

SUPREME COURT OF APPEAL OF SOUTH AFRICA

PRESS RELEASE

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STATUS: Immediate

CSARS v NWK (27/10) [2010] ZASCA 168 (1 December 2010)

Please note that the media summary is intended for the benefit of the media and does not form part of the judgment of the Supreme Court of Appeal

The Commissioner for the South African Revenue Service had levied additional assessments against NWK, a maize trading company, formerly a co-operative, for the years 1999 to 2003. He had also imposed additional tax (at the rate of 200 per cent) as a penalty for making false statements in tax returns, and interest. The basis of the assessment was that NWK had concluded transactions with First National Bank and its subsidiary that were simulated. While intending to borrow R50m from FNB, NWK, in April 1998, had purported to borrow over R96m from a subsidiary of FNB, repayable by the delivery of a specified quantity of maize five years after the contract was concluded. It had paid interest on the sum of R96m, and claimed that as a deduction from income tax on the basis that it was expenditure in the production of income.

A number of other agreements were entered into which in effect cancelled out the obligation to deliver maize. The real sum lent was R50m, while deductions were claimed in respect of interest paid on R96m. The Tax Court, Johannesburg found that the parties had intended to perform the contracts on the terms agreed: there was no simulation. It took into account the performance, five years later, by the parties of their respective obligations under the various contracts, including the constructive delivery of maize (by exchange of silo certificates in front of a notary) by NWK to FNB and the immediate delivery of the same quantity of maize by FNB to NWK. It upheld NWK's appeal against the Commissioner's assessments.

The Tax Court also declined to invoke the former s103(1) of the Income Tax Act 58 of 1962 (which allows the Commissioner to impose tax where he is satisfied that a transaction has been entered into for the purpose of avoiding liability for tax) on the basis that it could not be used as an alternative ground to a finding that a transaction was simulated.

Today the Supreme Court of Appeal upheld the Commissioner's appeal against the decision of the Tax Court. It held that the loan was simulated, and that there had never been an intention to effect delivery of maize as repayment. The court did, however, reduce the penalty, imposing only 100 per cent of the amount assessed as additional tax.

The SCA held that the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. 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.
