Limit the Efficacy of General Anti-Avoidance Rule in Income Tax Legislation: Lessons from South Africa, Australia and Canada' (2014) *Comparative and International Law Journal of South Africa* vol 47 pp. 429 - 430

<sup>7</sup> *ibid*

<sup>8</sup> Act no. 58 of 1962, as amended.

proceed should same be necessary. The above question will be answered by way of a historical and doctrinal analysis and discussion of selected influential cases which exemplify the use of the *plus valet* and *fraus legis* principles and their development within the case law as a means of combatting impermissible tax avoidance.

In answering the above question this paper must necessarily limit attention on certain aspects of tax avoidance and substance over form generally in order to provide a more focussed enquiry. As such, due to the limitations of this paper, discussion of the General Anti-Avoidance Rules contained in ss 80A – L in the Income Tax Act in any great detail, merely as a comparator for the simulated transactions doctrine. Similarly, discussion of the simulated transactions doctrine, the *plus valet* and *fraus legis* principles is focused to their use in cases of tax avoidance with limited discussion of their broader application in the common law merely as a means of providing the foundations for the development of these principles in a tax law setting and where same is necessary to understand the discussion of the tax avoidance case law.

Chapter 2 begins the enquiry by discussing the genesis of the *plus valet* and *fraus legis* principles in our law by providing a brief discussion regarding their origins in Roman and the writings of the later civil law by drawing primarily on the scholarship of Blecher<sup>9</sup> as well as the seminal work of Prof. Zimmerman<sup>10</sup> before moving on to the reception of these principles in our law in the cases of *Zandberg v Van Zyl*<sup>11</sup> and *Dadoo Ltd and others v Krugersdorp Municipal Council*.<sup>12</sup> These cases were chosen as they were the first cases to authoritatively discuss and lay down the principles of *plus valet* and *in fraudem legis* in the cases of *Zandberg* and *Dadoo* respectively. The chapter aims to provide a succinct critical analysis of the courts' treatment and discussion of the principles in these cases before discussing the case of *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*<sup>13</sup> where the *plus valet* and *fraus legis* principles were authoritatively discussed and applied to a tax avoidance arrangement, the differences in approach and

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<sup>9</sup> M D Blecher, *Simulated Transactions in the Later Civil Law*, 91 S. African L.J. 358 (1974)

<sup>10</sup> Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990)

<sup>11</sup> 1910 AD 302

<sup>12</sup> [1920] AD 530

<sup>13</sup> [1941] 33 SATC 48

tensions between the minority judgment of De Wet CJ and the majority judgment of Watermeyer JA will be highlighted and the repercussions for the further development of these principles as potential anti-avoidance rules will also be discussed.

Chapter 3 then moves the inquiry along to the discussion of the modern approach toward the use of these principles as anti-avoidance rules as exemplified in the cases of *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR*,<sup>14</sup> and *CSARS v NWK Ltd*.<sup>15</sup> The cases of *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR* will be discussed and analysed for its lucid and authoritative exposition of the principles of *plus valet* and *fraus legis* as well as their example of the courts' resolution of the tensions between the different approaches highlighted in Chapter 2. However, focus in this chapter will be given to the case of *CSARS v NWK Ltd* which has dominated the discussion surrounding simulated transactions in recent years. The chapter looks to discuss and analyse the approach of the court to the extant case law on the matter and critically evaluate the findings of the court that the doctrine is in need of development, this discussion will be highlighted and supplemented where necessary with reference to the literature surrounding this case to determine whether given the findings in chapter 2 and in light of the courts' determinations in *Ladysmith* and whether the court was correct in its finding that the doctrine requires development and whether the development proposed by the court is adequate in the circumstances and jurisprudentially sound.

Chapter 4 Then looks to discuss how the principles laid down in *NWK Ltd*. have been accepted by our courts. In this regard the cases of *Roshcon v Anchor Auto Body Builders*,<sup>16</sup> *CSARS v Bosch and Another*<sup>17</sup> and *Sasol Oil (Pty) Ltd v CSARS*.<sup>18</sup> are discussed. As with the previous chapters this chapter will look to analyse the reasoning of the courts in these cases and discuss whether the courts have adequately resolved the issues raised with the *NWK Ltd* judgment potential reasons for the courts' reversal with respect to the development of the simulated

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<sup>14</sup> 1996 (3) SA 942 (SCA)

<sup>15</sup> Commissioner for the South African Revenue Service v NWK Ltd 2011 (2) SA 67 (SCA)

<sup>16</sup> [2014] 2 All SA 654 (SCA)

<sup>17</sup> [2015] 1 All SA 1 (SCA)

<sup>18</sup> [2019] 1 All SA 106 (SCA)

transactions doctrine will be discussed and lastly an evaluation of the doctrine of simulated transactions as a means of curbing impermissible tax avoidance will be given to determine the potential for future development of this common law mechanism, should it be seen as necessary.

## CHAPTER 2: ORIGINS OF THE SIMULATED TRANSACTIONS DOCTRINE

Whilst rudimentary definitions for the substance over form principle, encapsulated in the maxim *plus valet quod agitur quam quod simulate concipitur*, and the *fraus legis* principle were provided above they create yet more questions to be answered: when is a court empowered to regard the substance of a transaction and disregard the contractual form? If the *fraus legis* principle is part of our law when can a law ever be avoided, if at all? How are these principles to be used to mitigate against impermissible tax avoidance? To answer these questions this chapter looks to discuss the origins of these principles and their reception into our law. As such, the origins of the principles in Roman law and their development in the writings of later civil law scholars will be used as a point of departure for the critical analysis of the reasoning employed in the cases of *Zandberg v Van Zyl*<sup>19</sup> and *Dadoo Ltd and others v Krugersdorp Municipal Council*,<sup>20</sup> each regarded as the *locus classicus* for the substance over form principle and the *fraus legis principle* respectively.<sup>21</sup> Further, the reception and development of these principles in a tax law framework will be analysed through a discussion of the *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*<sup>22</sup> case in order to provide a fuller and more robust definition of these principles and to highlight coincidence, thus creating the simulated transactions doctrine. These cases have been selected as the archetypes for the principles of *plus valet*, *fraudem legis* and simulated transactions respectively as they were the first cases in our law to authoritatively state the scope and content of each principle and are still used as authority today, thus how we understand the *ratio* of these cases is crucial to the understanding of the use of simulated transactions today. Whilst, “The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down”<sup>23</sup> the application of the principles to the facts in each case will be discussed as a means through which greater understanding can be given as to how the differing approaches would affect their application going forward The chapter then concludes

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<sup>19</sup> 1910 AD 302

<sup>20</sup> [1920] AD 530

<sup>21</sup> Hutchison, A & Hutchison, D “Simulated Transactions and the Fraus Legis Doctrine” 131 South African Law Journal 69 (2014)

<sup>22</sup> [1941] 33 SATC 48

<sup>23</sup> *Zandberg v Van Zyl* 1910 AD 302 at 309

with an evaluation and analysis of the principles laid out in the above case law and their continued relevance in our modern jurisprudence.

The practice of simulated transactions was not unknown in Roman Law, although they did not have a developed theory describing simulated transactions but rather a collection of laws describing discreet acts of simulation and the consequences thereof.<sup>24</sup> That said a generalised theory of simulation began to emerge from the rescripts of the codex, the most important of which were those collected under the rubric of *plus valere quod agitur quam quod simulate concipitur* which formed the basis of the later medieval writings on the subject of simulation although in the time of Justinian this did not denote purely simulated contracts but may also have applied to nude contracts as well.<sup>25</sup> Similarly, the Romans did not have a developed general rule with regards to transactions in fraudem legis, special clauses would have to be added prohibiting the doing of anything that might defeat the objects of the law in question.<sup>26</sup> The two concepts were juridically distinct in Roman times; the rubric of *plus valet quod agitur quam quod simulate concipitur* not being directly concerned with *fraus legis* but rather the divergence between the appearance and the reality of things irrespective of whether they may have been undertaken to circumvent an law.<sup>27</sup> Nevertheless the two concepts had become somewhat intertwined through the writings of the Glossators who had developed the same criteria for the determination of both transactions *in fraudem legis* and transactions the application of the *plus valet* maxim, although theoretically the two principles were still distinct – transactions *in fraudem legis* involving an *actus verus* which simulated transactions did not.<sup>28</sup> Transactions in *fraudem legis* being truly intended by the parties in order to circumvent the law whereas simulated transactions were not intended to be effective by the parties but merely to cloak the underling transaction. Secondly, simulated transactions were regarded as bilateral acts by the civil law scholars whereas *fraus* could potentially be committed unilaterally<sup>29</sup>. Thirdly, simulated contracts were void for lack of consensus whereas contracts *in fraudem legis* may nevertheless remain valid, concerned as the principle was with

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<sup>24</sup> Ibid note 9 at pp 358 - 359

<sup>25</sup> Ibid at 360

<sup>26</sup> Ibid

<sup>27</sup> Ibid 362

<sup>28</sup> Ibid 2 at pp 648 - 649

<sup>29</sup> Ibid 9 at 368

statutory interpretation rather than the mental state of the transactor(s).<sup>30</sup> The confusion between transactions in *fraudem legis* and simulated transactions in the writings of the medieval scholars might be attributed to their attempts to determine how the courts might determine the true state of affairs in a simulated transaction; thus the attempts to classify simulated transactions by subject matter, as where a loan of grain is really intended as a loan of money; by contract type, as where a sale disguises a loan; or where a contract between A and B is used to disguise the actual contract between A and C, where B cannot validly be substituted for C in each situation the contract may be simulated, in *fraudem legis* or both<sup>31</sup>. Thus the writings of the later civil law jurists show the vexed nature of providing a coherent theory with regards to simulated transactions distinct from that of *fraus legis* however it is nevertheless clear from their writings that simulation is primarily a defect of the intentions of the parties and simulated transactions were thus void for lack of consensus, which, as will be shown below, affected how our law received and understood the substance over form and *fraus legis* principles.

The earliest authoritative judicial pronouncement on the substance over form principle, its origins, ambit and meaning comes from the case of *Zandberg v Van Zyl*<sup>32</sup> which remains the *locus classicus* on the subject to this day. The dispute in question centred on the possession of a wagon and whether same had been validly sold. A brief synopsis of the facts as well as the reasoning of some of the judges follows below.

The question to be determined in the case was whether the wagon in question could be validly attached by the Magistrate's court in satisfaction of a debt owed by the respondent's mother-in-law to the Appellant. The Respondent had argued that the wagon in question was validly sold to him by his mother-in-law in satisfaction of a prior debt that she had owed him, accordingly the wagon was his property and not Mrs. Van Zyl's and therefore could not be attached. The Appellant had argued that the transaction as between the Respondent and his mother-in-law was not in substance a sale but a pledge, accordingly as he had relinquished possession of the wagon same could be attached in satisfaction of the debt. The court had to

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<sup>30</sup> Ibid

<sup>31</sup> Ibid note 9 at pp 363 - 369

<sup>32</sup> Ibid note 11

decide therefore whether the sale in question was a genuine transaction or if it merely disguised a pledge. The court found unanimously in favour of the Appellant that the transaction was truly a pledge. The focus of this analysis will be given to Innes J's judgment as his treatment of the *plus valet* maxim and substance over form principle are largely viewed as the authoritative statement thereof, Solomon J deciding the matter on similar reasons and De Villiers CJ deciding the matter entirely different grounds, Innes J remains the most apposite judgment for the purposes of this analysis.

Innes J decided the matter on the basis of the *plus valet* maxim where he held, the now authoritative view on the *plus valet* maxim, as follows:

“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 inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.”<sup>33</sup>

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<sup>33</sup> *ibid* at pg 309

Thus, for Innes J a court is justified in disregarding the contract where it is satisfied that a definitely ascertainable real intention of the parties which differs from the purported intention to contract on the terms alleged by the parties. Thus only when the court is satisfied that there is an ulterior intention can the court disregard the ostensible agreement, importantly merely concluding that the agreement could have been done in some other way is not enough, it must be shown that the parties did not intend the agreement to have effect according to its tenor.

Turning to the facts before the Court Innes J came to the conclusion that the substance of the transaction was that of a pledge and not a sale. This conclusion was supported by the fact that it was a condition of the agreement between Mrs. Van Zyl and the Respondent that she might repurchase the wagon at any time, further that Mrs. Van Zyl could use the wagon at any time and for any length of time that she wanted. These facts taken together "so operated upon the respondent's legal position as to make it well-nigh impossible to believe that he really thought that he was acquiring the ownership of this wagon. A man buys an article --- even though he takes it over in satisfaction of a debt --- because he wishes it to belong to him, so that his interests may be thereby advanced. But the respondent... did not in fact, and could not in law, exercise the ordinary rights of an owner"<sup>34</sup> Further, when these facts were considered in the context of the debt that Mrs. Van Zyl owed the respondent, the exact amount of the alleged sale, the balance of probabilities would have indicated that the parties did not intend a sale but rather to secure the debt owed by Mrs. Van Zyl in the form of a sale.<sup>35</sup> These facts lead the Justice to the conclusion that the *real object* of the parties was not to that the respondent would acquire the wagon but rather that his debt was secured by the sale should other creditors collected their debts, as such the real contract was one of pledge not sale as such the cancellation of the debt by the endorsement on the acknowledgement thereof was thus merely a formality undertaken to conceal the true character of the transaction.<sup>36</sup> That Mrs. Van Zyl was unlikely to ever make good on the debt and that the parties were taken to have known that the contract of sale would not stand up to scrutiny if the debt remained undischarged were sufficient to answer the

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<sup>34</sup> Ibid at 312

<sup>35</sup> Ibid at 311

<sup>36</sup> Ibid at 312 - 313

counterargument that if the contract was a pledge then the parties would not have discharged the debt.

At this point one might wonder if the reasoning employed by Innes J as regards the facts of this case is sound, surely if the contract was found to be that of a pledge rather than a sale because the respondent did not have the requisite *animus emendi*, a requirement for a contract of sale,<sup>37</sup> then equally it may be asked how the court could conclude that a pledge had been established where the respondent surrendered possession as extensively as he did, coupled with the fact that the respondent discharged the debt suggests just as much that the parties did not have the *real intention* of concluding a pledge as the lack of *animus emendi* suggests that the parties did not likely intend a sale. Put differently, the fact that the Respondent so extensively gave up possession of the pledged item and also seemingly discharged the debt do not support a finding that the parties must have intended a pledge. Whilst it was inferred by the court that the debtor's dire financial situation meant that she would never repay the debt and thus it was of no moment to the Respondent to discharge it, that this was merely part of the simulated form of the agreement; however, the debtors financial predicament, that she would in all likelihood never be able to repay the debt is surely evidence of the fact that the parties must have then intended a sale, otherwise one must conclude that the respondent risked ever recouping his financial outlay in order to appear as if he had secured it. Whilst it must be admitted this analysis is undertaken over a century later, and without the aid of the admittedly meagre evidence, this cannot be the more reasonable inference available to the court. Further complicating the reasoning of Innes J, he did not "apply any harsh word to the transaction...[merely saying that] it was in essence not a sale, but at most a pledge, and that the Court is bound to deal with it according to its substance, and not according to its form."<sup>38</sup> Accordingly, at the least Innes J did not feel it necessary to determine or comment on the nature of the simulated intention and possibly felt that the simulation was undertaken by the parties in innocence. What then can be taken away from this case? This case can be, and it has been, cited as authority for the principle that

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<sup>37</sup> K Lermen "Sale" in Francios du Bois (general ed) *Wille's Principles of South African Law* 9 ed (2007) Juta cites Zandberg as authority for the fact that where *animus emendi* is lacking the transaction in question may well be a pledge

<sup>38</sup> *Ibid* note 11 at pg. 313

where the transaction ostensibly intended by the parties is at odds with what the court determines is the real intention of the parties then court is empowered by the *plus valet* maxim to disregard the form of the transaction. However, how the court is to determine what the transaction really is between the parties is nevertheless vexed, the only guidance given by the court being that same object may have been achieved differently is not reason enough to conclude that it was simulated. On the one hand the reasoning of the court could be understood to be that a court is bound to give effect to the agreement that the facts support the existence of, in this case that the facts supposedly supported an inference that the parties did not intend the ostensible sale but rather the inference of a pledge, this view is problematic for the reasons given above. Alternatively, one may say that the court should view a transaction as simulated where the objective effects of the transaction do not support the conclusion that the parties intended the ostensible transaction to have: so, that the supposed contract had the effect of so depriving the respondent of almost all the rights of owner was inconsistent with the object of a contract of sale. Thus, it seems that the introduction of the *plus valet* principle in our law was just as confused as its early development was in the old authorities, a confusion that has it seems continued in the development of the simulated transactions doctrine as the next case to be analysed shows.

The next case in the development of the simulated transactions doctrine after *Zandberg v Van Zyl* was *Dadoo Ltd and others v Krugersdorp Municipal Council*.<sup>39</sup> Briefly stated the case centred on whether a person prohibited from owning land in our more racist past could nevertheless avoid the legislation through the incorporation of a company. This case was a significant development not only for the simulated transactions doctrine but also the *fraus legis* principle specifically, to briefly recall the discussion earlier whilst early writers on this subject frequently tangled the concepts of *fraus legis* and *plus valet* in their discussions of these concepts they nevertheless remained distinct concepts, at least theoretically, this case then was one of the first in our law to authoritatively discuss the two concepts and lay the foundations in our law for the future treatment thereof.

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<sup>39</sup> Ibid footnote 12

To place the case in context, the law at the time prohibited certain classes of people from owning land in the Krugersdorp municipality, amongst them people of 'Asiatic' decent. One of the Appellants, Mr Dadoo, incorporated a company, Dadoo Ltd, with a share capital of 150 shares of which he owned 149, the objects of the company were *inter alia* the acquisition of, and trafficking in, land and any further business to take place on the land. The company then purchased two plots of land within the municipality, the one being leased by the company to Mr Dadoo and the other being used for Mr Dadoo's residence. The Respondents then instituted action against the company, Mr Dadoo and another on the grounds that the transfers of the land in question were contrary to the purpose of the law and therefore in *fraudem legis*. The Transvaal Provincial Division, per Wessels J, granted an order in favour of the respondent setting aside the transfer of the land, which finding was then appealed in this case. Three judgements were written Solomon J.A for the majority, with Innes CJ writing a separate concurring judgment and De Villiers JA writing a minority judgment, all judgments centred on nature, scope and limitations of the *fraus legis* principle.

Both<sup>40</sup> Innes CJ and Solomon J questioned whether the *fraus legis* principle allowed a court to prohibit any actions or transactions which "did violence to [the law's] spirit and intent"<sup>41</sup> which would then, they reasoned allow a court to legislate by supplementing perceived omissions in the law. Both Innes CJ and Solomon JA held that our courts have not claimed such an authority to extend legislation beyond the meaning of the words and thereby, they both reason, legislate.<sup>42</sup>

Solomon JA held that:

"...where a statute prohibits anything being done, *the law cannot be circumvented by the doing of it 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

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<sup>40</sup> Per Innes CJ at 543 - 544 and per Solomon J at 558

<sup>41</sup> at 558

<sup>42</sup> *ibid* note 40

transaction, and should strip off any disguise which is intended to conceal its real nature. "Plus valet quod agitur quam quod simulate concipitur."<sup>43</sup>

[own emphasis added]

Similarly, for Innes JA:

“An examination of the authorities therefore leads me to the conclusion that a transaction is *in fraudem legis* when it is designedly disguised so as to escape the provisions of the law, but falls in truth - within these provisions. Thus stated, the rule is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things, --- a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur*.... But an Act thus construed may nevertheless be evaded; parties may genuinely arrange their transactions so as to remain outside its provisions. Such a procedure is, in the nature of things, perfectly legitimate. There is nothing in the authorities, as I understand them, to forbid it. Nor can it be rendered illegitimate by the mere fact that the parties intend to avoid the operation of the law, and that the selected course is as convenient in its result as another which would have brought them within it. An attempted evasion, however, may proceed on other lines. *The transaction contemplated may in truth be within the provisions of the statute, but the parties may call it by a name or cloak it in a guise, calculated to escape these provisions.* Such a transaction would be in *fraudem legis*; the Court would strip off its form and disclose its real nature, and the law would operate... And if that be so, then there is no practical difference between our rule on this point and the rule of English law. Under both systems the words of the lawgiver must be read in the light of his intention to be gathered from the enactment as a whole and from a consideration of the mischief dealt with. Voet (ad Pand. 1.3, par. 20) states this very clearly. That interpretation should be adopted, he says, which is most calculated to attain the object and most in accordance with the mind of the lawgiver; not a hide-bound interpretation nor one which

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<sup>43</sup> Ibid note 12 at 558

circumvents the aim of the law so as to allow that which the law does not wish to be done, though it has not expressly prohibited it. But he emphasises the importance of adhering to the language of the statute where there is any doubt... But an Act thus construed may nevertheless be evaded; parties may genuinely arrange their transactions so as to remain outside its provisions. Such a procedure is, in the nature of things, perfectly legitimate. There is nothing in the authorities, as I understand them, to forbid it... An attempted evasion, however, may I proceed on other lines. The transaction contemplated may in truth be within the provisions of the statute, but the parties may call it by a name or cloak it in a guise, calculated to escape those provisions. Such a transaction would be in *fraudem legis*; the Court would strip off its form and disclose its real nature, and the law would operate."<sup>44</sup> [own emphasis added]

For De Villiers JA, the answer to when a transaction was said to be *in fraudem legis* was to be answered with reference to the intention of parliament, so before determining that the transaction contravenes the law the intention behind the law of the legislature would need to first be determined.<sup>45</sup> Another difference between the other two judgments and that of De Villiers JA was that he clearly distinguished between simulated transactions and transactions in *fraudem legis*, noting that whilst simulated transactions were the means usually employed in avoiding the law they were not the only means, and whilst all simulated transactions were in *fraudem legis* not all transactions in *fraudem legis* were simulated transactions.<sup>46</sup> De Villiers rejects the claim that this construction of the *fraus legis* doctrine violates the canons of construction on the basis that the *fraus legis* principle is a part of our law to which the canons of construction are secondary.<sup>47</sup>

Applying the law to the facts of the case both Innes CJ<sup>48</sup> and Solomon JA<sup>49</sup> reasoned that the answer to whether the transfer of the land in question to Dadoo Ltd was in *fraudem legis* turned on whether the company was validly incorporated

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<sup>44</sup> Ibid at 547- 548

<sup>45</sup> Ibid at pp 564 - 565

<sup>46</sup> Ibid at pp 567 – 568

<sup>47</sup> Ibid at pg 571

<sup>48</sup> Ibid at 548 - 553

<sup>49</sup> Ibid at pg 560 - 562

or if it was merely a simulation designed to escape the provisions of the law. Given that the company was duly incorporated and that there was no evidence before the court that the incorporation was a sham as such it could not be found to be in fraud of the law. Further, neither Innes CJ nor Solomon JA could find justification in extending the interpretation of the statute beyond the ordinary scope of the words used because there was nothing to indicate that this scenario occurred to the mind of the legislature, likewise even if such an interpretation were indicated it would not be without difficulty.

De Villiers JA likened the imposition of a company in order to purchase land in question as similar in effect to the use of an agent to purchase land, accordingly if the use of an agent to effect one's purpose was barred then the use of a company was similarly barred.<sup>50</sup> Thus, for De Villiers JA the law in question extended beyond its wording to consider the legislative intent; of further interest is the clearly objective approach to determining the legislation and transaction under review: namely that given the effect it had the legal form of the company should be disregarded and the transaction should be analysed in terms of its purpose, namely to give control of the land to the incorporators further that the legislation should be interpreted in terms of the purpose of its enactment, interestingly De Villiers JA does not address the concern raised by Solomon and Innes JJA that by extending the legislation beyond the words used in effect would be legislating on behalf of parliament.

The majority judgment in *Dadoo Ltd and others v Krugersdorp Municipal Council* thus established in our law that a person is at liberty to avoid the application of a statute by deliberately arranging their affairs so as to remain outside of the statute's ambit. The majority of the court clearly favouring a reading of the *fraus legis* principle as only applicable to fraudulently disguised transactions, which by virtue of the fraudulent disguise avoid the law's application, the minority view holding that any transaction, simulated or not, which is contrary to the deemed intention of the

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<sup>50</sup> Ibid At 570

legislature would be in *fraudem legis*.<sup>51</sup> As noted earlier the principle of *fraus legis* was a means of interpreting statutes, in order to determine whether the statute in question had application beyond the literal meaning of the words used.<sup>52</sup> Thus, to reiterate Roman Law distinguished between the meaning of the words of the statute ( the *verba legis*) and the meaning of the statute itself ( the *sententia legis*) and where the two were found to not be coextensive, the real meaning of the statute (*sententia legis*) would be given effect, thus *fraus legis* was used as an empowering law to allow courts to investigate the meaning of the statute and the facts of the case to see if the former was applicable to the latter, the parties intentions were thus not relevant to the inquiry.<sup>53</sup> The majority judgments clearly indicate a shift away from this understanding of *fraus legis* viewing the principle as applicable to the correct nature of the transaction under review , whether this judgment is authority for the view that the underlying statutory purpose or the intention of the legislature cannot be used to determine whether a transaction is in *fraudem legis* is debatable,<sup>54</sup> however what is clear is that the majority judgment nevertheless views the transactional intention as integral to the application of the *fraus legis* principle. Accordingly, the disguised intentions of the parties becoming a necessary precondition of the application of the *fraus legis* principle, that is the finding of a simulated intention on the part of the transactors is the defining feature of the transaction being in *fraudem legis*. Thus where *Zandberg v Van Zyl* may have inadvertently conflated the *plus valet* principle with that of *fraus legis* in determining how the simulated transaction is to be evaluated, the majority in *Dadoo Ltd and Others v Krugersdorp Municipal Council* appears to expressly conflate the two principles in their rejection of the reading of *fraus legis* as allowing the court to go beyond the wording of a statute to determine its application and reading the application of the principle as necessarily involving a simulated transaction, which transaction is ostensibly entered into *in order to avoid the application of the statute*, on the part of the transactors. This case then raises further questions regarding simulated transactions, what may be said to be the limits of a statutes application, whilst the majority held that courts may not use the principle of *fraus legis* as a

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<sup>51</sup> Hutchison, A & Hutchison, D “Simulated Transactions and the Fraus Legis Doctrine” 131 South African Law Journal 69 (2014) at pg. 73

<sup>52</sup> MD Blecher, *ibid* note 9

<sup>53</sup> Anton G. Derksen, To What Extent Does the Common Law Allow the Avoidance of Statutes - A Discussion in Which Specific Reference Is Made to Tax Statutes, 112 S.African L.J. 88 (1995) at pp 94 - 95

<sup>54</sup> *Ibid* at 97

means of supplementing perceived omissions in the legislation it was conceded that the court may have recourse to the statutory purpose, to what end the statutory purpose may then be used to extend the meaning of the words of the legislation beyond the literal denotative meaning remains in question. Further, both this case and *Zandberg v Van Zyl* leave open the question as to how the court is to determine that a transaction is simulated, as noted above *Zandberg v Van Zyl* did not properly determine that there was some other real intention which was definitely ascertainable, but decided the case on the grounds that the parties to the transaction could not have intended the ostensible transaction seemingly based on the effects of the transaction; likewise, the majority in *Dadoo Ltd and Others v Krugersdorp Municipal Council* do not explain what is meant by a simulated transaction other than to say that it is not the real intention of the parties, the minority judgment holding that ultimately the parties' intention was not relevant for the application of *fraus legis*, but rather the intention of parliament.

The cases of *Zandberg v Van Zyl* and *Dadoo Ltd and Others v Krugersdorp Municipal Council* and an attempted answer to the questions posed above were addressed in the case of the *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*<sup>55</sup> which is discussed below.

The Respondents in this case were importers of material into the Republic which were then given to manufacturers under a contract of services to be manufactured into various garments. The Respondents had previously enjoyed a rebate on customs duties for the importation of said material. The regulations allowing for the rebate were changed in 1936 and required the manufacturers to declare the imported property as their own in order for the rebate to be applicable. The Respondent then changed their ordinary procedures and now purported to sell the materials to the manufacturers, in order to comply with the new regulations which required the manufacturers to declare *inter alia* that the goods were their own property, the manufacturers would then resell the manufactured goods back to the Respondents at the same price for which the materials were bought plus the agreed cost of manufacturing the items of clothing. Commissioner argued that

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<sup>55</sup> [1941] AD 369

notwithstanding the new contractual arrangement the Respondents remained at all times the owner of the material and therefore the rebates for the period under review should be disallowed. Accordingly, the case centred on whether the transactions should be set aside as being in *fraudem legis*. There were four judgments given by the court however, for the purposes of this discussion the analysis will focus on the majority judgment of Watermeyer JA and the minority judgment of De Wet CJ given the focus of the judgments on the nature and application of the *plus valet* and *fraus legis* principles and how these judgments exemplify the tension in understanding these principles alluded to in the cases above.

Watermeyer JA, writing for the majority, held:

“When a statute forbids or taxes a certain transaction, defined by name or description, and the question arises whether a particular transaction falls within or without the prohibition or tax, two problems of interpretation or construction always arises. Firstly, the law has to be construed to ascertain what kind of transaction is forbidden or taxed, and secondly the transaction has to be interpreted to ascertain whether it is a transaction of the kind which is forbidden or taxed...[referring to the judgment of Innes J in *Zandberg v Van Zyl*, Watermeyer JA held] I wish to draw particular attention to the words ‘a 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.

A disguised transaction in the sense in which the words are used above is something different. In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, *inter partes*, the legal effect which its terms convey to the outside world. The purpose

of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be *in fraudem legis*, and is interpreted by the courts in accordance with what is found to be the real agreement or transaction between the parties.

Of course, before the court can find that a transaction is *in fraudem legis* in the above sense, it must be satisfied that there is some unexpressed agreement or tacit understanding between the parties. If this were not so, it could not find that the ostensible agreement is a pretence. The blurring of this distinction between an honest transaction devised to avoid the provisions of a statute and a transaction falling within the prohibitory or taxing provisions of a statute but disguised to make it appear as if it does not, gives rise to much of the confusion which sometimes appears to accompany attempts to apply the maxim quoted above.”<sup>56</sup>

Contrastingly, in the view of De Wet CJ

“...the plaintiff contends that the Court must enquire into the real nature of the transaction and discover whether there is a real intention definitely ascertainable which differs from the simulated intention, irrespective of what the parties say the transaction is, and must give to the transaction the legal effects which the law gives it no matter what the parties intend. I think the last part of this proposition is too widely stated: the Court must give effect to the transaction according to what it finds to be the real intention of the parties...[noting the dicta of Innes J in *Zandberg v Van Zyl* quoted above].. I do not think they meant to lay down that the question whether the apparent intention was real or simulated must be determined by what the parties, however honestly, stated to be their intention and not from the real nature of the transaction as found by the Court. This view is

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<sup>56</sup> Ibid note 13 at 395 to 396

borne out by the subsequent case of *McAdams v Fiander's Trustee*<sup>57</sup> [quoting De Villiers JA at p 223]... I think the learned Judge intended to emphasise in the last sentence that, if the Court on a consideration of all the circumstances comes to the conclusion that the transaction was in fact not what it purported to be, it follows that however honestly the parties thought that their intention was in accord with the simulated transaction, that was not their real intention."<sup>58</sup>

Thus stated the tensions implicit within the judgments of *Zandberg v Van Zyl* and *Dadoo Ltd and others v Krugersdorp Municipal Council* are now explicitly brought to the fore. The distinction between the judgements here is that, for De Wet CJ, for a transaction to be simulated the substance of the agreement must be different from its form, irrespective of what the parties intended; whereas Watermeyer JA finds that not only must the substance not match the form of the agreement but in addition to this objective determination it must be determined that both parties intended, and therefore agree, that the substance of the transaction will not match its form.

Of further interest, Watermeyer JA distinguishes 3 separate steps to be undertaken when evaluating a transaction under the *plus valet* or *fraus legis* principles: firstly, the legislation should be interpreted in order to ascertain its meaning and scope;<sup>59</sup> Secondly, after having ascertained the nature and scope of the legislation, the transaction itself must be evaluated in order to ascertain its true nature: the court must then determine whether the facts firstly support the purported transaction by the parties, and, if not, whether the facts before the court establish a tacit agreement as between the parties that not only that the purported agreement would not be effective *inter partes* but also that some other agreement would be effective between them; Thirdly, having established some hidden tacit agreement between the parties it remains for the court to determine whether the law, as interpreted, would be applicable to the true transaction, as interpreted.

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<sup>57</sup> 1919 AD 207

<sup>58</sup> *Ibid* at pp 381 - 383

<sup>59</sup> *ibid* At pg 394

Contrastingly, De Wet CJ appears to approve of a more objective approach to determining whether a transaction is simulated, from the above quotation it appears that De Wet CJ holds a transaction to be simulated where the *real intention* as found by the court is found to differ from the apparently intended transaction. It is clear from the Honourable Justice's dicta noted above that the transaction must be in accordance with what the court holds the transaction to be irrespective of what the parties actually intended, and where the court is of the view that the parties *could not* have intended a particular transaction, given the necessary inferences to be drawn from the available evidence then the court should declare the ostensible transaction simulated. To illustrate this point, if we are to apply this dicta to the facts of *Zandberg v Van Zyl*: on an evaluation of the evidence the court must conclude that irrespective of the parties intentions, the necessary inference from the stated facts is that the ostensible transaction before the court was not one of sale, given that the purchaser/Respondent gave up so many rights to the purchased item and so extensively, that the court must conclude that the parties did not intend a sale, it being inimical to the objective understanding as to what a sale entails. Likewise, if we are to apply the reasoning of De Wet CJ to the case of *Dadoo Ltd and Others v Krugersdorp Municipal Council* the outcome would largely be the same as determined by the majority in that case: that the company in question purchased land and held same in its own name is in keeping with the objectively determinable nature of a company – that it has separate legal personality from its incorporators.

In application of the rules applicable to the facts, as determined by the Honourable Justices, Watermeyer JA held that the transaction in question was not simulated whereas De Wet CJ held that it was. De Wet CJ held that in using the words “my own property” in the regulations under review, the intention of the legislature was that beneficial ownership would have to pass to the manufacturer.<sup>60</sup> Secondly, when the unusual features of the purported contract of sale: that the price was arbitrarily fixed by the Respondent and of no difference to the manufacturers, that no risk in bearing the loss of destruction of the *merx* passed to the manufacturers were measured against the practical effect of the agreement, that the manufacturers debarred themselves from enjoying the essential benefits of

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<sup>60</sup> *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* at pg 380

ownership. In the circumstances the practical effect of the agreement and unusual terms of the contract were inconsistent with what the judge viewed as the legal features and effect of a contract of sale.

In contrast to the judgment of De Wet CJ, Watermeyer JA, assumed that the regulations in question required that ownership must pass from importer to manufacturer.<sup>61</sup> Further, where the law referred to ownership it was not open to the court to extend the meaning of the term "my own property" to mean "my own property untrammelled by any contractual obligations to manufacture the articles into specified garments and sell them to the importer after they have been manufactured."<sup>62</sup> As such whether the contract was one of *locatio operis or sale* was not dispositive of the issue, neither being inconsistent with the transfer of ownership (the means by which the parties could escape the taxing provision). However, the form of the contract could be a factor from which the intention to transfer ownership could be inferred.<sup>63</sup> In reviewing the transaction before the court, ostensibly one of sale the judge held that the genuineness of the contract could not be determined with reference to its form but that also the evidence showed that the parties had consensus as to the essentialia of the contract, the *merx* and the *pretium* and that the unusual features of the contract do not alter its essential nature.<sup>64</sup> But the transaction could be set aside if the transaction could be shown to be a pretence, but this was a difficult conclusion to arrive at because, *inter alia*, parties do not enter into a sham contract unless they are dishonest and unless the pretence brings them some advantage which they cannot get by entering into a real contract. But "It was so much in their interests to have the intention of transferring ownership that it is difficult to believe that they did not have it."<sup>65</sup> The key in comparing the unusual features of the contract between the parties in the present case and the ostensible contract of sale in the case of *Zandberg v Van Zyl* was that in *Zandberg* the parties dishonestly formed the transaction as a sale and that they never intended the contract to have the effect according to its tenor.<sup>66</sup> The key determination for Watermeyer JA was that in the present case the transaction could only be a

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<sup>61</sup> Ibid at 397

<sup>62</sup> Ibid at 401

<sup>63</sup> Ibid at 398

<sup>64</sup> Ibid at 400

<sup>65</sup> Ibid at 403

<sup>66</sup> ibid

pretence if the parties did not intend to transfer ownership, which was not the same as control; the factors relied on by the commissioner were not inconsistent with the intention to transfer ownership. The facts of the case would only prove that the transaction was a pretence if they were inconsistent with the view that the parties intended the transaction of a transfer of ownership.

From the outset this chapter looked to analyse the early case law on the principles of *plus valet* and *fraus legis* in order to provide answers as to when a court is empowered to regard the substance of a transaction and disregard the contractual form, when may a law be validly avoided and of most importance how the answer to these questions provide insight into how the *plus valet* and *fraus legis* might be used as mechanisms to curb tax avoidance. In answering these questions the cases of *Zandberg v Van Zyl*, *Dadoo v Krugersdorp Municipal Council* and *Commissioner for Customs and Excise v Randles, Brothers & Hudson* were chosen for discussion given their continued relevance in our discussions of these principles, these cases still being cited as authorities to this day. From the foregoing case law it may be said that a court is empowered by the *plus valet* principle to disregard the contractual guise of a transaction and apply what is deemed to be the substantive transaction where the expressed transaction is determined to be inauthentic. Similarly, a court may determine that where a transaction is undertaken in order to avoid the application of some law, the law will nevertheless be applicable where it is found that the transaction in question was simulated. Accordingly, in a tax avoidance context a court will disregard the contractual guise of a transaction when it is evident to the court that there exists some underlying tacit agreement between the parties that the contractual form of the transaction will have no effect *inter partes*, where this is the case the court will determine what the real transaction between the parties is and thereafter interpret the law in order to determine whether the law in question can be said to be applicable to the real transaction determined by the court.

Despite the relative simplicity with which these rules may be expressed there is nevertheless some difficulty in understanding their application, which difficulty is highlighted in the divergent approaches of the majority and minority judgments discussed in *Commissioner for Customs and Excise v Randles, Brothers & Hudson*.

The discussion of these two judgments highlights a divergent approach to determining the intention of the parties: for the majority the question would be answered by determining the correct intention of the parties (to transfer ownership) and to determine whether the evidence was consistent with such intention; whereas the Minority judgment took the view that the intention of the parties was to be determined with reference to the effects of the contract and evaluate them in comparison with what may be said to be the expected effects of an ordinary contract of sale. Likewise the judgments differed on the correct approach to the interpretation of the law in question: Watermeyer JA preferring an approach anchored in the words of the regulations whereas De Wet CJ taking a more extensive approach in considering the purpose and intent of the regulations, reminiscent of the differing approaches in *Dadoo Ltd and others v Krugersdorp Municipal Council*. These issues, far from being merely academic may have very real repercussions on whether a complicated transaction, designed with the purpose of avoiding tax, may be said to be simulated, as the case of *Commissioner for Customs and Excise v Randles, Brothers & Hudson* shows. Thus, in order for the simulated transactions doctrine to be an effective mechanism to combat tax avoidance these discrepancies would need to be addressed.

### CHAPTER 3: SIMULATION CONSIDERED IN TAX LAW

Having analysed the case law regarding simulated transactions what is hoped to have been made clear is that whilst stated in the abstract the rules relating to *plus valet* and *fraus legis* may seem simple, the application of these rules appears to be more complex; from an evaluation of the case law regarded as authoritative on this matter there appears to be two ways in which these maxims have been considered: on one hand the case law seems to suggest that the intention of the parties to the transaction should be evaluated according to whether the facts in evidence support the alleged intentions of the parties; alternatively, as some of the judgments in the cases thus far reviewed seem to show, one may view a transaction as simulated where the effects of the transaction are inconsistent with the effects of an ordinary transaction of the type alleged by the parties. This chapter then looks to review selected cases in which these principles, as laid out in the case law from Chapter 1, have been applied in a tax avoidance context. The aim then of this chapter is to determine whether the issues raised and discussed in Chapter 1 have been resolved. Much as in Chapter 2, the cases of *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR*,<sup>67</sup> and *CSARS v NWK Ltd*.<sup>68</sup> have been selected not only because they are recent but also for their discussion of previous case law on the subject, accordingly the discussion of these cases allows for the succinct discussion of the development of the principle of simulated transactions in our law more generally as well as allowing for the discussion of the simulated transactions doctrine as a means of combatting tax avoidance more broadly. The ultimate aim of this chapter is to highlight how the courts have attempted to resolve the issues raised in Chapter 2 in developing a more coherent doctrine of simulated transactions which may be used to curb tax avoidance. The discussion will proceed chronologically by first discussing *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR* and thereafter *CSARS v NWK Ltd*.

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<sup>67</sup> 1996 (3) SA 942 (SCA)

<sup>68</sup> Commissioner for the South African Revenue Service v NWK Ltd 2011 (2) SA 67 (SCA)

The case of *Erf 3183/1 Ladysmith and Another v CIR*<sup>69</sup> has long been regarded as the authoritative statement of the principle of simulated transactions in respect of common-law tax-avoidance mechanisms.<sup>70</sup> The facts of the case are discussed below.

A company called Pioneer Seed Company resolved to build a factory with one of its subsidiaries Pioneer Holdings, the two appellants in the case both acquired land in connection with the Pioneer resolution and Pioneer Holdings thereafter acquired the shareholdings in both the appellants. Thus the land in question was owned by the appellants, which was owned by Pioneer Holdings which was owned by Pioneer Seed Company. Thereafter, the Appellants then leased their land to the Board of Executors Pension Fund (the Fund). In terms of the lease the Fund could erect buildings on the land, which would become property of the lessors, but they were not obliged to do so. The Fund then sublet the land to Pioneer Seeds in which it was then obliged to construct the buildings for the benefit of Pioneer Seeds, for which Pioneer Seeds then paid a premium to the Fund. The net effect of this was that the Fund was obliged to Pioneer Seeds to construct the buildings but was not obliged to the appellants to build the buildings.

The argument on both sides focused largely on the application of two well-known legal principles. The first is the one expounded in *The Duke of Westminster's* case. The appellant arguing that the relevant law when correctly interpreted did not apply as the relevant section held that for the improvements to land to be included in the taxpayers taxable income such improvement "must accrue to the taxpayer in terms of an agreement; and the agreement must be of a particular kind viz an agreement relating to the grant to any other person of the right to the use or occupation of land or buildings" which right did not accrue to the taxpayer given that the leases in question did not oblige the lessee to erect buildings, given that the taxpayer could not enforce the erection of the buildings it followed that no right accrued to it, an interpretation of the law that the court found in favour of.<sup>71</sup> The Commissioner

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<sup>69</sup> 1996 (3) SA 942 (SCA)

<sup>70</sup> Legwalia T "Modernising the 'Substance Over Form' Doctrine: Commissioner for the South African Revenue Services v NWK Ltd (2012) 24 SA Merc LJ 115 – 127; Andrew Hutchinson & Dale Hutchinson, "Simulated Transactions and the Fraus Legis Doctrine" (2014) 131:1 SALJ 69

<sup>71</sup> Ibid note **Error! Bookmark not defined.** paras 12 - 15

argued that the documents did not reflect the parties true intentions, because the purpose was to avoid the tax the agreements were expressed to conceal the right to effect buildings on the land in question.

The Court began its judgment by observing that “Affiliated companies are of course at liberty to structure their mutual relationships in whatever legal way their directors may prefer; but when, for no apparent commercial reason, a third party is interposed in what might equally well have been an arrangement between affiliates, it is not unnatural to seek the motive elsewhere”<sup>72</sup> Accordingly, the Court found that the case centred on the application of two principles, namely the Duke of Westminster Principle and the plus valet principle.<sup>73</sup>

The Duke of Westminster Principle comes to our law by way of the English case *The Commissioners of Inland Revenue v The Duke of Westminster*<sup>74</sup> in which it was held, per Lord Tomlin:

"[e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be"<sup>75</sup>

In effect then, the court held, this principle is no more than the English equivalent of the *Fraudem legis* principle as shown in *Dadoo v Krugersdorp Municipal Council* and *Commissioner for Customs and Excise v Randles, Brothers & Hudson* that a person may arrange their affairs to remain outside of a statute, although the formulation above is broader, there is no requirement in the quotation above, that the arrangement be honest, as required by *Dadoo v Krugersdorp Municipal Council* and *Commissioner for Customs and Excise v Randles, Brothers & Hudson*. In contrast to the above, the second principle that finds application in this case, according to the court, is 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."<sup>76</sup>

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<sup>72</sup> Ibid at para 8

<sup>73</sup> Ibid at 15 -17

<sup>74</sup> 1936 AC 1

<sup>75</sup> Ibid at 19

<sup>76</sup> Per Wessels ACJ in *Kilburn v Estate Kilburn* 1931 AD 501 at 507

The Court found that the application of these principles is not mutually exclusive, as some have held but rather following the reasoning of *Dadoo*<sup>77</sup> the taxpayer is entitled to arrange their affairs to avoid the application of the taxing statute provided that they honestly intended their arrangement to have the legal effect *inter partes* and the arrangement was not designedly disguising some other arrangement that was taxed by the statute.

Accordingly:

“Provided that each of them is confined to its recognised bounds there is no reason why both principles cannot be applied in the same case. I have indicated that the court only becomes concerned with the substance rather than the form of a transaction when it has to decide whether the party concerned has succeeded in avoiding the application of a statute by an effective arrangement of his affairs. Thus applied, the two principles do not conflict.”<sup>78</sup> (emphasis added)

In discussing the Judgments of *Zandberg v Van Zyl* and *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*, it was argued that once it is found that the parties intended their agreements to be cast in the relevant form, in this case lease coupled with a sublease and a building contract then that is the end of the matter, the substance of the agreements is in line with its form and the court must give effect thereto. However the 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.”<sup>79</sup>

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<sup>77</sup> Discussed above in chapter 1

<sup>78</sup> *Ibid* at para 18

<sup>79</sup> *Ibid* at para 22 - 23

Since all the documents, the main lease, the sub-lease and the building contracts and the variation agreements, on behalf of all the parties it must be inferred that the parties signed each agreement with full knowledge of the terms of the other agreements. As such:

“the agreements cannot be regarded separately: 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; as appellants' attorney conceded, each one must be considered in the context of all the others in order to discover their total effect. So regarded there is a distinct air of unreality about the agreements... These anomalies are consistent with a wider, unexpressed agreement or tacit understanding the terms of which have not been divulged. As such they bear significantly on the question whether the accrual to the appellants of a right to the erection of the buildings has been concealed”<sup>80</sup>

Thus understood the agreements bore a “stamp of simulation” and the appeal was dismissed.

*Erf 3183/1 Ladysmith and Another v CIR* was a clear development of the simulated transactions doctrine in that it, if not developed certainly refined, the *fraus legis* principle by expressly confirming the *ratio* of Watermeyer JA in *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*, that it is only once the transaction has been found to effectively avoid the application of a particular law under review that the substance of the transaction is evaluated to determine if same was nevertheless simulated. Further, this case appears to have developed the simulated transactions doctrine by emphasising the aspect of the tacit agreement between the parties as set out by Watermeyer JA in *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* to the effect that even where the parties can be said to have deliberately arranged their affairs in a particular form, the key

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<sup>80</sup> Ibid at para 26 - 28

inquiry is whether the parties intended same to have effect *inter partes* accordingly even where parties can show that they did intend their transaction to take a particular form the evidence must show that the form of the contract created real rights and obligations as between the parties and not merely nominate ones.

The above case will be analysed in connection with its comparison with the case of Commissioner for the South African Revenue Services v NWK Ltd, accordingly the case of NWK Ltd will first be discussed before the two are compared and contrasted.

Briefly summarised, the facts of *CSARS v NWK Ltd*.<sup>81</sup> were as follows:

The relevant parties were: NWK Ltd, a public company which traded in Maize, Slab Trading Company (Pty) Ltd (Slab) which was a wholly owned subsidiary of First National Bank Ltd (FNB) and First Derivatives, which operated as a division of FNB. In 2003 SARS issued revised assessments against NWK, disallowing interest on a portion of loans for the tax years 1999 to 2003 which SARS viewed as simulated. The loans in question were structured as follows:

NWK and Slab entered into a loan agreement in the amount of R 96 415 776.00 at an interest rate of around 15% per annum. In payment of the interest NWK issued promissory notes to Slab totalling R 74 686 861.00. The capital of the loan was to be paid at the end of a 5 year period by the delivery of 109 315 tonnes of maize, done by way of delivering Silo certificates.

In order to limit its risk exposure to fluctuating maize prices NWK bought by means of a forward sale 109 315 tonnes of maize from First Derivatives, to be delivered again by means of a silo certificate in 5 years' time, at a price of R 46 415 776.00 payable immediately. As such in 5 years from the agreement NWK would receive 109 315 tonnes of maize from First Derivatives and deliver to Slab 109 315 tonnes of maize.

Thereafter, Slab discounts, by way of a cession, the promissory notes for the future interest payments on the original loan between slab and NWK to FNB for the

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<sup>81</sup> Commissioner for the South African Revenue Service v NWK Ltd 2011 (2) SA 67 (SCA)

consideration of R 50 697 518. Slab further sold the 109 315 tonnes of maize it was to receive as the repayment on the loan capital on its loan agreement with NWK to First Derivatives for the amount of R 46 415 776 which was payable immediately whilst delivery was to be effected in 5 years' time by means of a silo certificate.

The net effect of the above transactions was that, in 5 years' time, NWK would have to deliver the maize to Slab, who would then be obligated to deliver the maize to First Derivatives, who would have to deliver the maize to NWK.

From the outset Lewis JA noted that the burden of proof lay on the taxpayer to show that the transactions were not simulated and that the mere production of the agreements was insufficient to rebut the presumption that the transaction was simulated as they merely show the form in which the agreements were cast.<sup>82</sup> Further, the Court acknowledged that parties to a transaction are free to organising their affairs so as to avoid a peremptory law save for the fact that parties may not simulate a transaction.<sup>83</sup> Relying on *Zandberg* and *Randles* the court confirmed that the parties intention is the determinative factor in cases where a transaction as been alleged to be simulated, however Lewis JA held:

“...the cases do not consistently approach what is really meant by a parties intention in concluding a contract – what purpose he or she seeks to achieve and this warrants some investigation.”<sup>84</sup>

Indicative of the above, for the Court, was the divergence in approaching the case by the minority and majority judgments in the *Randles* case, Ms. Justice Lewis noting that the courts in subsequent cases have favoured the approach of the minority in *Randles*, *Brothers* where both De Wet and Tindal JJA.

The Court noted that the judgment of De Wet JA saw the fact that what was transferred in that case was an empty right which was temporary in nature, as such the parties could not have genuinely intended to transfer ownership by way of a Sale. Similarly, the Court noted that Tindal JA took issue with the fact that the

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<sup>82</sup> At para 40 to 41

<sup>83</sup> Ibid at para 42

<sup>84</sup> Ibid at para 45

purchase price was never paid in *Randles, Brothers*, accordingly that the *pretium* was never paid. Contrastingly, Lewis JA reading of the majority judgment turned on the fact that the parties to that case “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.”<sup>85</sup>

The Court noted that the subsequent cases the approach of the minority was often followed. Thus, in:

“*Vasco Dry Cleaners v Twycross Hoexter* JA examined all the peculiar features of a contract, ostensibly for the transfer of ownership, to determine the real intention of the parties. And in *Skjelbreds Rederi A/S v Hartless (Pty) Ltd* the court refused to recognize a cession of rights, enabling litigation, where it was clear that the successful litigant would have to retransfer the rights to the cedent after the litigation. Dishonesty was not in issue in any of these cases. But in each a transaction had been concluded to achieve a purpose other than that for which it was ostensibly concluded.”<sup>86</sup> (own emphasis added)

Contrastingly, the Court noted that in such cases as *Hippo Quarries (Tvl) (Pty) Ltd v Eardley*<sup>87</sup> and *CIR v Conhage*<sup>88</sup> the courts often looked to the form of the contract or whether the contract made good business sense. Here the court emphasised the dicta of Nienaber JA “*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.*”<sup>89</sup> In the oft quoted passage of the court, Lewis JA noting the distinction between motive and purpose.<sup>90</sup> The Court further noted that “in both *Friedman* and *Conhage*, where the courts held that the parties intended their contracts to be performed in accordance with their tenor, there were sound reasons for structuring the transactions as they did” as such the agreements

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<sup>85</sup> Ibid at para 47

<sup>86</sup> Ibid note 4 at para 49

<sup>87</sup> 1992 (1) SA 867 (A)

<sup>88</sup> 1999 (4) SA 1149 (SCA)

<sup>89</sup> Ibid note 87 at 877C - E

<sup>90</sup> Ibid note 15 at para 51 to para 54

under review in those cases were both commercially sound and served a legitimate purpose.<sup>91</sup>

Thus, it must follow that for the Court in *NKW*, the intention of the parties must be inferred from the features of the contract and the purpose for which it was transacted and that the parties intention in transacting must be found to be in accordance therewith, hence Lewis JA found in the *Freidman* and *Conhage* cases the intention could be gleaned from the fact that the intention of the parties was to be found in the form of the contracts coupled with the clear and unmistakable business purpose that was found to be the cause of the transactions in those cases.

Having thus analysed the development of the simulated transactions doctrine Lewis JA states:

“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”<sup>92</sup>

Applying the law as found by the court to the facts of the case the court held that the transaction was simulated, Lewis JA held:

“What then is the real purpose of the loan in this case? Does it have any commercial substance or make any business sense? *NWK* argued that the loan to it by *Slab*, like the sales...in *Freidman Motors*, was genuinely

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<sup>91</sup> Ibid note 15

<sup>92</sup> Ibid note 15 at para 55

intended to have legal effect in accordance with its tenor. But as I have said the hire-purchase agreements in that and similar cases had good commercial sense. They allowed the purchasers to raise finance while at the same time retaining possession of the vehicles. And there was a genuine transfer of ownership.

Was there any purpose or commercial sense – other than creating a tax advantage for the loan by Slab to NWK to be structured the way it was? Was there any genuine intention to deliver maize to Slab or a cessionary?”<sup>93</sup>

Further the court held:

“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”<sup>94</sup>

Ultimately, applying the law to the facts the court held that the transaction must be simulated. The reasons given were that FNB and NWK entered into 2 contracts on the same day for the two amounts owing (namely R50M and R96 415 776); that in law the payment of money in exchange for a commodity is in substance a sale in our law and that the repayment of a loan in a manner other than money raises doubts as to the parties intentions, the payments in terms of the forward sale between First Derivatives and NWK and the agreement between Slab and First Derivatives on the same day in effect meant that from FNB and straight back to FNB with the addition of FNB’s facilitation fees; Barnard (NWK’s own witness) had conceded that the price of maize in 5 years time would have been impossible to ascertain; that the maize in question was vaguely defined by the parties; that no security was required for the maize, which seems to only make sense when one considers that the rights and obligations for the cessions cease on *confusio*; further the obligations to deliver maize were very much interdependent as “if one did not

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<sup>93</sup> Ibid at paras 57 and 58

<sup>94</sup> Ibid at para 80

perform the other could not".<sup>95</sup> As such, the agreements between the parties were found to be simulated.

Thus, Lewis JA confirms that the principles established in *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR* and other judgements that whilst a taxpayer may arrange their affairs so as to attract the least tax they may not do so dishonestly by means of a simulated transaction. Lewis JA's judgment in this matter highlighted the theme discussed in chapter 2 which was made clear in *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* – there appears to be a divergent application of these rules of simulation and *fraus legis* by our courts. The divergence, as noted in chapter 2, stems from the differing manner in which courts have approached the determination of the parties' intention. Whilst some writers have viewed the matter as differing approaches as to whether the parties should be found to be dishonest or not, as a necessary precondition for a finding of simulation.<sup>96</sup> It is submitted that a more constructive manner in which to view this variance within the judgments is that advocated for in Chapter 2, on the one hand, certain judges view the parties intention through the paradigm of the effects of the contract, evaluated against what the court understands to be the ordinary effects of an archetypal contract of that nature, whereas other judges evaluate the intentions of the parties against the available evidence and determine whether the facts are consistent with the ostensible intention or some other intention. It should be noted that after *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* and *Erf 3183/1 Ladysmith v CIR* the courts' majority appears to favour the later interpretation in tax avoidance cases, this discrepancy should not be dismissed out of hat.

On the reading of the case law by Lewis JA, De Wet CJ in *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* preferred to look at the substance of what was done<sup>97</sup>, thus for Lewis JA the question was to determine what the purpose of the transaction was, what effects did the parties seek to

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<sup>95</sup> Ibid at 29

<sup>96</sup> Hutchison, A & Hutchison, D "Simulated Transactions and the *Fraus Legis* Doctrine" 131 South African Law Journal 69 (2014). Cf De Koker "19. De Koker Chapter 46.7 "Honest Simulation" in DE KOKER, A.P. & BRINCKLER, E. 2010. *Silke on International Tax*. [e-book] Durban: LexisNexis Butterworths. Available through: Mylexisnexis online.

<sup>97</sup> Ibid note 81 at para 48

achieve in structuring their transactions as they did. Thus understood the extension advocated for by Lewis JA is that in determining whether a transaction was genuinely entered into in order to avoid tax the real intention of the parties, and therefore the real substance of the agreement may be found by considering what commercial reasons / purpose they had for structuring their agreements in the form that they did; where the only benefit can be found in structuring the transaction in the form that they did would be to gain a tax benefit then the contract(s) may be said to be simulated. This can be likened to the ratio of *Erf 3183/1 Ladysmith* that the real inquiry was not whether the parties intended that the transaction take the form that it did but that they must intend that the agreements, cast in the form that they were, have inter partes the legal effect that they convey thus if we understand the extension of the test by Lewis JA in this light the parties performance in terms of the contract may be seen as merely part of the form of the transaction, what is of more import is what commercial justification exists for casting the contract(s) in the arrangement or form that they were.

It must be accepted that Lewis JA clearly viewed the test for simulation as inadequate, that it “needed to go further and consider the commercial sense of the transaction” accordingly it is prima facie clear that Lewis JA intended to develop the common law, at the very least by extending the traditional test to consider the commercial sense of the transaction. Accordingly, it must be admitted that Lewis JA at least intended to develop the common law in respect of simulated transactions, what remains to be seen is whether this finding was a development of the common law. Can it be said that the consideration of the the commercial purpose or sense of a transaction formed part of the ratio of the court, in which case same would be binding and become a rule to be applied in cases of simulation.

The terms of “commercial purpose”, “commercial reason” and “commercial sense” were used interchangeably throughout the judgement in analysing the transaction. The commercial reason for the transactions was indicative that they were genuine in *CIR v Conhage*<sup>98</sup> and *S v Friedman*,<sup>99</sup> further, Lewis JA qualifies the term

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<sup>98</sup> Ibid note 88

<sup>99</sup> *S v Friedman Motors (Pty) Ltd* [1972] (1) SA 76 (T)

commercial purpose as being the real substance and purpose noting that where a transaction's purpose is only to achieve some tax benefit then it *will* be regarded as simulated.<sup>100</sup> Likewise, a transaction's commercial substance or business sense was indicative of its real purpose.<sup>101</sup> Further, that the cession by NWK to FNB as security for its obligation to deliver maize made *no commercial sense* as the obligations were illusory.<sup>102</sup> Taken together, the court seems to hold that where a transaction did not have a commercial purpose then it would be considered simulated; where the rights and obligations ostensibly created by the transaction were without substantive content then they could not be what the parties truly intended. It is clear then that not only did Lewis JA intend to develop the common law but having thus given that development, that the test needs to consider the commercial sense of a transaction applied it to the case at hand, thus the reasoning of the court that the transactions lacked commercial purpose and this finding directly influenced the determination of the court that the transactions were then simulated. Accordingly, it is submitted that Lewis JA did develop the common law.

It should be borne in mind that at no stage did the court in *CSARS v NWK Ltd* seek to overturn the jurisprudence developed by our courts in regards to simulated transactions, either expressly or impliedly. Accordingly, it must stand that the development proposed by Lewis JA, that the test for simulated transactions should go further and consider the commercial sense of a transaction must be seen as supplementary to the test as developed by our courts, this is evident in the very passage proposing the development – that the test should go further. Added to this is the courts finding that a taxpayer may validly arrange their affairs to avoid tax and its endorsement of the principles laid out in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* militate against a new rule that would evaluate a transaction as simulated for lack of commercial purpose irrespective of the intentions of the parties. Thus understood it appears that the court would endorse the proposition that by “commercial sense” it is meant that the intentions of the parties to enter a transaction would mean that apart from showing that the parties intended the transaction to have the effects according to its tenor some justification is needed for the arrangement of the transaction in the form that it took. Given the reference to the minority and majority

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<sup>100</sup> Ibid note 15 at para 55

<sup>101</sup> Ibid

<sup>102</sup> Ibid at para 77

judgments in *Commissioner for Customs and Excise v Randles, Brothers & Hudson Ltd* it may be argued that the extension of the simulated transactions doctrine was an attempt to reconcile the two approaches through the medium of commercial sense. Thus where a transaction is substantively not in keeping with ordinary contracts of that type, either because it has unusual provisions or creates rights and obligations not otherwise associated with transactions of that type, then the court may be moved to inquire as to the commercial sense of the transaction or require the taxpayer to justify their reasons for having entered into such a transaction. For example where the parties ostensibly enter into a contract of sale but the purchaser's rights in the thing acquired are so denuded of content then it must be open to the court to evaluate whether, in spite of the performance in terms of the agreement, the purchaser would have entered into such an agreement, in short that there must be some justification. Where a transaction operates such that the rights and obligations appear to conflict then it is natural to enquire how they intended to receive a right which was without content, thus a party that purchases a wagon but gives to the seller all the rights of enjoyment of purchaser in an extensive manner it may be queried as to whether they actually intended to purchase the wagon in the first place, put differently that the purchase of the wagon was without commercial justification would entail, *ceteris paribus*, that the party did not actually intend on purchasing the wagon.

Contrastingly, the extension of the test to consider the commercial sense of a transaction may have developed in order to evaluate the transaction when same is a composite one, consisting of many separate agreements. In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* the court was justified in viewing the separate agreements as a composite whole as all were signed almost simultaneously and by the same people that they were seen as interdependent. Likewise then, the test in *CSARS v NWK Ltd* could be viewed as a mechanism by which the court is empowered to evaluate a composite transaction consisting of a series of steps, not limited to cases where the contracts were signed simultaneously. Seen in this light the test for commercial sense of the transaction can be compared to the English case of *Furniss v Dawson*<sup>103</sup> where it was established that where a taxpayer enters into a pre-ordained set of transactions consisting of a series of steps and those steps were

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<sup>103</sup> *Furniss (Inspector of Taxes) v Dawson and Related Appeals* [1984] 1 All ER 530

inserted with no other commercial purpose other than the avoidance of tax the court is empowered to disregard the intervening steps and determine the tax consequences from the end result.<sup>104</sup> Whilst this rule is not in keeping with our understanding of simulated transactions in our law, it is submitted that *mutatis mutandis* the rule proposed in *CSARS v NWK Ltd* may bear some similarities, perhaps, in keeping with *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* the rule may be phrased that where steps have been inserted into a composite transaction which when evaluated under the rubric of commercial purpose/sense do not carry any weight, as where they do not appear to have any intended effect on the overall commerciality of the endeavour then the court may inquire as to the real intentions of the parties, irrespective of whether the parties apparently intended the transaction to have effect, as evidenced from their performance in terms of the agreements.

Alternatively, Pretorius<sup>105</sup> notes that whilst, previously, the courts had endorsed a subjective approach in determining the parties intentions when deciding whether the transaction was simulated, this raises some difficulties such as how the intentions should be determined and to what extent objective criteria can be used to determine a subjective state of mind.<sup>106</sup> Further, whilst intention and purpose have been jurisprudentially separated, Pretorius does wonder whether the two can actually be separated.<sup>107</sup> Thus Pretorius agrees with the Court in *CSARS v NWK Ltd*, that the application of the simulated transactions doctrine has not been consistently applied throughout its legal history, which then leaves room for the courts to apply their own personal sense of justice.<sup>108</sup> Thus where a contract of sale containing terms typical of a loan agreement has been used to secure a loan and circumvent the usury laws, the courts have often held the courts have regarded the sale as a simulation and the contract of loan to be the real agreement although it may just as easily be said that the contract of loan was not intended and the contract of sale was.<sup>109</sup> Thus objective criteria, such as the commercial purpose of

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<sup>104</sup> Derksen, A. G. (1990). Should the South African courts adopt the English anti-tax-avoidance rule in *Furniss v. Dawson*. *South African Law Journal*, 107(3) pp 420 - 421

<sup>105</sup> C-J Pretorius 'Simulated agreements and commercial purpose – Commissioner for the South African Revenue Service v *NWK Ltd*' (2012)

<sup>106</sup> *Ibid* at 688

<sup>107</sup> *Ibid* at 693

<sup>108</sup> *ibid*

<sup>109</sup> *Zandberg v Van Zyl supra*

a transaction, could serve as a supplementary criteria to evaluate whether a transaction is simulated where the available evidence does not clearly indicate the parties actual intentions. Viewed in this light the role of commercial sense or purpose would function like a supplementary rule of interpretation of the transactions in question, thus only providing relief where the facts or indeterminate as to whether the parties had the requisite intention or not.

However, it should be borne in mind that this is mere speculation, the court gave no further guidance as to the meaning and application of commercial purpose/sense/reason as used in the judgment thus the exact ambit and application of this newly admitted criteria for the evaluation of simulated transactions should be developed by the courts.

Thus it can be seen that from the exposition of the above case law the simulated transactions principle was not only accepted by the courts as a mechanism to curb tax avoidance but was actively developed for this purpose. As can be seen from the above discussion, whilst not necessarily always the case, transactions with the purpose of tax avoidance usually entail a complex series of transactions which have as their consequence the avoidance or reduction in tax. Further complicating the development of common law anti-avoidance mechanisms is the right of the taxpayer to avoid tax, otherwise known as the *Duke of Westminster* principle, that if parties have validly arranged their affairs so as to avoid the imposition of tax then a court may not thereafter use "the so-called doctrine of the substance" to nevertheless hold the taxpayer liable. Thus, it seemed prima facie that the principle of substance over form was inimical with the *Duke of Westminster* principle. The case of *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR* however resolved the conflict between these two principles by defining the right to avoid tax as only applicable where the parties had genuinely arranged their affairs, thus the first step in the simulated transactions doctrine was to determine whether the ostensible arrangement had the effect of avoiding tax. Further, it was held in *Erf 3183 /1 Ladysmith (Pty) Ltd and Another v CIR* that it was not enough that the parties actually intended that the agreements in question would have effect according to its tenor, what was required was that the parties intended the transactions to have

effect inter partes. *CSARS v NWK Ltd* provided the greatest development in the simulated transactions doctrine essentially extending the test to require an analysis of the commercial purpose of a transaction. Whilst one can speculate as to the exact ambit and meaning of this development how exactly this new principle should operate within the doctrine of simulated transactions should be developed by the courts, as one interpretation advocated in for in this chapter shows, this principle may be developed as a more robust mechanism for evaluating composite transactions. Both cases further illustrate that the simulated transactions doctrine is not limited to the consideration of transactions in isolation but that where a transaction is a composite one the transaction as a whole will be evaluated. That being said, it now remains to be determined *how* this development from *CSARS v NWK Ltd* should be refined and greater clarity should be given to its meaning and scope. In this regard the discussion in Chapter 4 attempts to give an explanation as to how this further development was treated by our courts.

## CHAPTER 4: NWK RECONSIDERED

That *CSARS v NWK Ltd* represented a momentous shift in our development of the simulated transactions doctrine cannot be disputed, at the very least it is evident from this that our courts will not shy away from raising to the challenge of meeting impermissible tax avoidance and developing the common-law tools to curb same. This chapter then looks to the treatment of the simulated transactions in light of the contentious developments in *CSARS v NWK*. Firstly, the reaction in academia and of practitioners toward this judgment will be discussed and the proposed understandings of the new rule created by *CSARS v NWK Ltd* will be evaluated against these concerns. Secondly, the reaction of the judiciary will be examined in the cases of *CSARS v Bosch and Another*<sup>110</sup> and *Sasol Oil v CSARS*<sup>111</sup> in order to determine how, if at all, our understanding of the doctrine of simulated transactions has changed in light of the cases discussed in chapter 3. Once given the judgment of *CSARS v NWK Ltd* caused some confusion amongst practitioners and has been criticised, applauded, and analysed extensively before the subsequent decisions of *Bosch* and *Sasol*, a brief discussion of which requires some analysis. This paper begins by providing some of the criticisms written of the judgment and how the interpretation of the judgment should be affected by these considerations. Thereafter the judicial reaction to the judgment of *CSARS v NWK Ltd* will be discussed. The discussion in this regard will be limited to *CSARS v Bosch and Another*<sup>112</sup> and *Sasol Oil v CSARS*<sup>113</sup> as these cases were decided on the basis of supposed impermissible tax avoidance and as such would be best placed to provide an understanding of how *CSARS v NWK Ltd* has affected the development of the simulated transactions doctrine as a means of combatting impermissible tax avoidance, although the discussion will refer to the judgment of Wallis JA in *Roshcon v Anchor Auto Body Builders*<sup>114</sup>.

Apart from Pretorius, whose views are discussed in chapter 3 above the case of *CSARS v NWK* has received little support in academia and from legal practitioners.

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<sup>110</sup> [2015] 1 All SA 1 (SCA)

<sup>111</sup> [2019] 1 All SA 106 (SCA)

<sup>112</sup> [2015] 1 All SA 1 (SCA)

<sup>113</sup> [2019] 1 All SA 106 (SCA)

<sup>114</sup> [2014] ZASCA 40

However, Legwalia<sup>115</sup> argues that CSARS v NWK Ltd changes the substance over form inquiry to review the substance of the transaction as not only what the parties really intended, as understood in previous cases, to now consider whether the transaction has the necessary substance that a transaction of that nature should have, thus for example “a transaction in which the risk element falls on a party that it normally would not fall on, or which lacks legal force where ordinarily it does, should also fail the test”.<sup>116</sup> If by this the author contends that a contract that has unusual provisions which one would ordinarily not associate with a given transaction then by virtue of that fact alone the transaction must be said to be simulated then this reading must be rejected; whilst unusual provisions in a contract have been, and may be, considered as a factor in determining whether a contract is simulated, it cannot be extended to mean that in all cases where a transaction contains unusual provisions then it is simulated. This view is not only not supported by the case itself, seeing as the judgment of Lewis JA appears to approve of the cases of CIR v Conhage<sup>117</sup> and S v Friedman,<sup>118</sup> both of which were found not to involve simulations despite the transactions containing provisions unusual for transactions of that type.

Broomberg SC<sup>119</sup> argues that the court went too far and was too late in its extension on the principle as “the Legislature had already closed the door on the mischief that the Court was seeking to avert” and in so extending the rule regarding simulated transactions had usurped the Legislature’s powers. For Broomberg SC the new rule entailed from the judgment of CSARS v NWK Ltd was a clear departure from the principles stated in *Commissioner for Customs and Excise v Randles, Brothers & Hudson Ltd* if the new rule was to be understood that a transaction will be regarded as simulated where the purpose of the transaction was only to avoid tax.<sup>120</sup> In effect, according to Broomberg SC, if we are to accept that the courts use of the term “tax evasion” it was meant “tax avoidance” then the court would have created a separate and parallel anti-avoidance rules which would then

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<sup>115</sup> Thabo Legwaila, Modernising the Substance over Form Doctrine: Commissioner for the South African Revenue Service v NWK Ltd, 24 S. Afr. Mercantile L.J. 115 (2012)

<sup>116</sup> Ibid at pg 121

<sup>117</sup> Ibid note 88

<sup>118</sup> S v Friedman Motors (Pty) Ltd [1972] (1) SA 76 (T)

<sup>119</sup> Broomberg E (2011) “NWK and Founders Hill” Cape Town, *The Taxpayer* (vol 60)

<sup>120</sup> Ibid at paras 10 and 11

impermissibly tread on the legislature's jurisdiction and thus offend against the separation of powers doctrine<sup>121</sup>.

Kujinga<sup>122</sup> has raised similar issues with the decision in *NWK* noting that the now added element that the transactions pass commercial muster would overbroaden the inquiry and that whilst this may appear beneficial in tax settings it would nevertheless complicate other areas of law<sup>123</sup>. Secondly, echoing Broomberg SC, Kujinga notes that this supposed new rule created by *CSARS v NWK Ltd* would have the effect of creating a more general anti-avoidance rule applicable to any avoidance arrangement whereas the older rule was more specific and only concerned itself with whether the parties intended to actually perform in terms of the contract.<sup>124</sup> This overbreadth of the new test would create confusion as it would not be clear when the Commissioner would use the statutory General Anti-Avoidance Rules and when they would use the common law simulated transactions test, similarly whilst Lewis JA acknowledged that it was open to taxpayers to avoid the imposition of tax it was not clear how anyone would be able to do this under the new conditions created by the court.<sup>125</sup> Further, De Koker<sup>126</sup> notes that even if the inquiry were confined only to the common law the notion that *NWK* introduces an independent supplementary test of commercial substance cannot be sustained given the following *reductio ad absurdum*:

“Where, by contrast, a transaction is not disguised, but merely lacks ‘commercial substance’, what assessment can the Commissioner conceivably make and what order is the court empowered to hand down – acting in terms of the common law principles – to nullify the tax benefit?”<sup>127</sup>

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<sup>121</sup> Ibid at paras 19 - 22

<sup>122</sup> Benjamin T Kujinga “A Comparative Analysis of the Efficacy of the General Anti-Avoidance Rule as a Measure Against Impermissible Income Tax Avoidance in South Africa” (LLD Thesis, University of Pretoria, 2013)

<sup>123</sup> Ibid

<sup>124</sup> Ibid at pg 47

<sup>125</sup> Ibid at pp 47 -48

<sup>126</sup> De Koker (2011) SILKE on South African Income Tax (vol 1 – 4) LexisNexis (online Version) at para 19.3

<sup>127</sup> Ibid

The argument being that where the transaction is found to be simulated as the parties truly intended some other transaction then the simulated transaction is ignored and the transaction truly intended is given effect because the court is empowered by virtue of the plus valet principle to do so; however, there is no basis in our law to disregard a transaction based solely on the transaction's commercial substance.

These concerns all seem to stem from the view that *CSARS v NWK Ltd* developed a separate inquiry apart from the real intentions of the parties and view the enquiry as to a transactions commercial sense/purpose as being something objective outside of the intentions of the parties. That the court was not clear in its formulation and thus created some confusion must be admitted; however, this alone is insufficient to disregard the clear development that this judgment made to the the doctrine of simulated transactions. Further, that these criticisms are correct, in that they highlight the issues raised where the new rule is understood to apply beyond the traditional scope of the simulated transactions doctrine and allow a court to declare transactions honestly entered into to be simulated on the basis of lack of commercial purpose, must again be admitted. However, it is submitted that these are merely reasons then not to prefer a reading of the development in these terms. Where, as advocated above the test is viewed as an evaluation of the intention of the parties, either as some tertiary rule of interpretation, a rule to the effect that parties cannot legally be said to intend transactions which are self-cancelling and appear to have no effect, or that the intention of the parties should be evaluated against the commercial justification of the supposed intention these concerns fall away.

*Hutchison et. al.* was critical of the judgment in that it appeared to ignore the requirement of intention all together, arguing that it is contradictory to evaluate a transaction as simulated without a finding that the parties intended to simulate the transaction, where the intention of the parties may be derived from objective factors only if there is no direct evidence to support a finding of intention.<sup>128</sup> However, the

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<sup>128</sup> Ibid note 4 at pg 85

major criticism of Hutchison et al. is that Lewis JA apparently ignores the distinction between intention, to genuinely carry out the transaction in question, and purpose, the reason why the parties contracted.<sup>129</sup> Further, this new objective approach toward simulation would allow for an objective determination of fraud between the parties, where a transaction which lacks sound commercial purpose being found to be a sham.<sup>130</sup> Some of these criticisms have already been dealt with.

However, the concern that the *CSARS v NWK Ltd* judgment conflate purpose with intention should be addressed, as this is exactly what it seemingly purports to do. It is submitted that if the courts dicta were understood to be that commercial purpose referred to the intended commercial consequence then this issue falls away. By way of example: Hutchison et al make use of the example wherein someone hires a car for the purposes of transporting marijuana. The resultant transaction may be invalid for being illegal, that is the purpose to transport marijuana is what invalidates the transaction. Likewise it might be said that where this miscreant hires the vehicle they do so with the expected consequence that they will be able to use the vehicle but if they were to enter into a contract of hire that debarred them from all the benefits expected from a contract of hire then it is difficult, and likely dogmatic, to maintain that they nevertheless intended to hire the vehicle, put differently the contract is invalid because the parties cannot be said to have actually intended a contract of hire given this apparent lack of any commercial purpose.

The criticism was not limited to academia, Waglay J for the minority, in the case of *Bosch and Another v CSARS*,<sup>131</sup> held:

“...*NWK* cannot be read to serve as a precedent in this case where evasion is not the issue. In any event, any transaction which has its purpose tax evasion is unlawful as tax evasion constitutes a criminal offence in terms of the Income Tax Act, *NWK* cannot therefore be authority for setting aside a transaction as simulated by reason of being a vehicle for tax evasion as this is automatic in terms of the law. On the other hand if the words “evasion of tax” are to be substituted with “avoidance of tax” then the dictum goes against the accepted

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<sup>129</sup> *ibid*

<sup>130</sup> *ibid*

<sup>131</sup> [2013] SA 130 (C)

practice in our Income tax law which permits transactions aimed at tax avoidance. Furthermore the confusion created by the judgment, mitigates against it serving as a precedent binding upon the lower courts.”<sup>132</sup>

Briefly stated the facts of the case were that the Taxpayers were employees of a high-end fashion retailer group of companies. The Taxpayers were offered the opportunity to enter into an employee share incentive scheme. In terms of the Scheme the taxpayers were given the option to purchase shares in the company which option was under a time-limit, both taxpayers opted to partake in the scheme. Delivery of the shares was to take place on two year intervals from the date of their notice date. Once delivery of the shares was made all risk and benefit passed to the taxpayers. The scheme allowed the employer to repurchase the shares in certain circumstances, of relevance was that the taxpayers were entitled to sell their shares to the employer if their value fell below the price paid by the taxpayers on the implantation date. The effect of the scheme was the avoidance of Section 8A of the Income Tax Act, in that the full gain in value of the shares from the date of notice to the date of implementation was not taxable income for the Taxpayers. The Commissioner relied on the case of *CSARS v NWK Ltd* and argued that the resale provisions were uncommercial, that the resale provisions had no commercial purpose and were merely entered into to disguise the conditional sale.

The majority judgment of Davis J in that case interpreted the judgment of NWK as not departing from the settled principles regarding simulated transactions in our law stating:

“there is nothing in the careful judgment of Lewis JA which supports the argument that the reasoning as employed in NWK was intended to alter the settled principles developed over more than a century regarding the determination of a simulated transaction for the purposes of tax... It appears that the intention of this paragraph is to point in the direction which the mandated enquiry must take in such cases namely to examine the real

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<sup>132</sup> Ibid at para 9 of minority judgment

commercial sense of the transaction. If there is no commercial rational, in circumstances where the form of the agreement seeks to present a commercial rational, then the avoidance of tax as the sole purpose of the transaction, would represent a powerful justification for approaching the set of transactions in the manner undertaken by the Court in NWK. In this way the dictum in a relatively recent case of Scott JA in *Mackay v Fey NO and Another* 2006 (3) SA 182 (SCA) at para 26 can be reconciled with para [55] of NWK:

‘ before a court will hold a transaction to be simulated or dishonest in this sense it must therefore be satisfied that there is some unexpressed or tacit understanding between the parties to the agreement which has been deliberately concealed’<sup>133</sup>

Davis thus clearly was of the view that the *CSARS v NWK Ltd* judgment should be interpreted not as creating a new rule but rather in line with the decided principles of the doctrine already established. Although Davis J does allow for the possibility that where a transaction purports to have a commercial basis and yet none can be found this would be a powerful justification for holding the transaction as simulated.

The matter was clarified some a year later in the Supreme Court of Appeal in the case of *Roshcon v Anchor Auto Body Builders*<sup>134</sup> where Wallis JA in a separate concurring judgment followed similar reasoning to that of Davis J above.

In this case the Appellant sought to purchase a number of trucks which required bespoke fitment. The trucks were ordered from a Toit's Commercial Property Limited (henceforth Toit's). Toit's in turn purchased the vehicles from Nissan Diesel (SA) (Pty) Ltd (henceforth Nissan) through

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<sup>133</sup> Ibid at para 78 – 86 of Majority judgment

<sup>134</sup> [2014] ZASCA 40

financing provided by Firststrand Bank Limited (trading as Wesbank and henceforth referred to as Wesbank). Nissan and Wesbank thus concluded a supply agreement in which Nissan provided trucks to Wesbank. At the same time Wesbank and Toit's entered into a floor agreement where Wesbank would provide financing to Toit's as an authorised Nissan dealer. Thus the trucks that were purchased by Wesbank from Nissan were thus delivered to Toit's. Toit's thereafter caused the trucks to be sent to Anchor Auto Body Builders (henceforth Anchor) in order to make and fit the required modifications. Thereafter two trucks were delivered to the Appellant and the Appellant purportedly took ownership of the other three vehicles by the signing of a handover sheet, however these trucks were not delivered to the appellant as further modifications were required. Sometime after the Appellant made final payment for the trucks to Toit's, however Anchor retained possession of the other three trucks as payment was outstanding from Toit's for work done.

Roshcon thus settled payment with Anchor but at this time Toit's was in liquidation, accordingly Wesbank instructed Anchor not to release the vehicles as Wesbank claimed ownership given that Toit's had not paid for them. Some months later Anchor then released the vehicles to Wesbank who then sold them to a third party. Roshcon contended that the floor agreement and supply agreements were simulated. It was alleged that the Floor plan agreement was in truth a loan against security of the trucks, to which Wesbank did not take possession of same. Wesbank argued that Roshcon had not discharged the onus of proving the agreements were simulated.

The case being decided on the facts of the case the main judgment per Shongwe JA does not appear to add any new insight into the development of the simulated transactions doctrine, however, Wallis JA took the opportunity to attempt to provide some clarification as to the law post-CSARS v NWK Ltd

Having discussed the establishing principles of simulated transactions Wallis JA thereafter emphasised the fact that it was incorrect to view NWK Ltd as derogating from these principles.

“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. There are various mechanisms for doing this, but they all involve taking straightforward commercial transactions and adding complex additional elements designed solely for the purpose of claiming increased or additional deductions from taxable income, or allowances provided for in the legislation. The feature of those that have been treated as simulated transactions by the courts is that the additional elements add nothing of value to the underlying transaction and are very often self-cancelling. Thus in *Erf 1383/1* Hefer JA said that ‘there is a distinct air of unreality about the agreements’. In *Relier Harms* JA referred to the ‘unusual and unreal aspects’ of the transactions. 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”<sup>135</sup>

“It appears that in some circles this, and particularly the statement that ‘If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated’, has been understood to condemn as simulated transactions any and all contractual arrangements that enable the parties to avoid tax or the operation of some law seen as adverse to their interests. But that fails to read this sentence in the

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<sup>135</sup> At para 33

context of both the particular paragraph in the judgment and the entire discussion of simulated transactions that precedes it. If it meant that whole categories of transactions were to be condemned without more, merely because they were motivated by a desire to avoid tax or the operation of some law, that would be contrary to what Innes J said in *Zandberg v Van Zyl* in the concluding sentence of the passage quoted above, namely that:

‘The inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.’

That was manifestly not Lewis JA’s intention...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”<sup>136</sup>

This position has been reaffirmed by the Supreme Court of Appeal on two further occasions of *CSARS v Bosch and Another*<sup>137</sup> and *Sasol Oil (Pty) Ltd v CSARS*.<sup>138</sup>

On appeal in *CSARS v Bosch and Another*<sup>139</sup> Wallis JA reiterated his findings in *Roshcon* discussed above with the added gloss that

“ If it is genuine then it is not simulated, and if it is simulated then it is a dishonest transaction, whatever the motives of those who concluded the transaction....for [the argument for simulation to succeed] it required the participants in the scheme to have intended, when exercising their options to enter into agreements of purchase and sale

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<sup>136</sup> At para 35 to 37

<sup>137</sup> 2014 ZASCA 171 at 40

<sup>138</sup> (2018) All SA 153 (SCA)

<sup>139</sup> 2014 ZASCA 171 at 40

of shares, to do so on terms other than those set out in the scheme. That is manifestly implausible...”<sup>140</sup>Is the Honourable Justice Wallis correct in his findings as regards *CSARS v NWK Ltd*? It appears as though Lewis JA seems to find this interpretation to be the correct one, in *Sasol Oil (Pty) Ltd v CSARS* she held:

“In *NWK* I pointed out the difficulties inherent in applying this test. The test itself is uncontroversial. We must ascertain the intention of the parties having regard not only to the terms of the impugned transactions but also to other factors, including the improbability of the parties intending to give them effect. Applying the same test, the judges in [*Commissioner for Customs and Excise v Randles, Brothers & Hudson Ltd*] were divided in their approach to the application of the principle to the facts.

I suggested in *NWK* that

‘[T]he 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 meant to give credence to their simulation.’

The judgment in that matter was apparently thought to have changed the law. It did not. *It pointed out merely that in order to establish simulation one could not look only at the terms of the disputed transaction. And it suggested that simulation was to be established not only by considering*

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<sup>140</sup> Ibid at para 40

*the terms of the transactions but also the probabilities and the context in which they were concluded.*"<sup>141</sup>

The Honorable Justice Lewis thus appears to have tempered her words in respect of simulated transactions. However, this is difficult to reconcile this reading, that the Honorable Judge merely held that in order to establish simulation one could not only look at the terms of the disputed transaction but also consider the probabilities and context in which they were concluded with her call that the test should go further and her dicta at paragraph 56 of *CSARS v NWK Ltd* where she held:

"The Tax Court found, however, that Barnard of NWK had intended the transaction to have effect in accordance with its tenor. As I have said, that test is not enough to allay the possibility of simulation: one must have regard to the purpose of the transaction – what it is really intended to achieve."<sup>142</sup>

It is clear from the entire judgment in *CSARS v NWK Ltd* that the court felt the traditional test for determining the genuineness of a transaction with reference to the parties' intentions, however that was to be determined, was inadequate. It was not enough to allay the possibility of simulation. Accordingly, it is difficult to agree with the Honourable Justices in the cases of *Roshcon v Anchor Auto Body Builders*, *CSARS v Bosch and Another* and *Sasol Oil (Pty) Ltd v CSARS* that Lewis JA did not develop the test for simulation *at all*, however it is agreed that the case did not develop the simulated transactions doctrine to the extent that a transaction would be regarded as simulated merely because it has the purpose of avoiding legislation.

Thus, from the cases of *Roshcon v Anchor Auto Body Builders*, *CSARS v Bosch and Another* and *Sasol Oil (Pty) Ltd v CSARS* it can be seen that the fears of many in the legal community and academia that *CSARS v NWK Ltd* extended the enquiry in the simulated transactions doctrine to the extent that a transaction may be simulated irrespective of the parties' intention were ill-founded. The courts in each of

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<sup>141</sup> *Sasol Oil (Pty) Ltd v CSARS* supra at para 57 - 59

<sup>142</sup> *CSARS v Nwk* supra at para 56

these cases were clear that *CSARS v NWK Ltd* did not have such an effect on our law.

It has been argued that these cases clearly indicate that a transaction's commercial purpose would be but a *factor* in considering whether it is simulated<sup>143</sup> Joubert has noted that from a survey of the history of simulated transactions that the courts have considered the form of the contract, the surrounding circumstances of the contract and the unusual or atypical terms of the contract when assessing the genuineness of the transaction.<sup>144</sup> He further notes that whereas the courts of the past considered the object of the contract, this had fallen out of favour.<sup>145</sup> Thus, given the judgment of Wallis JA in *Roshcon v Anchor Auto Body Builders* the judgment of *CSARS v NWK Ltd* may be read as a return to this mode of determining a transaction's genuineness. But as shown above this clearly could not have been the intention behind the judgment of Lewis JA in *CSARS v NWK Ltd*, as argued above, it was very clear from the judgment that Lewis JA felt that merely inquiring as to the parties' intentions was inadequate, thus she could not have intended that Commercial purpose was merely a factor to consider.

As noted by the Honourable Justice Wallis in *Roshcon v Anchor Auto Body Builders*, in the quotation from that case set out above, where tax avoidance arrangements have involved taking straightforward commercial transactions and adding complex additional elements designed solely for the purpose of claiming increased or additional deductions from taxable income, or allowances provided for in the legislation a key feature that all those that have been held to be simulated had was that the additional steps added nothing of value to the underlying transaction. It is submitted that this can only be the case where the court determines what the commercial purpose of the transaction was. It can only be determined that an additional step added nothing of value to the transactional arrangement if the purpose of the arrangement is determined. The case of *CSARS v NWK Ltd* thus expressly states this underlying and unstated premise.

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<sup>143</sup> Silke on International Tax LexisNexis (online Version) at para 46.6 accessed 01/02/2020

<sup>144</sup> Nereus L. Joubert, *Asset-Based Financing, Contracts of Purchase and Sale, and Simulated Transactions*, 109 S.African L.J. 707 (1992) at pp 712 - 714

<sup>145</sup> *ibid*

Several possible interpretations of *CSARS v NWK Ltd* were discussed in Chapter 3: that the commercial purpose of the transaction be considered in conjunction with other surrounding circumstances to establish whether the parties truly intended the agreement, that commercial purpose be used as a supplementary rule of interpretation regarding the parties' contract where the facts are indeterminate or that it is a mechanism by which the court is empowered to evaluate a composite transaction consisting of a series of steps, not limited to cases where the contracts were signed simultaneously. The cases discussed in this chapter can be seen as clearly discounting the first option, this much is clear from their discussion. However, which of the others is the correct meaning remains to be seen.

It is submitted that given the court held in *CSARS v NWK Ltd* that it was not sufficient that the parties intended the transaction to have effect according to its tenor but also what it attempted to achieve would indicate that the third possible interpretation - that commercial purpose/reason is a mechanism or principle by which the court is empowered to evaluate a composite transaction consisting of a series of steps should be the preferred interpretation, this is bolstered by the dicta of Wallis JA in *Roshcon v Anchor Auto Body Builders* that the common feature of composite transactions found to be simulated was that the additional steps added nothing of value.

This chapter looked to evaluate how the courts have developed the simulated transactions doctrine after the case of *CSARS v NWK Ltd*. From the above discussion it is submitted that whilst no development of the law in respect of simulated transactions took place *per se* the law was certainly refined. The criticisms aimed at the judgment in *CSARS v NWK Ltd* were allayed in that the court, per Wallis JA, in *Roshcon v Auto Body Builders* where this interpretation of the case was expressly rejected. The views in these suggest that the simulated transactions doctrine will not develop into a generalised anti-avoidance mechanism. The views regarding *CSARS v NWK Ltd*, that it does not develop the law at all and was merely confirming a factor in determining simulated transactions however must be rejected.

## CHAPTER 5: CONCLUSION

This thesis set out to examine and discuss how, and to what extent, the simulated transactions doctrine has developed in our common law as a mechanism to curb impermissible tax avoidance. Put differently, how were the legal principles of *plus valet quod agitur quam quod simulate concipitur* and *fraus legis* developed as mechanisms to curb impermissible tax avoidance.

Chapter 2 thus began the discussion at the early foundations of the simulated transactions doctrine in our law. It was shown that whilst the Roman law understood the two principles of *plus valet quod agitur quam quod simulate concipitur* and *fraus* to be theoretically distinct they were nevertheless often jurisprudentially confused in the writings of the early jurists of our law. The defining features of a simulated transaction were thus laid out in our law through an intertwining of these concepts. In *Zandberg v Van Zyl* it was held that the plus valet principle empowered a court to disregard the transactions form where it was found that the real intentions of the parties differed from the simulated intention, that is to say, that where the transactions form does not accord with what the court determines the real intentions of the parties to be the court will enforce the real intentions of the parties. The *fraus legis* Principle was discussed in the case of *Dadoo Ltd and Others v Krugersdorp Municipal Council* two understandings of the principle were mooted, the majority favouring the view that a transaction was in fraudem legis, and therefore in valid, where the transaction was mere a disguise for the real transaction in which case the law would nevertheless be applied, on this view the *fraus legis* principle is merely different application of the *plus valet* principle – echoing the jurisprudential confusion of the early writers. This view was shown to be the accepted view in *Commissioner for Customs and Excise v Randles, Brothers & Hudson Ltd* where the use of these principles in a tax setting were first discussed. In that case the majority, per Watermeyer JA held that it is only where a transaction is dishonest that it will be held to be invalid and a dishonest transaction was held to be one where the parties do not actually intend the ostensible agreement to have any effect between them but rather some other tacit agreement would be. Whereas, the minority view, per De Wet CJ, was to evaluate the authenticity of the transaction itself.

Chapter 3 then turned to discuss the simulated transactions doctrine as discussed in *Commissioner for Customs and Excise v Randles, Brothers & Hudson Ltd* in more recent case law. In this respect the cases of *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* and *CSARS v NWK Ltd* were discussed. It was clear from these cases that the courts were prepared to extend the simulated transactions doctrine to evaluate not just single transactions but composite ones as well. Whilst in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* the court felt justified in this owing to the interdependence of the agreements and that they were signed simultaneously the court in *CSARS v NWK Ltd* felt justified in doing so because of the lack of “commercial purpose” of the arrangement. The doctrine was also developed in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* where the court demonstrated the application of the simulated transactions doctrine in relation to the Duke of Westminster Principle. Various possible interpretations for what was meant by the term commercial purpose, as used in the case of *CSARS v NWK Ltd* were mooted which it was clear would require the courts to determine which would have been the better choice.

Chapter 4 then looked to discuss how the developments in *CSARS v NWK Ltd* were received. Various criticisms of the judgment were discussed and the more recent case law where in the courts addressed the developments in *CSARS v NWK Ltd* were discussed. Whilst the refinement of the judgment in *CSARS v NWK Ltd* addressing the concerns raised by various critics were addressed the conclusion that *CSARS v NWK Ltd* did not develop the law was rejected. The various possible meanings of commercial purpose mooted in chapter 3 were evaluated against the reasoning the concurring judgment of Wallis JA in *Roschcon v Auto Body Builders* and it was determined that the better view is that commercial purpose be viewed as a principle which may empower a court to consider a composite transaction as one transaction when determining the consequences of a tax avoidance arrangement.

Thus, the simulated transactions doctrine can be said to have been developed quite extensively from its early acceptance in our law towards the present as a means of combatting tax avoidance. In this regard the courts have shown a willingness to develop the law to find that impermissible tax avoidance transactions would be said to be simulated. However, the courts have, rightfully, shown a reluctance to develop the doctrine beyond the foundations of the doctrine. At all times it should be remembered that the simulated transactions doctrine invalidates transactions

because of a lack of consensus between the parties, they do not actually intend for the agreement to have effect inter partes, but rather intend that their real transaction is disguised. Thus, the courts have been clearly unwilling to accept the extension of the doctrine that would allow for a transaction to be said to be simulated even where the parties genuinely intended the transaction to take the form that it did. Nevertheless, the development of the doctrine of simulated transactions goes a long way to combatting impermissible tax avoidance.

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