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# A review of the trend in the judicial interpretation, and judicial attitudes towards tax avoidance in the United Kingdom, Australia and South Africa, with reference to the "declaratory" and "choice" theories of jurisprudence

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virtually meaningless. It has been held that the purpose of the section is to override the general rule of law that in the absence of a specific statutory prohibition, an individual has an unrestricted right to minimise his tax liability. In Australia, steering a path between these conflicting considerations, the judiciary has had a significant role to play. In doing so it has developed three approaches in particular, which are described in the next chapter.

## Chapter Nine

## Aspects of the application of Section 260

### Bona fide dispositions

In Deputy FC of T v Purcell (1921) 29 CLR 464, the taxpayer, a grazier, declared some of his pastoral holdings in trust for himself, his wife and his daughter, and achieved a three-way split of his previous income. He retained wide powers of management, control and investment in the trust deed. The Commissioner sought to invoke section 53 of the Income Tax Assessment Act, 1915-1916, (the precursor to section 260) and assessed the taxpayer on the whole of the income derived during the year of assessment.

The court held that the declaration which created the trust was binding on the settlor and could not be affected by section 53. The court found that the section did not extend to the case of a bona fide disposition, by virtue of which the right to receive income from a source which belongs to the taxpayer was transferred to and vested in another person.

From the decision in Purcell's case it follows that a bona fide

disposition will not fall within the scope of section 260, and so long as the person to whom the property has been disposed of bears tax, the section will not apply. If this case were to be decided by the House of Lords, it would be likely, in my view, to go the other way.

The exercise of a "choice"

When Clarke v FC of T (1932) 48 CLR 56 was decided, the Assessment Act treated premiums received in consideration of a lease of premises as assessable income, but treated receipts for payments received as consideration for the assignment of a leasehold interest as capital. The taxpayer devised an elaborate scheme by way of a lease and sub-lease to take advantage of these provisions. The Court found for the Commissioner, but in the course of its judgment held, at p.77:

> "Where circumstances are such that a choice is presented to a prospective taxpayer between two courses of which one will, and the other will not, expose him to liability to taxation, his deliberate choice of the second course cannot be readily be made a ground of the application of the provision. In such a case it cannot be said that, but for the contract, agreement or arrangements impeached, a liability under the Act would exist. To invalidate the transaction into which the prospective taxpayer in fact entered is not enough to impose upon him the liability which could only arise out of another transaction into which he might have entered but in fact did not enter."

A line of cases followed the decision in Clarke in which the taxpayer was held to have exercised a "choice" offered under the Assessment Act, to which section 260 consequently had no application. These cases were similar and were concerned with schemes adopted to avoid "private company" status, in order to avoid the tax on "undistributed profits" imposed on "private companies". See W V Keighery (Pty) Ltd v FCT (1957) 100 CLR 66; 7 AITR 107; FCT v Sidney Williams (Holdings) Ltd (1957) 100 CLR 95; 7 AITR 126.

The business or family dealing test - Newton's case

In Newton v FC of T 7 AITR 298; [1958] 2 All ER 759 (PC), the Privy Council had to consider the meaning of "arrangement" having the "purpose or effect" in section 260 of the Act. It held that "arrangement" meant:

> "Something less than a binding contract or agreement, something in the nature of an understanding between two or more persons - a plan arranged between them which may not be enforceable at law."

The Privy Council held that the section is not concerned with the motives of individuals or their desire to avoid tax, but only with the means of doing it.

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had made large profits, and continued to make profits. If the profits were distributed to the shareholders, they would have been liable to pay tax at the rate of 15/- in the £. If the money were to be kept in the coffers of each company, it would have had to pay tax at the same rate. Consequently, the Articles of Association were amended to give special dividend rights to the shareholders, equal to an amount of about £460 000, as a special dividend. The shareholders sold the shares to a private company, at a price of almost £460 000. The purchaser paid the original shareholders by cheque, and at about the same time received from the motor company a cheque in payment of the special dividend. New shares were then issued by the motor company to the purchaser, who sold the new shares to the original shareholders. All of this happened simultaneously. In the result, the motor company had distributed £460 000 as a special dividend which found its way back to the original shareholders, who received £460 000, of which they reinvested £400 000 as capital in the company and kept £60 000 in cash. The purchaser had received the original shares, on which it was thereafter entitled in terms of the amended articles to a fixed dividend. These were sold by the purchaser to a subsidiary company for their face value. The purchaser was a company dealing in stocks and shares, and was entitled to deduct losses on its deals from the dividends it received. It had made a loss on the purchase and resale of the shares. It was not disputed that the transactions were genuine and were not sham, they were intended to have the effect

they purported to have. In other words, it was a scheme which would have enabled the shareholders to receive a capital receipt, and to re-purchase the shares after the dividends had been declared in order to satisfy the "sufficient distribution" requirement. The dividends received by the purchaser would have more than covered the cost of acquiring the shares, and the purchaser would have been entitled to a rebate on the dividends under section 46 of the Act.

It was held, by Lord Denning:

> "In order to bring the arrangement within the section, you must be able to predicate - by looking at the overt act by which it was implemented - that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealings, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section. Thus, no one, by looking at a transfer of shares cum dividend can predicate that the transfer was made to avoid tax."

Lord Denning held that on analysis of the facts it was clear that the avoidance of tax was not the sole purpose or effect of the arrangements. The raising of new capital was an associated purpose. However, as one of the purposes or effects was to avoid liability for tax, looking at the arrangement as a whole, the Court considered it was an arrangement which fell within the scope of section 260. The transactions as a whole showed that there was concerted action directed to an end, and that one of the ends sought to be achieved was the avoidance of liability for tax.

The test propounded by Lord Denning is ambiguous. It is capable of three different interpretations, namely:

(a) it could mean that section 260 could apply if an arrangement could be objectively predicated as being a means of avoiding tax; or

(b) it could mean that even if there is an arrangement that can be objectively predicated, the arrangement would be outside the section if it is capable of explanation as an ordinary business or family arrangement; or

(c) it could mean that where a transaction is capable of explanation as an ordinary business or family dealing, section 260 will not apply at all.

Newton's case, which was decided in 1958, was the first case concerning section 260 to be decided by the Privy Council. The Privy Council impliedly overruled the decisions in Keighery's case and the Sidney Williams (Holdings) case. Although the Privy Council upheld the decision in Purcell's case, their Lordships expressed a reservation as to what one could predicate where the sale of shares was made cum dividend. However, the High Court has set its face against giving a broad interpretation to section 260, as

demonstrated in FCT v Casuarina (Pty) Ltd (1971) 127 CLR 62; 1 ATR 755, and has continued to give a narrow interpretation to section 260.

In Casuarina the taxpayer was a company incorporated by a firm of accountants, which had been kept "on the shelf". The shareholders of a private company consulted the firm. A scheme was evolved by which 47% of the ordinary shares in the taxpayer were allotted to the shareholders, and 51% of the redeemable preference shares were allotted to another company, controlled by the accountants, which was a subsidiary of three public companies, and which would therefore have had the status of a public company. The redeemable preference shares carried rights to a 7% non-cumulative preferential dividend, and to share rateably with ordinary shareholders in other dividends. The shares in the private company were transferred to the taxpayer. The private company paid a dividend to the taxpayer, which resulted in taxable income. The Commissioner assessed the taxpayer as a private company, allowing a rebate in respect of half of the dividend received. He adopted the attitude that the holder of the redeemable preference shares was not capable of controlling more than one-half of the voting power of the company because its shares could be redeemed. The Commissioner contended that section 260 operated to deny the company the status of a public company.

The Court held that a person could, by choosing one legal status

rather than another, affect his liability to tax. The Court did not agree that section 260 would enable the Commissioner to assess that person as had some other status. Section 260 could do no more than qualify for the purposes of the Act, arrangements which fell within its scope, but could not create some new arrangement. The section did not enable the Commissioner to select part of a scheme, and treat that as a nullity, while allowing other parts of the scheme to stand and to exact tax on that basis.

In the course of his judgment Windeyer J commented as follows:

> "... when transactions are, by virtue of section 260, absolutely void as against the Commissioner, what is meant is, as the Privy Council held in Peate's case .... that 'it (section 260) only operates notionally to destroy, for the validity of the transactions is only affected so far as the Commissioner and the proceedings under the Act are concerned.'
>
> A company is in the eye of the law an entity, a person. Section 260 requires and enables the Commissioner to disregard this in certain circumstances when a company owes its existence to a tax avoidance scheme. But that does not mean that the company is not in law an entity. It means only that the Commissioner may treat it as a non-entity. Professor Hart in his inaugural lecture, delivered in 1954, entitled "Definition and Theory in Jurisprudence" printed in the Law Quarterly Review Volume 70 page 37, said (at pp49 - 50) that it is said by many that the juristic controversy over the nature of corporate personality is dead. If so, we have a corpse and the opportunity to learn from its anatomy. In the course of his post-mortem, he adverted to the mixed lot of beings to which what he called the one-man tax-dodging tax company belongs. Juristic controversies about corporate personality and its derivation may be dead. But they seem to me to be at times stirring in their graves. I adopt the metaphor

because the whole topic is so replete with metaphors. Cardozo J, once said in the New York Court of Appeal the whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberated thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterised as an alias or a dummy. All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation. Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent (Berkey v Third Avenue Railway Company (1926) 24 NY 84 at pp 94 - 5). I am indebted for a knowledge of this to Paton Jurisprudence Third edition, by Professor Derham p377. It is referred to in the learned commentary there on jurisprudential theories as to the nature, for the purposes of our law, of corporations as legal persons. I mention that basic question as it seems to me to be inevitably involved in a consideration of the attitude the Commissioner has taken. I do so with some diffidence but undeterred by Professor Wedderburn's acid comment on judicial disregard of academic writings and adherence in this field to outmoded theories: see Modern Law Review 28 (1965) p70. 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 act in the law to be called shams. Its existence as a legal person is not incompatible with its practical obedience to orders:..."

In Hollyock v FCT (1971) 125 CLR 647; 2 ATR 601; Gibbs J declined to follow the interpretation given by the Privy Council to Newton's

case in Mangin's case. This case was followed by the Privy Council in Ashton v CIR (NZ) 5 ATR 411, approving Lord Denning's statement in Newton's case, that the inclusion of the words "so far as" showed that the avoidance need not be the sole purpose, and commenting that since one of the purposes or effects of the arrangement under consideration was to avoid the instance of tax, "it matters not what other purposes or effects it might have, section 108 (of the New Zealand Act) applies".

In the Europa Oil case (No. 2) supra the Privy Council held, at p754, that the section did not strike down transactions which did not have as their main purpose, or one of their main purposes, tax avoidance. It would not strike down ordinary business or commercial transactions which would incidentally result in some saving of tax. This statement appears to resurrect the "principal purpose" test used in Mangin's case. The "real test", as propounded in Newton's case, is that the arrangement should be examined to determine what was sought to be achieved, and what was accomplished or achieved, that is, whether the arrangement has as its end in view or as its end achieved, the avoidance of tax.

In Slutzkin v FCT (supra), the Supreme Court of New South Wales (6 ATR 81) held the transaction fell in the net of section 260 as it was not in the nature of an ordinary business or family dealing. The decision was reversed (7 ATR 166) by the High Court. The Court found

that, notwithstanding the fact that the taxpayers appreciated the tax advantages offered by the course on which they had embarked, this did not reveal a purpose or effect as envisaged by section 260. The decision may be open to question on the ground that if the vendor had not sold the shares, the company would have been liable for tax. By doing what was done, it was hoped that the liability of the company for tax would be avoided. This was a course of action taken by the shareholders, and therefore section 260 should have been applicable. The shareholders wanted to avoid an impending liability, to which section 260 would apply. (This would be the approach which the South African courts would follow in the light of Hicklin's case, infra).

In Cridland v FCT (1977) 8 ATR 169, the benefits of the averaging provisions of primary producers were made available to university students. A trust was set up to carry on the business of primary production, the beneficiaries of the trust being university students. The distribution of the trust income was at the discretion of the trustees, but it was clear that no distribution would be made to the student beneficiaries. The taxpayer was a beneficiary. It was admitted that his purpose in subscribing was to obtain the benefits of income averaging and that he did not expect to receive any substantial income from the trust. In the Supreme Court of New South Wales section 260 was held to apply so as to deny the appellant the benefit of the averaging provisions, on the ground that the

appellant was party to an arrangement which had both the purpose and the effect of altering the incidence of income tax, or which could have that effect if it operated according to its terms. On appeal, applying the dictum of Lord Denning in Newton's case (at 304-5), the Court held that:

> "The transactions into which the appellant entered in the present case by acquiring income units in the trust funds in question were not, I should have thought, transactions ordinarily entered into by university students. Nor could they be accounted as ordinary family or business dealings. They were explicable only by reference to a desire to attract the averaging provisions of the statute and the taxation advantage which they confer. But these considerations cannot, in light of the recent authorities, prevail over the circumstances that the appellant has entered into transactions to which the specific provisions of the Act apply, thereby producing the legal consequences which they express."

The other aspect of section 260 is what is known as its "annihilating" effect: it cannot be used to reconstruct or create some other arrangement. Section 260 deems a situation to exist which will support assessment to income tax designed to counter the avoidance. The assessments must still be based on facts, namely the facts remaining after section 260 has been applied. The limitation to this has become apparent in several cases. In Cecil Brothers (Pty) Ltd v FCT (1964) 111 CLR 630; 9 AITR 246, it was held that even if an arrangement could be said to exist within the meaning of the section, its effect, apart from annihilation, could not result in an increase in the taxable income of the taxpayer.

In Peate v FCT (1964) 9 AITR 355; 10 AITR 65 (PC) the Privy Council found, on appeal, that a partnership comprising medical practitioners would continue until the resignation of one of the members. In effect, a partnership within the extended meaning of the Assessment Act continued, as the medical practitioners continued to carry on the business jointly. The Privy Council endorsed the view that the section operated only to destroy, and that it supplied nothing. A similar result followed in Polden and Wilson (Pty) Ltd v FCT (1976) 6 ATR 144, where the court found that there was an arrangement within the meaning of the section, but the effect of section 260 was to treat the transaction as a nullity which rendered void the issue of the redeemable preference shares, as also the acquisition and resale of the assets. The court reached the conclusion, accordingly, that there was no income on which to base an assessment.

In the dividend stripping cases the effect of the application of section 260 has been that the vendor, who subsequently re-acquired the shares, has been held to be deemed to have received the dividends declared to the purchaser and is held liable to tax on the dividend accordingly.

In Mangin v Inland Revenue Commissioner [1971] 1 All ER 179 (PC) the taxpayer, a New Zealand farmer, leased different paddocks of his farm to trustees who were to hold the land for one year at a fixed

rental, and who were to cultivate it. Under a trust deed, any income from the leases was to be held on trust for the taxpayer's wife and children. This arrangement was termed a "paddock trust". The taxpayer himself, as the employee of the trustees, harvested the crops from the land, sold them and accounted to the trustees for the proceeds. The trustees paid the taxpayer for his labour and for expenses which he had incurred, and distributed the net income to the taxpayer's wife, partly for herself and partly for her children, on which income they could claim allowances and reduced rates of tax. The arrangement also resulted in less tax being paid by the taxpayer on the profits of the farm.

The majority opinion, delivered by Lord Donovan, was that the taxpayer was liable to income tax on the profits as they would have stood but for the paddock trusts, because the section (ie section 108) has a fiscal effect, operating not only as between the parties to the arrangement, but also as against the Commissioner. It was held that the section was not to be construed as referring only to an arrangement by which the burden of any liability to tax already accrued was shifted from the taxpayer, but also to an arrangement by which the incidence of tax on the taxpayer's income was distributed so that he would be liable to less tax in the future. It was held that although the section would not apply if it could be shown that the arrangement could be regarded as an ordinary family trust for the maintenance and advancement of the taxpayer's

family, even though it might have some tax saving feature, the paddock trust was devised for the sole, or at least principal, purpose of avoiding tax liability on a substantial part of the taxpayer's income. In reaching this conclusion the majority agreed with the finding of the Court of Appeal that the whole scheme "... smacks of such business unreality..." that it could not be accepted.

Lord Wilberforce differed from the majority, and found, on the wording of section 108, that it had a narrower application than section 260, and applying the law to the facts, found that the income was not properly assessable to tax.

From this review of the Australian cases it seems likely that the Australian courts will follow the trend in the United Kingdom. First of all, the "anti" attitude towards tax avoidance will make itself felt, and secondly, the Privy Council would impose the trend experienced in England on the Australian courts.

# Chapter Ten

## Anti-tax avoidance legislation in Southern Africa

Section 103 of the Income Tax Act, No 58 of 1962, sets out the anti-tax avoidance measure applicable in terms of the Act to tax avoidance schemes.

The section provides that when any transaction has been entered into, which has the effect of avoiding or postponing the liability for any tax or duty or reducing the amount of any tax or duty, and the Commissioner considers that the transaction was entered into or was carried out by means or in a manner which would not normally be employed in entering into or in carrying out a transaction of that nature, or the transaction has created rights and obligations which would not normally be created between parties dealing at arm's length, and if the Commissioner is of the opinion that the avoidance or postponement of tax was the sole or main objective of the transaction, the Commissisoner must determine the liability for the tax as if the transaction had not been entered into, or in any other manner which the Commissioner may deem appropriate to prevent the avoidance of tax.

Section 103(2) provides that whenever the Commissioner is satisfied that any agreement affecting any company or any change in the shareholding in any company, as a direct or indirect result of which income has been received by or has accrued to that company during the year of assessment, has been entered into or effected solely or mainly for the purpose of utilising any assessed loss or the balance of an assessed loss incurred by the company, in order to avoid liability on the part of that company or any other person for the payment of any tax or duty on income, or to reduce the amount of any tax or duty that would be payable on income, the set off of the assessed loss or the balance of the assessed loss against income shall be disallowed. (By virtue of an amendment to Section 103(2), introduced in 1984, its provisions will be applicable to the activities of a close corporation.)

Section 103(3) creates a deeming provision in respect of transactions entered into between persons who are ordinarily resident or carry on business in the Republic, and who dispose of shares in a domestic company to a person who is not resident in the Republic, shall be deemed to be carried out by means or in a manner not normally employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the scheme in question.

Section 103(4) provides that a decision of the Commissioner in terms

of Section 103 (1), (2) or (3) shall be subject to objection and appeal. However, whenever it is proved that the transaction in question would result in the avoidance or postponement of liability for payment of tax or duty on income, or in the reduction of the tax or duty, it shall be presumed, until the taxpayer proves the contrary that:

(a) the transaction or scheme was entered into or carried out solely or mainly for the purpose of the avoidance or postponement of liability for tax or the reduction of the amount or liability for tax; or,

(b) in the case of an agreement or change in shareholding, it has been entered into or effected solely or mainly for the purpose of utilising the assessed loss or balance of the assessed loss in question in order to avoid or postpone liability or to reduce the amount of the liability for income tax or duty.

Other provisions of the Act create what may be regarded as anti-tax avoidance measures, for example Section 7, 8 B, 8 C and 8 D, the Sixth Schedule and Section 31, read with the Double Tax Conventions.

The taxes imposed by the Act are normal tax, donations tax, undistributed profits tax, non-resident shareholders' tax, and non-resident's tax on interest. The other laws administered by the

Commissioner are the Estate Duty Act, the Sales Tax Act, the Transfer Duty Act, the Stamp Duties Act and the Marketable Securities Act. Where the purpose envisaged in terms of Section 103(1) is present in relation to any of these Acts, and the other conditions of section 103(1) are present, the Commissioner will be able to apply the section to assess the taxpayer for the taxes which may have been avoided, postponed or reduced, although the avoidance, postponement or reduction of tax was not a purpose of the transaction.

## Chapter Eleven

### Interpretation of fiscal legislation in South Africa

Lord Cairn's dictum in Partington (supra) has been approved in South Africa, see CIR v George Forest Timber Co Ltd 1924 AD 516 at 531-2. Rowlatt J's dictum in Cape Brandy (supra) has similarly been approved, see CIR v Simpson 1949 (4) SA 678 (AD).

In Levene v IRC (1928) AC 217 it was held, by Viscount Sumner, at p.227, that:

> "Taxpayers are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing act. They incur no legal penalties and, strictly speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them".

These cases were, however, narrowed down in CIR v Delfos 1933 AD 242, and by Centlivres CJ in Dibowitz v CIR 1952(1) SA 55(AD). More recently, in Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (AD) Botha JA held:

> "Apart from the rule that in the case of ambiguity a fiscal provision should be construed contra fiscum

> (Estate Reynolds and others v CIR 1937 AD 57) which is but a specific application of the general rule that all legislation imposing a burden on the subject should, in the case of ambiguity, be construed in favour of the subject, there seems little reason why the interpretation of fiscal legislation should be subjected to special treatment which is not applicable in the interpretation of other legislation. ... in the interpretation of fiscal legislation the true intention of the legislature is of paramount importance, and, I should say, decisive."

Botha JA went on to hold that section 103 should be construed so as to advance the remedy it provides and to suppress the mischief against which it is directed. He held that the discretionary powers conferred on the Commissioner should not be restricted unnecessarily by interpretation.

In common with the United Kingdom, over the years South African judges have formulated a number of canons of construction. The primary rule is to establish the intention of the legislature. To do so one has regard to the words used by Parliament. Innes CJ expressed a limitation to this approach in Venter v R 1907 TS at 913 where, referring to 'a difficulty inherent in language' he held:

> "... no matter how carefully words are chosen, there is a difficulty in selecting language which while on the face of it expressing generally the idea of the framer of the measure, will not, when applied under certain circumstances, go beyond it, and, when applied under other circumstances, fall short of it."

The primary rule is that once the will of Parliament has been

established from the words it used to express its will, the Court must give effect to that. In Farrar's Estate v CIR 1926 TPD 501 Stratford J held:

> "The governing rule of interpretation, - overriding the so-called Golden Rule - is to endeavour to ascertain the intention of the lawmaker from a study of the provisions of the enactment in question ..."

Complementary to the primary rule are a number of sub-rules: words must be understood according to their normal meaning; general words must be understood in a general sense; one may not go beyond the words used in the enactment; the judge may not alter the words used, or supply words to fill a casus omissus; a meaning must be ascribed to every word, and so on.

For the purposes of this dissertation I do not think that it is necessary to set out the qualifications and extensions to the primary rule. These are set out in detail in Steyn, Uitleg van Wette, 3rd ed. Juta 1963. However Steyn CJ expressed the view, since adopted in Glen Anil by Botha JA, that there is no satisfactory reason why a more literal interpretation should be applied to taxing legislation than to other legislation. Where the words fall to be interpreted the normal rules should apply, so that in cases of ambiguity the presumption against burdening the subject should apply. In other words, in cases of doubt the contra fiscum rule (Estate Reynolds) should apply. In other cases, however, if the subject falls within the ambit of the enactment, he will be subject to taxation.

## Chapter Twelve

### How the Courts have dealt with tax avoidance: "form" and "substance"

In Commissioner of Customs and Excise v Randles Brothers & Hudson Limited 1941 AD 369, the Defendant had adopted the practice, prior to 1936, of importing goods and transferring them, in accordance with the regulations, to a registered manufacturer to be made up into shirts and pyjamas for the Defendant on the cut, make and trim principle. Under the Regulations, which had been framed under Act 36 of 1925, the goods were imported under a customs duty rebate. In 1936 new regulations were promulgated, so that in order to obtain the rebate of duty, the registered manufacturer to whom the importer transferred the goods was required to make a declaration that the goods were his own property. As a result the Defendant, in order to comply with the regulations, changed its procedure. It purported to sell the goods to the manufacturer, and agreed to purchase the garments at the price of the sum at which the goods had been sold, plus the cost of making. The goods were delivered to the manufacturer pursuant to this agreement, who signed the form declaring that the goods were his own property. When the garments which had been made up were delivered to the importer, it paid in cash and the manufacturer received the agreed cost of manufacturing the garments. The Commissioner of Customs contended that the

importer remained at all times the owner of the goods, and therefore was liable to pay the duty.

Relying on Zandberg v Van Zyl 1910 AD 302, Counsel for the Commissioner contended that regard should be had to the form of the transaction, but more particularly to the substance, the position of the parties and the circumstances under which the transaction came about. On those facts he contended that the transactions were in fraudem legis, and to ascertain whether they were or not, the Court should adopt a construction of the statute in order to avoid the possibility of evasions which might perpetuate the mischief.

Expanding on that argument, he contended that it was a fundamental doctrine that the law would regard the substance rather than the form of things, and that the provisions of a statute might not be circumvented by contraventions of its provisions in an indirect manner; for these propositions counsel relied on Dadoo Limited and Others v Krugersdorp Municipal Council 1920 AD 530.

In the course of the majority judgment Watermeyer JA held that in regard to taxing statutes, two problems of interpretation would arise. Firstly, the law has to be construed to ascertain what kind of transaction is to be taxed, and secondly the transaction has to be interpreted to ascertain whether it is a transaction of the kind which is to be taxed. He approved the dictum of Innes JA (as he then was) in Zandberg v Van Zyl where he had held:

"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 indicates its limitations. The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be.

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

Watermeyer JA went on to consider the nature of a "disguised transaction". In his view a transaction was not necessarily a disguised one because it is devised for the purpose of evading the prohibition in a statute or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties honestly intended it to have effect according to its tenor, should be interpreted in that way, and then the only question would be whether, so interpreted, it falls inside or outside the prohibition or tax.

On the other hand, a disguised transaction is in essence a dishonest transaction, because the parties do not intend it to have, as between themselves, the legal effect which its terms would convey to a third party. The purpose of the disguise is to deceive by concealing the real agreement or transaction between the parties. Dealing with the question whether there had been a transfer of ownership by the importer to the manufacturer, the Court was satisfied that the importer had had the intention necessary to transfer ownership when the goods were delivered to the manufacturer. This inference was strengthened by the fact that the manufacturer executed a form acknowledging that the goods were its property, so the evidence did not establish a "mental reservation" on the part of the importer or the manufacturer.

In Secretary for Inland Revenue v Hartzenberg 1966 (1) SA 405 (AD) the Respondent purchased immovable property in 1961, the purchase price being payable in instalments. The purchaser was entitled to possession of the property with effect from the date of sale. Transfer duty was not paid, as it should have been within six months of the date of sale. After three years the purchaser had paid only the initial instalment in respect of the purchase price.

In the meantime the Transfer Duty Act, No. 40 of 1949, was amended, to provide for a lower rate of transfer duty in respect of the acquisition of immovable property after 16 March 1964.

Consequently, a new agreement was entered into between the purchaser and the seller, cancelling the first agreement, and re-constituting an agreement of sale in respect of the same property and at the same price. The amount paid under the first agreement was refunded to the purchaser, and simultaneously was repaid to the seller as the deposit on the second agreement. The purchaser continued to be entitled to possession of the property sold with effect from the date of the first agreement.

The second agreement was entered into, in terms of that agreement, so as to enable the purchaser to take advantage of the lower rate of transfer duty. The Secretary claimed duty on the higher basis, in terms of the Act as it had been prior to the amendment.

It was contended for the purchaser that he was entitled, in accordance with the principle of the Duke of Westminster, approved in the minority judgement of Centlivres CJ in Commissioner for Inland Revenue v Estate Kohler and Others 1953 (2) SA 584 (AD) at 592, so to order his affairs that the transfer duty payable by him under the Act would be less than it otherwise would have been, so that he was entitled to cancel the first agreement and to enter into the new agreement in order to take advantage of the lower rates of duty.

Having regard to the wording of section 5 (2) (a) of the Transfer Duty Act, Botha JA held that:

> "Thus the formal cancellation of a deed of sale, accompanied by the simultaneous substitution for that deed of a new deed of sale between the same parties, in respect of the same property, where the object of the parties is a variation of the terms of the original deed, is in my view not such a cancellation of the deed as is contemplated by section 5 (2) (a) of the Act. This is so because there was neither in fact nor in law an effective termination of the original deed, but a mere substitution therefor of a new deed, which did not have the effect of extinguishing the jus in personam ad rem acquirendam acquired under the substituted deed".

In Commissioner for Inland Revenue v Estate Kohler 1953 (2) SA 585 (AD), Kohler owned all the preference shares in Premier Timber Company Limited. He owned the majority of the ordinary issued shares, each ordinary share having a value of £83.15s. At a shareholders' meeting the company increased the authorised capital by creating 35 000 new shares ranking pari passu with the original 5000 shares. The new shares were allotted to the members of Kohler's family, so that their market value at the time of allottment was £8 each. The allottees paid the company for the shares allotted to them.

In the winding up of Kohler's estate the Commissioner sought to include, for death duty purposes, an amount representing the difference between that which Kohler received in respect of the allotment of the new shares, and the fair market value of the paid up shares. The Commissioner contended that the difference was property deemed to pass upon the death of the deceased. If this contention was upheld, Kohler's estate for death duty purposes would be increased by about £300 000.

The essence of the transaction was that the deceased caused to be allocated at a price of £1 each to the members of his family shares in a company which he had controlled, which prior to the allotment had had a value of £83.15s, which value decreased, after the allotment, to £8 each.

In delivering the majority judgment, Schreiner JA, in considering the meaning of the word "disposition" in the Act, went so far as to state that he could see no reason for not treating the word as covering all acts which effect property. He held that it would include such transactions as an allotment of shares by a company, although the company's estate is not diminished by it. (Schreiner's JA analysis of the section should be compared with that of the House of Lords in Plummer's case, supra.) To hold that the allotment of shares, which is not property of the company, but a "bundle of rights" creating personal rights against a company, would constitute a "disposition" of property by the company, is, with respect, incorrect. In the result, Schreiner JA held that there had been a "passing" of property, and that the difference between the value of the shares prior to the allotment and afterwards should be included in computing the value of Kohler's estate.

In a minority dissenting judgment, Centlivres CJ re-affirmed the law that a person may order his affairs so as to escape taxation (see pp 591 to 592). Proceeding from that basis he went on to hold:

> "When a company donates money or any right it has to any property and that donation takes effect, the subject matter of the donation becomes the property of the donee; in such a case property passes from the company to the donee. But when a company issues shares to an allottee, no property passes from the company to the allottee. The allottee acquires a right against the company, but the company does not part with any portion of its property. The result of issuing shares in the present case to the allottees did not in any way affect or detract from the proprietary rights of the company; it did, however, affect the value of the shares held by those who were shareholders before the fresh allotment took place. This is, however, irrelevant, as the persona of a company is entirely distinct from that of its shareholders".

The difference between the approaches of Schreiner JA and Centlivres CJ is that the former adopted a literal approach while the latter's attitude is strict and formalistic. The decision in Kohler heralded a new approach to the analysis of facts in tax avoidance cases, namely that the court will look closely at the substance of the transactions giving rise to a tax avoidance scheme and will not be bound by the form of the transaction. This approach was adopted, for example in Berold's case, infra.

With respect to Schreiner JA, his finding that the issue or allotment of a share in a company would constitute a disposition by the company of its property cannot be supported, yet it has been accepted and followed in subsequent cases, see for example Estate Furman v CIR 1962(3) SA 517 (AD).

In Barnett v COT 1959(2) SA 713 (FC) much the same result attached

to the income tax saving plan the taxpayer adopted. A company was formed in which the taxpayer and his attorney held the preference shares, and his children held the ordinary shares. The company purchased the taxpayer's portfolio of shares. The company later declared dividends to the children. The Commissioner sought to deem the dividends declared to the children as the income of the taxpayer. This contention succeeded. In his judgement Tredgold CJ held:

> "There are a number of cases ... that establish that the Courts, in their approach to issues such as those now under consideration, will not allow the forms of the Company law to conceal the causal connection between the various acts that go to make up a transaction of this nature."

These are words which hardly give comfort to a tax planner about to embark on a plan to maximise fiscal advantages !

In Commissioner for Inland Revenue v Berold 1962 (3) SA 748 (AD) the taxpayer incorporated a company, Luzen Holdings (Pty) Limited, and subscribed, with his wife, for shares in the capital. He then transferred assets to Luzen, and became a substantial creditor for the purchase price of the assets. Ten days later he created five trusts, to which he donated two shares in Luzen each and £2000 of the debt owed to him by Luzen. Consequently, he divested himself of his entire shareholding in Luzen. No interest was charged to Luzen, so the trusts were not liable to pay interest either. About six

months later the taxpayer repeated the process in respect of a trust established for the taxpayer's son.

Subsequently another company, Zenlu Investments (Pty) Limited was incorporated. It purchased from the trustees of each of the trusts the shares held by each trust in Luzen, and paid a nominal amount for the shares so acquired. The audited financial statements in respect of Luzen showed that at the time of the sale the liabilities of Luzen exceeded the market value of its assets. In the result, the individual trusts held no shares in Luzen, all of which were held by Zenlu, and the trusts acquired shares in Zenlu, representing the issued share capital of Zenlu.

Dividends were declared by Luzen to Zenlu, and in turn Zenlu declared dividends to the trusts. The Commissioner sought to include in the Respondent's income the dividends declared by Zenlu and received during the year of assessment by the five trusts.

The Commissioner based his argument on the provisions of section 9(3) of the Income Tax Act, No. 31 of 1941, (now section 7(3)) which creates a deeming provision in respect of income which has been received by or has accrued to a minor child by reason of a donation, settlement or other disposition made by the parent of that child, or has been used for the child's maintenance, education or benefit, or has been accumulated on the child's behalf. It was common cause that

the dividend received by each of the five trusts represented income which had been accumulated for the benefit of each child nominated as beneficiary. The question was whether it had been accumulated by reason of a donation by the taxpayer as parent of the child in each case.

Hoexter JA held, at 753 :

> "When the taxpayer sold and transferred a large number of valuable assets to Luzen, he did so on credit and without charging interest on the purchase price. In effect he lent a substantial sum of money to Luzen, and as long as he refrained from compelling Luzen to repay that sum, there was a continuing donation by him to Luzen of the interest on that loan. This donation benefited the shareholders of Luzen, but initially the taxpayer was the sole shareholder and the donation did not alter his financial position. When, however, he donated his shares in Luzen to the five trusts which he had created, those trusts obtained the benefit of his continuing donation to Luzen, and it was, of course, for this very purpose that he donated the Luzen shares to the trusts".

The Court went on to consider what was the "source" of the income derived by the children, and concluded that the only source was the donations made by the taxpayer, in respect of Luzen, and the grandmother who had made a donation in respect of Zenlu. With these considerations in mind, the Court held that although in form the dividend was derived from Zenlu, in fact it derived from the taxpayer's donation. It held that the Court -

> "should not allow the forms of the company law to conceal the effective cause or connection between the taxpayer's donation and the income accumulated for the benefit of the children".

It is submitted, with respect, that the way in which the court ignored the legal nature of the relationship between the taxpayer and Luzen, and subsequently between Zenlu, the trusts and Luzen, shows that the "substance" doctrine has become all important, the "form" being virtually irrelevant. Similarly, the Court's rejection of the separate legal personalities of the intermediate companies is inexplicable in legal terms.

In SIR v Geustyn, Forsyth and Joubert 1971 (3) SA 567 (AD) a partnership was converted into an unlimited liability company, in which the former partners became the shareholders and directors. The directors were credited with goodwill on which interest was payable, but in respect of which they did not take security for payment. The directors received payment of a salary and directors' fees, which together with interest on their loan accounts was less than they would have earned as partners. They did not have service contracts with the company. The Commissioner contended that the cumulative effect of this showed that the transaction had not been carried out in a normal manner, and created rights and obligations which would not normally be created between persons dealing at arm's length. The Court of first instance found that the transfer of the partnership business to a company had been carried out in a normal manner, that

no rights or obligations had been created which would not normally be created between persons dealing at arm's length, and that the avoidance of tax was not the sole purpose or one of the main purposes of the taxpayers. On appeal these findings were upheld. In the course of the judgment the Court held:

> "Section 103(1) is couched in very comprehensive terms but in forming his opinion .... the Commissioner is required to have regard to the circumstances under which the transaction, operation or scheme was entered into or carried out. The criterion of 'persons dealing at arm's length' mentioned in section 103(1)(ii) is, however, not easy of application in a case such as the present. For the section enjoins the application of that criterion in relation to a transaction, operation or scheme 'of the nature of the transaction, operation or scheme in question'. Yet the Court is in the present case ex hypothesi concerned with partners who have, in the circumstances outlined above made over their practice, not to an independent third party with whom they would ordinarily deal 'at arm's length' but to an unlimited liability company of which they are the sole directors and whereof they have the full and complete control. However, inasmuch as it is not essential for the decision of this case to pronounce upon this particular aspect of the matter (which was not exhaustively argued before us) I prefer to express no conclusion upon the point ...".

The Court held that the evidence for the taxpayers established that the reduction or postponement of liability for income tax was not the sole or one of the main purposes of the scheme. On the contrary, a number of other features were found to show that there were sound commercial reasons behind the decision to incorporate, of which income tax saving was not one.

Meyerowitz comments, at para 1617, that when the transactions in Geustyn are looked at from the objective angle of an 'arm's length' transaction, if the partners had been dealing with an independent company, they would have taken security from the directors and shareholders for payment of the amount owed to them, and that the company would have entered into service agreements with each of them. Where the partners were themselves the directors and shareholders of the company, those steps would have been a mere formality without substance, because whatever was done, they could have altered the situation at any time by virtue of the control which they exercised over the affairs of the company.

The case is of importance, because it should be compared with the later case of Louw, infra, where a different result was reached.

In COT v Ferera 1976 (2) SA 653 (RAD), the Court noted that a company which had been formed which was innocent of an income tax avoidance purpose, both in its origin and in its end, could nevertheless be operated in a way that would open the way for an attack by the Revenue. In the course of his judgment MacDonald JP let it be known that he regarded tax avoidance schemes as evil and unproductive, open only to the rich, and casting the burden of tax on the less astute. Throughout the judgment the learned judge makes it clear that it is his dislike of tax avoidance as "an evil", which drives him to find that the creation of the company was to avoid

super-tax. This finding was contrary to the evidence led by the taxpayer, which was not shown to be improbable or false. The case demonstrates the way in which the judiciary are influenced by their personal prejudices in dealing with many of the tax cases which come before them.

In Estate Dempers v Secretary for Inland Revenue 1977 (3) SA 410 (AD) the taxpayer created nine trusts in favour of his two children and each of his seven grandchildren. He donated R100 000 to each trust. The money donated to each trust was lent by the trustees to a company, General Imports (Pty) Ltd, which carried on business in partnership with the taxpayer. The company paid interest to the trusts. The interest was put through the books of the partnership.

The question on appeal was whether the interest accumulated in the trusts, which had not been paid out to the beneficiaries, fell within the ambit of section 9 (5) of Ordinance No. 10 of 1961, which is identical to section 7(5) of the Income Tax Act, 1962.

In considering the provisions of section 9(5) the Court held that:

> "... generally speaking, a taxpayer is perfectly entitled to reduce the amount of his income, and thereby the income tax payable, by giving away income producing assets owned by him."(at 421B)

The Court had to consider whether the trust deed contained a stipulation to the effect that the beneficiaries would not receive the income until the happening of an event, either fixed or contingent, in order to make section 9 (5) applicable. It found it was not necessary to decide whether the exercise of a discretionary power by a trustee was "an event" of that nature, but in reaching its conclusion the Court appeared to hold that the exercise of a discretionary power would constitute "an event". As a result the Court held that when the matter was viewed in its totality the income of the trust would have accrued to and been received by the donee, but for the stipulation in the deed of trust to the contrary.

Accordingly, section 9(5) was applicable to the trust income, which would be deemed to be that of the donor. Corbett JA held that any other conclusion would lead to a curious result that, while section 9(5) would apply to a trust in terms of which trust income was withheld absolutely from the beneficiaries, it would not apply to a trust in which the trustees enjoyed discretionary powers to withhold and accumulate the income or to pay it to the beneficiaries. He concluded that it was unlikely the legislature would have intended to exclude such a transaction from the operation of section 9(5).

With respect, this is a perfect example of judicial legislation. It must be obvious that Parliament would like to see no tax avoidance at all, and in that hypothesis any case which came before a court

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