THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case no**: 27/10**

In the matter between:

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Appellant**

and

NWK LIMITED **Respondent**

Neutral citation: ***CSARS v NWK*** **(27/10) [2010] ZASCA 168 (1 December 2010)**

Coram: HARMS DP, LEWIS, CACHALIA and SHONGWE JJA and BERTELSMANN AJA

Heard: 11 NOVEMBER 2010

Delivered 1 December 2010

ORDER

On appeal from the Tax Court sitting at Johannesburg (per Boruchowitz J and assessors sitting as a court of appeal):

1 The appeal against the order of the Tax Court is upheld with costs including those of two counsel.

2 The order of the Tax Court is replaced with:

'(a) The objection to the assessments is dismissed and the additional assessments are upheld.

(b) The objection to the imposition of additional tax of 200 per cent is upheld.

(c) Additional tax of 100 per cent of the total amount of the additional assessments is imposed in terms of s 76 of the Income Tax Act 58 of 1962.'

JUDGMENT

LEWIS JA (HARMS DP, CACHALIA AND SHONGWE JJA and BERTELSMANN AJA concurring)

[1] Over a period of five years, from 1999 to 2003, the respondent, NWK Ltd, claimed deductions from income tax in respect of interest paid on a loan to it by Slab Trading Company (Pty) Ltd (Slab), a subsidiary of First National Bank (FNB), in the sum of R96 415 776. NWK is a public company which formerly operated as a co-operative society trading in maize. The deductions were allowed. But in 2003 the appellant, the Commissioner for the South African Revenue Service, issued new assessments disallowing the deductions and refusing to remit any part of the interest on the amounts assessed. He also imposed additional tax and interest in terms of ss 76 and 89quat of the Income Tax Act 58 of 1962. The amount claimed pursuant to the additional assessments, including additional tax, was R47 360 583.

[2] The basis of the revised assessments by the Commissioner was that the loan was not a genuine contract: it was part of a series of transactions entered into between NWK and FNB and its subsidiaries, all designed to disguise the true nature of the transaction between NWK and FNB, with the intention of NWK avoiding or reducing its liability for tax.

[3] NWK appealed against the assessments and the imposition of additional interest and penalties. Boruchowitz J and two assessors in the Tax Court held at Johannesburg upheld the appeal. It is against the order of the Tax Court that the Commissioner appeals. The basis of the Commissioner's argument on appeal is that the loan was simulated: that it had to be viewed in the light of several other agreements concluded between NWK and FNB, and FNB and its subsidiaries, which together showed that a sum of only R50m was lent by FNB to NWK, and that the transactions were devised to increase the ostensible amount lent so that deductions of interest on a greater amount could be claimed. NWK argued, on the other hand, that there was an honest intention on the part of NWK, represented by Mr E Barnard, its financial director, to execute the contracts in accordance with their tenor, and the claims for deductions were valid. The Tax Court accepted this contention and upheld the appeal to the Tax Court on this basis.

[4] The Commissioner contended, in the alternative, both before the Tax Court and this court, that s 103(1) of the Act, in operation at the relevant time, was applicable: the Commissioner was satisfied that the transactions in question had been entered into for the purpose of avoiding tax. The Tax Court held that once the Commissioner had concluded that the transactions were simulated he could not be 'satisfied' that they been entered into for the purpose of avoiding or reducing liability for tax. Section 103(1) thus had no application.

Background to the transactions and their conclusion

[5] Before discussing the transactions that the Commissioner sought to impugn it is helpful to look at the events leading to their conclusion. As I have said, the main business of NWK was trading in maize. In 1998, according to Barnard, it had an annual turnover of R1.5b. Its net operating profit was R103m. It had over the years borrowed money from the Land Bank and had banking facilities with a number of commercial banks, including FNB, but had not used the latter. In January of that year, two representatives of FNB, Mr Louw and Mr McGrath visited Barnard and offered a structured finance loan facility to NWK.

[6] Neither Louw nor McGrath testified. Indeed no witness from FNB was called by NWK. I shall revert to this briefly, since there was criticism of the Commissioner

for not calling any witnesses from FNB. It is of course NWK which bore the onus of proving that the transactions were not simulated, an issue to which I shall also return. The history and context of the impugned transactions emerge from Barnard's evidence, the written agreements and from other documents.

[7] Barnard questioned aspects of the proposal, in particular the tax implications. FNB sent him an opinion written by senior counsel who had commented on similar transactions. There is nothing to indicate, however, what instructions were given to counsel, and whether the transactions on which he commented were identical or even similar to those proposed to NWK by FNB. And while counsel indicated that his view was that the transactions described were tax-efficient, he did caution, in spite of having been advised that the transactions were normal, that there was always the possibility that the Commissioner might apply s 103(1) to them. The transactions, he suggested, might not be regarded as having bona fide business purposes.

[8] On 13 February 1998 Louw and Mr J van Emmenes, also from FNB, wrote an internal memorandum to the General Manager, Group Credit within FNB on the proposal to offer a 'structured finance facility' of R50m to NWK, 'repayable in 5 equal annual capital and interest payments over 5 years'. The facility would be used, they said, to reduce existing liabilities. They recommended the grant of the facility. Barnard did not see this internal memorandum at the time, but he did confirm when testifying that it correctly reflected what had been discussed.

[9] The proposal was made formally in a letter FNB sent to NWK on 28 February 1998, offering to update its existing banking facilities by the addition of a term finance facility of R50m, subject to what it called a term finance agreement. The formal proposal attached was said to be confidential and 'proprietary' to FNB and required NWK to sign a confidentiality undertaking to preserve FNB's trade secrets and highly confidential and sensitive information.

[10] A diagram reflected the suite of transactions that would constitute the finance facility. It used indicative amounts rather than the actual sums that would ultimately be paid and repaid. The diagram also appeared to indicate the sequence in which all contracts and performance would occur, though it did not specify that this was so and

in fact the transactions were not all concluded entirely as envisaged nor did they follow the apparent sequence.

[11] The contracts envisaged were these. (I shall not use the sums referred to in the proposals but rather the actual amounts reflected in the transactions concluded later).

(a) A subsidiary of FNB that dealt in financial instruments, Slab, would lend a sum of R96 415 776 to NWK, to be repaid over five years.
(b) The capital amount would be repaid by NWK delivering to Slab at the end of the five year period 109 315 tons of maize.
(c) Interest would be payable on the capital sum at a fixed rate of 15.41 per cent per annum payable every six months. To this end NWK would issue ten promissory notes with a total value of R74 686 861.
(d) To fund the loan Slab would discount the notes (sell them for an amount less than their face value) to FNB. NWK, on due date, would pay FNB.
(e) Slab would sell its rights to take delivery of the maize at the end of the five year period to First Derivatives, a division of FNB. This 'forward sale', for the sum of R45 815 776, would enable FNB to pay the full amount of the loan to NWK.
(f) NWK would sell to First Derivatives the right to take delivery of the same quantity of maize for the sum of R46 415 776, payable immediately on the conclusion of the contract, but delivery to take place only five years hence. This contract would neutralize the risks associated with delivery in the future.
(g) Slab would cede its rights to a trust company to relieve Slab of the 'administrative burden' of the transaction. (This transaction did not eventuate.)

[12] The proposal indicated that the series of transactions would enable NWK to deduct the interest paid on the capital sum in the year it was payable under s 11(a) of the Act. Barnard submitted the proposal to NWK's board of directors for approval which was granted on 30 March 1998. Contracts envisaged in the proposal were signed by Barnard on behalf of NWK on 1 April 1998 and by Slab and FNB on 2 April. I shall, for convenience, refer to the date of the contract as 1 April 1998.

<u>The contracts between NWK and FNB and its subsidiary or division</u>

The loan

[13] The contract provided that Slab would lend R96 415 776 to NWK. 'Repayment', to take place on 28 February 2003, would be effected by the delivery to Slab of 109 315 tons of 'dried white maize intended for human consumption'. (Although the transaction was, in my view, a sale and not a loan, I shall refer to it for convenience as a loan.) The delivery was to be effected by representatives of the parties meeting in the presence of a notary when appropriate certificates would be signed – a recognized means of constructive delivery in the industry.

[14] The parties agreed that Slab would be entitled to cede its right to delivery of the maize or to delegate any of its obligations under the contract, to a company within the FNB group, without the consent of NWK. NWK, on the other hand, was not permitted to cede any right or delegate any obligation, but it undertook to effect delivery to any cessionary.

[15] The capital amount of the loan was subject to interest at a fixed rate of 15.27 per cent per annum, compounded monthly in arrear. The interest was payable every six months. In respect of each payment NWK was to (and did) issue promissory notes, the face value of the total being R74 686 861. This is the amount that NWK claimed as a deduction over the five year period in terms of s 11(a) of the Act.

The forward purchase agreement: First Derivatives to NWK

[16] The second contract concluded on 1 April 1998 was labelled a 'forward purchase agreement'. First Derivatives, a division of FNB, sold to NWK the same quantity of maize (109 315 tons) as was supposed to be delivered in discharge of the loan for R46 415 776. The price was payable in cash on 1 April 1998 and delivery was to be effected on 28 February 2003, the same day on which NWK was to discharge its obligation under the loan. And delivery was to be constructive. The purpose of this transaction was to ensure that NWK would have possession of the requisite quantity of maize when it was required to effect delivery to Slab. NWK in fact paid the sum of R46 415 776 to First Derivatives on 1 April 1998.

The forward purchase agreement: Slab to First Derivatives

[17] On the same day, Slab sold to First Derivatives the same quantity of maize for R45 815 776. Again, the price was payable on 1 April 1998, and delivery of the maize

would be effected, in the same manner, on 28 February 2003. NWK was not party to this contract, but was aware that it would be concluded: a similar transaction (that Slab would sell its claim against NWK to First Derivatives) was an integral part of the proposal by FNB.

The cession of the rights in the promissory notes to FNB

[18] On 1 April 1998 a fourth transaction was concluded. Slab sold its rights (ceding them) to the promissory notes to FNB for R50 697 518. It will be recalled that the face value of the notes was R74 686 861. The discount was thus substantial. Again, although NWK was not a party to the transaction, it was envisaged in the proposal and Barnard was aware that the cession at a substantially discounted rate would be effected.

The June 1998 cessions

[19] On 29 June 1998 NWK and Slab ceded their respective rights to the delivery of maize to FNB. Barnard for NWK signed both deeds of cession at FNB's request. The NWK right to delivery arose from the forward sale between it and Slab. The Slab right to delivery arose from the loan agreement. In the proposal it was envisaged that Slab would cede its right to the maize to a trust company. Instead FNB was substituted as the cessionary. The Tax Court regarded the cession by NWK to FNB as one in securitatem debiti.

[20] In effect each cession cancelled the other. NWK transferred its right to FNB to claim delivery of the maize. And FNB acquired from Slab the right to claim delivery of the same maize from NWK. (The 'cancellation' of the delivery would have been by the process of *confusio*: where a right and corresponding obligation inhere in the same person, the obligation ceases to exist.) Slab ceased to be a party to any of the agreements in June 1998. Its participation in the transaction as a whole was ephemeral.

<u>The implementation of the contracts</u>

[21] The promissory notes issued by NWK in respect of its interest obligations were presented and paid on their due dates. And on 28 February 2003 FNB and NWK representatives met in the presence of a notary in Lichtenberg. FNB delivered

negotiable silo certificates to NWK in performance of its obligation to deliver the maize under the NWK forward purchase agreement. The same silo certificates were handed over to FNB in performance of NWK's obligation to deliver maize to FNB (as cessionary of Slab's right) five minutes later, according to the notary's certificate. The reader might well say 'What a charade'. But I shall revert to that.

A bank facility afforded by FNB to NWK on 23 February 1998

[22] Before turning to the issues before the Tax Court it should be noted that there was another agreement between FNB and NWK, concluded before the series of transactions concluded in April and June of 1998. On 23 February 1998 Louw and Van Emmenes of FNB wrote to NWK, following discussions with Barnard, and offered two bank facilities: a direct bank facility of R150m and 'termynfinansiering' in the sum of R50m. The latter was for a period of five years, and was subject to various terms, including that NWK would not borrow from any other financial institution (excluding the Land Bank) over the five-year period without the written consent of FNB.

[23] The offer by FNB was accepted by NWK on 1 April 1998, the same day as it signed the other loan agreement for R96 415 776. In an internal memorandum written to the General Manager, Group Credit, by Louw and Van Emmenes, it was pointed out that NWK was interested in a 'medium term structured finance proposal' and that FNB had been requested to consider a 'loan facility of R50m repayable in 5 equal annual capital and interest payments over 5 years'. This memorandum culminated in the letter of 23 February offering the short term facility of R50m.

Claims by NWK for deductions from Income Tax

[24] In each of the years of assessment for income tax from 1999 to 2003 NWK claimed and was granted a deduction from income in terms of s 11(a)[1] of the Act in respect of the interest paid to FNB. The amount claimed was equal to the face value of the promissory notes paid in the year, which NWK had issued to Slab and which Slab sold to FNB.

[1] The section allows the deduction from income of expenditure and losses actually incurred in the production of the income, provided they are not of a capital nature.

[25] In June 2003 (and in March 2004 in respect of the 2003 year of assessment) the Commissioner issued additional assessments in terms of s 79 of the Act, disallowing the deductions previously made. He also, in terms of s 76, imposed additional tax of 200 per cent (the maximum permissible) and interest (s 89quat – interest on underpayment). NWK objected to the additional assessments. The Commissioner disallowed the objections, and NWK duly appealed against the respective assessments and the imposition of the additional tax and interest.

Grounds of assessment

[26] The basis of the additional assessments was the Commissioner's view that the agreements concluded between NWK and FNB and its subsidiary Slab did not reflect the substance of the real transaction. Slab, it contended, was interposed as a party solely for the purpose of reducing or evading liability for income tax. The loan by Slab to NWK, although ostensibly of R96 415 776, was in reality one for R50m. And the effect of the forward sales and the cessions was that the same maize that NWK would use to discharge its obligation to repay Slab (the right to performance having been ceded to FNB), was sold by FNB to NWK.

[27] The loan, the Commissioner contended, was a 'mere paper exercise and/or simulation'. The reasons for this were that none of Slab, NWK or FNB intended to trade in maize before or after the transactions were entered into. The value of the maize at the time of delivery (in February 2003) was uncertain. The purchase price for the maize was based on a fictitious value and was determined without reference to the value of the maize on the date of conclusion of the contracts. On 1 April 1998 the price of maize quoted on the South African Futures Exchange (SAFEX) was R715 per ton, whereas the price agreed was R419 per ton. The total amount payable for the maize under the forward sale agreement (R45 815 776) was determined by discounting the loan amount of R96 415 776 at the rate of 15.27 per cent per annum – the same rate as that for interest payable on the loan. To this was added the sum of R97 518 which was payable to Slab as a fee for its participation in the series of transactions.

[28] Further indiciae of simulation, the Commissioner considered, were that the risks associated with delivery of maize five years after the conclusion of the sales

were great: the market is volatile. Yet no account had been taken of volatility, of arrangements for storage after harvest, or the costs of storage or transport. Moreover, the Commissioner asserted, the description of the maize in all the agreements was inadequate. The grade of the maize was not stipulated although it would materially affect its market value.

[29] NWK had no intention of repaying its loan with Slab through the delivery of the maize; Slab had no intention of acquiring the maize or selling it, in turn, to FNB; and the cessions from Slab to FNB and of NWK to FNB effectively cancelled the respective obligations. (The Commissioner contended that the respective obligations were extinguished by set-off.) The obligations of NWK and FNB respectively to deliver the identical maize in February 2003 by the issue of silo certificates by a notary were dependent on each other: if one did not perform the other could not.

[30] The Commissioner thus considered that the transactions 'were specifically designed to conceal the fact that in reality, the actual loan amount advanced' to NWK was R50m. The additional amount was simulated with a series of contracts purporting to sell maize which the parties never intended to have any effect. Slab had no real role to play and its participation was 'artificially engineered and specifically designed to conceal the fact that the true loan amount was the sum of [R50m]. Slab's sole purpose was therefore to facilitate the enhanced deduction claimed by [NWK] in terms of s 11(a) of the Act'. FNB made an immediate profit of R600 000 when it bought the promissory notes for R50 697 518 from Slab. Furthermore, FNB, in receiving the sum of R74 686 861 (the face value of the promissory notes), in effect was paid interest on the real loan of R50m.

[31] Thus having regard to the 'substance and reality of the transaction' the face value of the promissory notes was determined by combining the capital value of the loan (R50m) with interest over the period of the loan of R23 989 343. The total of these two amounts, plus the fee of R697 518, was equal to the face value of the promissory notes.

[32] The Commissioner considered that the actual transaction that was contemplated by FNB and NWK was a loan for R50m: the promissory notes covered

both the capital and interest. Thus the portion of the notes that constituted repayment of capital was not deductible as interest in terms of s 11(a) of the Act and was also not expended in the course of trade.

[33] In the alternative the Commissioner contended that the series of transactions constituted a 'transaction, operation or scheme' in terms of s 103(1) of the Act that had the effect of avoiding or reducing NWK's liability for tax in the 1999 to 2003 years of assessment and that the transactions were abnormal and were entered into solely or mainly for the purpose of obtaining a tax benefit.

[34] The Commissioner imposed additional tax and interest, as I have said. The grounds for this were that NWK represented in its tax returns in question that the payment of the promissory notes was in respect of interest when in fact it was also in respect of capital. In so doing, NWK also represented that the transactions were normal commercial transactions, in terms of which there would be deliveries of maize, when in reality no delivery was ever intended. The deliberate attempt to disguise the true nature of the transactions warranted the imposition of the additional tax, he contended.

The grounds of appeal

[35] NWK alleged in its grounds of appeal that the contracts concluded between Slab, NWK and FNB were performed in accordance with their terms: NWK received the amount of R96 415 776 in terms of the loan agreement, and delivered the promissory notes to Slab. NWK paid the price of the maize – R46 415 776 – to First Derivatives in terms of the forward sale agreement. NWK was not party to the agreements between Slab and FNB. The terms of the loan reflected the intention of NWK and were implemented and performed in accordance with their tenor. And there was no tacit understanding or unexpressed agreement on the part of NWK that was not recorded in the contracts to which it was party.

[36] NWK contended thus that the loan for the full capital amount was correctly reflected and no portion of the payment made by it was of a capital nature. In so far as s 103(1) of the Act was concerned, NWK denied that the contracts had the effect of avoiding or postponing liability for tax: they were concluded solely or mainly for the

purpose of securing loan finance. NWK also contended that its tax returns over the years of assessment contained full and accurate information and that it was not liable for the additional tax nor for the additional interest.

The decision of the Tax Court

[37] The Tax Court found that NWK had acted in terms of the agreements. It accepted that Barnard, representing NWK, had genuinely intended to act in accordance with the terms of the loan agreement and although aware of the agreements between Slab and FNB, was not a party to them. The Tax Court held that Barnard was a credible and satisfactory witness. I shall deal with his evaluation after considering some of the evidence. It is important to note that the Commissioner's case in the Tax Court was that the simulation of the transactions was deliberate. There was no contention that the parties had genuinely believed that the transactions were bona fide and would be performed in accordance with their terms. It was argued in that court that NWK and FNB were acting deliberately to conceal the true nature of the transaction.

Onus of proof

[38] In this court the Commissioner maintained his stance that NWK, represented by Barnard, had concluded the loan agreement and the forward sales and cessions to which it was party, knowing that they were simulated transactions, and in order to gain a tax advantage rather than really to borrow the sum of R96 415 776. In terms of s 82(b) of the Act NWK bore the onus of proving that the transactions were not simulated.[2] NWK argued that the agreements themselves provided prima facie proof of the true transaction between the parties. Accordingly, the burden rested on the Commissioner to rebut the prima facie inference.

[39] The Commissioner, on the other hand, contended that the agreements had to be viewed in context and having regard to all other evidence, and that NWK had not discharged the onus of proving that the loan was not simulated. The mere production of the agreements was not enough to discharge the onus. NWK had to refute the

[2] The section provides that the burden of proof that any amount is subject to any deduction is upon the person claiming the deduction: in any appeal against a decision of the Commissioner 'the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong'.

assessment that it had a dishonest intention to disguise a transaction. And the substance of the loan agreement, viewed in the light of other transactions and negotiations preceding it, was such that NWK had to prove that it genuinely intended to borrow R96 415 776 from Slab, and to repay it by delivering maize five years after the money had been lent.

[40] This court has previously held that the mere production of agreements does not prove that the parties genuinely intended them to have the effect they appear to have. In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*[3] Hefer JA, dealing with a contention that agreements should be given effect in accordance with their tenor (form), said:
'This is plainly not so. That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they had been advised to do. The real question is, however, whether they actually intended that each agreement would *inter partes* have effect according to its tenor. If not, effect must be given to what the transaction really is.'
After referring to s 82 of the Act Hefer JA continued:
'Therefore, unless the appellants have shown on a preponderance of probability that the agreements do indeed reflect the actual intention of the parties thereto, the Commissioner's decision cannot be disturbed.'

[41] This was the view also of Harms JA in *Relier (Pty) Ltd v CIR* [4] where he said that if the agreements in issue were taken at face value the taxpayer would have to succeed: but the agreement in question had 'unusual and unreal aspects to it' which raised questions as to the real intention of the taxpayer. How then does a court ascertain the real intention of a party to a contract when the contract appears to be simulated? This is the question to which I now turn before examining any of the evidence.

Real intention and simulation: Substance and form

[42] It is trite that a taxpayer may organize his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements

[3] 1996 (3) SA 942 (A) at 953A-F.
[4] 60 SATC 1 (SCA) at 7.

that are tax effective.[5] But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law. However, as Hefer JA said in *Ladysmith,*[6] one must distinguish between the principle that one may arrange one's affairs so as to 'remain outside the provisions of a particular statute', and the principle that a court 'will not be deceived by the form of a transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance' (per Wessels ACJ in *Kilburn v Estate Kilburn,*[7] cited by Hefer JA in *Ladysmith*[8]). As the court said in *Ladysmith*[9] the principles are not in conflict.

[43] I shall not traverse the long line of authority in which these two principles have been invoked. They are dealt with comprehensively in *Ladysmith.* And they are expressed in classic statements in *Zandberg v Van Zyl*[10] and *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd.*[11] In *Zandberg* Innes JA said:
'Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is: not what in form it purports to be. The maxim then applies *plus valet quod agitur quam quod simulate concipitur.* But the words of the rule indicate its limitations. The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. *For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the*

[5] *IRC v Duke of Westminster* [1936] AC 1 at 19, cited by the court in *Ladysmith*, above. The principle is affirmed by Hefer JA in *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA) para 1.
[6] Above at 950H-951D.
[7] 1931 AD 501 at 507.
[8] At 951C-D.
[9] At 951D-953A.
[10] 1910 AD 302 at 309.
[11] 1941 AD 369.

circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down' (my emphasis).

[44] In *Randles* Watermeyer JA, after quoting this statement said:[12]
'I wish to draw particular attention to the words "a real intention, definitely ascertainable, which differs from the simulated intention", because they indicate clearly what the learned Judge meant by a "disguised" transaction. A transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties honestly intend it to have effect according to its tenor, is interpreted by the Courts according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax.'

[45] While there may be no conflict between the two principles referred to in *Ladysmith* there is a divergence in their application: the cases do not consistently approach what is really meant by a party's intention in concluding a contract –what purpose he or she seeks to achieve – and this warrants some further consideration. Indeed, the best illustration of this divergence is to be found in *Randles*,[13] where the different approaches are to be found in the minority and majority judgments. The facts in that matter bear repeating.

[46] Before 1936 Randles had imported fabric under rebate of customs duty. Various manufacturers made up the fabric into shirts and pyjamas, and returned the items so made up to Randles for sale to retailers. In 1936 the customs regulations changed. In order for Randles to get the rebate the manufacturers had to declare that the material was their property. Randles thus changed its former practice and contracts with the manufacturers. They purported to transfer ownership of the material to the manufacturers, so that the declarations could be made. But the 'right' that the manufacturers acquired was severely restricted. They had to make up the garments in accordance with Randles' instructions and to resell the finished items to Randles at a

[12] Above at 395.
[13] 1941 AD 369.

price equal to that which Randles charged them, plus the cost of making up the garments. Randles bore the risk of loss or damage to the material at all times.

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

[48] De Wet CJ preferred to look at the substance of what was done: the parties could not possibly have intended sales, pursuant to which ownership of the materials would pass, he considered, since the manufacturers acquired a 'right' devoid of content. Tindall JA too considered that the court should have regard to what was done rather than what was said.[14] In cases that have followed, discussed below, the minority approach has in fact been followed.

[49] In *Vasco Dry Cleaners v Twycross*[15] Hoexter JA examined all the peculiar features of a contract, ostensibly for the transfer of ownership, to determine the real intention of the parties. And in *Skjelbreds Rederi A/S v Hartless (Pty) Ltd*[16] the court refused to recognize a cession of rights, enabling litigation, where it was clear that the successful litigant would have to retransfer the rights to the cedent after the litigation. Dishonesty was not in issue in any of these cases. But in each a transaction had been concluded to achieve a purpose other than that for which it was ostensibly concluded.

[50] In other cases, such as *Hippo Quarries (Tvl) (Pty) Ltd v Eardley*,[17] courts have looked at the form of a transaction and concluded that the parties genuinely intended to give effect to that which they had apparently agreed. And in *CIR v Conhage* [18] Hefer JA found that sale and leaseback agreements, which had unusual terms but

[14] Above at 409.
[15] 1979 (1) SA 603 (A).
[16] 1982 (2) SA 710 (A).
[17] 1992 (1) SA 867 (A).
[18] 1999 (4) SA 1149 (SCA).

which made good business sense, were honestly intended to have the effect contended for by the parties.[19]

[51] In *Hippo Quarries* the court drew a distinction between motive and purpose, on the one hand, and intention on the other, in trying to determine the genuineness of a contract, and of the underlying intention to transfer a right, where the transfer was not an end in itself. Nienaber JA said:[20]

'Motive and purpose differ from intention. If the purpose of the parties is unlawful, immoral or against public policy, the transaction will be ineffectual even if the intention to cede is genuine. That is a principle of law. *Conversely, if their intention to cede is not genuine because the real purpose of the parties is something other than cession, their ostensible transaction will likewise be ineffectual. That is because the law disregards simulation.* But where, as here, the purpose is legitimate and the intention is genuine, such intention, all other things being equal, will be implemented' (my emphasis).

[52] NWK likened the transactions in this matter to those featuring in *S v Friedman Motors (Pty) Ltd*[21] where the contracts in question were designed to avoid legislation regulating money-lending transactions. In order to obtain funds to acquire a motor car, an individual would sell his car to a bank. The bank would immediately resell the car to the individual for a higher price, but would reserve ownership in the car until the full purchase price was paid – a hire-purchase contract. The individual would pay a cash deposit and monthly instalments and on payment of the full purchase price ownership of the car would revert to him. The same object would usually be achieved through a loan of the price by the bank to the individual, repayable with interest.

[53] Colman J considered that the transactions might be loans, disguised as sales, or genuine sales, depending on the parties' intention. He said:[22]

'If two people, instead of making a contract for a loan of money by one of them to the other, genuinely agree to achieve a similar result through the sale and repurchase of a

[19] See in this regard Professor Nereus Joubert 'Asset-Based Financing, Contracts of Purchase and Sale, and Simulated Transactions' (1992) 109 *SALJ* 707, referred to in *Conhage* para 9.
[20] At 877C-E.
[21] 1972 (1) SA 76 (T), upheld on appeal, 1972 (3) SA 421 (A).
[22] At 80F-H.

chattel, there is no room for an application of the maxim *plus valet quod agitur quam quod simulate concipitur*. The transaction is intended to be one of sale and repurchase, and that, at common law, is what it is.'

[54] But in both *Friedman* and *Conhage*, where the courts held that the parties intended their contracts to be performed in accordance with their tenor, there were sound reasons for structuring the transactions as they did: the purchaser of the car in *Friedman* was required to give security in return for the funds advanced by the bank. A pledge would have deprived him of the car and its use. Hence the sale and resale: it allowed the purchaser to keep and use the car. In *Conhage* the sale and leaseback of manufacturing equipment permitted the manufacturer to retain possession of the equipment. There was a commercial reason or purpose for the transactions to be structured as they were. In both instances there was a genuine transfer of ownership. Had the purchaser failed to pay the seller he would have lost the right to become owner in due course.

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

A genuine intention to borrow R96 415 776? The peculiar features of the transactions

[56] In this matter the Commissioner contended that NWK had deliberately disguised its contract to borrow R50m from FNB as a transaction in terms of which it would borrow R96 415 776, repayable by the delivery of maize which in fact was never intended. The Tax Court found, however, that Barnard of NWK had intended the transaction to have effect in accordance with its tenor. As I have said, that test is

not enough to allay the possibility of simulation: one must have regard to the purpose of the transaction – what it is really intended to achieve.

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

[58] Was there any purpose or commercial sense – other than creating a tax advantage to NWK – for the loan by Slab to NWK to be structured in the way it was? Was there any genuine intention to deliver maize to Slab or a cessionary? The Tax Court did not address these questions, accepting the contracts in issue at face value and not questioning their purpose. There were several inexplicable aspects to the whole series of transactions that require scrutiny.

The other loan from FNB to NWK concluded on the same day

[59] It will be recalled that on 1 April 1998, the same day as the impugned loan was agreed, Barnard, for NWK, accepted the offer made by FNB on 23 February of a short-term loan of R50m. Why were two loans agreed on the same day? And, more pertinently, why was there an agreement to borrow R96 415 776 at all when it was not needed by NWK? The clear inference to be drawn was that the loan for R96 415 776 was a transaction concluded for a different purpose entirely, and that the genuine agreement was to borrow R50m.

Repayment of a loan of money through the delivery of maize?

[60] I have already indicated that a contract for the payment of money in return for the delivery of a commodity such as maize is a sale and not a loan. That in itself is not necessarily significant. The label attached to a contract does not determine its validity. In my view, however, the fact that the parties called it a loan shows that what was really intended was that NWK would borrow money from FNB or its subsidiary and repay it in the usual way – repayment of the capital and interest. The repayment

through delivery of something other than money raises the question as to what was really intended.

The payments out of and into FNB's account on the same day: 'round tripping'

[61] In terms of the forward sale agreement between First Derivatives, a division of FNB, and NWK, the price payable to First Derivatives by NWK was R45 815 776. It was paid on 1 April 1998. On the same day, Slab 'forward sold' to First Derivatives the same quantity of maize for R46 415 776. It too was paid on 1 April 1998. In effect, the money went out of FNB's account (pursuant to the loan) and straight back into FNB's account (pursuant to the first forward sale), with only the FNB fee making any difference.

The amount of the loan and the quantity of maize

[62] The Commissioner argued that various factors showed that the sum of the loan and the quantity of maize required to discharge the loan were artificially calculated. Given that it is NWK's intention that must be ascertained, Barnard's evidence itself is crucial in determining whether there was a genuine loan from Slab to NWK.

[63] I referred earlier to the negotiations preceding the conclusion of the loan agreement. FNB had suggested a means of providing finance to NWK and NWK had needed R50m. The proposal itself did not relate to the sum actually needed by NWK. It suggested 'indicative' figures.

[64] Barnard conceded that NWK required only R50m and did not question the calculation of the amount purportedly lent. In fact, the amount of the loan should have been insignificant since repayment was to take place by delivery of a specified quantity of maize. And whatever amount NWK borrowed, it would in fact receive a net amount of R50m.

[65] The amount of the loan was obviously calculated with reference to a factor that did not bear any relation to the amount needed by NWK. Calculations done by an expert witness for the Commissioner, Professor H Wainer, showed how the loan sum was calculated in order to yield interest of R74 686 514, the face value of the promissory notes. The loan sum was thus established by taking the interest payable

and calculating what capital sum was needed to generate that interest at the rate agreed. NWK argued that Wainer's evidence was irrelevant and inadmissible, but did not dispute the calculations. The Tax Court held Wainer's evidence, and that of a Professor Brink, an expert in agricultural trading, to be inadmissible. It was irrelevant, said that court, because the opinions were based on the transactions from an accounting and financial point of view: they did not deal with the intention of the parties. Thus Wainer's view that there was no economic substance to the transactions was disregarded by the Tax Court.

[66] The calculation of the quantity of maize to be delivered was done by an agricultural economist, employed by FNB, Mr E Janowsky. Barnard did not question the calculation or take steps to verify it. He accepted Janowsky's estimate as soon as it was proffered without taking into account the volatility of the maize market, or any forecast of the maize price five years hence.

[67] Janowsky, who testified for NWK, also conceded that an estimate of the maize price five years after the loan was advanced was impossible. He said that the price per ton in 2003 – the year when delivery was to have taken place – fluctuated by over R1 000 per ton. No attempt was even made to forecast an average price per ton.

[68] Moreover, no account was taken of the cost of storage of what was admittedly a very large quantity of maize. So too, no provision was made for actual transportation and delivery costs. And the contract itself made no provision for any adjustment to the quantity of maize to be delivered by NWK. Barnard's responses to questions about storage and transport costs were that with hindsight he might have thought of these matters.

The description of the maize

[69] The maize was described in the loan and other agreements as 'dried white maize fit for human consumption'. The Commissioner argued that the description was vague since there are three classes of white maize that could have been meant, each with a different value. NWK would thus have had a choice whether to deliver maize of a lesser value. Barnard was not perturbed by this feature. He said that he assumed that the maize would be 'WM1', the best quality produced, but acknowledged that

there were two other classes that could be covered by the description. His responses to the questions put about the quality of the maize to be delivered to Slab were evasive.

The absence of security

[70] NWK was not required to provide security to Slab for the repayment of the loan. As the Commissioner argued, if NWK had been liquidated prior to 28 February 2003, Slab (and FNB as cessionary) would have been in a precarious position. The absence of security, the Commissioner contended, is explicable only on the basis that NWK and FNB knew that Slab would almost immediately after the conclusion of the loan, cede its rights to delivery to FNB, and that both NWK and FNB would be relieved of their respective duties to deliver the maize. And indeed that is what happened.

[71] Barnard attempted to explain the lack of security on the basis that NWK did not usually give banks security for funds borrowed. But in fact NWK had previously given security to the Land Bank which required it. His evidence in this regard is thus not credible. In my view the lack of provision for security is explicable on the basis that there really was nothing to secure: the parties knew that the respective obligations to deliver maize had been extinguished by *confusio*. Had the obligations to deliver five years after the loan was made been genuine, security would no doubt have been provided.

The context in which the loan was concluded

[72] When Barnard concluded the loan agreement on behalf of NWK he knew that the forward sale agreement between Slab and FNB would be concluded, and that the promissory notes would be sold by Slab to FNB. He thus knew that Slab had no real role to play in the whole transaction. It would sell its rights to delivery of the maize, to be effected five years later, almost immediately after the loan had been concluded. The loan agreement made express provision for the cession by Slab of any of its rights.

<u>The other agreements concluded pursuant to the proposal</u>

[73] The transactions that were concluded by NWK on the same day as the loan agreement was entered into, and the subsequent cessions in June 1998, have already

been discussed. Slab sold the same quantity of maize that NWK was supposed to deliver to First Derivatives, an FNB subsidiary, on the day that the loan was concluded – 1 April 1998. Again, no provision was made for securing payment of the price of R45 815 776. The peculiar features of this contract were that the price, which was required to fund the loan to NWK, was determined with reference to the amount of the loan – R96 415 776. The quantity of maize and its price were determined in the same way as they had been calculated for the loan. The description of the maize was the same as that in the loan and was equally deficient.

[74] The Commissioner argued that it was no coincidence that after the sale of the promissory notes by Slab to FNB for R50 697 515, Slab was left with the right to claim R45 718 258: that meant that it made a profit of R97 518 which was effectively its fee. Although NWK was not a party to this contract it was envisaged in the initial proposal and Barnard was aware that it would be concluded. It was an integral part of the finance arrangement. And on the same day that that sale was concluded (1 April 1998), FNB sold the same maize to NWK for R46 415 776, the price being based on Janowsky's estimate. Again, delivery would be effected on 28 February 2003. The price was in fact paid on 1 April 1998, yet no security was given for the delivery five years later. The difference in the prices for the respective sales was R600 000 – 1.2 per cent of R50m, which was the amount that NWK had needed in the first instance. This represented FNB's fee.

[75] Slab ceded its rights to delivery of the maize to FNB in June 1998. As I have said, the loan made express provision for the cession and it was envisaged in the proposal made to NWK at the outset. Barnard understood the consequences of the cession: effectively NWK's obligation to deliver the maize was cancelled. The debts were reciprocally discharged by *confusio* – the concurrence of the right and the obligation in the same person – FNB.

[76] Although NWK argued that set-off would have taken place only when both debts were due (when NWK had to deliver the maize to FNB and FNB had to deliver to NWK on 28 February 2003) in fact Barnard must have appreciated that any delivery would be meaningless. Although silo certificates were exchanged they were in respect of the identical maize, and the exchange and notarial certificates had no

purpose. Barnard's protestations that the delivery obligations remained extant are not credible. The entire transaction in respect of the maize was effectively of no significance. At the outset, there was, as the Commissioner has contended, no intention to effect delivery at all. Contrast this result with that in *Friedman* and like cases: there, although the goods remained with the purchaser when the full amount owed had been paid, there was a genuine change of ownership, delivery being constructive.

[77] Similarly, the cession by NWK of its rights to delivery of maize to FNB as security for NWK's obligation to deliver maize pursuant to the cession from Slab to FNB made no commercial sense. The obligation was illusory given that FNB's and NWK's obligations in effect cancelled each other. There were no longer any rights that could be ceded.

[78] Barnard attempted to explain the arrangements in respect of the delivery of maize as a 'hedge': the additional R46m added in respect of the maize was to ensure that its obligation to deliver the maize as repayment of the loan could be fulfilled. But in fact there was no 'hedge' and the agreements, examined together as they must be, envisaged no actual delivery of maize as provided for. The Tax Court found nothing unusual in the creation of a hedge or safety net within the same banking group. First Derivatives, a division of FNB, was in fact a large trader in the agricultural market. What the Tax Court did not consider, however, was that there was no commercial reason for the so-called hedge given the extinction of the respective obligations to deliver maize.

Simulation and motive for deception

[79] The Tax Court found that although NWK required only R50m for business purposes, it had been offered a greater sum by FNB, structured in a particular fashion that would enable it to claim a tax advantage to which it would not otherwise have been entitled. NWK was not obliged, the court said, 'to choose the less tax-effective route'. That is of course correct, as the authorities cited earlier show. But the Tax Court went on to say that given the apparent tax benefit of the structure proposed by FNB it was difficult to see why NWK would have wished to simulate the transaction. There was, it held, 'no financial or other disadvantage to actually implementing the

alternative structure as opposed to pretending to do so'. NWK, the court said, had no motive for deception. Hence it had established on a balance of probabilities that its true intention was to contract with Slab and FNB on the terms reflected in the contracts.

[80] It is correct that FNB and NWK outwardly performed in terms of the various contracts, as indicated earlier. But before then, in January 2003 FNB wrote to NWK reminding it of its obligation to deliver 109 315 tons of maize on 28 February, and stating that on receipt it would deliver the same quantity to NWK. Yet on 13 February 2003 Rand Merchant Bank, a division of FNB, wrote to Barnard suggesting that set-off would occur, and that various clauses in the original loan agreement should be amended retrospectively in the event that actual delivery would be made. Barnard must have known then, if he did not know before, that the respective delivery obligations had been extinguished by *confusio*. The intention to perform in accordance with the terms of the contract is accordingly questionable, and the Tax Court should have considered this. It should have asked whether there was actually any purpose in the contract other than tax evasion. This is not to suggest that a taxpayer should not take advantage of a tax-effective structure. But as I have said, there must be some substance – commercial reason – in the arrangement, not just an intention to achieve a tax benefit or to avoid the application of a law. A court should not look only to the outward trappings of a contract: it must consider, when simulation is in issue, what the parties really sought to achieve.

Barnard's credibility

[81] The Tax Court found that Barnard was a credible and satisfactory witness. It accepted at face value his evidence that he thought he was contracting with Slab despite the fact that the proposal and the loan agreement had been drafted by FNB and that he had not ever encountered a representative of Slab who was not also an official of FNB. It also accepted his evidence that delivery of the maize was always intended and had taken place.

[82] The Commissioner argued that various features of his evidence showed that Barnard was not credible. I shall not traverse them all. In my view, the most significant are these: his concession that the actual amount lent was not of any

significance; his inability to explain the inadequate description of the maize in the loan and forward sale agreements; his conflicting responses about knowledge of the Slab cession, first saying he did not know it would take place and later admitting that it had been contemplated at the outset and was part of the structure of the FNB proposal; his refusal to accept that the Janowsky forecast did not take into account important factors affecting the price of the maize, such as market fluctuations, and storage and delivery costs; his insistence that security was not required for the performance of the obligations on the basis that banks did not generally require security from NWK, this despite having provided the Land Bank with security for a loan; and lastly, his acknowledgment that unless Slab had discounted the promissory notes it would not have had the funds to advance the loan.

[83] In my view the inconsistencies and obfuscations in Barnard's evidence are significant. And his inability to explain the way in which the prices and quantities were calculated was telling. His evidence was simply not credible and the Tax Court erred in finding him to be a credible and satisfactory witness.

The loan was a simulated contract

[84] The Commissioner led the evidence of two experts on the way in which the amount of the loan and the quantity of maize was computed, and on the factors that should have been taken into account in determining the price of the maize in the future. The Tax Court did not admit this evidence and thus did not take it into account. It is not necessary to determine whether that was incorrect. It is plain from a reading of Barnard's testimony, and a comparison of it with the documents tendered in evidence, that the amount of the loan was determined not by what was needed by NWK but by reference to other factors.

[85] Moreover, Slab was able to advance the sum of R96 415 776 only by discounting the promissory notes, the face value of which was the equivalent of the capital sum of R50m and interest at the rate agreed. And NWK initially intended to borrow only R50m. The balance was added on for a purpose that Barnard could not explain, other than as a hedge. But a hedge was needed only if the real amount borrowed was the artificially constructed sum of R96 415 776. The mere nature of the hedge shows the artificiality: why would NWK incur a liability to deliver maize

valued at R46m in order to purchase the same quantity of maize to discharge the same obligation? As pointed out by the Commissioner, to ascertain the true intention of NWK one had to ignore entirely all the rights and obligations in respect of the maize.

[86] As I have said, the appropriate question to be asked, in order to determine whether the loan and other transactions were simulated, is whether there was a real and sensible commercial purpose in the transaction other than the opportunity to claim deductions of interest from income tax on a capital amount greater than R50m. None is to be found. What NWK really wished to achieve was a tax advantage. What else could it, or did it, achieve through the transactions in respect of the maize? Barnard did not explain any, other than the creation of a hedge which had no effect. He could thus not honestly have believed that the contract was to be performed in accordance with its tenor.

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

[88] There was no evidence that Barnard was deceived by FNB. He knew how the contracts, even those to which NWK was not a party, were to be structured and that the deliveries in respect of maize were simulated. And since NWK bore the onus of showing that the Commissioner's assessments were wrong, the production of the contracts themselves was insufficient to discharge that burden. Yet, despite that, NWK did not call the officials of FNB who had proposed the transactions to give evidence. I do not consider, however, that any inference need be drawn from the failure to call the FNB officials. Barnard's evidence speaks for itself.

[89] In summary: Barnard could not explain (and indeed there was no explanation possible for) the following extraordinary features of the transactions. The sale of

maize by NWK to FNB was dressed up as a loan. NWK and FNB entered into two contracts of loan on the same day, the one where FNB lent NWK R50m and the other where it 'lent' NWK R96 415 776. Virtually the same amount in excess of that which was required by NWK (R46 415 776) was paid by FNB to NWK and then in effect paid back by NWK to FNB on 1 April 1998. The amount lent in the impugned loan was determined not by reference to what was needed but by reference to a capital sum needed to generate a particular sum of interest. The description of the maize in the various contracts was vague. No security was afforded to Slab for repayment of the loan. The loan was concluded with the knowledge on the part of Barnard that Slab would sell its right to delivery of the maize to FNB and that Slab would sell the promissory notes at a discount to FNB all on the same day: Slab's role in the transactions was momentary. These aspects all lead to the conclusion that the agreements in respect of maize were illusory: there was never any intention to deliver maize in the future. The loan was a simulated transaction, designed to create a tax benefit for NWK.

[90] In view of the conclusion that I have reached that the loan for R96 415 776 was a transaction designed to disguise the real agreement between the parties – a loan of R50m – the Commissioner's assessments were correct, and the appeal against the decision of the Tax Court in this respect must succeed. There is thus no need to examine whether s 103(1) of the Act could have been applied. However, since NWK argued that the Commissioner may not raise s 103(1) as an alternative ground it is convenient to deal briefly with this submission.

Section 103(1) as an alternative basis

[91] It must first be noted that this section has been repealed, and replaced by a new part to the Act.[23] I have set out the basis of the application of s 103(1) already. In summary, if satisfied that a transaction has been entered into which has the effect of avoiding or reducing liability for tax, and would not normally be employed for bona fide business purposes, the Commissioner shall determine liability for tax as if the transaction had not been entered into.

[23] Sections 80A to 80L: note, in particular, 80C which deals with transactions that have no commercial substance.

[92] NWK argued that if the Commissioner had been satisfied that the loan was simulated and did not have a tax avoidance or reduction effect, he could not, even in the alternative, be satisfied that the transaction was one that had a tax avoidance effect. Satisfaction, it was argued, is a subjective jurisdictional fact. The Commissioner cannot be satisfied on two apparently conflicting grounds. NWK relied in this regard on ITC 1625[24] where Wunsh J said that unless the Commissioner demonstrates that he is of the opinion that tax has been avoided, he cannot issue an assessment under s 103. Thus if tax has not been avoided because the transaction was not simulated, he cannot, even on an alternative basis, be satisfied that tax has been avoided.

[93] In *CIR v Conehage*[25] this court was also presented with alternative bases for the Commissioner's assessments, one being that the transactions were simulated and the alternative that the Commissioner was satisfied that they had been entered into for the purpose of avoiding liability for tax. The court found that the contracts were genuine, but also considered s 103, finding that the Commissioner had not shown that the transactions had had the effect of avoiding liability for tax. There is, implicit in this approach, a view that s 103 could be invoked as an alternative ground for assessment. There appears to me to be no reason why an invalid transaction cannot also be abnormal and concluded for the purpose of avoiding tax. Had the Commissioner not proved that the loan was a simulated contract, it would have been open to the Tax Court to consider the soundness of an assessment under s 103.

Additional tax and interest

[94] As indicated earlier, in the additional assessments for the period from 1999 to 2003 the Commissioner levied a penalty of 200 per cent and additional interest on the deductions claimed for interest in excess of that on R50m. The penalty, he argued, was warranted because NWK had deliberately made incorrect statements in the returns for the years of assessment, intending to evade taxation. There were no extenuating circumstances. This justified also the imposition of the additional interest in terms of s 89quat of the Act.

[24] 59 SATC 383 at 395.
[25] 1999 (4) SA 1149 (SCA), referred to above.

[95] Section 76(2)(a) permits the Commissioner to remit the additional tax, even where there is a dishonest attempt to evade tax, where there are extenuating circumstances. NWK argued that he failed to take into account the following extenuating factors. FNB had approached NWK with its proposal, and NWK had not solicited finance from FNB. The proposal was said to be confidential and proprietary to FNB. NWK played no role in crafting the terms of the various agreements. Barnard had relied on the expertise of the officials of FNB. FNB had furnished to Barnard the opinion of counsel which had suggested that a structure similar (or the same as – we do not know) to that proposed was legally sound, although he had cautioned against the application of s 103 by the Commissioner.

[96] The consequence of the imposition of 200 per cent of additional tax is that the amount payable pursuant to the new assessments would have been R47 360 583. Only R15 786 861 of that would have been the interest that should not have been claimed as a deduction over the five years of assessment. The penalty is severe and out of proportion to the wrong committed by NWK.

[97] I consider that these factors do militate against the imposition of the highest penalty possible, and would reduce the additional tax to 100 per cent of that for which NWK was liable. Counsel for the Commissioner accepted that this would be appropriate. To this extent the appeal should fail. And NWK has conceded that if the appeal succeeds on the first basis the interest in terms of s 89quat was properly levied.

[98] Accordingly:

1 The appeal against the order of the Tax Court is upheld with costs including those of two counsel.

2 The order of the Tax Court is replaced with:

‘(a) The objection to the assessments is dismissed and the additional assessments are upheld.

(b) The objection to the imposition of additional tax of 200 per cent is upheld.

(c) Additional tax of 100 per cent of the total amount of the additional assessments is imposed in terms of s 76 of the Income Tax Act 58 of 1962.’

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C H Lewis

Judge of Appeal

APPEARANCES:

APPELLANTS:	C Puckrin SC (with him D Fine SC, G D Goldman, and T Molokomme) Instructed by the State Attorney Johannesburg The State Attorney Bloemfontein
RESPONDENTS:	W Trengove SC (with him A Stewart SC and H V Vorster) Instructed by Vorster Pereira Attorneys Sandton Bezuidenhout Inc Bloemfontein