THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

CASE NO: 256/96 In

the matter between:

RELIER (PTY) LIMITED APPELLANT

and

COMMISSIONER FOR INLAND REVENUE RESPONDENT

CORAM: MAHOMED CJ, VAN HEERDEN DCJ, VIVIER, HARMS et ZULMAN JJA

HEARD: 18 NOVEMBER 1997

DELIVERED: 25 NOVEMBER 1997

J U D G M E N T

HARMS JA/

HARMS JA:

This appeal raises factual and legal issues similar or identical to those that were considered in Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue 1996 (3) SA 942 (A). The taxpayer, the present appellant, appealed against an assessment issued by the Commissioner for Inland Revenue to the Transvaal Special Court for Income Tax Appeals (Wunsh J sitting as President). The appeal was materially unsuccessful (reported as Income Tax Case No 1611 1996 ITC 126) and this further appeal is with

leave of the court below.

To understand the matter more easily, it is

convenient to sketch the applicable statutory matrix.

In terms of par (h) of the definition of ' gross

income' in s 1 of the Income Tax Act 58 of 1962, gross income

includes -

* in the case of any person to whom,

* in terms of any agreement

* relating to the grant to any other person

* of the right of use or occupation of land

* there has accrued

* the right to have improvements effected on the land

* by any other person

* the amount stipulated in the agreement

* as the amount to be expended on the improvements. (Bullet points have been added and matter not germane to the appeal is omitted.) In Ladysmith (at p 950B-F), Hefer JA affirmed that par (h) does not deal with the benefit accruing to the first mentioned person (usually the owner of the land) as the result of an improvement to his property as such. It deals with the accrual of a right to have improvements effected. The right must accrue in terms of an agreement and the agreement must be of a particular kind.

The "other person" who undertook to effect improvements may be entitled to an allowable deduction from his income in determining his taxable income (s 11(g) of the Act).

A computer company, Economic Data Processing (Pty) Ltd (hereinafter 'EDP'), wished to erect a building for its business purposes in the most tax efficient way possible. The sole shareholder of EDP, one Holloway, had land available for this purpose. He was advised by Mr Anderson, then the managing director of National Acceptances Ltd, to enter into a series of simultaneous transactions to which a provident fund ('the Fund') controlled by National Acceptances would be a party. Provident funds were not subject to income tax. Another party to the arrangement was to be the appellant, Relier (Pty) Ltd (hereinafter 'Relier'), a dormant company belonging to the Fund. Holloway accepted the advice and on 29 March 1983 the following agreements were concluded and signed by Holloway and Anderson, both acting in various capacities:

[1] Holloway sold his properties to Relier for R100 000 payable in cash upon registration of transfer. As with all the other agreements, this contract provides that the document constitutes the sole record of the agreement between the

parties.

[2] Relier leased the property to the Fund. Initially the lease was for ten years but could thereafter continue indefinitely. The rental during the initial and any extended period amounted to R1 750 per month. That represents a return of 21% on R100 000, the relevance of which will appear later. The lease was conditional upon the conclusion of the deed of sale [1] . The property had to be used for the erection of office buildings, the buildings had to be insured by the tenant, the insurance policy had to be ceded to Relier and the tenant had to pay all expenses concerning the property. The tenant was not entitled without the prior consent of Relier to sublet or make structural alterations or additions. At the termination of the lease all improvements were to become the property of Relier without any compensation.

[3] A consent to sublease was given in terms of [2] and a sublease [4] between the Fund and EDP was approved.

[4] The sublease referred to between the Fund and

EDP is identical to [2] in relation to commencement, duration, rental and conditions precedent. So, too, in respect of insurance, use, maintenance and related provisions. Important and different is the obligation to build - EDP had to erect at its own costs an office building of not less than R820 000. At the termination of the sublease the improvements were to become the property of Relier, without any compensation.

[5] Relier did not have the funds to purchase the property from Holloway, and in order to pay the purchase price, it borrowed R100 000 from the Fund at 21% interest. The effect of this was that the amount of interest and rental was the same, no rentals flowed between Relier and the Fund, and EDP's rental payment was in effect the interest payment on the loan. [6] The R100 000 lent by the Fund to Relier to pay Holloway was then "pledged" by Holloway to the Fund. This amount had to be invested for the benefit of Holloway and was to be released once the loan had been repaid to the Fund by Relier or the value of the properties as improved exceeded R1,2

million.

[7] As mentioned, Relier became the owner of the property. The intention was that this would be a temporary arrangement and an option was granted to the Holloway Family

Trust to purchase all the shares in Relier at their nominal value. The option agreement contains conflicting provisions about whether the option could have been exercised before the tenth anniversary of the lease, but in the event it was by agreement so exercised.

In furtherance of the scheme additional arrangements were entered into, and they were -

[8] a loan by Holloway to EDP of R300 000,

[9] a further loan to EDP by The Board of Executors, both for financing the building,

[10] a deed of suretyship by Relier in favour of The Board of Executors for payment of R550 000 lent and advanced to EDP, and

[11] a first surety mortgage bond registered against

the property of Relier in respect of the loan [9] . In the option [7] it is stated that the bond would be for R850 000, but the financial statements indicate that it was for R880 000. Finally, Anderson, who was acting on professional advice, warranted on behalf of the Fund the tax effectiveness of the scheme. Mr Vorster for the appellant informed us that the warranty referred to in the evidence was contained in the option [7].

The intended result of the scheme was that EDP would utilise s 11(g) of the Act and claim an allowance in respect of the building costs because of its agreement, the sublease [3], with the Fund. The Fund was a non-taxable entity and the benefit it received could not be taxed in its hands. Relier would get the building as a capital gain without any tax liability because neither the Fund nor EDP had any contractual obligation towards it to erect the building. The Holloway Family Trust would eventually hold the shares in Relier. To interpose for a moment, the Special Court found that the series

of transactions constituted a "package deal"; none of the agreements would have been entered into without the others; and that it was an unstated term of the main lease (and, presumably, the other agreements) that it was conditional on the signing of the main other agreements. The correctness of these findings was accepted by Mr Vorster.

The Commissioner, by letter of 8 September 1986, contended that the building costs formed part of Relier's gross income for the particular tax year. He later issued an additional assessment to tax on Relier in respect of a lease premium of R988 425 in terms of par (h) of the definition of 'gross income' in s 1 of the Act. That gave rise to the appeal to the Special Court which was upheld to the extent only that the amount that had to be included in Relier's gross income was reduced to R820 000 - the amount reflected in the sublease [4]. It should be noted that the issue in the present instance is not whether the scheme falls foul of the anti-avoidance provisions of s 103(1) of the Act, but whether Relier has

established on a balance of probabilities that the building costs were not part of its gross income because no right had accrued to it, in terms of an agreement relating to the grant to any other person of the right of use or occupation of the land, to have improvements effected on the land by that other person.

One commentator hailed the decision in Ladysmitn as a welcome reminder that many tax-avoidance schemes can be nullified by the application of common-law principles (R C Williams Income Tax; Disguised Transaction; Unexpressed Agreement or Tacit Understanding 114 (1997) SAW 458 at 460. In the main this Court concluded that although the law permits people to arrange their affairs so as to remain outside the provisions of a particular statute (at p 951A-B), including a taxing provision, the question in the end remains whether the arrangement was one of substance and not one of form (at p 952B). More to the point, it was held that parties cannot arrange their affairs through or with the aid of simulated

transactions (at p 951C-D) and effect will be given to unexpressed agreements and tacit understandings (at p 954I-J). Mr Vorster argued that because the scheme was structured with full knowledge of the tax provisions referred to and since the parties intended not to attract tax, there can be no question of a simulated agreement or of unexpressed terms. He made the same submission in Ladysmith where Hefer JA pointed to the fundamental flaw therein (at p 953C-D):

> "That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they have been advised to do. The real question is, however, whether they actually intended that each agreement would inter partes have effect according to its tenor."

If the agreements are taken at face value, the appeal must succeed. The interposition of the Fund as tenant and lessor, however, has unusual and unreal aspects to it and the question that immediately springs to mind is whether the Fund actually intended to lease and then to sublet the property.

It was readily conceded that the Fund never had the

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intention to use the property as tenant by occupying it or otherwise. To rent in order to sublet is not unusual in itself, but one would have expected that in such circumstance some advantage would accrue to the tenant. In this case there was none. The rental received by the Fund from EDP was the same as the rental payable by the Fund to Relier which, in turn, was equal to the interest due by Relier to the Fund. All the obligations of the Fund as tenant were, according to the sublease, placed upon EDP. The Fund had no interest in the increase in the value of the property, whether in its capacity as tenant) sublessor or as sole shareholder of Relier. That was not only the evidence of Anderson but further appears from the terms of the option granted to the Trust. The option price was the nominal value of the shares. According to Holloway the rental payable or receivable was not market related. As stated, the rental was fixed, not only for the first ten years of the lease, but also during any extension. The Fund, in

fact, incurred obligations which one would not have expected a trustee (Anderson) to have entered into. One such was the warranty given to Holloway concerning the tax effectiveness. In addition, in terms of the option, Relier was no longer effectively under the control of the Fund because Relier could no longer be involved in any business beyond that agreed with Holloway.

The Fund, as sublessor, imposed a contractual obligation upon EDP to erect a building to the value of R820 000, not on its own behalf, but in the sole interests of Relier. No other reason for the term was suggested. Relier, the owner of the property and the Fund's landlord, who, in terms of the scheme was not supposed to have any interest in the imposition of the obligation upon the subtenant, EDP, stood surety for the loan incurred by EDP to erect the building and passed a surety mortgage bond over its property. As was the case in the Special Court, "[n]o basis was suggested on which, bearing in mind their fiduciary duties, the directors of the

appellant could have undertaken this liability without a corresponding obligation on the part of the principal debtor [EDP], which had no contractual nexus with the appellant, to improve the appellant's property which could be enforced, directly or indirectly, by the appellant." (At p 147 of the reported judgment.)

Holloway, a pivotal figure in the scheme, did not understand what the scheme involved and was thus a party to agreements, the import of which escaped him. From this one can fairly deduce that the written agreements did not reflect his true intentions. Nevertheless, the effect of the considerations mentioned is that the interposition of the Fund as tenant was not truly intended and amounted to a simulation. They also lead me to conclude that Relier had an enforceable right to have the improvements effected in terms of and as set out in the sublease. It is inconceivable in the scheme of things that the parties intended that Relier could not enforce the obligation incurred by EDP. If one poses the question

whether the Fund and EDP could have cancelled or amended the obligation to erect a building by agreement without the consent of Relier, the answer must perforce be in the negative. Similarly, it is unthinkable that the Fund could have elected not to enforce the obligation of EDP to erect without the permission of Relier. The submission by Mr Vorster that since the Fund controlled Relier this could not happen does not take account of the fact that a taxpayer must accept the consequences of the separate legal personalities involved.

Reference was also made to the evidence that the same tax advantages could have been attained as those contemplated by the scheme by the adoption of another scheme which was considered by Anderson. This scheme, it was argued, would have been unimpeachable. That may be so, but I fail to understand how that establishes that the scheme chosen did not contain simulated elements or unexpressed terms.

An attempt was made to distinguish the present facts from those in .Ladysmith. I have some difficulty in

appreciating how the differences enure to the benefit of the appellant. In any event, the effect of my conclusion set out earlier is that the Commissioner's case in casu is stronger than what it was in Ladysmith.

The appeal is dismissed with costs, including the costs of two counsel where employed.

L T C HARMS
JUDGE OF APPEAL

MAHOMED CJ)
VAN HEERDEN DCJ) CONCUR
VIVIER JA)
ZULMAN JA)