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SUBSTANCE AND FORM IN SOUTH AFRICAN REVENUE CASES

INTRODUCTION

To remain within the law and at the same time order your affairs so as to pay less tax, is the solution to the fiscal riddle, the search for which has led to many complicated financial schemes, skirmishes with the Commissioner for Inland Revenue; and the creation of a booming market for astute tax planners.

The recent case of Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 1996 (3) SA 942 (A) should have sent a quiver down the spine of those tax planners who previously felt safe in the apparently mistaken belief that the Commissioner for Inland Revenue is obliged to rely mainly on Section 103 of the Income Tax Act, in order to attack a taxpayer's scheme on the grounds of alleged tax avoidance.

This case has again raised the question of whether the principle enunciated in the old English Duke of Westminster case (1), where it was said by Lord Tomlin that:

> "Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise might be." (2)

still truly applies in South African fiscal cases.

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1. IRC v the Duke of Westminster 1936 AC 1
2. At 520

The judgment in that case was an attempt by the english courts to quash any hopes which the English revenue might have previously fostered that a principle was emerging in English fiscal cases, whereby the English courts would examine the substance of a transaction rather than the form i.e. which permitted a court to ignore the legal format of a specific transaction in favour of its economic effect or results.

The judgment in that case put pay to English revenue authorities' hopes that in any examination of whether a particular act or transaction fell within the scope of fiscal legislation, an adoption by the courts in favour of the substance of those transactions over their form, was imminent. In this regard Lord Russell in his majority judgment adopted with approval the principle originally laid down in 1869 by Lord Cairns in the case of Partington v the Attorney General:

> "... I myself have arrived without hesitation at the conclusion that the judgment ought to be affirmed. I do so upon form and also upon substance. I am not at all sure that in the case of this kind - a fiscal case - form is not amply sufficient, because as I understand the principle of all fiscal legislation, it is this: if a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case may otherwise appear to be." (3)

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3. [1869] LR 4 E & I App HL 100 at 122

After citing this case with approval Lord Russell went on to comment regarding the doctrine which Revenue was pursuing, that a court may ignore the legal position and regard what is called the substance of a matter as follows:

> "If all they have meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good... If, on the other hand, the doctrine means you may brush aside deeds and disregard the legal rights and liabilities arising from a contract between parties, and decide the question of taxability or non-taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine." (4)

This was thus the starting point that the English courts were obliged to thereafter adopt when examining a transaction where the possibility of a motive or purpose of tax avoidance had been raised by Revenue, and in light of the fact that South Africa has inherited a substantial portion of its legal tradition (as far as commercial and tax matters go) from Britain, it is not surprising that early on in our law, the Partington principle was adopted into South African law with approval.(5)

4. At 524
5. see for example Isaacs v CIR 1949 (4) SA 561 (A)

The principle appears simple and definitive in that all the courts are obliged to do is to ascertain the true nature of the transaction between the parties, and thereafter decide whether that transaction falls within the scope of the statute in question.

However what will become more apparent from the discussion below, is that the matter is by no means simple or settled. The second "half" of the formula used by the courts in tax avoidance cases, as specified above, is always an examination of the ambit of the statute or statutory clause in question. Whether the court first decides on the ambit of the legislative clause, and then determines whether the transaction falls within that ambit, or applies the "formula" conversely by examining the transaction first, both "halves" of the equation need to be completed by the Court, before it can come to a decision. (6)

In a certain sense the interpretation of the statute in question is the second time the court is obliged to enter the "substance or form" debate. All statutes have a certain form, this being the plain language of the statute; as well as a substance, which is normally the motive, purpose or overall intent of the legislature in promulgating the statute or clause in question.

Thus in any discussion of our courts' approach to tax avoidance, the whole question of how the courts approach the interpretation of fiscal legislation must also be examined, not only in respect of what the courts say they are doing, but also an examination of what the courts in effect achieve.

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6. See Commissioner of Customs and Excise v Randles Brothrs & Hudson 1941 AD 369, at 394

The Duke of Westminister doctrine has been substantially altered by subsequent developments in English case law, initiated to some extent by the English case of WT Ramsay Limited v IRC 1982 AC 300 and crystallised in the important case of Furniss (Inspector of Taxes) v Dawson [1984] 1 ALL ER 530.

These cases have effectively provided a gloss on the Duke of Westminster principle (at least in so far as it applies to composite transactions), which gloss was succinctly stated by Lord Templeman in his majority judgment in the later English case of Craven (Inspector of Taxes) v White [1988] 3 All ER 475:

> "... The nature of the principle ... is this: the court must first construe the relevant enactment in order to ascertain its meaning; it must then analyse the series of transactions in question, regarded as a whole, so as to ascertain its true effect in law; and finally it must apply the enactment, as construed, to the true effect of the series of transactions and so decide whether or not the enactment was intended to cover it. The most important feature of the principle is that the series of transaction is to be regarded as a whole." (7)

Accordingly it appears that the English courts, whilst initially adhering strictly to the Partington principle and refusing to look at the motive or purpose of the parties who concluded genuine transactions, have now developed a more complex and objectively less easy to define approach, whereby an interpretation of the statute is of no more importance than the transaction itself, which is interpreted

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7. At 479

having regard to the **whole** transaction, often ignoring legally binding contracts contained in the composite transaction; and therefore of necessity examining the purpose or motive of the parties, in order to define the parameters of the composite transaction itself.

In South Africa, the Ladysmith case (8) is important in that instead of using the general anti-avoidance provisions provided by Section 103 of the South African Income Tax Act, ("the Act") the Commissioner for Inland Revenue based his allegation of tax-avoidance on the argument that various distinct and apparently separate transactions concealed a different purpose of the parties, which could only be ascertained by considering the agreements as a whole. (9) Whilst grounding his judgment on the principle that the real intention of the parties must be ascertained in order to allow the court to determine whether that agreement fell under the provisions of the statute, (i.e. relying on the court's common law jurisdiction to have regard only to genuine transactions), and so finding that the parties intended to conclude one agreement, it will be submitted that in fact what the court did was, (through the back door so to speak), was to adopt the emerging principle in English fiscal cases, first enunciated in the Ramsay case (10), and as expounded and developed in the Furniss case. (11)

Whether this new attitude of our courts is a result of the ineffectuality of Section 103 of the Income Tax Act ("the Act"), in ably equipping the Commissioner for Inland Revenue with the statutory ammunition necessary to circumvent anti-avoidance schemes, or whether it is a logical development of South African law based on the *fraus legis* principle, is still a debatable question, where only speculative answers are possible, going as it does, to a question of a judges' undisclosed subjective motives.

8. Supra
9. At 950 G - H
10 Supra
11. Supra

In this paper an analysis of the reasoning in the Ladysmith case will be attempted, but in order to examine the case properly, it will first be necessary to discover what is meant by the concepts of *fraudem legis* , "sham transactions" and "substance and form" in tax avoidance cases in South Africa. In addition and in light of the fact that South Africa has such strong bonds with English law in this area (12), a brief comparative examination of the developments in English courts will be beneficial, in order to compare and occasionally distinguish the development and interpretation of fiscal law in the two countries.

FRAUS LEGIS DOCTRINE AND SHAM TRANSACTIONS

Innis CJ in the case of Dadoo Limited and Others v Krugersdorp Municipal Council (1920) AD 530 stated :

> "That a transaction in *fraudem legis* is of no effect is an undoubted principle of our law." (13).

A logical interpretation of this statement must mean that not only unlawful contracts, but also ones in *fraudem legis* are of no force and effect. The problem however is defining what exactly a contract has to be to fall within it of *fraus legis* , ie in defining the principle and placing the principle in its proper context within the substantial body of South African law surrounding the doctrine.

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12. See for example the frequency of the citation of The Duke of Westminster v Commissioners for Inland Revenue case in South African revenue cases
13. At 543

In an attempt to explain and limit the concept of the *fraus legis* principle, Innis CJ said the following in the above case:

> "Speaking generally, every statute embodies some policy or is designed to carry out some object. When the language employed admits of doubt, it falls to be interpreted by the court accordingly to recognised rules of constructions, paying regard, in the first place, to the ordinary meaning of the words used, but departing from such meaning under certain circumstances, if satisfied that such departure would give effect to the policy and object contemplated ... But their must be, of course, be a limit to such departure. A judge has authority to interpret, but not to legislate and he cannot do violence to the language of the law-giver by placing upon it a meaning of which it is not reasonably capable, in order to give effect to which he may think to be the policy or object of the particular measure." (14)

By examining the Roman law text dealing with the doctrine of *fraus legis*, the Chief Justice reached 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 those 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 ... conveniently expressed in the *maxum plus valet quod agitur quam quod simulate concipitur*." (15)

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14. At 543 to 544
15. At 547

After expounding what the rules and their applicability in South African law are, the Chief Justice concludes:

> "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 law-giver must be read in light of his intention to be gathered from the enactment as a whole, and from the consideration of the mischief deal with." (16)

In a concurring judgment in the same case Solomon JA stated that :

> "These rules.. are, in my opinion merely an application of a general principle, which is as much a part of English as Roman jurisprudence, that courts should have regard to the substance rather than to the form of a transaction and should strip off any disguise which is intended to conceal its real nature." (17)

The facts of the Dadoo case were that statutes dealing with land ownership in the Transvaal at the time, prohibited Asiatics from owning immovable property in the province and coloured persons from acquiring or occupying ground held under the gold laws. Two Asiatics formed a private company which then acquired land and leased it to one of the shareholders. The municipal council in question obtained an order from the Transvaal Provincial Division setting the transfer of the land to the company aside, as being in

16. At 558
17. At 560

fraudem legis; and the question before the court was whether the transaction fell within the scope of the statute.

The Court found that the company was in substance and not merely in form a company and therefore being a separate legal persona which did not fall under the definition of an Asiatic person, the statute in question had no application.

In coming to this conclusion the court found that there was no question of a "simulated" transaction as the parties genuinely intended to form a company and accordingly the *fraus legis* doctrine as interpreted by the court had no application.

Whilst from this case it appears straight forward that the *fraus legis* doctrine is in fact no more than an application of the more fundamental Roman Dutch rule that the law only has regard to genuine transactions i.e. that sham transactions are of no force and effect, with respect, the matter is not as simple as the Chief Justice in the Dadoo case made it appear.

The Dadoo case attempted to define the parameters of the *fraus legis* doctrine as being no more than a formulation of the principle that the true nature of a transaction should be given effect to by the courts; and that where that nature has been disguised, the "simulation" should be disregarded. In effect the court therefore amalgamates the Roman law principle of *fraus legis* with the english law concept of the simulated transaction, and

whilst appealing in its simplicity the theoretical basis for this decision has been heavily criticised.

Aquilius (18) finds the court's contention that the rule of simulated transactions under English law is the same as the *fraus legis* doctrine, "rather startling". (19) He goes on to elaborate that the Roman legal system had a developed body of law regarding the notion of simulated transactions and questions why, ... "if transactions in fraud of law and simulated transactions were one and the same thing, did they never discover this identity?" (20)

He answers his own question by averring that simulated transactions are the equivalent of sham transactions i.e. where the parties either did not intend any legal results to flow from the transaction at all or alternatively where the parties simulate one form of the transaction but conclude another.

ie sham or disguised

He forcefully argues that in neither event is there is scope for the rule of *fraus legis* to be applied to those situations; and justifies his argument by an in-depth discussion into the Roman development of legislation and the Roman jurists interpretation thereof.

Aquilius argues that the Roman jurists, in interpreting legislation, personified the law and "... contemplated it is being desirous of preventing certain situations or economic results, but as not having succeeded in closing all roads leading to that result. Accordingly a transaction was in *fraudem legis*

18. Aquilius 1942 SALJ at 332
19. At 334
20. At 334

when it was repugnant, not to any express term of the statute but to its unexpressed intention (*sententia*)" (21).

What Aquilius is at pains to point out is that the object or design of the authors or author of the transaction was **irrelevant** and what had to be examined was the intention of the legislature, inter alia what was the economic effect or the mischief which was being prevented.

Accordingly he concludes that the general position in post classic Roman and Dutch law can be stated as follows:

> "... where the statutory prohibition is obviously directed at a material or economic result or to repress an evil, although the intention, as expressed, covers only the more usual or some other juridical means by which that result could be attained or the mischief wrought, and parties enter into a transaction (whether overtly or by means of disguise is immaterial, for the law will only regard the real transaction) which is not covered by the terms of the statute but would, if upheld, bring about that material or economic result or do that mischief, the transaction is in *fraudem legis* and is unenforceable." (22)

He accordingly argues that the majority judgment in the Dadoo case is wrong, having misinterpreted the writings by the Roman jurists on the concept of the *fraus legis* doctrine.

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21. At 336
22. At 340

In a certain sense Aquilius' views are shared by those of another eminent writer on the subject, Derickson, (23) whose argument is that the *fraus legis* rule, as it is found in Roman law, was merely the expression of a certain approach to the interpretation of legislation.

However Derickson differs from Aquilius in that he is not prepared to admit that there was any kind of independent *fraus legis* rule in Roman law and he argues that from a legal theoretical point of view it is impossible for a legal rule to stipulate the intention of a party to avoid a statute to be relevant.

Derickson relies on the writings of a German writer, with whom he agrees and who objects to such a notion on legal theoretical grounds which opinion can be translated as follows:

> "The requirements set by an Act cannot include the element of the intention to avoid. A rule of law is not an end in itself, but serves the purpose of regulating the relationships between people. The legal consequences that an Act prescribes take effect regardless of whether the parties intend to respect the statute.
>
> All that is required to bring about the legal consequences that a statue prescribes, is that the requirements stipulated by the *sententia legis* are present. " (24)

According to Derickson because one of the elements of the doctrine is stated as being an intention to avoid a statute; the doctrine itself is fundamentally flawed. He concludes that it was therefore an aid to the interpretation of Statute rather than a legal rule itself.

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23. Derickson *het daar 'n fraus legis reël in die Romeinse regbestaan? 1990 (53) THRHR 502*
24. ibid at 514

Aquilius on the other hand argues that the intention of the parties is irrelevant and that it is the personification of **the statute** and accordingly its intention which determines the *fraus legis* principle.

The common ground between the two commentators appears to be the fact that the *fraus legis* doctrine, as it evolved in Roman law, appears at most to have been an aid to interpretation of statutes and was clearly distinguishable from the theory of sham transactions in that the intention of the legislature was the important consideration and the intention of the parties was irrelevant to the doctrine.

Aquilius concludes his comments on the Dadoo case by stating that the majority judgment, whilst premised on a wrong legal theoretical basis, can be justified on the basis that the modern interpretation of the statutes must now take into account the constitutional considerations which apply in South Africa. In the Roman Empire the sovereignty of the executive was paramount, whereas under the (old) Constitution of the Republic of South Africa, the people's will as expressed through the legislature being their elected representatives, was paramount.

Accordingly the executive and judiciary can only interfere insofar as the people, through their elected representatives, have consented in unequivocal language to encroachment upon liberty or freedom of action; and such

encroachment cannot be deemed to extend any further than the intention of a legislature as expressed indicates.

Accordingly whilst it was constitutionally valid for the jurists in Roman times to contemplate the extent of the "sententia" of a statute, being the unexpressed intention of a strong executive, irrespective of the inroads such unexpressed sententia might make into the rights of the citizens of Rome, this approach could not be theoretically sustained under the modern concepts of a democracy, governed as we are primarily by statutes promulgated by Parliament.

Irrespective of the criticisms which have been levelled at the judgment in the Dadoo case, it is significant, not only for its exposition on the *fraudem legis* principle, but more importantly for the attitude which the court displayed towards sham or simulated transactions. Irrespective of whether the doctrine existed as an independent legal rule in Roman and Roman Dutch law or was no more than an approach to the interpretation of statutes, the rule which has been adopted into our law, appears simply to be that our courts are obliged to have regard to the true nature of the transaction between the parties. The distinction between the principles applicable to sham transactions and those attaching to the *fraudem legis* principle have at best been temporarily blurred, at worst irreparably amalgamated.

The so-called sham transaction, with which the doctrine of *fraudem legis* has been amalgamated , has been said to embody the principle that it is to

the substance rather than the form of a transaction that the court must have regard to; and involves the situation where the intention of the parties to the transaction is in fact not to enter **that specific** form of transaction, or otherwise not to contract at all.

The english court first used the term "sham" to denote the disguised transaction, (25) and the word has been adopted into South African Law in a similar sense. Unfortunately the word has also been used by our courts to describe transactions which the parties genuinely intend to conclude, but which are motivated by tax avoidance objectives. (26)

As the concepts of sham transactions and the *fraus legis* doctrine as adopted in South Africa appear to be restricted to non-genuine transactions in the sense described above, (27) the body of law surrounding the substance over form debate, should thus be restricted to the examination of **genuine intentions**, being either those of the parties to the transaction, or that of the legislature itself.

It is accordingly not the notions of substance and form that are applicable to sham transactions, but simply the common law rules applicable to disguised transactions.

In the Randles Bros case (28), the court quoted the view of Innes JA in the case of Zandberg v Van Zyl 1910 AD 302 who said:

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25. Snook v London and West Riding Investments Ltd (1967) 1 All ER 518 (CA)
26. See for example the case of Hicklin v CIR 1980 1 SA 481
27. see for example the words of Waterman JA in C of C & E v Randles Bros & Hudson 1941 AD 369 at 38833 SATC 48 at page
28. Commissioner of Customs and Excise v Randles Bros and Hudson (1941) AD 369.

"... as a general rule, the parties to a contract express themselves in a 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 ... the parties to a transaction endeavour to conceal its real character. They call it by name or give it shape, intended not to express but to disguise its true nature. And when the 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." (29)

In an attempt to distinguish between sham transactions and one in which the intention of the parties to enter into that specific transaction is genuine, but motivated by the purposes of avoiding the provisions of a specific Act, Waterman JA stated the rule as follows:

"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. The transaction devised for that purpose, if the parties honestly intended to have the effect according to its tenor, is interpreted by the court according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax. A disguised transaction in a sense in which the words are used above is something different. In essence it is a dishonest transaction: dishonest inasmuch as the parties do not really

29. At 314

intend it to have, inter partes, the legal effect which its terms convey to the outside world." (30)

The majority judgment in the Dadoo case confirms the duty of a court to look at the true legal effect of a transaction between the parties, notwithstanding that they may have couched that transaction in a form designed to create the outward impression of a transaction of a different nature.

It also amalgamates the *fraus legis* principle with those principles applicable to sham transactions by stating that the *fraus legis* rule is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things. In effect it limits any possibility for a court to justify an examination of the legislatures "intent" in terms of the *fraudem legis* principle and has accordingly contributed to our courts applying a strict literal interpretation to statutes, being the exact opposite of what the doctrine originally signified. The result has been that on those occasions when the courts are inclined to find against the taxpayer in tax avoidance cases, although the transaction in question does fall within a reasonable extended interpretation of the words of the statute, they are forced to develop contrived reasons for finding the transaction in question falls within the ambit of a statute, whilst still vocalising an adherence to the standard rules of interpretation of Statute. (31)

Irrespective of whether one adopts Derickson's or Aquilius' point of view, the *fraus legis* principle, in its true form can only be used in one leg of

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30. C of C & E v Randles Bros & Hudson 1910 AD 369 at 388
31. for example see Selickson AJ's Special Tax Court judgment handed down in case number 9420 on 1 Feb 1994.

the dual enquiry in tax avoidance matters. According to the writers it should be used to determine legislative intent, and according to The Dadoo case, it is used to examine the true intent of the parties in entering the transaction. Assuming that our courts are obliged to follow the judgment in the Dadoo case (due to the stare decisis rule), the doctrine does therefore not assist the courts in the second leg of the enquiry in these matters ie an enquiry into the scope of the legislation itself. Accordingly rather than the *fraus legis* doctrine being "... merely being a branch" of the enquiry into simulated transactions (32), it is submitted that the one step logically only follows the other **distinct** step i.e. the true nature of the transaction must be established (if uncertain) and thereafter the scope of the legislation must be established in order to ascertain whether the transaction falls within the ambit of the legislation.

The first step involves applying the sham transaction *fraus legis* principles and the second step involves an application of the theories of interpretation of statute.

This approach was confirmed in the case of Commissioner of Customs and Excise v Randles, Bros & Hudson Ltd, (33) which is regarded as one of the early leading cases on form and substance in South Africa revenue law. In that case the parties concluded a somewhat contrived arrangement, which they alleged was a sale agreement, purely to qualify for a customs duty rebate. The court confined itself to examining the genuineness of the parties' intention to conclude a sale agreement and by placing a heavy reliance on the Dadoo case, held that the determination of

32. As per Innes CJ in the Dadoo (supra) case at 547
33. 1941 AD 369

this question of fact disposed of the matter if it had the result of bringing them within the letter of the law.

Watermeyer JA stated the following:

> "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 arise. 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." (34)

Accordingly and at the time of the Randles Bros judgment in 1941 the following rules were firmly in place as regards sham transactions and the *fraus legis* doctrine:

> "The true transaction is determined by looking at its form, and only when surrounding facts and circumstances make it apparent that such form is a sham, is the "substance" or true form of the transaction looked to. Care must be taken, however, not to label what appears to be an artificial transaction as a sham. If the contracting parties truly intend to be bound by the obligations credited, and to be entitled to the rights created, the transaction is not a sham, and no matter how artificial it appears to be, it must be taken into account in determining the tax position of the parties." (35)

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34. at 394
35. Haupt, PK; *Substance v Form in the Application of Tax Law in South Africa* (1989) 28 income tax reporter 231 - 235; at 233

What the rules of Statutory interpretation which our courts are obliged to apply, can now be examined.

THE INTERPRETATION OF STATUTE

Early case law indicates that whilst the courts in revenue cases applied what is known as the cardinal rule to the interpretation of tax statutes, as was defined in the case of Farrars Estate v CIR :

> "The governing rule of interpretation - overriding the so-called golden rule, is to endeavour to ascertain the intention of the law-maker from a study of the provisions of the enactment in question..." (36)

meaning that the intention of the legislature in promulgating the statute in question must be ascertained by the courts, in fiscal cases, in fact the judges in these early cases refused to look beyond the ordinary grammatical meaning of the words when attempting to ascertain the intention of the legislature.

The initial approach of the South African courts to the interpretation of Fiscal statutes was thus a restrictive one, and whilst the "golden rule" of interpretation was still adhered to, ie that the literal meaning of the words of a statue must be adhered to unless that would lead to an absurdity which cannot have been intended by the legislature (37) , in the context of taxation statutes, this legislative intent was almost invariably gleaned solely from the plain language of the words in the section in question.

how is this different?

36. 1926 TPD 501 at 508
37. As per Venter v R 1907 TS 910 at 915

De Villiers JA, in the case of CIR v George Forest Timber Company Ltd (38) endorsed the rule of construction of taxing statutes as layed down by Lord Cairns in the Partington case:

> "If a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the crown, seeking to recover the tax cannot bring the subject **within the letter of the law**, the subject is free, however apparently within the law of the case might otherwise appear to be." (39) (my emphasis)

Whilst it is trite that our courts are not empowered to make law but rather to simply interpret it (40), different theories of interpretation have evolved alongside the development of South African case law, which developed to some extent as a reaction and possible explanation of the inconsistency of approach displayed by our courts over the years, in their interpretation of statutes. One of the leading commentators on the subject, Du Plessis, (41) has identified what he calls three traditional theories of interpretation:

1. The "narrower textual theory" where the courts contend that the true meaning of the legislature must be sought by examining only the ordinary meaning of the words used by the legislature. (42)

2. The "wider, contextual theory" (which includes the mischief approach) advocates an approach which forces the courts to attempt to ascertain what the state of affairs was that the legislature wanted to redress; and then to promote the remedy that will best eliminate that mischief. (43)

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38. 1924 AD 516
39. At 523
40. Dadoo case supra at 543
41. Du Plessis, LM *The Interpretation of Statutes* 1986 Durban: Butterworths
42. Ibid at 31
43. Ibid at 33

3. The "Judicial free theory" which advocates a creative role played by the judiciary in the interpretation of statutes, having regard to the intention of the legislature as ascertained from the legislation as a whole and even goes so far as to state that the judiciary may remedy defects or gaps in the legislation, once that intention has manifested itself. (44)

The courts' initial approach in revenue cases can be classified, using Du Plessis's classification, as a narrow textual approach, an early example of which can be found in the Dadoo case (45) which also gives an insight into the policy considerations behind the approach:

> "It is the wholesome rule of our law which requires a strict construction to be placed upon statutory provisions which interfere with elementary rights. And should be applied not only in interpreting a doubtful phase but in ascertaining the intent of the law as a whole." (46)

Whilst the later case of CIR v Delfos (47) appears to promote a less strict approach to the interpretation of fiscal statutes in that, on commenting on the George Forest and Partington cases it was stated by Cecil CJ that:

> "I do not understand [these cases] to mean that in no case in a taxing Act are we to give a section a narrower or wider meaning that its apparent meaning, for in all cases of interpretation we must take the whole

44. ibid at 34
45. 1920 AD 530
46. At 552
47. 1933 AD 242

statute into consideration and so arrive at the true intention of the legislator." (48)

However as he was dealing with the words "received by or accrued to" as contained in the definition of the gross income, in this case the Chief Justice was not prepared to deviate from the plainly expressed meaning of the words.

The early trend is fiscal cases was again firmly stated in the Appellate Division case of CIR v Simpson (49) where the court summarised what it saw as the proper approach to the interpretation of Taxing statutes:

"In a taxing Act one has to look merely at what is said. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used." (50)

Clearly in the early stages of our court's development of the approach to the interpretation of fiscal statutes, not only did they apply a strict literal interpretation to the statutes but felt obliged to state that their approach to fiscal statutes was somewhat stricter than their approach to statutes which did not encroach upon the liberties of the individual.

Whilst it is impossible to theoretically justify the courts' attitude to taxing statutes for being different to their approach to the interpretation of other statutes, a possible logical explanation for the courts' approach to the interpretation of tax statutes is a consideration of

48. At 254 - 255
49. 1949 (4) SA 678 (A)
50. At 695

the fact that in truth what a taxation statue does is deprive a person of his right to property, or income, which is in all other respects validly his.

Viewed from this angle it is true that to look to principles of equity in order to determine an "equitable claim" to a taxpayer's purse, will in most cases be a fruitless enquiry, as from a moral point of view there is no justification for the money being owed, other than the statute itself. (51)

It is thus true in a certain sense that normal principles of equity are incapable of yielding an amount of tax which is "fair" and accordingly the taxpayer's liability can only be determined with reference to the language of the statute, unaided by equitable considerations. However without acknowledging this subconscious bias against a liberal or contextual interpretation of statutes because of this inherent inequity, the courts simply stated that they were not even prepared to consider interpreting the words of the statute in question by extending their ambit through the use of a contextual analysis, although those avenues of interpretation were clearly open to the court, as per the Chief Justice's comments in the Delfos case. (52)

The South African courts' initial strict approach to the interpretation of fiscal statues was however not maintained, nor consistently applied and although after the Delfos case (53) there was little sign of willingness on the part of the courts to disregard the legal effects of the transaction on the grounds of a possible tax avoidance motive, the courts attitude towards a proper interpretation of the extent or ambit of statutory tax provisions gradually changed.

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51. See Emslie, Davis, Hutton "Income Tax Cases and Materials", 1995 at 16
52 Supra at page 23
53. 1933 AD 242

In the case of CIR v Lazerus Estate 1958 (1) SA 301 (A) Schreiner JA was faced with a situation where the court was asked to determine what the words "a usufructuary or like interest" meant, as contained in section 3(4)(c) of The Death Duties Act 29 of 1922.

One of Counsel for the taxpayer's (an estate) arguments as to why the court should find that death duty was not payable was that the assessment provisions of the said Act, (section 5 (i)(b)), could not be applied to the facts of the case without awkwardness; and this could not have been the intention of the legislature. Schreiner JA quoted with approval the English case of Whitney v Inland Revenue Commissioners 1926 AC 37, where Lord Dunedin said the following:

> "Once it is fixed that there is a liability, it is antecedently highly improbable that the statute should not go on to make that liability effective. A statute is designed to be workable, and the interpretation thereof by a court should be to secure that object, unless crucial omissions or clear direction make that end unattainable." (54)

Relying on this statement, Schreiner JA went on to hold that:

> "Assessment provisions in taxing statutes receive a large liberal and generous interpretation." (55)

Indeed, more recent judgments indicate that our judiciary now does not appear to feel constrained to interpret fiscal legislation differently to any other legislation, for example the more recent case of Glen Anil Development Corporation Ltd v CIR 1975 (4) SA 715 (A) where Botha JA stated:

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54. At 325
55. At 326

> "Apart from the rules that in the case of an ambiguity a fiscal provision should be construed *contra fiscum*, which is but a specific application of the general rule that all legislation imposing a burden upon the subject should, in the case of an ambiguity, be construed in favour of the subject, there seems little reason why the interpretation of fiscal legislation should be subject to special treatment which is not applicable to the interpretation of other legislation." (56)

This approach was again confirmed by the Appellate Division in the more recent case of CIR v Ocean Manufacturing Ltd 1990 (3) SA 610 (A) at 617. Where the Appellate Division was asked by the legal representative of the taxpayer to interpret the word "any" in the clause "*an agreement affecting any company*" in Section 103(2) of the Income Tax Act, as it then was, restrictively to mean only agreements which affect the control of the company.

Presumably this argument was premised on a reliance on previous case law to the effect that tax statutes are to be interpreted strictly and, if a possible ambiguity arises, the provision should be construed "contra fiscum".

The Appellate Division roundly rejected this argument stating that:

> "Section 103(2) ... should be construed in such a way so as to advance the remedy provided by the subsection and suppress the mischief against which it is directed". (57)

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56. At 627
57. At 617

Whilst both the above cases involved an interpretation of Section 103 of the Income Tax Act, a section specifically designed to circumvent tax avoidance, the statements made by the courts regarding the interpretation of statutes, give a clear indication that the courts have moved towards a wider "contextual theory" of interpretation of taxing statutes. A direct acknowledgment by the courts of this shift in judicial thinking will probably not be forthcoming, presumably for fear of being criticised as usurping powers reserved for the legislature.

In the case of CIR v Nemogim (58) Corbett JA went so far as to state:

> "It has been said that there is no equity about a tax. While this may in many instances be a guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result with seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus and it may be fairly inferred that such a result is in conformity with the intention of the legislature." (59)

Accordingly it appears that today, the courts interpretation of fiscal statutes is not characterised by any unique rules of construction. The rules, which from an examination of the early cases in this field, might appear to be peculiar rules of construction applicable only to fiscal statutes, are in fact nothing more than the application of the general principles of interpretation of statutes, as was confirmed by Botha JA in the case of Glen Anil case:

> "... There seems little reason why the interpretation of fiscal legislation should be subject to special treatment, which is not applicable to the interpretation of other legislation." (60)

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58. 1983 (4) SA 935(A)
59. At 958
60. Supra, at 727

Although the courts have rejected the judicial free theory of Du Plessis' in the past, as for example Corbett JA in the case of Summit Industrial Corporation v Claimants against the Fund Comprising the Proceeds of the Sale of Motor Vehicles Jade Transportation (61):

> "It is not the function of the court to supplement a statutory provision in order to provide for a casus unisus",

it is submitted that an examination of case law proves otherwise.

Nowhere can an example of the judicial free theory, as classified by Du Plessis, be seen more clearly than in a recent Special Court case (no 9420) where judgment was handed down by Selickson AJ on 1 February 1994. The facts of that case were that in terms of a divorce order a father was obliged to pay maintenance to his ex-wife (the taxpayer), in respect of the three minor children born of the marriage.

The father subsequently made a Will, creating a testamentary trust which comprised of the residue of his estate, and directed the administrators of the trust to utilise the income, and if necessary the capital assets, in order to discharge the testator's maintenance obligations in respect of his minor children. On his death the administrators of the trust duly carried out the terms of the trust deed and the deceased's ex-wife was taxed by the Commissioner for Inland Revenue on receipt of the maintenance as an annuity, in terms of the then Section 7(2) of the Act. The taxpayer objected to her assessment and whilst an interpretation of the words the section in question contain no ambiguity at all, Selickson AJ held that a literal interpretation of the words of the statute, as applied to the set of facts before him:

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61. 1987 (2) 547 (A) at 596

"... would create a glaring anomaly with inequitable results."

In attempting to justify his judgment by using words such as "a parity of reasoning" Selickson JA held that differential treatment of ex-wives receiving maintenance from their husbands and ex-wives receiving maintenance from the estates of their ex-husbands could not have been the intention of the legislature. He goes on to interpret the section in a way which is, with respect, clearly contrary to the ordinary meaning of the words, but which is necessary in order to come to "... a consistent, harmonious and equitable interpretation of the Act." He concludes that:

> "... I am satisfied that to restrict the exemption to the case of a living spouse and to exclude therefrom maintenance paid in compliance with the divorce order by the estate of the subsequently deceased ex-spouse, would produce a glaring anomaly which the legislature could not have intended and **one wholly in conflict with the real legislative intent.**" (my emphasis)

Clearly the question must be asked as to how Selickson JA ascertained what the "clear legislative intent" was, in light of the fact that the golden rule of statutory interpretation stipulates that one only when words themselves are capable of ambiguity or absurdity does the court need to look further than the plain meaning of the words to ascertain the intention of the legislature. It is submitted that whilst the ordinary meaning of the words might appear inequitable, they certainly do not lead to an absurdity, even when applied to the facts of the case, unless one is to interpret the word "absurd" generously so as to include moral concepts; and to do so would then appear to justify Du Plessis' judicial free theory.

In his judgment AJ Selickson does not utilise this aspect of "absurdity" to justify his extrapolation of the intention of the legislature and one cannot establish how he ascertains the intention of the legislature.

His judgment in effect therefore amounts to a rejection of the previous principles of statutory interpretation as enunciated in the George Forest and Simpson cases and is a prime example of Du Plessis' "judicial Free Theory" being put into practice by our courts.

In conclusion it appears that whilst as a general statement it made be said that the courts in South Africa still apply a literal approach to the interpretation of tax statutes and will only deviate therefrom if such an interpretation leads to absurdity, precedents do exist to justify a deviation from the clear language of the words, even in circumstances where no absurd result is obtained on a literal interpretation.

The remarks of Watermeyer JA in the case of Commissioner of Customs and Excise v Randles Bros and Hudson: (62)

> "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." (63),

draw attention to the duel nature of the enquiry in tax-avoidance cases. As I have now briefly dealt with the enquiry in so far as the interpretation of the legislation is concerned; the discussion herein below turns to concentrate on the court's approach to the specific transactions in question, bearing in mind the previously discussed principles which apply in South Africa respect of sham transactions and the *fraus legis* doctrine.

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62. 1991 AD 369
63. At 394

SOUTH AFRICAN SUBSTANCE AND FORM CASES PRIOR TO JUNE 1995

In the case of Zandberg v Van Zyl (64) Innis JA was of the view that:

> "As a general rule the parties to a contract express themselves in a 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 is assumes is what they meant it should have.
>
> Not infrequently however the parties to a transaction endeavour to conceal its real character. They call it by name or give it a shape, intended not to express but to disguise its true nature. And when the 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 they intend it to be." (65)

This simple statement of the law, that the court gives effect to genuine transactions concluded between parties, rather than simulated or sham transactions, contains within it the kernel of the problem which the courts have to face in applying this deceptively simple formula. The problem is that by stating that the courts only have regard to genuine transactions, the court forces itself to examine the subjective intent of the parties to ascertain what the true transaction is. Two kinds of "intent" exist in tax avoidance cases-: intent to contract; and intent to avoid tax; and the two are not necessary identical. The first form of intent is more simply designated as motive, which the courts have stated to be irrelevant (66), unless expressly required by the statute, for example Section 103 of the Act. Accordingly the motive or intended purpose of entering into transactions

64. 1910 AD 309
65. At 313
66. See Commission of Customs and Excise v Randles, Bros, Supra

must be clearly distinguished from the intention as to the form of the transaction. In the Randles Bros case Watermeyer JA said:

> "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 intended 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 prohibitional tax." (67)

There is however often a fine line between false, simulated transactions where the parties never intend to conclude the alleged agreement *inter partes*; and those that are genuine but entered into with the intention to avoid the unwanted legal consequences that would flow from the structuring of affairs if the parties had done so in a different way.

The discussion herein below therefore concentrates on those transactions which are genuine irrespective of motive; and is based on the assumption that the *fraus legis* doctrine, as has been received into our common law by the courts, is no more than a representation of the principle that simulated transactions are disregarded by our courts. It is accordingly assumed that the doctrine as was adopted by the court in the Dadoo case, does not extend to include genuine transactions which achieve indirectly what the law prohibits in a direct form. This non-extension of the doctrine, is to some extent, the reason why the substance over form debate rages on in South African law.

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67. Supra at 388

Following the Zandberg case, the court in the Dadoo case, on concluding that the parties genuinely intended to form a company and therefore a separate legal persona, disregarded any motive and/or intention in creating the company (to avoid the parameters of the prohibitive legislation), as once it found the intention of the parties to be genuine, the substance and form of a transaction were one and the same thing. Refusing to extend the interpretation of the legislation to find some deeper "intention " behind the statute (68) the court was confined to finding that the transaction between the parties was valid, notwithstanding that they may have couched the transaction in a form designed to counteract the words of the statute.

The Appellate Division confirmed its decision in the Dadoo case in Commissioner of Customs and Excise v Randles Bros and Hudson Ltd (69), where the court, in a situation where parties concluded a sale agreement purely to qualify for a customs duty rebate, confined itself to an examination of the genuineness of the parties' intention to contract a sale agreement and by placing reliance on the Dadoo case, held that the determination of this question disposed of the matter if it had the results of bringing the transaction within the letter of the law. Combined with the courts' reluctance at that stage to diverge from the plainly expressed meaning of the words as contained in the statute, the effect of the court's attitude as expressed in these early cases, was a marked reluctance to disregard the genuine transactions, on the grounds of a purpose or motive was to avoid tax.

However it was the process which was applied by the courts in ascertaining the "true nature" of the transaction, involving as it did a disregarding of sham transactions and an ascertaining of the "genuine transaction" which led

68. As was done in the dissenting judgment of De Villiers JA in this case, at 556
69. 1941 AD 369

international commentators in the late 1970's to remark that the South African courts showed a preference for substance over form in revenue cases, see for example the comments of Durack (70), who having discussed the decision of SIR v Sidley 1977 (4) SA 913 AD stated:

> "...An Australian commentator would be excused for forming the opinion from this statement that the South African courts now manifest a preference for substance over form in revenue cases..." (71)

The Sidley case followed the case of CIR v Berold (72) where, in deciding whether certain income received by a trust, accrued to the taxpayer who had created the trust, in terms of Section 9 (3) of the Income Tax Act, as it then was, the Appellate Division held that:

> "the effective cause of the income being received by the trust was the donation by the taxpayer and ... the court should not allow the forms of the company law to cancel the effective cause or connection between the taxpayer's donation and the income actually accumulated for the benefit of the children." (73)

The effect of this judgment was that the Appellate Division in this case was prepared to disregard the fact that there had been an interposition of a separate legal entity i.e. a company. To reconcile this judgment with that of the Dadoo case is difficult. In both cases separate legal persona were genuinely introduced into a chain of events, both clearly with the motive of avoiding penalties or prohibitions contained in statutes. In the first case the court accepted the chain of events on a strict legal basis and paid no regard to the motive. In the second case the court held that:

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70. Durack, JW : "Tax Law Form v Substance" De Rebus Nov 1979 at 603
71. Ibid at 605
72. 1962 (3) SA 748 (A)
73. At 753

> "Furthermore, ... the taxpayers' donation was **intended** to have the result it ultimately achieved, even though every step may not have been worked out beforehand; and the conclusion cannot be avoided that his donation was the efficient cause of the accumulation of income for the benefit of his children." (74) (My emphasis).

There is nothing express in the section of the statute which the court was examining in the Berold case, to justify it examining the motive of the parties, however this is precisely what the court did; and once it found the motive was to avoid tax; this then became proof that the taxpayers' actions were the `efficient cause' of the trust income received and the court held furthermore that this `efficient case' was a sufficient nexus between the taxpayer and the income received by the trust to qualify for the Section of the Act in question..

Whilst not theoretically justifiable, it is submitted that the only basis of reconciling these two cases is an examination of the intention of the legislature in the statutes involved rather than the transactions in question. The statute under scrutiny in the Dadoo case was a draconian racist piece of legislation, which infringed peoples rights to such a degree that the court, in attaching some kind of morality to a parliament that could pass such laws, felt comfortable interpreting the clause in question strictly. The Berold case involves an examination of a statute where the intention of the legislature in regard to income received by trusts created for minor children of the doner is relatively clear, and the court again could feel comfortable in giving effect to that perceived intention. The method chosen by the court however chooses to deny any expression what is being done in effect, i.e. the giving effect to the intention of the legislature, and elects rather to meddle with the forms of the transactions in question, so as to force the "adjusted" transactions within the expressed ambit of the section.

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74. At 754

The case of CIR v Sidley 1977 (4) SA 913 (A) went even further than the Berold case, and disregarded the plain meaning of a trust deed without in any way stating that it was doing so due to the non-genuineness of the expressed intention donor at the time of the creation of the trust. In this regard the court stated:

> "viewed in a practical manner, clause 25 is merely an administrative provision which determines the way in which the income of the trust fund is to be dealt with." (75)

Accordingly the court disregarded the express words of the donor in order to give effect to what it perceived to be the true substance of the trust deeds.

Again in the case of General Motors of South Africa v CIR (76) McCreath J quoted with approval from the judgment of the court a quo as follows:

> "To my mind the logic of the situation ... demands that one should look at the substance and reality of the transaction and not at the juristic nature of the loan which eventually resulted." (77)

Clearly the courts espouse that what they are doing is ascertaining the "true intention" of the parties, in order to unearth the legal nature of the transaction which will then enable the court to decide whether that transaction falls within the parameters of the statute in question. However the question to be asked is whether, if it becomes clear that the motive of the taxpayer is to avoid tax, this modifies the courts' attitude as regards its formulation of the substance of the specific transaction. In this regard it is submitted that by having regard

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75. At 920
76 1982 (1) SA 196 (T)
77. At 200

to the above cases, it is clear that in those revenue cases where a tax avoidance intention **in the legislation** is apparent, the courts are swayed by anti-avoidance motives, in some cases to the extent that genuine transactions are disregarded.

Why this attitude has manifested itself is unclear, but may well be found to lie in a gradual and perhaps subconscious acknowledgment by the courts of the defects in Section 103 of the Income Tax Act (which does allow the court to look at motive), which prevent effective circumvention of tax-avoidance schemes by Revenue.

In contrast and almost paradoxically to this general attitude to substance and form problems in revenue cases, our courts' approach to any attack by the Receiver using Section 103 of the Act, has been to strictly demand that the Commissioner prove compliance with the all the elements of that section, providing as it does, for further inroads into the taxpayers right to legitimately organise his affairs so as to decrease his tax burden.

In the case of Hicklin v SIR 1980 (1) SA 481 (A) the Commissioner for Inland Revenue attempted to bring a transaction within the framework of Section 103(1) of the Income Tax Act and Trollip JA stated the following:

"Counsel's argument wrongly ignored the form, substance and legal

effect of the loans to shareholder ... after all the loans ... were not simulated or sham transactions. On the contrary they were genuine and *bona fide*. Now at the stage when one is still enquiring whether or not the requirements of Section 103 have been fulfilled, none of those factors can be ignored, they must duly be accorded their full legal effect. It is only when the requirement of Section 103(1) are all fulfilled that the forms, substance or legal effect of those factors may wholly or partly be ignored." (78)

The court accordingly found that Section 103(1) was not applicable, notwithstanding that the main aim of the transaction was to avoid tax, the reason being that because the parties had transacted as arms length, the abnormality requirement had not been satisfied; and accordingly all the requirements of Section 103 had not been met.

It thus appears that whereas the courts are not prepared to adopt an expansive approach in examining whether there has been compliance with the requirements of Section 103, they are still obliged to examine the motive of the parties in those transactions which come under attack under this section. Given that there is a presumption of motive on the part of the taxpayer, if the other requirements of Section 103 are complied with, the courts appear to be comfortable in examining motive under this section. The problem that the Receiver has in enforcing that section, appears mainly to be in proving the requirement of "abnormality", as defined by case law; and accordingly the comments by the courts on the aspect of motive in these cases is therefore often of a brief, orbiter nature. However in those revenue cases which do not directly deal with Section 103, the courts have adopted a far more robust approach to the question of motive, as has been described above.

78. at 492

Revenue cases abound in South Africa, where there can be said to have been a triumph of substance over form, a fine example of which it can be found in the case ITC 1427 50 SATC 25. In that case the taxpayer acquired the option to purchase shares in a company which owned the farm where the taxpayer was conducting small scale farming operations, in terms of a rent agreement with the company. When the taxpayer received an offer for the purchase of the farm, far in excess of the purchase price of the option, he exercised his option and sold his shares on the same day. In deciding the question of whether the taxpayers' income from the proceeds of the sale of the shares was capital or revenue, the court disregarded the standard rule, which specifies that regard must be had to the intention of the taxpayer at the time of acquisition of the asset; and held that the intention of the taxpayer at the time when the option was acquired was the relevant intention to have regard to. Having found that this intention was to hold the rights under the option as a capital asset, the court held that the exercise of the option had merely been the manner in which the sale was concluded.

Again in this case the court disregarded the hard facts of the case in order to give effect to the true intention of the taxpayer, i.e. to hold the option as a capital asset.

Accordingly it is submitted that prior to 1996, the South African courts, when scrutinising transactions under applicable Revenue statutes, initially showed a marked reluctance to have regard to a taxpayers possible motive of avoiding tax, **other than** when required to do so in terms of Section 103 of the Income Tax Act.

Later case law however shows a definite change of attitude by our judges, to a gradual recognition of the existence of some unexpressed intention of the legislature to circumvent tax avoidance, in certain sections of the Income Tax Act, other than Section103, which recognition was often expressed by the courts as an examination and resultant condenmation of the motive which the parties had in contracting.

This unacknowledged recognition by the courts, when combined with a knowledge of the ineffectiveness of Section 103 in combating tax avoidance schemes, was not expressed by the courts as an adoption of the judicial free theory, as expounded by Du Plessis, nor as an adoption of the relevance of motive in tax- avoidance cases, but rather simply as a giving effect to the genuine transaction of the parties. Thus the courts stated that they were simply applying the *fraus legis* and sham transaction principles to the facts before them, in order to ascertain the substance of the transaction which had to be scrutinised.

The flaw in this reasoning is that, on occasion, as pointed out above, genuine transactions concluded between the parties were disregarded by the courts in their search for the "genuine" transaction in question!

The question has already been asked as to whether, because of the courts' awareness of the presence of Section 103 in our Income Tax Act, they did not have an aversion to developing the field of law which examines the motive of parties in entering into a specific transaction, as happened in the English law, where tax avoidance legislation has not been enacted.

ENGLISH CASES

The judgments in the Partington and Duke of Westminster case (79) as discussed above, held sway in England for many years, presumably causing the English Revenue authorities much anguish as wily taxpayers manipulated their affairs with blatant tax avoidance motives and felt secure in doing so, by reason of the judgments in the above cases.

Due to the fact that no general tax avoidance section exists in English tax statutes, specific tax provisions were enacted as and when loopholes in the legislation were exploited by taxpayers. This however was not completely satisfactory to Revenue in assisting it in preventing tax avoidance schemes, due partly to the fact that the courts were interpreting tax statutes strictly and not allowing revenue to extend the ambit of a section beyond its clear meaning, as well a strict adherence by the courts to the Duke of Westminster principle. (80)

With the increased commercial sophistication that developed in England, a shift in the attitude of the courts became apparent, most notably with the advent of dividend stripping schemes in the 1960's (81). Lord Denning in the case of JP HARRSON (WATERFORD) LTD v GRIFFITHS 40 TC 281, stated in a dissenting judgment:

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79. Supra
80. Davis & MacFarlane : "Substance over Form: A new Approach to Tax Avoidance" The Taxpayer January 1987 pg 5
81. Durack : "Tax Law: Form and Substance" De Rebus November 1979 at 607

"...The Commissioners were entitled to see these people as they really are, prospectors digging for wealth in the subterranean passages of the revenue, searching for tax repayments. They are not simple traders dealing in stocks and shares." (82)

Whilst his attitude was not shared by the majority, it shows the growing awareness by the English courts of the exploitation by taxpayers of the inability of the Commissioners in effectively curbing complicated tax avoidance schemes, with the legislation available to them.

More than 40 years after the Westminster approach was determined, it was successfully challenged in the case of IRC v RAMSAY [1982] AC 300. This case involved a farming company, which, in order to mitigate capital gains tax after the sale of a farm, concluded a series of loan transactions calculated to produce a "loss" on paper.

The court accepted that each step in the transaction was a genuine step, producing its intended legal result, but went on to hold that this fact did not confine the court to considering each step in isolation, for the purpose of assessing the fiscal liability of the taxpayer. In his leading speech, Lord Wilberforce said the following :

"To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting approach, which the parties themselves may have negated, would be a denial rather than an affirmation of the true legal process. In each case the facts must be established; and a legal analysis made; legislation cannot be required or even be desirable to enable the court to arrive at a conclusion which corresponds with the parties' intentions." (83)

82. At 290
83. At 326

What the Ramsay case effectively decided was that whilst the courts are confined to examining genuine transactions between parties, in order to ascertain what the transaction is, it might be necessary to look at whether it is not perhaps an ingredient of a wider transaction as a whole.(83)

It is important to note from this case that the fact that the motive for a transaction may be to avoid tax does not invalidate it, unless a particular enactment so provides. The court emphasised the continued applicability of the Westminster principle, but added the gloss that, where it is plain that a particular transaction is but one in a connected series of inter-dependent steps, designed to produce a single composite over-all result, the court can have regard to the composite whole.

This tougher approach to tax avoidance displayed by the English courts continued in the case of IRC v Burmah Oil Co Limited (84) in which Lord Diplock commented on the Ramsay case as follows:

> "It would be disingenuous to suggest ... that Ramsay's case did not mark a significant change in the approach adopted by this house in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of the liability to tax, which in the absence of those particular steps would have been payable. The difference is in approach." (85)

83. Davis, Supra, at 5
84. [1982] STC 30
85. At 32

Lord Diplock in the above case, commenting on the effect of the Ramsay case, then stipulated what he believed the requirements of the principle or rule which had emerged from the Ramsay case :

1. A pre-ordained;
2. Series of transactions; where one transaction is inserted
3. With no commercial purpose other than;
4. The avoidance of tax (i.e. a purpose requirement)

Accordingly the formulation set out above by Lord Diplock in the *Burmah* case expresses the limitation of the *Ramsay* principle, in that unless factually there is a composite transaction, which contains steps inserted without a business purpose, apart from a tax advantage, the principle has no appliability. (86)

This innovative line of reasoning in tax-avoidance cases, where composite transactioned are involved, culminated in the famous English case of Furniss (Inspector of Taxes) v Dawson (87).

Whilst the case itself did not involve tax avoidance but rather tax deferment, Lord Brightman succinctly indicated the rational of the English court's new approach, which he held

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86. As per Lord Brightman in Furniss v Dawson [1984] 1 ALL ER 530 at 543
87. [1984] 1 ALL ER 530

no longer made any distinction, in a preplanned tax saving scheme, between

> "(i) A series of steps which are followed through by virtue of an arrangement which falls short of a binding contract; and
>
> (ii) A like series of steps which are followed through because the participants are contractually bound to take each step *seriatim..." (87)*

The facts of the Furniss case were relatively simple, the taxpayers, being shareholders in a certain company wanted to sell those shares to another company. In terms of the English legislation if they sold those shares at full market price, the gains they made as a result thereof would be subject to capital gains tax. Accordingly they incorporated a company on the Isle of Man, to which they sold their shares, in exchange for shares in that company. That company ("Greenjacket") then sold those shares it had acquired from the taxpayers to the original prospective purchaser of the taxpayers' shares, effectively deferring the tax the taxpayers would have been liable for, until such time as the taxpayers sold their shares in the new company.

The effect of the decision in the Furniss case was that the House of Lords disregarded the sale of shares to the Greenjacket company and treated the series of transactions as a sale from the taxpayers to the eventual purchaser of the shares from Greenjacket.

The House of Lords' decision came as a rude shock to those taxpayers who thought that the ratio's from the Burmah Oil and Ramsay cases could be restricted to the facts of those cases. Lord Diplock in the Burmah Oil case had already warned that the Ramsay principle was a new approach (88), however it was generally hoped that the

87. At 543
88. Supra, at 32.

new attitude would be restricted to situations where losses and tax relief were fabricated (as was the case in the Ramsay case), or where commercial reality was lacking and where the main objective of the transaction was the avoidance or reduction of liability to tax.

The basis of the emerging principle was explained by Lord Bridge of Harwich in the Furniss case:

> "In another sense the present appeal marks a further step, as a matter of decision rather than mere *dictum* in the development of the courts increasing critical approach to the manipulation of financial transactions to the advantage of taxpayers." (89)

COMMENTS ON THE FURNISS CASE

The House of Lords was clearly intent on extending the approach adopted by the courts in the Ramsay and Burmah Oil cases and thus the principles applicable to English tax avoidance cases, after the House of Lords' decision in the Furniss case can now be summarised as follows:

The Duke of Westminster doctrine is still applicable and accordingly it is still perfectly legal for a taxpayer to order his affairs, so as to reduces his tax liability. In addition he will only be taxed according to the clear words of the statute in question. However in determining what the clear words are, the court is not limited nor confined to a literal interpretation thereof but must look at the context and scheme and purpose of the Act as a whole (90).

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89. At 535
90. As per Lord Wilberforce in the Ramsay case at 328

In addition only genuine transactions are scrutinised by the court and once the genuine transactions which the parties intended to contract has been ascertained, the court does not go beyond it to find some underlying "substance", however where there is a series of transactions before the court and it can be seen that a transaction was part of or an equivalent of a series of transactions, there is nothing preventing the court from having regard to the wider transaction. (91)

Accordingly the Ramsay principle is confined to situations that where there is more than one transaction and where there is a step therein which has no commercial (business) purpose apart from the avoidance of tax. The effect of the approach is that the step which has been inserted for no commercial purpose, will be disregarded for fiscal purposes. This has lead to this new approach to composite transactions being labelled by British commentators, as the "disregard" approach. (92)

It is submitted that what the House of Lords has effectively done in the Furniss v Dawson judgment is to adopt a policy which gives effect to the principles of the original *fraus legis* doctrine as is suggested to have existed, by Aquilius. (93)

If one has regard to the Roman jurists' approach to the the interpretation of their statutes, whereby the general context of the legislative Act in question was legitimately interpreted by the Roman jurists, including, if the necessary implication was there,the element of improper motive, the analogy becomes even more apt.

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91. As per Lord Brightman at 542
92. Tiley, John : All ER Annual Review, 1984 at page 277
93. Aquilius : SALJ 1942 at 333

According to Aquilius (94) Roman Law initially did not have any general "anti-avoidance" provisions but in light of constitutional make up of the Roman Empire and the the fact that it was not a democracy with a representative legislature, the interpretation of statute was not based on the intention of parliament and the jurists were accordingly justifiably entitled to assume, that there was no need to limit the interpretation of the statute to a restrictive literal interpretation.

So too in the United Kingdom there is no general anti-avoidance provision in fiscal statutes and as the taxpayers develop more sophisticated schemes designed to exploit apparent loop holes in revenue law as it exists in the United Kingdom, the Duke of Westminster principle became a valuable ally of the taxpayer in that it not only obliged the court to interpret tax statutes narrowly, but also obliged them to disregard the motive of the taxpayer.

Whilst not recognising that the motive of avoiding tax is unlawful, (which would be a direct contradiction of the principle as expounded in the Duke of Westminster case), a gloss has now been effectively added to that principle, as per Lord Diplock in the Burmah Oil case:

> "... Lord Tomlin's oft-quoted dictem in IRC v Duke of Westminster, ..., tells us little or nothing as to what methods of ordering ones affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straight forward way." (95)

providing, as it does, a justification for the courts to now examine the motive of those parties entering into composite transactions in order to

94. Ibid at 337
95. IRC v Burmah Oil Company Limited [1982] STC 30 at 32

ascertain whether any one of those steps was inserted with no commercial purpose other than to avoid paying tax; and allowing the courts, if the requirements are present, to disregard genuine transactions **which are acknowledged to be genuine.**

The finding of the House of Lords in the Furniss case has been criticised on various grounds inter alia that following Lord Brightman's judgment,:

> "One ends up with the uncomfortable fact that the taxpayers are left holding shares in Y and yet the existence of Y has been disregarded" (96)

In light of the fact that Lord Brightman's statement allows the English Commissioner to blatantly disregard genuine transaction, it is pointed out that much litigation is anticipated as to the way in which he will be permitted to reconstruct a transaction, indeed whether the Commissioner is entitled to reconstruct it in the first place. (97)

Furthermore the element insisted on by Lord Brightman of "no commercial purpose" for the application of the Ramsay principle, presumably means no commercial purpose **at all** must exist, in other words, if there is some commercial motive, the new rule will be prevented from being applied. Tiley goes on to argue that:

> "One wonders how long it will be before this principle is reformulated so that the new approach will apply unless the commercial motive is the *main* one." (98)

In effect what the British courts have done is to adopt the "business purpose test" utilised in the United States of America, where the court, whilst initially

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96. Tiley, John "The Avoidance of Tax" ALL ER Annual Review 1984 at 277
97. ibid at 278
98. ibid at 279

conservative in their approach to the motive of tax payers, (99) early on recognised the substance over form in transactions under scrutiny for tax avoidance in the landmark case of Gregory v Helvering (1935) 293 US 465.

The Unites States courts however use the terms substance to mean "economic effect" or "business purpose". In the above case, this "business purpose" test was first enunciated and it is now accepted that in the United States, in tax avoidance matters, the courts will have regard to the substance or economic reality of transactions rather than to their specific form.

Lord Oliver in the Craven v White case (100) commented on the Ramsay doctrine as expanded in Furniss; and stated that it still did not deviate from the established legal principle that the fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides:

> "... what it did decide was that the cardinal principle does not, where it is plain that a particular transaction is but one step in a connected series of inter dependent steps designed to produce a single overall result, compel the court to regard it as otherwise that what it is, that is to say, merely a part of a composite whole." (101)

However it is submitted that in an analysis as to whether a transaction is simply a part of a composite whole; and in light of the fact that the motive of a single transaction, inserted into a composite transaction **must** now be examined by the courts if they are to find that the Ramsay doctrine is applicable, the test of motive has in fact been adopted by the english courts, at least as far as composite transactions are concerned.

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99. See US v Isham 17 Wall 296
100. 1988 (3) WLR 423
101. At 452

South African commentators have been at pains to point out that the adoption of the Furniss principle should not take place in South African law. (102)

Haupt points out that the approach in the Furniss v Dawson case represents a true substance over form approach, in that *genuine* rights and obligations are ignored in determining tax liabilities and he argues that our courts have never adopted this approach. (103) He justifies his argument utilising South Africa's statutory anti avoidance provisions, by pointing out that should a composite of transaction contain steps which have no commercial purpose, such steps are likely to be considered "abnormal", which was a still a requirement of Section 103 of the Income Tax Act at the time Haupt wrote his article; and the scheme could therefore be legitimately attacked using Section 103.

What Mr Haupt fails to point out is the dismal success rate which the revenue authorities in South African law have had in their attempts to apply Section 103, more specifically in their attempts to label a transaction as "abnormal". (104) This difficulty which the Revenue faced has led to the recent amendment of Section 103, applicable to transaction in the business context, which specifically incorporates a new requirement of "*bona fide* business purposes, other than the obtaining of a tax benefit". (105)

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102. See for example: Clegg D : "Substance and Form" Tax Planning 1991 at 33; Haupt P : "Substance v Form in the Application of Tax Law in South Africa" Income Tax Reporter 28 1989 at 231.
103. Ibid at 233.
104. See Hicklin v SIR 1980 (1) SA 481 (A)
105. Section 103 (1)(b)(i)(aa) of Act 58 of 1962 as amended.

Derickson (106) provides a more compelling theoretical basis for rejecting any adoption by the South African courts of the Furniss principle. He argues that by adopting the "purpose" requirement, the English courts have effectively rejected the statements of the earlier court in the Duke of Westminster case to the effect that, when it is to be decided whether a taxed statute is applicable to a set of facts, the purpose of avoiding the statute is irrelevant (107).

Derickson points out that from a legal theoretical point of view:

> "When it has to be decided whether the legal consequences which a statute prescribes should ensue, the question whether an act was performed with the purpose of avoiding the statute should be regarded as irrelevant." (108)

Derickson basis his argument on a theoretical underpinning of what a legal rule should be. His argument in this regard is that a legal rule cannot co-exist as an aid to the interpretation of a statute, as the statute in itself lays down a legal rule.

Based on his assumption that the field of applicability of a statute cannot depend upon the subject's purpose of avoiding that statute, he argues that it is impossible for a legal rule to contain a requirement that acts must have been performed with the purpose of avoiding a statute. The reasoning behind Derickson's argument is presumably that of certainty, in that it is unwise to formulate a rule whereby a subjective state of mind determines a person's liability or non-liability for tax because in that event the determination of the extent of the statute is at no stage capable of objectively ascertained.

106. Derickson, AG: "Should the South African Courts adopt the English Anti - Tax - Avoidance Rule in Furniss v Dawson?" 1990 SALJ at 416
107. At 425
108. At 432

Derickson further comments that the invention of a certain set of facts, when one step in the series is disregarded and the "thinking away of other facts" (109) is a further unsatisfactory consequence of the Furniss judgment, and which provides another cogent reason why the South African courts should not adopt this new rule.

In his conclusion (110) Derickson argues that the Furniss decision was a reaction to the old problem facing any legal system, where the *mores* of a society are not being applied by the courts either due to defects in the statutes, or due to the inherent conservatism of the judiciary. In the Furniss case, modern society opinion required that tax liability attached to the facts, which facts do not fall within the possible word meanings of the taxing statute. Accordingly since the law should satisfy the requirements of the community opinion one must question how the law is best to do that. In the Furniss case the court did this by creating a new legal rule. Derickson favours a situation whereby when the interpretational aids require it, a meaning should be given to the statute to make it applicable to that set of facts. Accordingly he favours an approach whereby the power which is handed to the courts in interpreting the statute includes the power to have regard to the *ratio legis* as an interpretational aid, in determining the meaning of the statue and effectually extending same outside the plain meaning of the words if necessary.

109. At 431
110. Ibid

It is submitted that what Derickson is effectively proposing is an application of the *fraus legis* principle as understood by Aquilius (111).

This argument of Derickson's relating to the irrelevance of motive, is somewhat diffused in South African circumstances is one has regard to the anti-tax-avoidance provision contained in the Act, whereby one of the requirements of Section 103 is that the transaction, operation or scheme must be entered into or carried out solely or mainly for the purpose of obtaining a tax benefit (112).

Our statute itself therefore requires the court to examine the purpose of the parties in entering into the transaction and appears to be a rejection of the argument of Derickson irrespective of whether same has a sound theoretical basis. Whilst Section 103 is not directly relevant to this paper, Derickson's argument loses some force in light of our legislature's direct mandate to the courts to have regard to the parties' motive in these cases.

In a recognition of the ineffectuality of Section 103(1), in curbing tax avoidance schemes, Parliament's recent amendment of that section, (which as stated attempts to eliminate the "abnormality requirement" in the business context) (113) does not however provide the panacea to Revenue's woes in attempting to attack and/or stop tax-avoidance schemes.

111. Aquilius, supra.
112. Section 103(1)(c)
113. Section 103(1)(b)(i)

These previous woes having been to some extent created by the fact that our courts steadfastly held that transactions which are unusual are not necessarily abnormal. (114) By introducing the "*bona fide* business purposes" test as a replacement for abnormality, the legislature has adopted the recommendation of the Katz commission that a business purpose test be introduced into our anti-tax-avoidance legislation, similar to the test which exists in the United States. However the new version of our anti-avoidance legislation now refers to two separate purposes, namely a scheme which would not be employed for *bona fide* business purposes other than the obtaining of a tax benefit, as well as a scheme which was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit.

Revenue still has to prove the existence of the elements of Section 103, including the purpose requirements and it is now possible that, given the courts attitude in the past that unusual transactions are not necessarily abnormal in in the context of a particular case, a scheme may now be entered into or be carried out solely or mainly for a commercial or economic purpose, and at the same time in a manner not normally employed for *bona fide* business purposes because of the tax benefit. (115)

It is perhaps the recognition of these difficulties which are still inherent in our anti-avoidance legislation which prompted the Commissioner for Inland Revenue to attack the scheme involved in the Ladysmith case, not on the basis of Section 103 at all, but rather on the court's common law jurisdiction, to have regard to the substance of a transaction rather than its form.

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114. Hicklin v SIR 1980 (1) SA 481
115. Taxpayer June 1996, page 113.

POST JUNE 1995 CASE LAW

IC 1606

The Ladysmith case, was to some extent fore-shadowed by an earlier Special Income Tax Court case No. 9895, where judgment was handed down by Tebbutt J, on 2 June 1995. The facts of the scheme involved a lease premium property-development scheme, whereby Company A, a development company bought and developed land at the behest of Company B (from a group of companies) who paid Company A a lease premium of R1.5 million, together with further annual rentals. Company C (from the same group of companies as Company B) purchased the bare dominion of the property from Company A at a lower than normal market value. The benefit to Company A was that the lease premium and purchase price, plus rentals equalled the cost of the land together with the development costs and a management fee; and because Company A was a trader in lease premiums and a developer, all the costs associated with the development were deductible. Company B deducted the lease premium which was payable in terms of Section 11 (f) of the Act; and because of the interposition of Company A; Companies B and C were theoretically dealing at arms length to avoid the provisions of Section 103 of the Act.

The Commissioner was however not prepared to allow Company B the deduction in terms of Section 11 (f) of the Act and attacked the scheme in terms of Section 103 of the Act.

I thought should have done in Ladysmith

In coming to his decision Tebbutt J found that central question to be asked was whether the "normality" requirement had been complied with (i.e. had the parties contracted at arms length), and:

> "...tweedens of dit aangegaan is uitsluitlik of hoofsaaklik vir doeleindes van verminderings van belastingaanspreeklikheid." (116)

116. At page 11 of the judgment

Relying on the Hicklin case (117) where the requirements of an arms length transaction are set out, Tebbutt J adopts with approval, the postulation that the "normality" of a specific scheme must depend on the facts of the case. Whilst quoting with approval the principle laid down in the Westminster case, Tebbutt J goes on to state that the principle can, however not be used as a shield behind which a taxpayer can shelter, where he has entered into an abnormal transaction to avoid tax liability. (118)

What he fails to distinguish is that this non ability to shelter behind the Westminster principle in tax avoidance cases is specifically because of the existence of Section 103 in South Africa revenue law, which does not exist in English law.

This case involved the court examining whether the requirements of Section 103 were present in a particular scheme, but in examining whether the abnormality requirement had been proved, Tebbutt J quotes with approval from the Furniss case as well as two unreported judgments of Zulman J in the Income Tax Special Court in 1993 (cases 9592 and 9593) and goes on to hold:

> "... gesonde verstand dit voorse dat waar een van die transaksie's in 'n reeks transaksies ingesluit is wat geen kommersiele doel het nie en bloot daar is om 'n belastingvoordeel te probeer kry, dit nie as 'n normale transaksie tussen persone, die uiterste voorwaardes beding, beskou kan word nie." (119)

By examining the facts in question, Tebbutt J finds that Company A :

117. Supra
118. At page 13 of the judgment
119. At page 19 of the judgment

" in die prentjie gebring is bloot om die vermindering van belastingpligtigheid ten doel te he kan die transaksie, onses insiens, in sy geheel gesien,nie normaal of een, uitserste voorwaardes beding (one at arms length) beskou word nie." (120)

Holding further that the Appellant had not rebutted the presumption that because the scheme had the effect of reducing tax, it had been entered into wholly or partly for the purposes of avoiding tax, Tebbutt upheld Revenue's argument and disallowed the appeal.

By drawing an analogy between the facts of the present case, and the Furniss case, Tebbut J utilises Derickson's arguments (against adopting the Furniss principle into our law) against him when Section 103 is in issue, i.e. to confirm has opinion that the intention of the legislature in enacting the abnormality requirement contained in Section 103, is based on the same reasoning as that of the court in the Furniss case. In essence what the court did was to reject genuine transactions between companies, as did the court in the Furniss case, but on the basis that the transaction was not normal between parties acting at arms length, having found that the insertion of company A had no commercial purpose. Whilst Section 103 specifically allows our courts to disregard transactions in this case, it cannot be denied that in effect what the court did was to adopt the Furniss principle into South African law, for the limited purpose of examining the "abnormality" requirement contained in section 103, as it then stood.

Clegg, (121) criticises Tebbutt's decision on the facts rather than in principle by suggesting that the South African courts are obliged to distinguish between the purpose of the arrangement or scheme as a whole; and the purpose of the individual element of the composite transaction, due to the wording of Section 103. Arguing that the courts are constrained by

120. At page 17 of the judgment
121. Clegg, D "Preordained Transactions & Section 103(1)" 1996 Taxplanning

that wording (which envisages situations where a transaction or an element thereof may be abnormal, but an overriding business purpose protects it from the applicability of Section 103) (122), to examining the overall purpose of the whole transaction; and if finding that the composite transaction's purpose is commercial, Section 103 should not be applied, he rejects the court's finding in the case at hand. Clegg suggests that the court in this case incorrectly distinguished between the overall purpose of the parties (being the wish to gain access to the use of commercial property) and the subsidiary purpose of a particular element of the transaction, namely the introduction of a otherwise irrelevant third party.

What however he finds more important is the fact that the court in this case adopted with approval, the business purpose/preordained transaction test as set out in the Ramsay and Furniss cases, albeit for the limited purpose of Section 103(1)(b), prior to its recent amendment. That section has now specifically been amended so as to incorporate the business purpose test more directly; however as per Mr Clegg's prediction in his article, (123) the final word had not still been said on this area of the law. The case of Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue (77) will cause Mr Clegg to at least consider revising his statement that the Ramsay doctrine is limited in applicability in South Africa to Section 103 (1) (b) of the Act.

ERF 3183/1 LADYSMITH (PTY)LTD AND ANOTHER V CIR 1996 (3) SA 942 (A)

The facts of this case were simple. The Appellants purchased immovable property and thereafter entered into lease agreements with a pension fund,

122. Ibid at 83
123. Supra at 83

as lessor of those properties. The lease agreements (which were identical in respect of both pieces of land) provided that the pension fund was *entitled* to erect buildings on the property, but was to have no claim to compensation against the Appellant.

The pension fund entered into sub-lease agreements with the holding company of the Appellant, which sub-leases provided that the pension fund would erect buildings on the properties and on completion of those buildings, the sub-lessees would pay a premium to the pension fund, for having agreed to erect buildings, and lease the buildings from the pension fund.

The Appellants had previously only been taxed on the amount of (relatively low) rentals they had received in respect of the leases to the Pension Fund, but the Commissioner for Inland Revenue thereafter taxed the lease premiums paid by the sublease to the Pension Fund, in the hands of the Appellants, claiming the right to do so in terms of section 1 (h) of the Act which defines "gross income" as including:

> "in the case of any person to whom in terms of any agreement relating to the grant to any other person of the right of use or occupation of land or buildings...there has accrued in any such year or period the right to have improvements effected on the land or the buildings by any other person:
>
> (1) the amount stipulated in the agreement as the value of the improvements or the amount to be expended on the improvements..."

The Appellants argued that no such right accrued to the appellants because the main lease agreements did not place an obligation on the fund to erect the buildings, they only *entitled* the fund to do so. It was however not

disputed by the Appellants that the Fund was indeed obliged to erect the buildings in question, but they argued that this obligation arose form the sub-lease agreements which the fund had entered into and could not be enforced by the Appellants, who were not a party to the sub-lease agreements.

Relying on the Duke of Westminster principle, the Appellants argued that they had legitimately structured their affairs so as to limit their tax liability.

The Commissioner's case was that the individual documents did not reflect the true intentions of the parties, and the court, in terms of its inherent powers, had to have regard to the agreements read as a whole. The Commissioner argued that when regard was had to the composite transaction as a whole, the Appellants DID acquire the right to have the buildings erected on the property and accordingly should be taxed on the value of that right.

The following points are important to note:

1. The evidence by the Appellants witnesses that the scheme was aimed at providing a benefit for the sub-lessee under Section 11 (f) of the Act, being a deduction from gross income allowed in respect of lease premiums paid, was rejected (124). The court found that :

> "In context the agreements must therefore be regarded as the formal arrangements of the affairs of the three companies within the group." (125)

124. At 949 F
125. At 949 E

2. Hefer JA attempted to reconcile two applicable fundamental principles in South African revenue law; the Westminster principle (on which the Appellant relied) and the *fraus legis* doctrine, as adopted by the South African courts (upon which the Receiver was relying). His reconciliation was along the same lines as those used by Lord Diplock in the Burmah Oil case, when justifying the gloss on the Westminster principle:

> "..Of course in every case in which this principle is invoked, it is for the court to decide whether the party concerned has succeeded in achieving that result." (126)

Stated this way Hefer JA found that the two principles are mutually coexistent, being simply two sides of the formula which the court must apply in examining tax avoidance cases.

The court found that whilst the argument of the Appellants was:

> ".. undoubtedly sound as a matter of pure logic,... if the enquiry is confined to the four corners of the agreements..." (127),

this was still not sufficient for the Appellant to succeed in discharging the onus on it to prove that a right to have the improvements effected had not accrued to them. Hefer JA found that there was a :

likely

> "..wider unexpressed agreement, or tacit understanding, the terms of which have not been divulged." (128)

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126. At 951 B
127. At 950 G
128. At 953 C - D

and on that basis Appellant had not discharged its onus.

The startling aspect of this case is that the court fully acknowledged the fact that **genuine** transactions had been concluded between the parties, but chose to ignore them in favour of some tacit unexpressed arrangement between the parties! :

> "That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted..." (129)

It must be clearly remembered that prior to this case the fundamental difference between English and South African law, as regards substance and form in tax avoidance cases, was that the English courts **acknowledge** the fact that they disregard genuine transactions between parties, when certain conditions are met. The South African courts on the other hand have always stated that they will give effect to **genuine** transactions between parties, as ascertained by the courts.

On what legal basis therefore could the court in the Ladysmith disregard what it acknowledged to be genuine transactions?

I submit that the answer lies in the aspect of motive. The court examines the circumstances surrounding the signing of each document and concludes:

> "Regarded separately and without reference to the others, there is nothing unusual about the terms of the main leases or of any of the other documents, except for one remarkable feature. Since the same signatories signed the main leases, the sub leases and the building

129. At 954 C - D

> contracts simultaneously on behalf of the [parties], we must infer that they signed each agreement with full knowledge of the terms of the others which were awaiting their signatures or had already been signed." (130)

Given this assumption, Hefer JA concludes:

> "....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." (131)

It is submitted that in terms of established case law the motive for entering into each contract should have been regarded as irrelevant, and the assumption of the awareness of the parties of the terms of the other agreements, whilst logical on the facts, is mere conjecture by the court. In order to give the judgment which it did, the court was obliged to disregard genuine transactions, and the only possible justification for doing so was that of improper motive (i.e. tax avoidance), as extrapolated from the transactions as a whole.

The result of this judgment is that the Westminster principle has been effectively overruled and motive, in composite transactions has become a determinant as to what is, and what is not, a "genuine transaction".

It is important to note that nowhere in the Ladysmith judgment is the Furniss doctrine approved or adopted. However the similarity between the two cases is astounding and credit must be given to the Receiver for not trying to force

130. At 953 F - G
131. At 954 C

the court to adopt the Furniss line. If he had done so, he might well have had his argument rejected on the basis that South African courts are not entitled to reject genuine transactions. By demanding that the court simply comply with its obligation to have regard to the "true transaction' the Receiver placed the court in familiar surroundings and did not force it to choose between the Dadoo principle and the Furniss principle.

Whether this case can be cited as authority for the adoption by the South African court of the Ramsay/Furniss doctrine, is doubted. However what is certain is that the reasoning behind the English courts' decisions in those cases WAS adopted by the court in this case, and the element of motive must now be carefully considered by tax planners in the drafting of inter-linked agreements, which have an overall tax avoidance motive.

In effect what the court did in the Ladysmith case was to acknowledge the importance of motive in tax avoidance cases involving composite transactions, not via an expanded interpretation of statute, but rather through a conglomeration of the aspect of motive with intention. Whether this approach is a tacit acknowledgment by the courts of the ineffectuality of section 103 in the past, or some deeper understanding of what the modern *mores* of society demand in these cases, the result is that tax planners can no longer arrange their clients affairs with their eyes exclusively on the avoiding provisions of Section 103 of the Act.

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