IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE HIGH COURT, CAPE TOWN)

Reportable

CASE NO: A 94/2012

In the matter between:

MARIANA BOSCH	First Appellant
IAN McCLELLAND	Second Appellant

And

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES	Respondent

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JUDGMENT: 20 November 2012

DAVIS J

Introduction

[1] This is an appeal against an order of the Income Tax Court which was delivered on 14 September 2011, pursuant to an appeal confirming the taxation of gains received by or which accrued to certain participants in the Foschini 1997 Share Option Scheme ('1997 Scheme).

[2] In 2008 respondent raised additional assessments against the appellants, together with some 115 other employees and ex-employees of the Foschini Group of companies, who were participants in the 1997 scheme and sought to

tax these participants in terms of s 8 A of the Income Tax Act 58 of 1962 ('the Act') in respect of various years of assessment. The additional assessments were raised upon the difference between the cost of the shares of each of the appellants on the dates when each of them exercised options under the scheme ('the strike price') and the market value of these shares on the second, fourth and sixth anniversaries of the dates of the granting of the options. These were the dates, set out in terms of the scheme, whereby the shares would be delivered to the appellants in equal tranches against payment.

[3] In respondent's amended statement of the grounds of assessment in respect of the first appellant and the statement of the grounds of assessment in respect of second appellant, respondent invoked paragraph 2 (a) of the Seventh Schedule to the Act as an alternative ground for a liability in respect of shares delivered prior to 26 October 2004. In these statements, which set out the grounds of assessment, respondent also invoked s 8 C of the Act as an alternative basis for liability in respect of shares delivered after 26 October 2004 and raised paragraph 2 (a) of the Seventh Schedule as a further alternative basis in respect of these shares.

[4] The first appellant was assessed in respect of the 2001, 2003, 2005 and 2006 years of assessment, all of which assessments were adjudicated upon by the court *a quo*. Second appellant was assessed in respect of the 2001, 2003, 2004, 2005 and 2006 years of assessment. However, in this case, it was agreed

that only the additional assessment issued in respect of 2005 would be adjudicated upon by the court *a quo*. The two appeals were heard together. The court *a quo* decided to set aside the additional assessments in respect of the first appellant for the 2001 and 2003 years of assessment and upheld the additional assessments in respect of the 2005 and 2006 years of assessment as well as the additional assessment in respect of the second appellant for the 2005 assessment.

[5] As there was no cross appeal by the respondent against the decisions of the court *a quo* which were favourable to the appellants, the present appeal against the decision of the court *a quo* was defined so as to canvass only the additional assessments in respect of the first appellant for the 2005 and 2006 years of assessment and, regarding the second appellant, in respect of the 2005 year of assessment.

The factual background

[6] In 1990 the Foschini Group of companies decided to introduce an Employee Share Incentive Scheme. To the extent that it is relevant to this dispute, it appears that, although the 1990 scheme involved two alternative mechanisms, namely a share purchase and option scheme, it was only the latter that was implemented. In terms of the option scheme, an employee could exercise the option for a third of the designated shares on or after the third, sixth and ninth anniversary dates of the date on which the option was granted,

whereupon these shares would be transferred from Foschini Limited to the relevant employee. On the tenth anniversary date, the option would lapse, to the extent that it had not been exercised. If an employee left the employ of the Foschini Group, any unexercised option would lapse.

[7] This particular scheme did not prove entirely satisfactory to the Foschini Group, as a result of which careful consideration was given to altering the scheme. In January 1997 the Foschini Group briefed both its attorneys and accountants to review the 1990 scheme and 'to make a proposal with regard to creating a new cost and tax effective and sufficient scheme to take over from the existing scheme'. In its brief, it set out the problems which it had encountered with the 1990 scheme and what it considered should be the necessary attributes for a new scheme. These included the following:

> "1. *The new scheme had to "provide the essential benefits of a Share Option Scheme in terms of rewarding and motivating the achievement of superior financial performance and retaining the services of key employees";*
>
> 2. *the new scheme had to be "market competitive", given that the 1990 scheme "may not be competitive from an employee market point of view";*
>
> 3. *the new scheme had to be "easily administered", given that the 1990 scheme was "cumbersome and confusing from an administrative viewpoint";*

4. *the new scheme had to utilise "a vehicle that will be directly affected by the financial result of the company [TFG]", given that the shares utilised by the 1990 scheme - Lefic shares – were "not necessarily the ideal vehicle"; and*

5. *the new scheme had to be "tax efficient to the greatest degree possible for both employer and employee", given that the 1990 scheme "is not tax efficient either to the employee or employer". "*

[8] In December 1997, a memorandum was prepared for the chairman of the Foschini Group, Mr Stanley Lewis, for use at the general meeting of shareholders in order to explain why a new scheme was necessary. In that memorandum, the following justifications for the introduction of the new scheme were set out:

"1. *a share incentive scheme is necessary to motivate and maintain "the focus and commitment of the senior management team";*

2. *in the period since Foschini had introduced the 1990 scheme, "new and improved incentive schemes have been devised";*

3. *whereas under the 1990 scheme options may be exercised in tranches after three, six and nine years, under the new scheme options are granted for a short period only and must be exercised in that period (21 days), which has the effect that the executive is "committed" to purchasing share irrevocably for the beginning and brings about "more focus and commitment to the business of the company and significant behavioural changes in senior management";*

4. *in line with the "trend towards shorter periods", the new scheme will allow executives to enjoy the benefits of share ownership far sooner than was the case with the existing scheme, i.e. in three equal tranches after two, four and six years instead of three, six and nine years;*
5. *a benefit to the Foschini group is that the new scheme will be operated by TFG which earns taxable income and would be able to deduct the costs for the scheme for tax purposes, whereas the existing scheme was operated by Foschini Ltd (as investment holding company) with the result that the costs of the scheme were being paid out of after tax income; and*
6. *"[an] ancillary benefit for the executives is the fact that in terms of the New Scheme, the tax burden upon the executives is substantially reduced and accordingly the benefits accruing to them are correspondingly enhanced. The reciprocal benefit for the Group is that less shares have to be made available in order to achieve desired benefit levels."*

[9] According to the evidence of Mr David Nurek, who apart from being a senior attorney at the Foschini Group's firm of attorneys during the relevant period had also been a director of the Foschini Group from 1 May 1990, the 1997 scheme, which was classified as a deferred delivery scheme, was structured around certain fundamental requirements. There had to be an exercise of the right of acquisition in respect of the shares and the agreements, which were

entered into between the parties, had to be unconditional. The tax advantage, as Foschini understood it, was that the employees would gain an advantage provided that he or she exercise the option within a relatively short period after it was granted, so that the taxable amount in terms of s 8 A would be relatively small, particularly as any gain made between the date of exercise and the date at which the shares were delivered would not be subject to income tax although it could constitute a capital gain. The advantage to the employer was that in order to arrive at the same benefit, it could grant less options and issue less shares.

[10] Second appellant also testified, in this connection, confirming:

> "*From the company's point of view there was multiple delivery dates, which could be very numerous, which were difficult for administration. There was a significant disturbance concerning the N shares, there was a lot of concern about the fact that the option scheme was not in the employer company, giving rise to tax leakage. There was a discussion about the fact that if we put it into a new scheme we could offload unnecessary shares; if you were not using the N shares, you could sell them off. There were probably others as well.*"

[11] Following advice given by Foschini's attorneys and accountants, a most eminent senior counsel also furnished an opinion on the tax consequences of the scheme. As a result of a positive opinion, it appeared that the scheme agreement was finalised. On 4 November 1997, it was resolved that the scheme

agreement would be signed and approved, which approval took place at general meetings of the relevant companies on 10 December 1997.

The 1997 Scheme: the basic principles

[12] In terms of Clause 2 of the scheme, the object was to give employees an incentive to promote the continued growth of the company by giving them the opportunity to acquire share in the company. The scheme provided for the granting of options by the Foschini Group, which had to be exercised in writing within 21 days of the relevant notice date. Shares, which were the subject of the option that had been exercised, were referred to as sale shares. Shares, which had been delivered after the implementation date, were referred to as scheme shares. A participant was not required to pay consideration immediately upon the exercise of the option but only against delivery to the participant of the scheme shares. A participant was entitled to delivery of the scheme shares in three equal tranches, being on the second, fourth and sixth anniversaries of the relevant notice date against payment of the portion of the consideration attributable thereto. Each of the second, fourth and sixth anniversaries of the relevant notice date were referred to as an implementation date. Prior to the delivery of the shares in the three equal tranches, a participant was not entitled in any way to alienate, transfer, cede, pledge or encumber his or her rights in terms of the scheme, including the right to delivery of the shares in question. The risks and benefits of the shares did not pass to the participant. A participant was not entitled to participate in any cash dividends declared in respect of the

shares. The participant was not entitled to exercise or dispose of any voting rights in respect of the shares.

[13] If on the particular implementation date, the middle market price of the scheme shares which were due for delivery to a participant was less than the consideration payable in respect of the shares by the participant and, if the participant wished to dispose of such shares, the participant was entitled to resell his or her shares to the Foschini Group for the same amount for which they were purchased. In turn, the Foschini Group was obliged to purchase them for the amount on the implementation date, whereupon the amount owing by the participant to the Foschini Group ('the consideration') would be set off against the amount owing to the Foschini Group by the participant. This was referred to as the stop loss provision. If, on the relevant implementation date, a participant did not pay the portion of the consideration attributable to the transfer of the shares tendered by the Foschini Group, the latter was entitled to enforce payment against delivery or to cancel the shares without prejudice to its rights to claim damages. If, on the relevant implementation date, the transfer shares was delivered and paid for, the risks and benefits of the shares passed to the participant. If it any time prior to the implementation date in respect of a transfer shares, a participant's service with the Foschini Group was terminated for reasons, other than sequestration, death, superannuation or ill health of the participant, the latter was obliged to sell the shares to the Foschini Group which was obliged to buy them at a purchase price equal to the consideration attributable thereto.

[14] The Foschini Group was entitled to repurchase sale shares in certain specified circumstances and held a pre-emptive right, in the event that the participant wanted to sell any scheme shares.

[15] After the establishment of the Foschini Share Incentive Trust ('trust') on 27 July 1999, the Foschini Group assigned its rights and obligations in terms of the scheme to the trustees of the trust. Shortly thereafter, a restructuring of the Foschini Group took place and the appellants became employees of the Foschini Retail Group (Pty) Ltd ('Foschini Retail').

[16] Initially the Foschini Group and later the trust, acting in terms of the provisions of the scheme, granted options to certain employees to acquire scheme shares at stipulated prices, being either the middle market price of the scheme shares on the relevant notice date or such price, less a discount of up to 10%. The notice days, which were initially granted by the Foschini Group to first and second appellants and which are relevant to this appeal, were 14 August 1998 and 2 December 1998. The notice dates in respect of options which were granted by the trust and which are relevant to the first appellant's appeals were 19 March 2001 and 1 April 2003. All of the options were exercised by the appellants.

[17] Between 2001 and 2002, the implementation dates were postponed by agreement between the trust and the appellants, mainly because at the time, the market price of the shares was low. Shortly before each of the implementation dates, the trust offered the appellants a choice of having their shares transferred into each of their names against payment of the consideration or selling them on each of their behalf and paying to them the proceeds, net of the selling costs and the consideration respectively. On all of these occasions, first appellant asked the trust to sell the shares on her behalf and a formal agreement was reached in respect thereof. In the 2005 year of assessment, second appellant asked the trust to transfer the relevant shares into his name.

Respondent's assessments and the appeal to the Tax Court

[18] When respondent initially assessed first appellant to tax in respect of the 2001, 2003, 2005 and 2006 years of assessment, he did not include the difference between the costs of the shares to her when she exercised the options under the scheme and their market value on the implementation dates in her taxable income.

[19] In June 2008, respondent issued additional assessments to first appellant for the 2001, 2003, 2005 and 2006 years of assessment in which respondent assessed first appellant to tax on the amounts of R 18 806 (2001), R 45 208 (2003), R 120 163 (2005) and R 212 488 (2006) on certain specified grounds

which can conveniently be referred to as the first additional assessments, all of which had a due date of 1 July 2008.

[20] On 16 March 2010 respondent issued, what can be referred to as a second additional assessments in respect of first appellant, in which, in the alternative to the first additional assessments and in the event that the shares were not delivered to the appellant, respondent assessed first appellant to tax on income of R 18 585 (2001), R 44 158 (2003), R 61 099 and R 58 400 (2005) and R 208 528 (2006). First appellant objected to the first additional assessments on a range of grounds and by agreement was deemed to have objected to the second additional assessments which objections were disallowed. Thereafter, first appellant submitted a notice of appeal to the Tax Court.

[21] Respondent delivered an amended statement of grounds of assessment in terms of Rule 10 of the Tax Court Rules, in which the grounds upon which the objections were disallowed and the material facts and legal grounds upon which the respondent relied for such a disallowance were set out. First appellant delivered an amended statement of grounds of appeal in terms of Rule 11.

[22] In essence, the issues in the appeal to the Tax Court were defined in these two documents.

[23] The case in respect of second appellant can be summarised thus: when respondent first assessed second appellant in respect of the 2005 year of assessment, he did not include in second appellant's taxable income the difference between the costs of shares to him when he exercised options under the scheme and their market value on the implementation date. On 29 February 2008, respondent issued an additional assessment to second appellant for the 2005 year of assessment in which he assessed second appellant to tax on income of R 108 965 on certain specified grounds, referred to as the additional assessment with a due date of 1 April 2008. Second appellant objected to the additional assessment on a number of grounds. These were disallowed by the respondent, whereupon second appellant appealed to the Tax Court. Respondent delivered a statement of grounds of assessment in terms of Rule 10 and second appellant delivered his statement of grounds of appeal in terms of Rule 11 in terms of which he documented the basic dispute between the parties.

The decision of the Tax Court

[24] The court *a quo* was confronted with five separate issues relating to first appellant's assessments and three issues relating to second appellant's assessment.

[25] The five issues relating to first appellant can be summarised thus:

1. was respondent precluded from issuing an additional assessment for the 2001 and 2003 years of assessment in terms of paragraph (i) of s 79(1) of the Act?
2. was respondent precluded from issuing additional assessments for the 2001 and 2003 years of assessment as result of paragraph (iii) of the proviso to s 79(1) of the Act?
3. was respondent precluded from issuing additional assessments for the 2001 and 2003 years of assessment by virtue of first appellant's legitimate expectation that she be taxed solely on the basis that the exercise of an option or acceptance of an offer to sell share is the sole relevant event for the purposes of s 8 A and that the gain in terms of the section was the difference between the consideration payable and the value of the shares at the date of such exercise for acceptance?
4. whether, with regard to both first and second appellant, liability to tax was triggered in terms of s 8 A upon delivery of the scheme shares?
5. whether the first and second appellants became liable for tax in terms of paragraph 2 (a) upon, delivery of the scheme shares?
6. in respect of both appellants 2005 year of assessment and first appellant's 2006 year of assessment, whether first and second appellants became liable for tax in terms of s 8 A on delivery of the scheme shares?

7. whether first and second appellants became liable to tax in terms of paragraph 2 (a) of the Seventh Schedule upon delivery of the scheme shares; and

8. whether the first and second appellants became liable to tax in terms of s 8 C of the Act.

[26] The court *a quo* held that the first additional assessment of 2003 in respect of first appellant had to be set aside on the basis that the respondent had failed to prove that his failure to assess first appellant to tax within three years from the due date of her original assessment was due to non-disclosure on the part of first appellant. The court also held, in respect of the second tax issue, that the additional assessments against first appellant in respect of 2001 and 2003, had to be set aside on the basis that the practice of the respondent generally prevailing was not to assess to tax those gains made on delivery of the relevant scheme shares at that stage. The court further held, in respect of the third tax issue, that the appellants could not establish a legitimate expectation to justify their argument as framed above in the third question.

[27] In respect of the fourth and sixth issues, the Court held that s 8 A applied to gains made on delivery of the relevant scheme shares when delivery took place prior to 26 October 2004, as taking delivery constituted the exercise of the right to acquire a marketable security for the purposes of s 8 A. In terms of the fifth issue, the court held that, as s 8 A was applicable, paragraph 2 (a) of the

Seventh Schedule was thus inapplicable. There was no express finding in respect of the seventh tax issue. Regarding the eighth tax issue, the Court held that s 8 C applied to gains made upon delivery of the relevant scheme shares when delivery took place after 26 October 2004 as taking delivery constituted the vesting of equity instruments acquired during the relevant years of assessment as contemplated by the provisions of s 8 C.

[28] In the result, the Tax Court held that first appellant's 2001 and 2003 first additional assessments had to be set aside, the 2005 and 2006 first additional assessments were confirmed and second appellant's 2005 additional assessment was confirmed.

[29] It is against these findings that the appellants have proceeded to this Court on appeal.

[30] The appellants lodged a voluminous list of grounds of appeal against the adverse decisions of the Tax Court. However, by the time the matter proceeded on appeal the issues had been carefully defined. They can be summarised thus: In respect of the 2005 additional assessments, insofar as they related to the delivery of the relevant scheme shares before 26 October 2004, the issue is whether the first and second appellants became liable for tax in terms of s 8 A upon delivery of the scheme shares and whether the first and second appellants

became liable for tax in terms of paragraph 2 (a) upon delivery of the scheme shares.

[31] The issues before this Court in relation to the 2005 additional assessment, insofar as they are related to delivery of the relevant scheme shares after 26 October 2004 as well as in respect of the 2006 additional assessment, can be summarised thus:

1. whether the first and second appellants became liable for tax in terms of s 8 A on delivery of the scheme shares;
2. whether the first and second appellants became liable for tax in terms of s 8 C; and
3. whether the first and second appellant became liable for tax in terms of paragraph 2 (a) on delivery of the scheme shares.

Common cause facts

[32] Given the complexity of the factual background to this case and the disputes as I have outlined them, it is useful to distil the common cause facts which are relevant to the determination of this dispute. First and second appellants entered into various agreements in terms of which they purchased scheme share at stipulated prices. The following sale agreements are relevant to both the 2005 and 2006 years of assessment.

1. In August 1998 first and second appellants each purchased scheme shares from the Foschini Group. The Foschini Group's rights and

obligations in terms of this agreement were subsequently assigned to the trust as I have already noted.

2. In December 1998 the first and second appellants each purchased scheme shares from the Foschini Group. Again the Foschini Group's rights and obligations were assigned to the trust.
3. In March 2001 the first appellant purchased scheme shares from the trust.
4. In April 2003 the first appellant purchased scheme shares from the trust.

Turning to the relevant implementation dates in respect of these various sale agreements, the third implementation date in respect of the August 1998 sale agreements was 14 August 2004. The third implementation date in respect of the December 1998 sale agreements was 2 December 2004. The second implementation date in respect of the March 2001 sale agreement was 19 March 2005 and the implementation date in respect of April 2003 sale agreement was 1 April 2005.

[33] At each of these implementation dates, the first appellant elected that the trust would sell the shares and, pursuant to these elections, the trust did sell these shares and paid the net proceeds to the first appellant. At the time of the third implementation dates in respect of the August 1998 and December 1998 sale agreements, second appellant elected to have the shares transferred into his name rather than have the trust sell them on his behalf and pay him the proceeds net of consideration and the costs of the sale. Pursuant to this election, the trust

delivered on each of the third implementation dates in respect of the August 1998 and December 1998 sale agreements, the third tranches of shares to the second appellant.

[34] The third implementation dates in respect of the August 1998 and December 1998 sale agreements were 14 August 2004 and 2 December 2004 respectively, both of which fell within the 2005 year of assessment.

[35] On these implementation dates, the market value of the relevant shares and the prices paid for such shares in terms of sale agreements were as follows:

	DATE	MARKET VALUE	PRICE	DIFFERENCES
First Appellant	14/08/2004	R81,106	R20,007	R61,099
First Appellant	02/12/2004	R69,671	R10,607	R59,064
Second Appellant	14/08/2004	R40,621	R10,021	R30,600
Second Appellant	02/12/2004	R92,494	R14,129	R78,365

[36] The second implementation date in respect of the March 2001 sale agreement was 19 March 2005 and the first implementation date in respect of April 2003 sale agreement was 1 April 2005, both of which fell within the 2006 year of assessment. On these implementation dates, the market value of the relevant shares and the prices payable for such shares in terms of sale agreements were as follows:

	DATE	MARKET VALUE	PRICE	DIFFERENCES
First Appellant	19/03/2005	R118,571	R17,332	R101,239
First Appellant	01/04/2005	R153,279	R42,030	R111,249

[37] Given these facts, the essential finding of the court *a quo*, in respect of the 2005 and 2006 years, was that first and second appellant took delivery of some shares before 26 October 2004 and others after 26 October 2004, being the date on which s 8 A was superseded by s 8 C as a regime for taxing benefits of this kind. The court held that s 8 A applied to the shares delivered before 26 October 2004 and s 8 C applied to the shares delivered after 26 April 2004. Since the appellants argued that s 8 A applied to all of these share transactions, regardless of when they were delivered and that, on a proper construction of s 8 A, there were no gains to tax, the starting point for an analysis of this Court must be s 8 A.

Section 8 A

[38] To the extent that it is relevant s 8 A provides thus:

> *"(1)(a) There shall be included in the taxpayer's income for the year of assessment the amount of any gain made by the taxpayer ... by the exercise ... during such year of any right to acquire any marketable security ... if such right was obtained by the taxpayer before 26 October 2004 ... in respect of services rendered or to be rendered by him as an employee to an employer*".

[39] It was common cause that, for s 8 A to apply, the taxpayer 'must exercise... a right to acquire' the relevant shares. In his grounds of assessment, the respondent contended that, when the substance of the agreements which underpinned the 1997 scheme was analysed, the clear intention of the parties

was, save in the exceptional circumstances contemplated in clauses 10.1 and 8.2 of the scheme (sequestration of a share participant, ceasing to be an employee as a result of death, superannuation or ill health or a decision to terminate employment by the board)) the sale envisaged by the exercise of the option took place only if the employee remained in the employer's employ until the relevant anniversary dates and only, if by virtue of the current value of the shares being higher than the specified consideration, it was to the employee's financial advantage to take delivery of the shares and to pay a specified consideration. Respondent thus contended that the employee only acquired an unconditional right to delivery of the relevant shares upon the arrival of the defined implementation dates and, if at those dates, the sale, had been an unconditional one, that is there would be no termination of the employees employment prior to the anniversary date, the middle market price of the shares at the anniversary date was higher than the specified consideration, or, if lower, the employee had not made an election.

[40] In argument, Mr Rogers, who appeared together with Mr Janisch and Mr Cassim on behalf of respondent, contended that, even if the mere exercise of an option, rather than the assertion of a claim for delivery of the shares, fell within the meaning of the phrase 'exercise of a right to acquire' shares and, even if the exercise of an option in these circumstances would be the only possible event which would trigger the s 8 A, this could only be so if, upon the exercise of the option, the employee had obtained an unconditional right to obtain delivery of the shares on a future date.

[41] Mr Rogers submitted that the exercise of the short term option of the 1997 scheme did not give rise to any such unconditional right. Accordingly, s 8 A was not triggered 'upfront' but only when the claim to the shares became unconditional; that is when, on arrival of the deferred implementation date, the employee, who was still employed, claimed the shares against tender of the payment of the purchase price. Alternatively, s 8 A would not be triggered at all and the benefit, which accrued to the employee on the deferred implementation date, was taxable in terms of paragraph 2 (a) of the Seventh Schedule.

[42] By contrast, appellants assert that the right to acquire shares in terms of the scheme is triggered, for the purposes of s 8 A, when the relevant option to purchase shares was exercised and accordingly they contest that the right to acquire shares was exercised for the purpose of s 8 A <u>only</u> when the shares were delivered.

The conditionality argument

[43] The key question for determination in respect of this central argument between the parties was whether the 1997 scheme conferred on a participant, such as first and second appellant, a definite and unconditional entitlement to acquire shares upon the exercise of the option pursuant to s 7.1 of the scheme agreement or whether the entitlement could only be determined upon the relevant implementation dates.

Appellant's case

[44] Mr Solomon, who appeared together with Mr Breitenbach (the heads of appellants were also prepared by Mr Hodes) on behalf of appellants, referred to Clause 7 of the Scheme agreement in support of the argument that unconditional sales of the scheme shares took place upon the exercise of the option. Clause 7.1 specifically provided that the participants shall become entitled to delivery thereof against payment of the portion of the consideration attributable thereto on the various anniversary dates. In addition, Clause 7.1.4 specified, in the case of a participant whose service with the Foschini Group was terminated for specific reasons, the Foschini Group would be entitled to effect earlier delivery of the sale shares to the participant against payment of the consideration by the participant, who was, in turn, obliged to effect payment thereof on the particular dates as determined. Clause 7.3 provided that, if at any prior time to the implementation date in respect of any sale shares, a participant's service with the Foschini Group was terminated for any other reason, the participant would be obliged to sell his or her shares to the Foschini Group which would be obliged to purchase such shares at a purchase price equal to the consideration which would have been payable by the participant on the implementation date in respect of these sale shares. Set off would then apply.

[45] Mr Solomon also referred to clause 7.4 which provided that if the middle market price per share of the participant's sale shares on the implementation date was less than the consideration payable in respect of such sale shares by the participant and, if the participant wished to dispose of the shares, the Foschini

Group would be obliged to repurchase the sale shares at an amount equal to such consideration. Again set off would apply. Clause 7.5 specified that, failing payment of the consideration in respect of the shares against tender of delivery of the shares by TFG in terms of Clause 7.1, the Foschini Group would be entitled to enforce payment against delivery of the sale shares or cancel the sale without prejudice to its rights to claim damages. Clause 10.2 provided that in the agreement, whenever the Foschini Group was entitled or obliged to repurchase sale shares prior to delivery to a participant, the Foschini Group would be entitled to elect to cancel the sale, provided that, subject to clause 7.4, the amounts which would have been payable by the participant and the Foschini Group respectively, would be taken into account in determining the amount of payable to the participant, pursuant to such cancellation.

[46] Accordingly, if Clause 7.3 of the scheme was examined in terms of its purpose to deal with the situation where a participant's service with the Foschini Group was terminated for a specific reason, the participant would be obliged to sell his or her shares to the Foschini Group or, later to the trust, which, in turn, would be obliged to purchase the shares at a purchase price equal to the consideration which would be payable by the participant on the implementation date in respect of these shares. In Mr Solomon's view, this mechanism was predicated upon the existence of an agreement of a sale between the participant and the Foschini Group and, in the later years of the scheme, the trust.

[47] Unlike a suspensive condition, this mechanism did not suspend the content of the agreement, that is the delivery of the shares, against payment of the purchase price, pending the fulfilment of the condition. The deferral of the seller's obligation to deliver the shares and the buyers obligation to pay them arose as a result of Clause 7.1, that is the time clause which qualified these obligations with reference to a series of three determinable future dates referred to as the implementation dates. Similarly, Clause 7.4, dealt with the situation where the middle market price per share of a participant's sale shares on the implementation date was less than the consideration payable in respect of such sale shares by the participant. In short, it could be described as a stop loss mechanism. If a participant decided to dispose of these shares, the trust would be obliged to repurchase the shares at an amount equal to such consideration. This mechanism did not operate unless the participant decided to invoke it, that is to sell the shares back to the trust. Viewed accordingly, the operation of the mechanism was completely dependent on the will of the participant and could not be considered to be a true condition.

Respondent's case

[48] By contrast, respondent contends that the form of deferred purchase arrangement adopted by Foschini was subject to a number of suspensive conditions. Further, a participant's right to delivery was conditional on payment or a valid tender of payment on the implementation date. Relying on **ESE Financial Services (Pty) Ltd v Cramer** 1973 (2) SA 805 (C) at 808 – 809, Mr Rogers submitted that a purchaser's entitlement to delivery of the shares was

conditional on his or her payment or tendering of payment of the purchase price and the seller's right to this payment of the price. Accordingly, the right of a participant to insist on performance by the trust was the subject of the condition that he or she makes prior or concurrent performance of his or her own obligation. This type of conditionality is not dependent upon a suspensive or a resolutive condition in the strict sense but flows from a proper interpretation of the enforceable terms of the contract.

[49] To the extent that this particular argument did not find favour with the Court, respondent contends that the various agreements were subject to suspensive conditions. In particular, respondent argues that Clause 7.3, which provides that a participant is not entitled to acquire the shares unless he or she is still employed at the implementation date (save for various restricted reasons), is no more than a suspensive condition. In respondent's view, the terms of the resale process in terms of Clause 7.3 is unrelated to a general commercial consideration, for, regardless of the current value of the shares at the time that the participant's employment, ends the resell price is identical to the original purchase price. The condition was therefore a suspensive one because there could not be any implementation until the requirement of the continued employment was fulfilled as at the implementation date.

[50] In terms of Clause 7.4, the stop loss condition, for all practical purposes, gave the participant the same right to decide whether or not proceed with the

purchase as the grantee of an unexercised option. According to Mr Rogers, Clause 7.4 was clearly designed to create this very result. Referring to the evidence of first appellant, Mr Rogers submitted that it was her understanding that she was not obliged to take the shares on implementation date if it was unfavourable to her to do so.

[51] When Clauses 7.3 and 7.4 were read together with the balance of Clause 7, in respondent's view, the substance was that there was a fundamental uncertainty prior to the implementation date as to whether the deferred sale would ever be implemented. The deferred purchases under the 1997 scheme were, in effect, as uncertain as the unexercised options pursuant to the earlier 1990 scheme. Accordingly, when the appellants concluded their deferred purchase agreements within the initial 21 day period, in respondent's view, they did not exercise a right to acquire shares within the meaning of s 8 A.

Evaluation

[52] In **SIR v Kirsch** 1978 (3) SA 93 (T) Coetzee J, writing for a Full Bench, engaged in a careful analysis of the key phrase 'any right to acquire' as set out in s 8 A. In particular, the learned judge analysed the argument that the phrase 'right to acquire' should be equated to an option which '*involves a concluded agreement binding the offeror to keep the offer open. Respondents counsel argued that in 'tax law'... a 'right' in this context is always only an enforceable one.*

Because a simple offer is revocable at will, no right, so the argument runs, flows therefrom until the parties agree to embody it in an option.' At 94 B-C

[53] Coetzee J rejected this argument on the basis that 'the word 'right', in 'legal parlance' is not necessarily synonymous with the concept of a 'legal right' which is a correlative of a duty or obligation. On the contrary, "*legal literature abounds with 'right' being used in much wider sense ... An owner, for instance, has at common law the right to use or abuse his property. The problem, in casu is simply to determine whether the Legislature employed this term only in its strictest sense as the correlative of a legal duty or whether its wider meaning could be included.*" At 94 F

[54] Basing his interpretation, to a considerable extent, on a finding of the common use of 'right' in the wider sense in the very field of financial activity covered by s 8 A, Coetzee J held that this context was indicative of the intention of the Legislature to adopt a wider meaning of the word 'right'. The learned judge concluded that there was no reason "to limit the operation of s 8 A to rights in the strict sense of options." At 95

[55] This approach was followed in **ITC** 1493: 53 SATC 187 at 201, in which Melamet J said:

"It matters not for purposes of the decision in the appeal whether the right is a simple offer, which, upon acceptance by the offeree will bring into existence a contract for the acquisition in the shares, or whether the right is an option to acquire shares and upon the exercise of which a contract for the acquisition in the shares is perfected. The right contemplated in the subsection is a right enjoyed by a taxpayer to bring into existence by his voluntary and unilateral act of exercise or acceptance a contract which entitles him to claim the shares."

[56] The reference to **ESE Financial Services (Pty) Ltd v Cramer** 1973 (2) SA 805 (C) at 808 – 809, which was employed by respondent to contend that any right which might have been enjoyed by the appellants was conditional upon the appellant's prior or concurrent performance of his or her own obligation, has, admittedly, been employed within our tax jurisprudence. See **ITC 1444**; 51 SATC 35. However, this case dealt with the question of the interpretation of 'actually incurred' as provided for in s 11 (a) of the Act. The Court held, on the evidence, that it was clear that the liability of the taxpayer to effect payment of the purchase price in terms of the relevant contract was conditional upon the performance or tender of performance by the seller. Thus, the condition that the seller was required to fulfil before an absolute and unqualified legal ability to pay the purchase arose was to effect the delivery of bills of lading and invoices in respect of supplies of materials which had been referred to in the contracts. As that had not been done, it could not be held that there was an unconditional liability, sufficient to justify a deduction in terms of s 11 (a) of the Act.

[57] That situation is entirely distinguishable from the kind of right envisaged in s 8 A. This is confirmed, particularly in the judgment in Kirsch's case, *supra* which, in my view, represents a correct interpretation of s 8 A of the Act. It therefore requires a different form of enquiry to that which is employed to determine the meaning of 'actually incurred' pursuant to s 11 (a) of the Act. As Coetzee J held in **Kirsch**, *supra*, the word 'right' is not a right *strictu sensu* In this connection WN Hohfeld's classic work *Fundamental Legal Conceptions as applied in Judicial Reasoning* (1946) proves a very useful point for analysis. In Hohfeld's analysis, the concept 'right' could be expanded to four different meanings: right, privilege, power or immunity. Whereas a right has a correlative of a duty, the correlative of privilege is a no-right, the correlative of power is a liability and the correlative of immunity is a disability. In the case of s 8 A, the word 'right' appears to be better analysed as a privilege given to the employee. It then follows that the arguments raised about conditional obligations imposed upon the employee who enjoys a privilege are not applicable Furthermore, the attempt to apply 'the analysis of 'actually incurred' to a privilege is clearly still born and is not relevant to the present transaction.

[58] To the extent that an explanatory memorandum to a section is of any interpretive utility, the Explanatory Memorandum to the Income Tax Bill of 1969, states:

> "*Where, for instance, an employee has been granted an option by his employer to acquire shares, the gain will be difference between the market*

value of the shares as at the date in which the option is exercised and the amount paid by the employee for the shares..."

Clearly, what the legislature had in mind was the acquisition of an option to acquire shares which reveals an entirely different set of analytical requirements to that which must be used to parse s 11 (a). Accordingly, it does not appear to me that the argument with regard to bilateral obligations is relevant to the determination of the meaning of 'right to acquire' in terms of s 8 A.

[59] The fact that the approach advocated by the appellant as to the meaning of 'right to acquire' in s 8 A has been followed by respondent ever since **Kirsch's** judgment is an added factor to be taken into account. As Marais JA said in **Nissan (Pty) Ltd v CIR** 1998 (4) SA 860 (A) at 870, if there is at least room for the interpretation in the language of the provision, as advocated in this case by the appellant, and that interpretation is the one which has been accorded to the words for sufficiently long, without being gainsaid, this provides a good reason for concluding that that is what the phrase was intended to mean.

[60] A further interpretive aid is to have recourse to s 8 C which, on 26 October 2004, superseded s 8 A. This provision draws a distinction between an unrestricted equity instrument and a restricted equity instrument. For the purpose of s 8 C (2), (a) the amount, to be included in the income of a taxpayer is the amount by which the market value of the equity instrument, determined at the time that it vests in that taxpayer, exceeds the sum of any consideration in

respect of the equity instrument (s 8 (2) (a) (ii)). In terms of s 8 C (3), an equity instrument acquired by the taxpayer is deemed, for the purposes of the section, to vest in the taxpayer; in the case of the acquisition of an unrestricted equity instrument, at the time of that acquisition.

[61] In order to understand the meaning of an unrestricted equity instrument, it is necessary to compare it to the definition of restricted equity instrument which, *inter alia,* in relation to a taxpayer means an equity instrument which is subject to any restriction that could result in the taxpayer;

(i) forfeiting ownership or the right to acquire ownership of that equity instrument otherwise than at market value; or

(ii) being penalised financially in any other manner for not complying with the terms of the agreement for the acquisition of that equity instrument.

Had s 8 A carried the meaning that 'acquire' does not take place until the participant has fulfilled his or her obligations, then there would have been no need for s 8 C to draw the clearly crafted distinction between restricted instruments and unrestricted instruments, as set out above.

[62] That then brings the inquiry back to the question of the conditionality of deferred purchase agreements and respondent's argument that the 1997 scheme did not confer a definite and unconditional entitlement to acquire shares in any

participant. To recapitulate, the question was whether a participant would be entitled to acquire the shares only on the relevant implementation dates.

[63] Turning to the question of conditionality, the key submission of respondent was that there were two relevant suspensive conditions, namely the requirement of continued employment and the stop loss provision.

[64] Clause 7.3 of the agreement specified that, if at any time prior to the implementation date in respect of any sale shares, a participant's service with the Foschini Group was terminated for any other reason, a participant would be obliged to sell his or her shares to the Foschini Group. In turn, the Foschini Group would be obliged to purchase such shares at a purchase price equal to the consideration, which would have payable by the participant on the implementation date in respect of such sale shares.

[65] While the benefit of the scheme might not flow to a participant whose services with the Foschini Group had been terminated as specified in Clause 7.3, it cannot be contended that the agreement fails in circumstances where a participant left the employ of the Foschini Group. The very terms of the agreement provide for the rights and obligations of the parties in these circumstances, which is distinct from an agreement failing, which would be the case in the event that the clause could be construed as imposing a suspensive

condition. Viewed in this fashion, it could not be suggested that Clause 7.3 suspends the very operation of the rights and obligations of the agreement read as a whole. It is true that Clause 7.3 may create a different obligation to those which would occur in the event that employment was not terminated but that itself is insufficient to sustain an argument that this Clause itself can be construed to be a suspensive condition as advocated by respondent. See Christie's *The Law of Contract in South Africa* (6th ed) at 145.

[66] Contrary to the submission of respondent that the condition is suspensive because there will never be an implementation until the requirement of continued employment has been fulfilled on the implementation date, an implementation of the terms of the contract does take place, albeit within the specific terms of the framework as provided for in Clause 7.3. Clause 7.4 provides that, if the middle market price per share of a participant sale shares on the implementation date was less than the consideration payable in respect of such sale shares by the participant and, if the participant disposes of such shares, the Foschini Group would be obliged to repurchase such sale shares at an amount equal to the consideration. Set off would then apply. Similarly, Clause 7.5 specifies that, failing payment of the consideration in respect of the sale shares against tender of delivery of the shares by the Foschini Group, pursuant to Clause 7.1, the latter would be entitled to enforce payment against delivery of the sale shares or to cancel the sale without prejudice to its rights to claim damages. These clauses need to be read together with Clause 10.2 which provides that in the agreement, whenever the Foschini Group was entitled or obliged to repurchase sale shares

prior to delivery to a participant, it would be entitled to elect to cancel this sale provided that, subject to clause 7.4, the amounts which would have been payable by the participant and the Foschini Group respectively could be taken into account in determining the amount, if any, payable to the participant pursuant to such cancellation.

[67] These clauses do not sustain an argument that the sale was subject to conditions, namely that the agreement was suspended until the fulfilment of the condition. Unconditional sales of the shares took place upon the exercise of the option, albeit that the method of payment would differ, depending upon which clause was triggered by the events which superseded Clause 7.1. It was specified clearly that, upon the exercise of an option, the participant shall become entitled to delivery thereof against payment of the portion of consideration attributable thereto on specified dates.

[68] Furthermore, an examination of the stop loss mechanism reveals that it does not operate until such time as a participant decides to invoke it and sell the shares back to the Foschini Group or the trust. In this connection see Lewis JA in **Grey Global Group Inc. v Khumalo** [2011] ZASCA 161 (SCA) at para 14.

> *"[I]t is trite that a condition in the true sense is the occurrence (uncertain at the time of entering into the contract) of an event that is not entirely dependent on the will of any of the parties."*

[69] Given the finding that the sale agreements did not trigger conditions which would justify the argument that 'no right to acquire' had taken place in terms of the meaning of s 8 A, respondent invited the Court to examine the substance of the transactions in order to conclude that, in substance, the various provisions were subject to the kind of conditions which justify respondent's contention regarding the applicability of s 8 A.

Substance over form

[70] Mr Rogers submitted that, were the Court to accept the submissions of the appellant with regard to the wording of Clause 7 of the scheme, the true substance of what the parties intended revealed that a suspensive condition of continued employment had been created. Further, Clause 7.3 read with Clause 10.2 was formulated in order disguise this fact and thereby justify an argument that the participants could avoid tax in terms of s 8 A.

[71] In this connection Mr Rogers relied on the decision in **CSARS v NWK Ltd** 2011 (2) SA 67 (SCA). In this case, the parties had concluded a set of interrelated contracts in terms of which a subsidiary of First National Bank (FNB) had lend R 96.4 m to **NWK**, repayable upon the delivery of a specified quantity of grain over a period of five years. **NWK** then claimed interest deductions on the capital of R 96.4 m. The Commissioner contended that the true substance of the arrangement was that **NWK** had only borrowed R 50 m which was the actual cash flow and that a series of offsetting maize transactions between FNB, its

subsidiary and **NWK** had been introduced to give an appearance of the loan of R 96.4 m so as to increase the tax deduction which could be claimed by **NWK**.

[72] While accepting the fundamental principle that a taxpayer is entitled to arrange his or her affairs as to remain outside of the provisions of the Act, Lewis JA held that a court will not be deceived by the form of a transaction but will examine its true nature and substance. Accordingly, the onus which rests upon a taxpayer in terms of s 82 (a) of the Act is not discharged simply by a party showing that effect was given to the contract in accordance with its terms.

[73] Lewis JA went on to say:

> "*The test should go further and require an examination of the commercial sense of the transaction; of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax or of a peremptory law, then it will be regarded as simulated.*" para 55

In amplification of this approach, Lewis JA then went on to say:

> "*It (The Tax Court) should have asked whether there was actually any purpose in the contract other than tax evasion. This is not to suggest that a taxpayer should not take advantage of a tax – effective structure. But as I have said, there must be some substance – commercial reason – in the arrangement, not just an intention to achieve a tax benefit or to avoid the amplification of a law. A court should not look only to the outward trappings of a contract: it must consider, when simulation is in issue, what*

the parties really sought to achieve." para 80. See also para 86 of the judgment.

[74] Following this approach, the court in **NWK** held that the contracts were simulated and that the true loan was only R 50 m, notwithstanding that the parties had actually implemented all the elements of the simulated transaction by an exchange of negotiable maize silo certificates in front of a notary. Although, on one level, the parties had intended to give effect to the maize transactions, the court held that there was no commercial sense or purpose for the loan to be structured as it was other than to create a tax advantage. Expressed differently, **NWK** required R 50 m for commercial purposes and the additional loan was a simulation in order to ensure that the tax deduction of interest would be significantly increased.

[75] Mr Rogers sought to apply this approach to the present dispute. He contended that in **NWK** there were at least outward displays of implementation in respect of the maize transactions. In the present dispute, he contended that nothing at all happened when a participant left Foschini's employ prior to the arrival of an implantation date. There is no outward manifestation at any time of the implementation of a sale and resale. Thus, the terms of the resale were analysed, they were uncommercial for no regard was had to the current value of the shares. The resale provisions were designed to ensure that the original sale simply lapsed without the need for implementation on either side. There was no

commercial purpose nor reason for introducing a resale provision, save to disguise the fact that the original sale was in fact conditional on continued employment. Referring to the evidence of first appellant, Mr Rogers submitted that she understood perfectly that her rights to the shares were conditional upon her remaining in employment. In Mr Rogers' view, there could be only one reason for the ostensible resale which was to try to avoid taxation of the true employment gain by creating the impression that the participant's rights in terms of deferred purchase scheme were unconditional.

[76] Turning to the stop loss condition as set out in Clause 7.4, Mr Rogers contended that the question of whether the purchase would be implemented depended on whether, at the implementation date, the shares were worth more than the purchase price. Where the shares at that date were worth less than the purchase price, clause 7.4 afforded the participant the unfettered choice of requiring the trust to repurchase the shares at the original sale time terms. The trust had no choice but to comply with the exercise of the participant's choice. The consequences of a resale in these circumstances were the same as where there was an absence of continued employment; that is as if there never had been a purchase agreement. Mr Rogers submitted further that it could be taken as certain that no participant would elect to implement a deferred purchase if the price exceeded the current market value of the shares of implementation date. There would be no point served to holding onto the shares because even if the employee was optimistic about the company's future prospects and thought that the share may increase over time, he or she could buy shares on the market at a

lower price. There would be no purpose served in purchasing shares at a price that would be higher than the market value in terms of the deferred purchase agreement. For all practical purposes therefore, the stop loss provision gave the participant the same right to decide whether to proceed with the purchase as would a grantee of an unexercised option.

[77] Based on these submissions, respondent's case is that 'the practical reality' was that, prior to the implementation, there was a sufficiently fundamental uncertainty as to whether the deferred sale would be implemented to justify the conclusion that there was no unconditional right acquired by the participant under the 1997 scheme which was as uncertain as an unexercised option in terms of the 1990 scheme. For this reason, when appellants concluded the deferred purchase agreements within the initial 21 day period provided in terms of the scheme, they did not, at that stage, exercise a right to acquire shares within the meaning of s 8 A. It therefore followed that the relevant right in terms of s 8 A would be exercised on delivery, that is on the implementation date or, alternatively, in the event that s 8 A was inapplicable, both at the conclusion of the original agreement and the implementation date, in which case the Court was required to consider the application of para 2 (a) of the Seventh Schedule.

Evaluation

[78] Given the respondents reliance on **NWK**, *supra,* it is necessary to examine this case and its implications in some further detail. In my view, in **NWK**

the Court was confronted with a starkly clear set of simulated transactions. The facts of the case illustrated, without doubt, that the parties had not created genuine rights and obligations but had constructed a loan for R 95 m as opposed to R 50, purely to enable the taxpayer to obtain a greater tax benefit. Beyond this finding, there is nothing in the careful judgment of Lewis JA which supports the argument that the reasoning as employed in **NWK** was intended to alter the settled principles developed over more than a century regarding the determination of a simulated transaction for the purposes of tax.

[79] It is necessary to have a brief recourse to this history. In **Commissioner of Customs & Excise v Randles, Brothers and Hudson Ltd** 1941 AD 369 at 395 – 6 Watermeyer JA (as he then was) said:

> *"A transaction devised for that purpose, if the parties honestly intend to have effect according to its tenor, is interpreted by the Courts according to its tenor, and then the only question is whether, so interpreted, it falls within the or without the prohibition of tax."*

That principle followed an earlier decision of the Appellate Division in **Zandberg v van Zyl** 1910 AD 302 at 309. In **Randles, Brothers and Hudson**, *supra* Watermeyer JA then went on to compare a real transaction to a disguised one. In this connection, he said the following:

> *"A disguised transaction in the sense in which the words are used above is something different. In essence it is a dishonest transaction: dishonest, inasmuch as the parties to it do not really intend it to have, inter partes, the legal effect which its terms convey to the outside world. The purpose of*

the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be in fraudem legis, and is interpreted by the Courts in accordance with what is found to be the real agreement or transaction between the parties.

Of course, before the Court can find that a transaction is in fraudem legis in the above sense, it must be satisfied that there is some unexpressed agreement or tacit understanding between the parties."

[80] More than half a century later, in **Erf 3183 / I Ladysmith (Pty) Ltd v CIR** 1996 (3) SA 942 (A) at 952 Hefer JA (as he then was) said:

"[t]he Court only becomes concerned with the substance rather than the form of the transaction when it has to decide whether the party concerned has succeeded in avoiding the application of a statute by an effective arrangement of his affairs."

Hefer JA went on to confirm a *dictum* in **Zandberg v van Zyl** 1910 AD 302 at 309:

"The Court must be satisfied that there is a real intention, definitively ascertainable, which differs from the simulated intention, for if the parties in fact mean that the contract shall have effect in accordance with its tenor, the circumstances, that the same object might have been allowed 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." Cited at 952 E

[81] It is helpful to examine certain of the central facts which confronted the Court in **ERF 3183/1 Ladysmith**, *supra*. The case concerned the application of paragraph (h) of the definition of gross income and s 1 of the Act. That provision provides that a taxpayer's gross income for any year of assessment will include:

> "*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 or buildings, … there has accrued in any such year or period the right to have improvements effected on the land or to the buildings by any other person* –
>
> (i) *the amount stipulated in the agreement as the value of the improvements or as the amount to be expended on the improvements…*"

The essential facts of that case were that an agreement of lease was entered into in terms which of a taxpayer let a stand to the Board of Executors pension fund for a period of some seven years. An agreement of sublease was then concluded in terms of which the pension fund sublet the property to a company called Pioneer, which had decided to establish a furniture factory on this particular parcel of land. In terms of the sublease, the fund would cause buildings to be constructed on the land in accordance with plans approved by it and Pioneer. Pioneer would pay the fund in addition to a monthly rental, at the date of

the final completion of the building, a premium in consideration for the sub lessor having agreed to erect the building on the land and to lease the property to the sublesee. The building contract between the fund and a construction company was then entered into for this purpose.

[82] The key contention of the taxpayer was that no right in terms of paragraph (h) had accrued to the taxpayer because there was no obligation between the owner (taxpayer) and the pension fund to erect buildings on the leased land. The fund was obligated to erect the buildings but that obligation stemmed from the terms of the sublease to which I have made reference and was enforceable by Pioneer but not by the taxpayer. Accordingly, in the absence of an obligation enforceable by the taxpayer, a right to have the building erected had not accrued to them.

[83] Hefer JA framed the enquiry thus:

> "*The real question was, however, whether they actually intended that each agreement would inter partes have effect according to its tenor. If not, effect must be given to what the transaction really is.*" at 953 C

The Court placed emphasis on the fact that all of the agreements were signed simultaneously and were plainly interdependent. To the extent that none of them would have been concluded unless all of the others were signed, that led to a conclusion that was fatal to the taxpayer's case:

> *"When the party's representative sat down to signed the documents they knew precisely what the purpose of the exercise was The Fund, which had plainly had not been kept in the dark, was not interested in hiring the stands as an ordinary tenant and was prepared to enter into a lease merely because the land would immediately be sublet. From its point of view there would have been no commercial objection to such an arrangement particularly since, under s 10 (1)(d) of the Act, the Fund was exempt from tax. But the fact remains that it was obvious to all concerned that it was no ordinary transaction."* at 955 C

The Court held that there was a real likelihood that the written agreements did not reflect the true or full intention of the parties and that, when the substance of all the agreements were read together, it was clear that the purpose was to conceal the real or complete terms of what the parties had truly intended, which was that a right to have improvements effected on land, which ultimately belonged to the taxpayer, had taken place, sufficient for paragraph (h) to be invoked.

[84] In my view, the key paragraph relied upon by respondent in the **NWK** case needs to be read within this context so as to ensure that the body of precedent is read coherently rather than reading **NWK** as being an unexplained rupture from more than a century of jurisprudence. That paragraph, (55) reads thus:

> *"In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms... The test should ... go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If*

the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated."

[86] It appears that the intention of this paragraph is to point in the direction which the mandated enquiry must take in such cases namely to examine the real commercial sense of the transaction. If there is no commercial rational, in circumstances where the form of the agreement seeks to present a commercial rational, then the avoidance of tax as the sole purpose of the transaction, would represent a powerful justification for approaching the set of transactions in the manner undertaken by the Court in **NWK**. In this way the *dictum* in a relatively recent case of Scott JA in the **Mackay v Fey NO and another** 2006 (3) SA 182 (SCA) at para 26 can be reconciled with paragraph 55 of **NWK**:

> *"Before a Court will hold a transaction to be simulated or dishonest in this sense it must therefore be satisfied that there is some unexpressed or tacit understanding between the parties to the agreement which has been deliberately concealed."*

See also the instructive analysis of **NWK** by Eddie Broomberg "*On NWK and Founders Hill*" 2011 (60) *The Taxpayer* 183, particularly at 202:

> *"the stare decisis rule should not have been ignored by the Court because there is no apparent ground for asserting that all the preceding judgments is cases involving alleged simulated transactions were wrong in applying the principle laid down in* ***Zandberg v Van Zyl, Randles Brothers****, et al. In any case, it was not necessary to flout the stare decisis rule because*

the Legislature had already closed the door on the mischief which the Court was seeking to avert. Moreover, it was beyond the power of the Court to adopt the ***NWK*** *rule, since to do so was to usurp the function of the Legislature, and, finally, the adoption of the* ***NWK*** *approach could result in unfair discrimination."*

Broomberg thus views **NWK** as a new and unjustified rule which replaces the previous jurisprudence. In my view, without an express declaration to that effect, **NWK** should be interpreted to fit within a century of established principle, rather than constituting a dramatic rupture.

[87] Both appellant and respondent referred to the evidence of Mr Nurek, the director of the relevant companies and the trustees of the trust at the relevant times, in support of their arguments regarding the substance of the transaction. Mr Rogers also referred to the cross-examination of first appellant in which she accepted that the agreement in which she had entered into was binding '*in the sense that if she was still employed on the implementation date and if you paid for the shares you were entitled to get them.*' Reference was also made to the evidence of second appellant to the effect that he was entitled to the shares subject to being employed on the implementation date. The following exchange however is particularly relevant to obtain a sense of the flavour of second appellant's evidence in this regard;

"*<u>MR ROGERS</u>:* *I must thus put it to you, although it may be a legal conclusion from the facts and the Court will then just decide it, but I put it to you, that the position therefore under the 1997 Scheme was that you*

had a right, which you could elect to exercise on the arrival of the implementation date, to acquire the shares.

MR McCLELLAND: I had a right to exercise an option within 21 days, which I then did. If I did not do it, I would have forfeited the benefits. When the implementation date arose, there was a second opportunity in terms of that contract, which is a separate contract. Namely, whether to exercise my put or not exercise my put."

[88] Mr Rogers also referred to the following passage of cross-examination of Mr Nurek:

"*MR ROGERS: Yes, but from a commercial objective it serves the objective of ensuring that the employee cannot get the shares if he is not employed on the implementation date.*

MR NUREK: Yes that is correct, yes that is correct obviously once the employee had sold the shares back it obviously wouldn't get the shares on the implementation date."

[89] Mr Nurek was extremely candid in his evidence as to the thinking behind the deferred scheme. Thus he testified:

"[W]e specifically designed our documentation to ensure that the contract that was entered into on exercise of the option was in fact unconditional. We intended to do that, we set out to do that, we drafted the contracts on that basis and we believe that we have achieved that objective. That was

the purpose of having the documentation structured in this way and we have no embarrassment about that Mr Rogers."

[90] This evidence is however congruent with the scheme agreements read as a whole. The various clauses which have been subjected to scrutiny by respondent were not drafted to disguise the true intention of the parties. Indeed all of the documents which were prepared were consistent with an intention to conclude various agreements in accordance with their terms and reveal a clear commercial purpose. There is no evidence to suggest that the parties pretended that the sale agreement was subject to express terms contained therein or that there was a disguise as to the fundamental structure of the various agreements and their legal implications. Clauses 7.3, 7.4 and 10.2 indicated a clear commercial purpose. The deferred share incentive scheme of the kind proposed by Foschini had to contain conditions to apply to the exercise of a right by a participant to acquire the relevant shares. Furthermore, there was a clear commercial purpose for making provision for the situation where a participant left the employ of the Foschini Group in specified circumstances before the implementation date or, given the exigencies of the share market, for the possibility of the value of the shares being less than the price payable at the implementation date.

[91] That the latter condition reflects a clear commercial rational is evidenced further by the introduction of s 10 (1) (nE) to the Act which exempts from tax

certain amounts derived by an employee from a share incentive scheme operated for the benefit of employees 'upon the cancelation of the transaction under which a taxpayer purchased shares under that scheme' or 'upon the repurchase from the taxpayer at a price not exceeding the selling price to him or her of shares purchased by him or her under that scheme'. The respondent concedes that the arrangement was a stop loss condition. Responding to the argument related to s 10 (1) (nE), respondent accepted that such a clause serves a commercial purpose. That these clauses clearly fulfilled these objectives is illustrated by the following exchange between Mr Rogers and Mr Nurek:

"*MR ROGERS:* *That achieves from the company's perspective the requirement of continued employment.*

MR NUREK: *Well what it does achieve is that if the employment of the relevant participant in the scheme is terminated that the employee or the participant concerned is then obliged to sell back the shares which it had not yet taken delivery of at the same consideration as would have been payable in the implementation Date.*

MR ROGERS: *Yes, but from a commercial objective it serve the objective of ensuring that the employee cannot get the shares if he is not employed on the Implementation Date.*

MR NUREK: *Yes that is correct, yes that is correct obviously once the employee had sold the shares back it obviously wouldn't get the shares on the Implementation Date.*

MR ROGERS: *So it had the practical result that an employee who was no in employ at the Implementation Date would have no right to demand delivery of shares.*

<u>MR NUREK</u>: Absolutely not."

[92] The various clauses upon which the respondent relied to argue that, in substance, the transactions were different from the form, cannot be justified either on the basis of the evidence of the parties or the clear wording of the particular clauses. They are what they purported to be and thus stand upon an entirely different footing from the situation where a R 50 m loan is increased to R 96 m loan by way of a transaction which, in substance, reveals that the loan was for the former amount. As was the case in the 'sale and lease back' dispute between **CSAR v Conhage (Pty) Ltd** 1999 (4) SA 1149 (SCA), in this case the parties had every intention of entering into the agreements and of putting these agreements into effect.

[93] In turn, this conclusion means that the analysis is driven back to the earlier examination as to whether a right, sufficient to trigger s A, was created by way of agreements which stand clearly to be analysed in terms of their express tenor. Given the conclusion to which I have arrived with regard to s 8 A, there is nothing in the argument with regard to substance over form as advanced by respondent that should alter this initial analysis. For this reason therefore, in my view, s 8 A was triggered by the exercise of the option by the two appellants. It follows that delivery of the scheme shares to the appellant did not constitute the exercise by him or her of a right to acquire the shares for the purpose of s 8 A.

The applicability of paragraph 2 (a) of the Seventh Schedule

[94] The relevant provision of paragraph 2 (a) of the Seventh Schedule as they applied at the time of this dispute were as follows:

> "*For the purpose of this Schedule and paragraph (i) of the definition of 'gross income' in section 1 of this Act, a taxable benefit shall be deemed to have been granted by an employer to his employee in respect of the employee's employment with the employer, if as a benefit or advantage of or by virtue of such employment or as a reward for services rendered or to be rendered by the employee to the employer-*
>
> > *(a) any asset consisting of any… marketable security or property of any nature (other than money) has been acquired by the employee from the employer or any associated institution in relation to the employer or from any person by arrangement with the employer, either for no consideration or for a consideration given by the employee which is less than the value of such asset as determined under paragraph 5(2): Provided that the provisions of this paragraph shall not apply … in respect of any marketable security acquired by the exercise by the employee, as contemplated in section 8A of this Act, of any right to acquire any marketable security'.*" (my emphasis)

From the proviso to paragraph 2 (a), it is clear that a share acquired by a taxpayer within the meaning of paragraph 2 (a) by virtue of 'the exercise of a right contemplated in s 8 A renders paragraph 2 (a) inapplicable. In other words, if it is accepted that the right to acquire a share for the purpose of s 8 A is exercised

upon accepting the offer or the exercise of the option to purchase the share, then the application of paragraph 2 (a) is excluded in terms of the proviso.

The applicability of s 8 C

[95] Section 8 C provides that '*a taxpayer must include... in his or her income for a year of assessment any gain... determined in terms of subsection (2) in respect of the vesting during that year of any equity instrument if that equity instrument was acquired by the taxpayer (i) by virtue of his or her employment.*' For s 8 C to apply, the relevant scheme shares must have been acquired by the appellant within the meaning of s 8 C and s 8 (2) (b) of the Act 32 of 2004 and; that is the relevant scheme shares must not have been acquired by way of the exercise of any right granted before 26 October 2004 and in respect of which s 8 A applied.

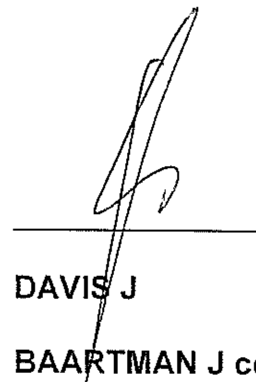
[96] On the evidence, the relevant scheme shares were acquired, by the exercise of rights which were granted to the appellant before 26 October 2004. Section 8 A therefore applies pursuant to our analysis above and therefore s 8 C is not applicable to this dispute.

Conclusion

[97] For these reasons the following order is made:

1. The appeal is upheld with costs, including the costs of two counsel.

2. The additional assessments in respect of the first appellant for the 2005 and 2006 years of assessment together with the additional assessment in respect of second appellant for the 2005 year of assessment are set aside.



DAVIS J

BAARTMAN J concurred