

would be decided in favour of the Commissioner, irrespective of the form, nature or substance of the transaction in question. This approach is also contrary to the accepted rules of interpretation which are summarised in Chapter Eleven.

In the result, the Court found that the income of the trust would have accrued to and been received by the donee, and therefore the trust income would be deemed to be that of the donor, ie. the taxpayer.

In Secretary for Inland Revenue v Sidley 1977 (4) SA 913 (AD) the taxpayer created three trusts for the benefit of his children. In terms of each trust deed he gave to the trustees R10 000 to be held upon trust for the purposes expressed in the deed. The trustees did not use the income of the trusts for the purposes set out in the deed, but withheld a portion and capitalised it. Consequently, relying on section 7(5), the Secretary deemed the withheld income to be the income of the Respondent. Counsel for the Respondent relied on the fact that there was a difference in wording between the trust deed in Demper's case and that in Sidley's case.

In giving the judgment, Kotze JA referred to Corbett's JA judgment in Estate Dempers, with which he agreed. Kotze JA adopted Corbett's JA reasoning and applied it to Sidley.

In the course of his judgment, at 919H, Kotze JA differed from the view of the Court a quo, which had held that section 7 (5) contemplated a suspensive condition and not a resolute provision. He did so on the basis that this approach was erroneous and unduly technical in stressing the form of the trust deed, rather than its substance. Kotzé JA remarked that this approach was, in his view,

"... erroneous and unduly technical in stressing the form of clause 25 (of the trust deed) rather than the substance thereof. 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. In substance it provides that the net income shall be devoted to the maintenance ... of the donee but that he or they shall not receive it for the said purposes until the trustees decide in their absolute discretion not to withhold it."

Here again the court demonstrated that its approach is to look at the underlying nature of a transaction rather than the form in which it is couched.

In Smith v CIR 1964 (1) SA 324 (AD) the Court had to consider the meaning of the term "avoiding liability" in section 90, the precursor to section 103. The taxpayer had transferred his shares in one company to another company, and had created a series of companies of which he was the ultimate controller. But for the

transaction dividends would have accrued to him, and not to the companies. It was common cause that the transaction was abnormal, and that his purpose was to reduce his liability to tax. The taxpayer was held taxable on the dividends. The Court held that "avoiding liability" means to get out of the way of, to escape or prevent an anticipated liability. This means that the alienation or disposal of any assets, or any other transaction in terms of which income which would otherwise have accrued to the taxpayer accrues to a third party, could be regarded as having the effect of avoiding, postponing or reducing liability to tax, although the taxpayer had no right to and would receive no benefit from the income. The Court held that the narrower reasoning in CIR v King 1947 (2) SA 196 (AD) did not apply, and that the dictum in ITC 963 24 SATC 705 was incorrect. In ITC 963 the taxpayer had transferred funds from the Republic to South West Africa and had invested them there so that the income accrued from a source outside the Republic. It was held that by doing so the taxpayer did not avoid liability for tax. These decisions should be compared with the Australian and New Zealand decisions on the same issue in regard to Section 260 of the Australian Act and Section 108 of the New Zealand Act, as reported in Newton v COT [1958] 2 All ER 759 (PC) at 763 F - G; Mangin v IRC [1971] 1 All ER 179 (PC) at 189 H.

In SIR v Gallagher 1978 (2) SA 463 (AD) the taxpayer embarked on a scheme designed to save estate duty, which incidentally resulted in

the saving of income tax. In terms of the scheme he disposed of his shareholdings on the JSE and in a private company to a company controlled by trusts for the benefit of his children. The Revenue was unable to show that the saving of income tax was the sole or one of the main purposes of the scheme. The Court held that in determining the object of a scheme a subjective test must be applied. On this basis the Court was satisfied on the evidence that the subjective purpose of the scheme was to reduce estate duty, having regard to the stock market trends and the nature of the Respondent's work. In embarking on the scheme he had been advised by his attorney that there would be no saving of income tax, although in the result the income tax he paid was less than it would have been but for the scheme. As a result, section 103(1) was amended with effect in respect of the years of assessment ending on or after 1 January 1979. The case is important, because it should be compared with the result in Ovenstone, *infra*

In Hicklin v SIR 1980 (1) SA 481 (A) the taxpayer and others owned shares in Reklame Bestuur (Edms) Bpk, a dormant company, which had undistributed profits. The company had managed the affairs of an advertising company. In due course Reklame sold its business and built up a non-distributable reserve. The appellant and his co-shareholders decided not to declare dividends, because of the tax that would attract, but sold their shares to Ryan Nigel at a slight discount. The latter then effected a "dividend-strip". The Secretary

sought to apply section 103(1) and endeavoured to assess the taxpayer to tax on a portion of the dividends received by Ryan Nigel.

In regard to this series of transactions the Court held:

"..... the liability of Appellant and the other shareholders to tax on Reklame's distributable profits, albeit a liability contingent upon their declaring those dividends, was clearly 'an anticipated liability' within the contemplation of section 103(1). After all they were always mindful that something unforeseen might occur that would compel them to declare them as dividends and incur the ensuing tax liability, as, for example, the early death of one of them. And, as will presently appear, the possibility of some such contingency occurring was sufficiently proximate and pressing to induce them to sell their shares under the RN agreement in order 'to get out of the way of, escape or prevent' such liability from falling on them. The RN agreement undoubtedly had the effect of avoiding that anticipated tax liability of theirs."

The Court held that a liability for tax may vary from an imminent, certain prospect to some vague, remote possibility. It found it was unnecessary to decide whether a line should be drawn somewhere along that range of meanings in order to delimit the connotation of an "anticipated liability". This decision highlights the willingness of the courts to ignore, with respect, the separate legal personality of a corporate body. It demonstrates the uncertainty which this approach creates, where the court itself is unable to draw the line between an "anticipated" or a "contingent" liability and avoids the difficulty by finding it not necessary to resolve the point.

The test of normality under section 103(1) was expressed by Trollip JA in Hicklin v SIR (supra) as follows:

"A few preliminary observations about paras (i) and (ii) of the sub-section. When the 'transaction, operation or scheme' is an agreement, as in the present case, it is important, I think, to determine first whether it was one concluded 'at arm's length'. That is the criterion postulated in para (ii). For 'dealing at arm's length' is a useful and often easily determinable premise from which to start the enquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself. Indeed, in the Afrikaans text the corresponding phrase is 'die uiterste voorwaardes beding'. Hence, in an arm's length agreement the rights and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by para (ii). And the means or manner employed in entering into it or carrying it out are also more likely to be normal than abnormal in the sense envisaged by para (i). The next observation is that, when considering the normality of the rights or obligations so created or of the means or manner so employed, due regard has to be paid to the surrounding circumstances. As already pointed out section 103(1) itself postulates that. Thus, what may be normal because of the presence of circumstances surrounding the entering into or carrying out of an agreement in one case may be abnormal in an agreement of the same nature in another case because of the absence of such circumstances. The last observation is that the problem of normality or abnormality of such matters is mainly a factual one. The Court hearing the case may resolve it by taking judicial notice of the relevant normal standards or by means of the expert or other evidence adduced thereon by either party. It is unnecessary to decide what happens if at the end of the day, because of the lack of its own knowledge or such evidence, the Court cannot resolve the problem." (at p 494 to 495).

Meyerowitz suggests, at 582 note 15, that if the evidence in Hicklin

had been that it was not in the contemplation of the shareholders to declare dividends in any foreseeable circumstances, it could not be said that the disposal of the shares and the declaration of dividend caused by the new shareholder had the effect of avoiding tax. While this would be correct it would be an unrealistic proposition. An "anticipated" liability is more imminent than a "contingent" liability. The Court treated the two concepts as synonymous, which is evident from the way it used the words interchangeably in the quotation.

Broomberg advises that where a transaction is proposed which would have the effect of avoiding tax, and the taxpayer relies on the test of normality to defeat an attack by the Commissioner, he should be able to account for "each right and each obligation created by the transaction, by way of providing a sound business purpose for such right or obligation", Tax Strategy p 213. In other words, the taxpayer should test the provisions of the agreement against commercial expediency and commercial normality in determining whether it would stand up to an attack by the Commissioner or not. Broomberg states, with respect, correctly, that the scheme should be adequately supported, by executing the documents that would be required in a commercial arm's-length transaction, such as an agreement of lease, even if this leads to payment of stamp duty, rather than by simply recording an occupancy between two companies in a group by way of a lease in the minutes of the board of

directors. The test of a normality is much the same, in effect, as what one would do nowadays in the United Kingdom so as to place a scheme beyond attack.

In Ovenstone v SIR 1980 (2) SA 721 (AD) the taxpayer had been advised in 1966 to sell shares in a South West African company, Scotia Investments (Pty) Ltd, to a trust he was to create, the purchase price of which would be interest-free. His purpose was to save estate duty. At the time the dividends on the shares were exempt from income tax in South Africa because they emanated from a source in SWA, and by virtue of section 10 (1) (k) of the Income Tax Act No 58 of 1962. He implemented the scheme in 1969, because dividends on the shares would become taxable in South Africa because of an amendment to Act 58 of 1962.

On the evidence the Court found that it was the announcement of Parliament's intention to repeal the exemption from income tax on dividends received from SWA companies which galvanised the appellant into action. It found that although his sole purpose in formulating the scheme was the saving of estate duty, an additional purpose of avoiding the anticipated liability for income tax on the dividends became the other main purpose when he hurriedly carried out the scheme in 1969. As the taxpayer was unable to discharge the onus of showing that the avoidance of income tax was not one of his main purposes, he failed to avoid the net cast by section 103.

It was held, by Trollip JA, at 732 E, that:

"It follows therefore that, even if the purpose or effect of the scheme when it is formulated is not to avoid liability for tax, it may have that effect or it may become one of the taxpayer's main purposes when he subsequently carries it out, thereby rendering section 103(1) applicable if its other requirements are fulfilled."

A fact which emerges from Ovenstone's case is that although the appellant made a loan to his minor sons, which was repayable, and on which interest had to be paid at the rate the bank charged the taxpayer, the Court concluded that the transaction was not a wholly business, commercial or at arm's-length transaction without any element of bounty. The Court found that because he asked for no security for the loans, and because the terms of repayment of the loans and interest were vague, it being a "family transaction" counted against the taxpayer. The Court went on to find that the rate of interest was unduly favourable. It reached this conclusion because no evidence was adduced to prove it was the ordinary, full or fair rate for loans of that kind prevailing at that time. This case demonstrates the lengths to which a court will go in analysing a transaction, and in legislating judicially to meet the case.

In Secretary for Inland Revenue v Safranmark (Pty) Ltd 1982 (1) SA 113 (AD) the Respondent held a franchise from Kentucky Fried Chicken SA Ltd to prepare and sell fried chicken in the manner specified by

Kentucky. It was obliged by Kentucky to follow and adhere to a procedure from the time the raw chicken was received until the fried chicken was sold to the customer. The procedure involved the use of certain ingredients, plant and machinery, and was intended to result in fried chicken all having the same taste, tenderness and brownish appearance. It claimed to deduct the "machinery initial allowance" in terms of section 12(1) of Act No 1958 of 1962, and the "machinery investment allowance" in terms of section 12(2) of the Act. The question before the Court was whether the operations conducted by the Respondent could be said to be a "process of manufacture".

The Commissioner contended that the process did not result in any substantial or essential change in the main ingredient, because the fried chicken was still chicken, and that the procedures and operations insisted upon related to quality control and not to the production of a manufactured article.

The Court upheld the Respondent's argument, namely, that as the ingredients ceased to retain their individual qualities and, upon completion of the process, a different compound substance having a special quality had been produced, this constituted a process of manufacture.

The minority, per Corbett JA, dissenting, held that the operation did not result in the production of an object or thing which was

essentially different from the materials or components. Corbett JA found that there was a change in the utility, because people eat cooked chicken and, generally speaking, do not eat raw chicken. He concluded that the phrase "process of manufacture" did not comprehend the production of cooked pieces of chicken from raw pieces of chicken.

At 116 E to G Corbett JA left little room for doubt as to how he regarded the undisputed facts of the case. He held:

"... In my opinion, however, the evidence ... should not be allowed to obfuscate one's perception of what appears to me to be a relatively straightforward cooking process."

In short, he held that a Court is not bound by the evidence or the facts, but is entitled to look behind the facts and to substitute its view of the matter for the facts admitted or proved in the litigation. Safranmark does not fall within a "form" and "substance" type of situation, but the decision is important because it demonstrates, in the majority judgment, what I would classify as the traditional, Lord Cairns' laissez faire approach, whilst the minority judgment of Corbett JA lends support to the "mischief" or Parliament's "unexpressed wish" type of approach. It also raises the novel jurisprudential issue, namely, whether a court is obliged to have regard to the evidence before it or not.

With respect, the approach of Corbett JA is not sound: one would not use iron ore out of which to mould a motor car, but the ore has to be smelted to make steel, and that would be used to make the car. The "utility" of iron ore for constructing a motor vehicle is nil, so its form has to be changed. The change in utility would classify the process as one of manufacture or not. However, if one adopts a test of utility, it is impossible to determine the degree of change in utility which would, in one case, amount to a process of manufacture, and in another case, would not. Interestingly, his decision in Safranmark should be compared with his finding in Blue Circle Cement v Commissioner for Inland Revenue 1984(2) SA 764 (AD), where he held that a railway line extension, connecting the Appellant's limestone deposits to its cement factory, constituted "plant" in the context of section 12(1) and (2). He found that as the process of manufacture commenced when the limestone was blasted and mined, the connecting rail link was in the nature of plant.

In Commissioner for Inland Revenue v Louw, 1983 (3) SA 551 (AD) the taxpayer was one of a number of partners in a partnership of consulting engineers. The partners decided to incorporate the practice, and did so by selling the partnership to a company. The purchase price was to be paid to the partners by way of an allotment of shares, and by crediting loan accounts in their names in the books of the company. The loan accounts were not to carry interest,

and would be repayable when the financial position of the company permitted. Shareholders agreements dealing with membership of the company, transfer of shares, salaries and directors fees were entered into. Thus far the case was much the same as Geustyn, supra. It later became apparent that the company was lending large amounts each year to the directors. The amounts received by the directors by way of salary and dividends were less after incorporation of the practice than their incomes had been before incorporation. The amount which the Respondent received was sufficient to meet his normal living costs, whilst the amount he would normally have saved was advanced to him by way of a loan by the company. The loans were made from the cash reserves of the company which were surplus to its requirements. The loans were interest free and no security was required.

On appeal, the court held in relation to the issue as to normality, that the incorporation was not abnormal, and was not affected by the provisions of section 103. However, the Court held that the provision of income to the directors by way of loan accounts was abnormal. But for the loans the salary and dividends paid to them would have been greater. It held that the granting of loans had the effect of avoiding or postponing liability for income tax, so section 103 was applicable to the directors loans. It is important to note that this was not even an issue on the appeal, yet the Appellate Division chose, of its own volition, to investigate this

issue and to reach this finding. The case again demonstrates the willingness of the Courts to impose a liability for taxation where the matter was not even an issue.

In Commissioner for Inland Revenue v Nemojim 1983 (4) SA 929 (AD) the taxpayer purchased dormant companies with substantial cash reserves available for distribution. The company would declare a dividend, distributing the total cash reserve as soon as the shares had been transferred into the name of the Respondent, which would then sell the shares in the stripped company. The dividend and the resale price of the shares constituted the proceeds of the transaction as a whole. In each case the dividends constituted by far the major component, and was a sine qua non to the profitability of the transaction. The receipt of the dividend was planned to take place immediately after the transfer of the shares. The issue was whether the Respondent was entitled, in calculating its taxable income, to deduct the cost of acquisition of the shares from the income derived by it from the sale of shares. If it could do so, it would be entitled to claim a substantial loss on the overall transaction, because the cost of acquisition was always substantially greater than the price realised on resale of the shares; furthermore, the dividends "stripped" from the purchased company would be exempt from tax in terms of section 10(1)(k) of the Act.

Adopting the test laid down by Schreiner JA in Commissioner for Inland Revenue v Genn & Co (Pty) Ltd, 1955 (3) SA 293 (AD) at 299 G -

"... in deciding how the expenditure should properly be regarded the Court clearly has to assess the closeness of the connection between the expenditure and the income-earning operations, having regard both to the purposes of the expenditure and to what it actually effects..."

Corbett JA held that the expenditure incurred by Nemojim in the acquisition of shares had a dual purpose, on the one hand being the receipt of moneys on resale, which would constitute income, and on the other hand, the receipt of a dividend, which would not constitute income, but would be exempt income. He held:

"I would further emphasise that in each case the receipt of the dividend was no adventitious event. It was something planned by Nemojim to take place immediately after it had taken transfer of the shares. After transfer Nemojim as sole shareholder had the unquestionable power to cause such a dividend to be declared. And, apart from being a sine qua non to the profitability of the transaction, the dividend was generally needed and used by Nemojim to pay the purchase price of the shares acquired by it."

Having found against Nemojim on the "dividend stripping", the court went on to allow a portion of the expenditure based on a formula which would allow a deduction for that portion of the expenditure incurred in earning income on a resale of the shares. This finding should be contrasted with what Hoexter JA held, in a minority

judgment, in CIR v Rand Selections Corporation Ltd 1956 (3) SA 124 D. He found in that case that there was a single purchase of shares with their potentialities. While one would purchase shares with their income producing potentialities in mind, that was different from saying that a portion of the purchase price of shares is to be allocated to the dividends that may be declared from time to time.

While accepting that King's case supports the proposition that where shares in respect of which a dividend is due to be distributed are sold it cannot be said that the seller is divesting himself of income which was in reality his, Corbett JA held that those cases did not apply to Nemojim, but that the test of "closeness" in Genn's case applied. The Court distinguished the decision in Umtali Finance (Pty) Ltd v Commissioner of Taxes, 1962 (3) SA 281 (FC), which had relied on CIR v Forrest 8 TC 704 and on the decision of the House of Lords in Griffiths v J P Harrison (Watford) Ltd, (supra). The Court distinguished Harrison on the basis it did not have any relevance to the issues in Nemojim, this notwithstanding the fact that the cases were, on the facts, on "all fours" with one another. In rejecting the findings in these cases Corbett JA simply held that he was not persuaded by them. He did not, as one would have expected, set out a reasoned analysis as to why the findings in those cases were incorrect.

The rejection by Corbett JA of the finding by the House of Lords in

Harrison that the exercise of share dealing and stripping was trading is, with respect, difficult to understand. In fact he found to the contrary in Nemojim. If it was not trading, what was it? Furthermore, if one accepts that dividend stripping was, in the circumstances, a trading operation, the stock in trade could only be the shares which are bought and sold, with their potentialities, so the fact that a dividend is, by statute, not "income" but "exempt income", is irrelevant. The taxpayer traded in shares. The expenditure was incurred to acquire the shares, not the dividends. The taxpayer bought the shares and sold the shares. The income as defined was earned from the sale of the shares, admittedly after the strip had been done. The fact that dividends do not constitute "income" is not a matter for the courts to legislate for, but Parliament should deal with that issue, as it has done.

In regard to the valuation of the "trading stock", the Court found that the accounting methods indicated by section 22 could only be applied with "adaptation". Corbett JA found it was necessary to adapt section 22, on the grounds that as section 11(a) and 23(f) required the apportionment of expenditure, apportionment could not be negated by the provisions of section 22. Corbett JA held, therefore, that it would be necessary to adapt section 22 but that "no great deviation would be called for". Consequently, the Court held that expenditure incurred in the acquisition of shares relating to companies where dividend stripping occurred should be apportioned in

accordance with a formula which the Court devised. In justifying the result, Corbett JA expressed the following view:

"It has been said that 'there is no equity about a tax'. While this may in many instances be a relevant guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus. And it may fairly be inferred that such a result is in conformity with the intention of the legislature. An acceptance of the case put forward by Nemojim would in circumstances such as these have the effect of permitting a taxpayer who is carrying on a profitable business to accumulate enormous annual assessed losses, which from a financial and accounting point of view can only be described as fictitious. This could not have been what Parliament intended. It is true that an amendment to the Act, which took effect on 2 October 1981 (section 8D) may render a scheme of dividend stripping, such as was embarked upon in this case, ineffective in that the taxpayer will be taxable on the dividends received, but I do not consider that this amendment in any way effects the interpretation to be placed on the Act as it was when the assessments under review were made."

The use by Corbett JA of the quotation "there is no equity about a tax" is ironic ! That phrase was coined, as I have shown, to justify the strict, legalistic approach to interpretation - if one's case did not fall within the statute one escaped liability for tax. (See Rowlatt J in Cape Brandy Syndicate at p.8, supra.) Corbett JA turned the phrase on its head to justify a fine piece of judicial legislation: the statute being deficient, the judicial mind would adapt it to meet the need postulated by the court !

With respect to Corbett JA, his approach to section 22 and the justification he advanced for it is no more than judicial legislation based on a personal prejudice. In my view he went far outside any recognised canon of interpretation. Similarly, his approach to the purchase of a share as being the purchase of an imminent dividend cuts across all company law principles, the essence of which is set out by Windeyer J in FCT v Casuarina (supra). It is a principle of law that a company has a separate legal personality, even if it is controlled by a single shareholder. As was held by Windeyer J in Casuarina (supra):

"A proprietary company may well seem to be, in reality, merely the trade name in which a man carries on some part of his affairs. But by a following of correct legal forms the name becomes in law a thing. Formalism produces a legal substance and its owner can by careful bookkeeping get all the advantages, be they limited liability, relief from taxation or other benefit, which the law annexes to his sedulous use of the corporate name. ... A company which speaks with the voice of the person who controls it, and which acts as he directs is not necessarily to be called a facade, nor its acts in the law to be called shams. Its existence as a legal person is not incompatible with its practical obedience to orders...."

To approach questions of income tax on the basis that the company is a facade, or that a sale is a loan or a donation, will, in the long run, cut across the principles of the law and render them useless.

In essence, what Corbett JA held in regard to section 22, was that he was not bound by the clear and unambiguous wording of the section as Parliament had expressed it to be: le droit c'est moi!

The approach of Corbett JA in Nemojim should be contrasted with his attitude to the separation of corporate personality from that of the shareholders as set out in Standard Bank of SA Limited v Ocean Commodities Incorporated 1983 (1) SA 276 (AD) at 288, where he re-affirmed that a share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder to a certain interest in the company, its assets and dividends.

The approach in Nemojim endorses the approach to judge-made law, so eloquently advocated for by Lord Scarman in Furniss v Dawson, where he held:

"The law will develop from case to case. Lord Wilberforce in W T Ramsay Ltd v IRC ... referred to 'the emerging principle' of the law. What has been established with certainty by the House in Ramsay's case is that the determination of what does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process. The best chart that we have for the way forward appears to me, with great respect to all engaged on the map-making process, to be the words of Lord Diplock in IRC v Burmah Oil Co Ltd [1982] STC 30 at 32 which my noble and learned friend Lord Brightman quotes in his speech. These words leave space in the law for the principle enunciated by Lord Tomlin in IRC v Duke of Westminster [1936] AC 1 at 19, [1935] All ER 259 at 267 that every man is entitled if he can to order his affairs so as to diminish the burden of tax. The limits within which this principle is to operate remain to be probed and determined judicially. Difficult though the task may be for judges, it is one which is beyond the power of the blunt instrument of legislation. Whatever a statute may provide, it has to be interpreted and applied by the courts; and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found."

In Furniss Lord Roskill sought to differ from the law as expressed in Duke of Westminster, rebuking the judges of first instance as follows:

"It is perhaps worth recalling the warning given, albeit in another context by Lord Atkin, who himself dissented in the Duke of Westminster's case, in United Australia Ltd v Barclays Bank Ltd [1940] 4 All ER 20 at 37, [1941] AC 1 at 29: 'When these ghosts of the past stand in the path of justice, clanking their mediaeval chains, the proper course for the judge is to pass through them undeterred.' 1936, a bare half century ago, cannot be described as part of the Middle Ages but the ghost of the Duke of Westminster and of his transaction, be it noted a single and not a composite transaction, with his gardener and with other members of his staff has haunted the administration of this branch of the law for too long. I confess that I had hoped that that ghost might have found quietude with the decisions in Ramsay and in Burmah. Unhappily it has not. Perhaps the decision of this House in these appeals will now suffice as exorcism."

It may be argued that the process of judge-made law in South Africa is part of a process of moving forward from the 1940's (Randles and others) to the 1980's (Nemajim). This is what Lord Roskill would contend. With respect, and for the reasons set out in this dissertation, I disagree with this approach. It has never been the function of South African judges to make law. They must interpret what they find. The law must be certain order to be effective. This cannot occur where the whim or fancy of a judge will determine the outcome, quite apart from the fact that the "separation of powers" doctrine teaches us that the office of law-giver should not coincide with that of the judge.

In Nemojim the Court had to find a jurisprudential basis for an apportionment of expense, as the Income Tax Act No 58 of 1962 makes no provision for this. The Court found, with reliance on Borstlap v SBI 1981 (4) SA 836 (AD) and other cases, that its approach was a "practical solution" to an otherwise "intractable problem". With respect, where the taxing act does not provide for some or other solution, the Act should be interpreted contra fiscum, and if the taxpayer scores, Parliament is entitled to remedy the situation.

In his judgment Corbett JA distinguished not only Umtali Finance but also Griffiths and Patcorp. His reasons are hard to find, but generally they relate, in the last two cases, to the nature and wording of the United Kingdom and Australian taxing acts, whereas, on the facts, the issues which arose in those cases related to the question whether a trade was being carried on, and if so certain deductions or rebates were permissible. As I have pointed out no ground for distinguishing Umtali was adduced, other than that the learned judge was "not persuaded" by it.

In CIR v De Beers Holdings (Pty) Ltd 1984 (3) SA 286 (T) the taxpayer had embarked on a liquidation and stripping operation which was never finally implemented. Several years passed, after which, as a result of a ruling by Inland Revenue, the liquidation of EHSA was re-considered. A new scheme was evolved. A number of steps were taken, the end result of which was that the taxpayer sold the shares

it held in EHSA for R1, having paid R4 158 947 for the shares six years previously, and in the meantime stripped out a dividend in the form of the reduction of capital. It was common cause that the taxpayer was a share dealer, and the shares were held as stock in trade. If the original scheme had been implemented the taxpayer would have received a distribution in liquidation which would have been taxable.

The question was, therefore, whether the amount paid to acquire the shares was expenditure in the production of "income" derived from the taxpayer's trade.

Goldstone J approached the case on the basis that Nemojim applied, although De Beers had not embarked upon a "dividend stripping" exercise of the nature in Nemojim. He found that when the shares were purchased it was intended to carry out a strip and distribution. It was never intended to sell the shares. The assets subsequently were received by the taxpayer as a reduction of capital, and on that basis, the form but not the substance changed. He held that the substance was the stripping of assets and distribution, whatever form that might taken. The original intention was accordingly carried out.

With respect, Goldstone J (with whom Irving Steyn and Flemming JJ concurred) approached the matter incorrectly. I have already set out

my criticism of Nemojim, so I do not repeat that, but there are other points. On the basis of Ovenstone the original intention was irrelevant. Once the shares were acquired as trading stock, and were brought to account each year, they remained trading stock. This was common cause. Goldstone J did not even deal with the Respondent's contention that shares are purchased "with all their potentialities", relying simply on Corbett JA in Nemojim. He did so notwithstanding his finding that the facts in the two cases were materially different (at 292D). He appeared to rely on the fact that the original scheme (which was never implemented) was not aimed at a tax advantage, nor was there an intention to obtain a commercial profit. He went on to find that as the expenditure in question had yielded a reduction of capital, which was not taxable and did not constitute "income", the expenditure could not be allowed. As I have pointed out in relation to Nemojim, this ignores the question as to what it was that was purchased and what was sold. Granted, it may be unfair that the recipient should not be taxed, but then the statute should be amended.

The other point which emerges from De Beers is that the expenditure allowed in one year in respect of the acquisition of the shares could not be reversed later on. In terms of section 22 it must be carried forward to the next year as the opening stock, at the value determined for it under section 22. An issue on appeal will be whether, and the extent to which, the adaptation of section 22 adopted in Nemojim, should apply.

The De Beers case highlights the uncertainty which confronts an ordinary investor who buys shares as trading stock and later receives a dividend, either for commercial reasons or in order to circumvent section 38 of the Companies Act, No 61 of 1973. If assessed on the basis of De Beers the investor would be in some difficulty: would he be allowed to claim a deduction ?

In Glen Anil Development Corporation Ltd v SIR, supra, the Court gave a wide interpretation to Section 103(2) as it then stood. It found that it was not necessary that there should be any change in shareholding in the company with the assessed loss, but as long as the company is affected by or is concerned with any agreement entered into for the purpose of avoiding tax, the section would become operative, even though the change in shareholding took place in another company which held shares in a subsidiary, which in turn held the shares in the company with the assessed loss.

Broomberg points out that in those cases where the taxpayer has failed to discharge the onus of proving a non-tax avoidance purpose behind the transaction relating to the acquisition of a company with an assessed loss, a tell-tale sign has been present. This has been that the purchase consideration paid by the taxpayer for the shares in the assessed loss company is more than the shares are worth, if one has regard to the net asset value of the company or its income earning potential. The only reason for the extra payment would be,

in the normal course, to pay for the tax benefit of the assessed loss. A similar tell-tale sign has been present in the "dividend stripping" cases decided in the United Kingdom.

Broomberg, 218-219, points out that in S A Bazaars (Pty) Ltd v CIR 1952 (4) SA 505 (AD) and in New Urban Properties Ltd v SIR 1966 (1) SA 217 (AD) it was held that if there has been a change in shareholding or an agreement in relation to any company which renders the company liable to attack under Section 103(2), then any income accruing to the company as a result of the transaction in question will be regarded as "tainted" income, and it cannot be set off against the assessed loss of the company. If the company does not earn any "untainted" income for the whole of the year, then the assessed loss of the company is irretrievably lost. Consequently, he advises that a contract which involves a change in shareholding in a company with an assessed loss must make provision for the company to remain in possession of some pre-existing assets which are capable of generating "untainted" income. In this way the assessed loss will be preserved by reason of the continued flow of "untainted" income.

If the main purpose of the transaction is to obtain the benefit of the company's assets, goodwill, trademarks, permits, or the like, so that there is a business or commercial reason for the agreement or change of shareholding, the fact that the assessed loss was taken into account as a subsidiary or secondary consideration would not

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result in the application of Section 103(2). This onus was discharged in ITC 983 25 SATC 55; ITC 989 25 SATC 122 and S (Pvt) Ltd v COT 1969 (3) SA 208 (R).

This summary of decisions in regard to "form" and "substance" in South Africa reveals a similar trend to that which has developed in the United Kingdom. It is obvious, particularly having regard to Safranmark and Nemojim, that the Courts will legislate judicially to meet cases which come before them. In doing this the Courts will be following the path of judicial map-making advocated by Lord Roskill and Lord Scarman in Furniss v Dawson.

It is likely that the new Commissioner for Inland Revenue will pursue an aggressive approach to tax avoidance schemes, and that this will have the support of the Minister of Finance and the Cabinet. The Minister's stupid and unwarranted comments about the auditors' profession should not leave any doubt as to the attitude the Department will adopt.

The "them" and "us" approach is disturbing: the legislation introduced in 1984 did not accord with the Ministerial announcement which had preceded it, by almost 6 months. The failure or unwillingness of the Revenue to publish draft bills for comment does much to heighten the feelings of antipathy, particularly when the legislation which is later enacted is almost always a "loop-hole"

stopper, and is not a well thought out, considered approach to commercial or fiscal matters.

A tax planner who is called upon to advise someone in this climate must have regard to the likely trend, not only on the part of the Revenue Department, but also by the judiciary. Any scheme which cannot be justified on commercial grounds will be open to attack. Extravagant schemes, such as those described in some of the English cases, will be almost certain to fail. As I have said in the review of the case law in the United Kingdom, the tax planner should limit himself to taking advantage of the concessions and incentives provided by the statute, because excessive schemes will attract the disapprobation of the Courts. Furthermore, as happened in Ramsay and in Louw's case, the Courts are willing to go further than the Revenue wants them to go.

Chapter Thirteen

The position in the United States of America

The study carried out in this dissertation would be incomplete without a reference to the position in the United States of America.

Corporate separations, being the term used in the U.S.A., adopt three varieties, namely, spin-offs, split-offs, and split-ups. In each case the purpose is to divide what was previously held in one corporate solution into two corporations, with the shares of both in the hands of the original shareholders. The spin-off partakes of a dividend in character, in that the shareholders receive the stock of the distributed corporation pro rata, without giving up any shares of the distributing corporation.

The split-off is a spin-off combined with an exchange, in terms of which the shareholders turn in some of their stock for the shares in the distributed corporation which they will receive. In a split-up, the distributing corporation, in control of two or more subsidiaries, distributes the shares to its shareholders as part of a plan of liquidation. (See "Draining the Serbonian Bog : a new approach to corporate separations under the 1954 Code", Charles S Witman 111 Harvard Law Review 81 (1967/68) 81 1194).

In terms of U.S. law separation is one of those activities which is intended to be exempt from taxation in order to promote corporate flexibility in commercial transactions. It is the tax free status which has made the separation an attractive vehicle for tax avoidance. Witman describes how, in the Pipeline Cases 234 U.S. 548 (1914) interstate pipeline facilities were held subject to the jurisdiction of the Interstate Commerce Commission, which had power to review rates and other corporate practices. Two of Rockefeller's companies, in Arkansas and Ohio, were engaged in producing oil from crude petroleum in addition to transporting it through their own pipelines. In order to avoid governmental regulation of the production end of these businesses, Rockefeller proposed to divide the corporations into their component parts, pipeline and production, by forming new corporations to hold the pipeline assets, and then spinning off the pipeline stock to the old shareholders pro rata. Rockefeller and other shareholders were assessed to tax on the value of the pipeline stock as a non cash dividend. The Supreme Court held for the Treasury, on the basis that Rockefeller had realised "income" within the meaning of the Constitution upon the severance of his ownership into two corporations (Rockefeller v United States 257 US 176 (1921)).

In Gregory v Helvering 293 US 465 (1935), the case which originated the "business purpose" doctrine, Mrs Gregory found a buyer for stock of the Monitor Corporation, which was held by the United Mortgage

Corporation, which she owned. She tried to avoid a taxable dividend upon United's distribution of the Monitor stock to her before sale. She formed a new corporation, Averill, to which United transferred the Monitor stock in exchange for all outstanding Averill stock, a tax free organisation under the Revenue Act of 1928. United then distributed the Averill stock to Mrs Gregory as part of the reorganisation plan. Three days later she liquidated Averill, then six days old, paid a gains tax on the difference between the value of the assets received (the Monitor stock) and the face value allocated to Averill stock after the distribution, and sold the Monitor shares to the buyer. The Treasury assessed a dividend tax.

On appeal, Judge Learned Hand held that the assessment should be sustained. He found that Mrs Gregory had complied with the literal wording of the Act, and had no duty to structure her transaction in such a way as to attract a higher rate of tax, but found that her arrangement fell outside Congressional intent, which was to exempt business adjustments "undertaken for reasons germane to the conduct of the venture in hand, and not to exempt mere shams to dodge taxes". In the Supreme Court, Mr Justice Sutherland affirmed this finding, on the basis that there was no "business or corporate purpose" in the transaction, which he characterised as a "mere device", "a contrivance", and "an elaborate and devious form of conveyance masquerading as a corporate reorganisation". He held:

"The whole undertaking ... was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganisation, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation because the transaction on its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provisions in question of all serious purpose".

It is important to note that this case was decided in the same year that the Duke of Westminster was decided in the House of Lords. If the principle expressed in Gregory's case had been applied in the Duke of Westminster the decision in the Duke's case and any subsequent cases would have been different both in the United Kingdom and South Africa. The "business purpose" test seems to underlie the recent decisions in the United Kingdom and in South Africa, as expressed in Furniss, de Beers and Nemajim. As I have pointed out, Counsel for the Crown in Ramsay's case did not advocate the adoption of the wide "business purpose test".

The "business purpose test", in terms of which income tax matters should be adjudged on the basis of their "substantial economic reality", rather than on form, has been upheld in subsequent cases; See Commissioner v Court Holding Company (1945) 324 US 321; Commissioner v P.G. Lake Incorporated (1958) 356 US 260. As a consequence the "step doctrine" applied in Gregory has been adopted, in terms of which a single arrangement should not be divided into its component steps, but that the end result should be examined regardless of how that was achieved.

As pointed in an article in De Rebus, November 1979, by J.W. Durack : Form v Substance, the Canadian developments, assisted by a more flexible section 245 of the Income Tax Act have gone a long way towards adopting the US position, as a result of the decision in Dominion Bridge Company Limited v The Queen (1975) CTC 263. In that case it was held by Decary J, cited by Durack, that an attempt to split income between a Canadian parent company and its offshore subsidiary in the Bahamas failed because the control over the subsidiary was so substantial that the parent company was in reality carrying on its own business on the Bahamian premises. Decary J referred to decisions in the House of Lords in dividend stripping cases, and held, at 278:

"In my opinion the authorities quoted herein by discarding the propriety of a legal entity to obtain the real nature of operations are in fact resorting to the theory of form and substance. It is surely not the name given to transactions or operations which determines their nature. Their nature is found by looking at what in fact they are, not at what they appear to be or are made to appear to be".

He went on to say:

"Therefore, the Appellant and Span in the present instance may have had between themselves dealings that for them were genuine but these dealings for third parties were not genuine. The Defendant as a third party is not precluded from looking beyond the appearance of the relationship between the Appellant and Span to get to the nature and substance of that relationship. It is not because the Appellant pretends that Span was a steel supplier that ipso facto Span was a steel supplier when in substance and in fact Span was nothing but a disguised steel supplier tied by blind obedience to the wishes of the Appellant. The contract between the Appellant and Span may be valid

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between themselves but they are not valid towards the Defendant because their nature and substance is not as it appears to be".

Chapter Fourteen

Conclusion

It is submitted that this analysis of the judicial approach to tax and the trends displayed in the decisions of the Courts in the United Kingdom, Australia and South Africa, with a passing reference to the United States of America, shows an increasing willingness on the part of the judiciary to legislate judicially in order to fill gaps which they perceive in the legislation as promulgated by Parliament. The judges claim that they have an understanding of what Parliament's intention would have been. This approach leads to uncertainty as to what the law is, because the judges, depending on their background, tend to express the law or even the facts, as they think it should be.

It may be that a possible reason for this trend is attributable to the fact that judges are elevated to the Bench from the Bar, throughout their professional careers having paid tax on income at or near the maximum marginal rate with little or no opportunity for tax saving. The judicial eye may be therefore jaundiced against the entrepreneur who is able, by obtaining expert legal and accounting advice, so to organise his affairs as to maximise the tax saving.

Another reason for the trend towards judicial legislation may be because of the excesses which some taxpayers have been able to get away with: a sort of Robin Hood approach. This view finds support in the dicta of some of the English judges such as Lord Denning MR, Lord Roskill and Lord Scarman. In South Africa Corbett JA is leaning, with respect, in the same direction.

It seems clear that this trend will continue, and is unlikely to be reversed. As I have pointed out, the pro fiscus leaning tends to ignore accepted principles of interpretation and of law. If the trend continues it will be likely to impinge upon what have thus far been treated as "safe" schemes, such as the creation of inter vivos trusts, family holding companies and other estate duty or income tax saving schemes. This has been the case in England, where the shock waves resulting from Floor v Davis, Plummer, Burmah Oil, Furniss v Dawson and Coates v Arndale Properties have not subsided. The South African tax advisers do not appear, in my view, to have grasped the significance of cases such as Hicklin, Ovenstone, Louw, Nemojim or De Beers. All of these decisions point in the same direction. It is difficult to say where it will lead. Lord Scarman said in Furniss that tax law is best evolved on a judicial basis; legislation is not suitably equipped to cope.

It is obvious that the "form" and "substance" doctrine is of

limited, if any, value. As judges have tended to ignore the form, however genuine or bona fide that may be, and have directed their attention at the substance as they perceive it, eg. the creation of a tax loss or fiscal advantage, which they view as morally undesirable, the "form" can play no part in analysing a tax transaction. At the end of the day an "artificial" transaction will go to the gallows, while a "commercial purpose" transaction should escape. Conceptually, however, even the "commercial purpose" scheme should not escape, because the motive, putting it at the lowest, in commercial transactions is to maximise the fiscal advantage. The parties to a deal will tend, if properly advised, to use a tax-cheap method as against a method which attracts tax.

Dugard has pointed out that the judicial function is an exercise in choice, so it is possible to draw an inference from the fact that a judge chooses one interpretation rather than another, or elects to accept one precedent and to distinguish another. (Human Rights and the South African Legal Order, Dugard, Princeton University Press, 1978). He goes on to say that a judge does not operate mechanically but a judge creates new law in selecting one authority in preference to another. In making this selection a judge is inevitably influenced by his perception of the needs of social policy of the expectations of society and even of inarticulate or subconscious factors which are part of his make up. This thesis runs counter to the declaratory theory of the judicial function. In that theory the judicial function is the mechanical application of legal rules in

which policy and value considerations play no part. Lord Reid dealt with the declaratory theory as follows:

"There was a time when it was thought almost indecent to suggest that judges made law - they only declare it. Those with a taste for fairy tales seem to have thought that in some Aladdin's cave there is hidden the Common Law in all its splendour and that on a judge's appointment there descends on him knowledge of the magic words Open Sesame. Bad decisions are given when the judge has muddled the pass word and the wrong door opens. But we do not believe in fairy tales any more."

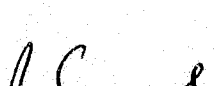
(Lord Reid, The Judge as Law Maker, cited by Dugard op cit pp 303 to 304.)

The validity of Dugard's theory and its relevance to income tax law is demonstrated not only in the United Kingdom, with the Duke of Westminster on the one end of the scale, and Furniss v Dawson at the other end of the scale, but also in South Africa, with the swing from Randles Brothers to Safranmark and Nemojim.

Having regard to factors such as the trend towards a move developed welfare state, the financial needs of the State or the Government to support those programmes and the resentment displayed by the judiciary to excessive and not-so-excessive fiscal schemes, it is clear that the judicial process will, to an increasing degree, move away from the declaratory theory in tax law towards "the exercise of a choice" theory. Unfortunately for the jurisprudential lawyer, this will make the practice of tax law difficult, because it will

introduce a pronounced ethical and moral outlook to that branch of the law. Judge Frankfurter once said of "obscenity" that it was like a greasy pig, and hard to get hold of. Much the same will happen to tax law if ethical or moral persuasion is permitted to dominate its application or its interpretation.

The conclusion is that tax avoidance activities will come under increasing scrutiny from the Courts in all the jurisdictions covered by this review. This approach is jurisprudentially unsound, because the "law" is reduced to the level of the "moral" or "ethical" outlook of the judge. The "moral" approach is based on no more than a feeling of "fair" and "unfair". It proceeds from the assumption that "if we all did our share, tax would be less." The answer to that is that bureaucracies are cash hungry, and even if everyone "paid his whack" taxes would still increase. It also reduces tax law to the level of the "inarticulate premise". Income tax is a young branch of the law, having entered this world for the first time in 1853. The principles of income tax are still evolving. The danger is that in the process of evolution principles of law, such as company law, are being ignored by judges who impose tax where it "leaves one with a sense of satisfaction", per Corbett JA. That danger should be watched carefully, for it will seriously impede the development of income tax law.


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