REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT MEGAWATT PARK, JOHANNESBURG)

Case No.: **IT 45781**

(1)	REPORTABLE: YES / NO
(2)	OF INTEREST TO OTHER JUDGES: YES / NO
(3)	REVISED.
8 July 2024	………………………..
DATE	SIGNATURE

In the matter between:

TAXPAYER MIR **Appellant**

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE **Respondent**

Coram: Strydom J (Mrs N Gosai, (Accounting member) and Mr CC Makuvele (Commercial member) concurring

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J U D G M E N T

STRYDOM, J

Introduction

[1] The appellant, Taxpayer MIR (MIR), appeals against the additional assessment issued by the Commissioner for the South African Revenue Service (SARS), the respondent in this appeal, pertaining to its income tax return for the 2013 year of assessment. The parties are *ad idem* that the additional assessment falls to be altered or set aside to the extent that it disallowed a deduction of R275 005 131 for unrecoverable interest and lease fees qualifying as a bad debt under section 11(*i*) of the Income Tax Act[1] (ITA), as amended. They also agree that understatement penalties of R56 354 620 have been remitted.

[2] However, they join issue on the deductibility of the advance payments (this term has been used by the parties, and will be used by this court, whilst it remains contentious whether certain payments were in fact advance payments for materials delivered or to be delivered, or constituted loans which are capital in nature as opposed to non-capital (revenue) in nature) totaling R1 737 659 862 in terms of sections 11(*a*) and 23F, as read with sections 22 and 24M, of the ITA, made by the appellant to its American supplier, A1, for the purchase of recycled materials containing platinum, palladium and rhodium, all of which are types of platinum group metals (PGMs), and base metals (PGM-bearing materials) used in the manufacture of refined PGMs, and whether a recoupment of R358 135 420 must be reversed if MIR fails on the advance payment deduction.

[3] The South African courts have laid down a general deduction formula by holding that sections 11(*a*) and 23(g) must be read together when one considers whether an amount may be deducted for income tax purposes (*Port Elizabeth Electric Tramway Co Ltd v CIR* (1936 CPD 241)). The general formula can be broken into the following six elements listed below:

a. Expenditure and losses;

b. Actually incurred;

c. During the year of assessment;

d. In the production of the income;

e. Not of a capital nature (meaning that it is of revenue nature);

f. To the extent that it is laid out or expended for the purpose of trade.

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[1] Act 58 of 1962.

[4] We assert that all the above six elements must be satisfied before an amount can be deducted in terms of the general deduction formula.

[5] In essence, the central issue for determination is the nature or characterisation of the advance payments made by MIR to A1, i.e. whether they were advance payments in respect of the purchase price for the PGM-bearing materials acquired by MIR as raw materials used in the manufacture of refined metals, or whether they were loans of a capital nature, with the result that they are not expenditure as contemplated in terms of section 11(*a*)[2] of the ITA and therefore do not qualify for deduction, as SARS contends.

[6] As a corollary to the determination of the central issue, the second issue before this court is set out in paragraph 6.2 of the rule 32 statement. It pertains to timing, and relates to the application of sections 23F(1)(*c*) and 24M(2) regarding deferral of the deduction, and the tax treatment of a recoupment arising from the impairment of the advance payments. That is, if the court finds the deductions claimed by MIR constitutes an expenditure actually incurred to acquire trading stock, as defined, whether the advance payments first became deductible in the 2013 year of assessment, as claimed by MIR, or whether they were deductible when the liability to make the advance payments first arose as alleged by SARS.

[7] The competing contentions of MIR and SARS in relation to the disputed deduction can be summarised as follows:

[8] In its rule 32 statement, MIR disputes SARS's contention that the advance payments made under the various metal purchase agreements (MPAs) and subsequent special agreements (SAs) were in substance loans, rather than genuine advance payments for the purchase of unrefined PGM-bearing materials. Specifically, it is contended by MIR that the advance payments made by it to A1, in terms of the relevant MPAs, properly interpreted, were payments in advance or part-payments in respect of the purchase price of the unrefined PGM-bearing materials purchased by it, and constitute expenditure incurred in the production of income as envisaged under section 11(*i*) of ITA.

[9] SARS disputes this interpretation and contends that despite that label given to the advance payments as payments in advance or part-payments in respect of the purchase price of the unrefined PGMs, such payments were not made as advance or part-payment of the purchase price of each lot. The advance payments were, as a matter of interpretation, substance and fact, capital loans and not expenditure as contemplated in terms of

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2 "**11. General deductions allowed in determination of taxable income.—**For purposes of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(*a*) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;"

section 11(*a*) of the ITA, and therefore is not a deductible expenditure from income for income tax purposes.

[10] In respect of the proper characterisation of the advance payments, SARS relies both on background evidence – the facts and circumstances known to the parties at the time of the conclusion of the MPAs – and subsequent conduct. For its part, MIR contends that subsequent conduct is inadmissible in construing and interpreting the MPAs and the subsequent SAs, including the June 2012 agreement. SARS believes that the interpretation of the MPAs and the subsequent agreements are governed and regulated by English law, and under English law the subsequent conduct of the parties is an inadmissible consideration when agreements are interpreted.

MIR's Submissions

[11] Firstly, MIR argues that the terms used by the parties in the MPAs and SAs to describe their relationship, namely, that of "advance payments" and "purchase price", must be given effect to. They contend that the payments were explicitly structured and intended by the parties to be advance payments or part-payments towards the eventual purchase price of the PGM materials supplied by A1. MIR asserts that the MPAs and SAs were genuine, *bona fide* agreements and should not be recharacterised based on SARS's view of their "true substance".

[12] MIR further contends that, if the advance payments are to be considered under English law (which governed the MPAs), they would still be properly characterised as advance payments, and not as loan accounts. MIR argues that under the Sale of Goods Act, 1979, the advance payments represented part of the purchase price which passed to it upon delivery of the goods, and therefore cannot be recorded and disclosed as loan accounts.

[13] Addressing the specific facts relied on by SARS, MIR disputes the significance of the "rollover" provisions in the agreements. They argue that the rollover of excess advances to future lots was simply a mechanism to manage the cash flow mismatch between A1's requirement for prompt payment and the final settlement date and does not transform the advance payments into loans.

[14] Similarly, MIR contends that the acknowledgement of "loans" in the July 2010 and June 2012 agreements does not change the substance of the transactions but was merely a renegotiation of the repayment terms considering the financial circumstances of A1 during that period. MIR asserts that the parties' own characterisation is not determinative, and that the true nature of the transactions must be objectively assessed.

[15] Regarding the deferral provisions, MIR argues that despite the actual incurrence of the advance payments, the deferred provisions in sections 23F(1)(*c*) and 24M(2) of the ITA entitled it to delay the deduction to the 2013 year of assessment. They contend that since the purchase price of the lots to which the excess advances were allocated had not been quantified at each year end, the expenditure was deemed to be incurred only on the "outturn date" in the following year.

[16] Overall, MIR maintains that the advance payments were genuine, *bona fide* transactions, properly recorded and disclosed as advance payments for the purchase of PGM-bearing materials as trading stock, and that the deferral provisions entitle it to claim the deduction in the 2013 year of assessment. MIR disputes SARS's recharacterisation of the payments as loan accounts and its reason for the disallowance of the deduction from the income as claimed.

SARS's Submissions

[17] SARS contends that the so-called "advance payments" made by MIR to A1 under the various MPAs and SAs were not actually advance payments or part-payments for the purchase of unrefined PGM-bearing materials but were in substance capital loans. SARS argues that despite the contractual language used, the true nature and substance of these payments, objectively viewed, was that of loans rather than advance payments.

[18] SARS points to several facts in support of this position. Firstly, the MPAs and SAs provided that if the advance payments were not fully settled against the value of the PGM materials in a particular lot, the excess would be rolled over as an advance payment for future lots. SARS contends this rolling over of "excess advances" has the characteristics of a loan, not an advance payment. Interest became payable. Secondly, SARS notes that the July 2010 and June 2012 SAs expressly acknowledged, recorded and disclosed the outstanding amounts as "loans" that needed to be repaid by A1 to MIR with interest, further indicating the true nature of the payments. Thirdly, when the agreements were ultimately terminated, MIR sought to recover the outstanding amounts as "loans" through arbitration and was awarded those amounts as debt owed by A1. This further demonstrates, according to SARS, that the parties themselves recorded and disclosed the advance payments as loan accounts. Finally, MIR recorded and disclosed these advanced payments as loan accounts in its own Annual Financial Statements (AFSs).

[19] SARS contends further that:

a. Regardless of the interpretation of the MPAs, these agreements were overtaken by the conclusion of the July 2010 SA, and/or, by the June 2012 SA, which converted the amounts due by A1 to MIR ("the excess advances") into long-term loans and prescribed the interest applicable and the repayment terms of both capital and interest.

b. SARS contends that MIR, if it intended to make prepayments of the purchase price, did not achieve this purpose. SARS does not rely on a sham but rather on the well-established principle that in each case it is a question of fact whether the purpose of the agreement was achieved. In this regard, the Court is not concerned with the subjective belief of the parties to the agreement, no matter how genuine, but whether the facts objectively viewed, established that that result was attained.

c. SARS contends further that even if the advances under the MPAs were in fact prepayments of the purchase price (which it denies), the two later SAs concluded between the MIR and A1, in July 2010 and in July 2012, either viewed individually or collectively, novated and/or superseded any previous agreement in relation to the "advances" and created new and discrete obligations in terms of which the advances were converted into long-term debt repayable on the terms and conditions set out in those agreements. The June 2012 agreement was the most recent agreement which made provision for the repayment of advances.

[20] As a result, SARS argues that the excess advance payments of R1.737 billion claimed by MIR as a deduction under section 11(*a*) of the ITA were not actually expenditure incurred in the production of income but were capital loans that are disallowed from being deducted from the income for income tax purposes. SARS contends that in any event, if the deductions could have been made, the deductions should have been claimed in the years the advance payments were actually made, not deferred to 2013 as MIR has attempted.

[21] Regarding the deferral provisions, SARS disputes MIR's reliance on sections 23F(1)(*c*) and 24M(2) to justify deferring the deduction to the 2013 tax year. SARS argues that section 23F(1)(*c*) is inapplicable because the unrefined PGM-bearing materials were not acquired by MIR for the purpose of disposal, but rather for use in the production and manufacture of refined PGMs. Section 24M(2), SARS argues, does not apply because the advance payments represented definite, unconditional liabilities incurred by MIR in the years the payments were actually made. The fact that the full purchase price was only payable later does not affect when the advance payment expenditure was incurred.

[22] Overall, SARS maintains that the advance payments were loans, not deductible expenses, and that MIR is not entitled to the claimed deduction. Alternatively, MIR should have claimed the deductions, if valid, in the years the payments were actually made, not deferred to 2013. SARS argues the deferral provisions do not apply to justify MIR's treatment of the payments.

[23] SARS maintains that the dispute between SARS and a taxpayer is governed by South African law and not the law determined in the contracts, i.e. the English law as claimed by the taxpayer. The latter only applied between the contracting parties *inter partes.*

[24] Before turning to the analysis and discussion, it is prudent, firstly, to provide the factual background to the dispute between the parties. Those facts are briefly as follows.

Synopsis of the Factual Matrix

[25] The dispute between MIR and SARS arises out of a longstanding contractual relationship which had previously existed between MIR and A1. The contractual background giving rise to the dispute stems from a series of MPAs and subsequent SAs concluded between MIR and A1 from 2008 to 2012, which governed the supply of PGM-bearing materials, advance payments, and ultimately the recognition and restructuring of A1's indebtedness to MIR.

[26] For purposes of explaining the business relationship between MIR and A1, the court will focus on an agreement entered into between MIR and A1 referred to as the DGA agreement. Other similar agreements were entered into. The DGA agreement was signed on 25 August 2008 but commenced from 1 July 2008 for 5 years until 30 June 2013. A1's business was, *inter alia,* to purchase PGM-bearing material in the USA. These materials were either sold to MIR who extracted the PGMs from the materials through refining or was sent to MIR to refine on behalf of A1. The latter was done in terms of Tolling-agreements. For this MIR was paid a fee to refine the materials, which remained to property of A1.

[27] The court will focus on the DGA agreement which was a purchase and sale agreement where MIR became the owner of the PGM-bearing materials from A1.

[28] In terms of clause 9.2 of the DGA agreement, A1 delivered PGM-bearing materials to MIR, with ownership passing to MIR upon delivery. MIR was required to pay the purchase price for each delivery on the settlement date after refining the materials. The exact value of the PGM materials could only be establish once the metal was extracted through the refining process (clause 11.1). Crucially, the MPAs entitled A1 to request one "advance payment" from MIR after delivery of a lot, representing a substantial portion of the estimated purchase price for that lot. Interest was payable in relation to the advance payment made (clauses 11.2;

11.2.1; 11.2.2). If the value of the refined materials on the settlement date was more than the advanced payment which was paid in relation to the specific lot, the amount of the advanced payment would be deducted from the purchase price of the lot and MIR had to pay the difference to A1. If it was less than the advanced payment made, there would be an over-advancement position, referred to as "such excess". Any excess advance could contractually roll over and be applied as an advance for subsequent lots, provided that such excess would carry interest (clause 11.2.5).

[29] The purchase price for the materials became quantifiable and payable when refined metals emerged from the "pipeline" on the "outturn date", some five months after delivery date had elapsed. It is common cause that this is the reason why A1 could request advanced payments, i.e. to bridge this gap. These advanced payments could be used by A1 to buy trading stock from its suppliers to resell to MIR.

[30] This estimated purchase price to determine the value of the advanced payment was based on preliminary assays of the delivered materials and the current average market prices for the relevant metals. When the market price of, especially, platinum was high, the provision of advance payments was directly linked to identifiable batches of PGM-bearing materials. Applying the agreed formula for determining the amount to be paid as an advance payment the result always was that the value of the refined PGMs extracted was more than the amount of the advance payments which were paid. Put differently, the value of the PGM-bearing materials in the "pipeline" was more than the advanced payments made. This difference was referred to as "headroom".

[31] However, after the 2008 financial crisis the value of PGMs over time more than halved and the final quantified purchase prices on the dates of turnout was now substantially less than the advance payments already made. This resulted in MIR being in a substantial over-advanced position, with A1 owing MIR substantial excess advanced amounts received. As stated, the DGA agreement catered for such an eventuality by providing for roll-overs of over-advanced amounts to be applied for future batches of PGM-bearing materials provided to MIR.

[32] The DGA agreement also provided that *in lieu* of payment for any lot, A1 was entitled to elect to receive the guaranteed return, (which was defined in clause 16), of the refined metals (clause 11.3). In the event A1 elected to take the guaranteed return of any lot in metal, any advanced payments plus interest made against that lot would be applied to subsequent lots, against which no advance payments had been made. If no lot was available to apply such advance payment, the advance payment plus interest was repayable immediately upon which the relevant metal would be released to A1 (clause 11.3.2). If these advanced payments were

not repaid for whatever reason that would have caused an escalation of the over-advanced position.

[33] The roll-overs referred to in clause 11.2.5 could, obviously, only be applied as long as A1 could supply sufficient quantities of materials against which the over-advanced payments could be used as advanced payments. This would mean that A1 could not request further advance payments for these lots, or at least not the full advance payment. In relation to clause 11.3.2 a lot had to be available for the advanced payments to be applied.

[34] Not receiving advance payments would have, needless to say, affected the cash flow position of A1 to purchase PGM-bearing materials from its foreign-based supplier (A1). This led to the conclusion of SAs between MIR and A1.

[35] From October 2008 onwards, MIR and A1 concluded several SAs aimed at reducing or discharging the advanced payments to below the value of PGM materials in MIR's pipeline, settling historic excess advance payments, providing for additional special advanced payments, and adjusting contractual terms related to the delivery of PGM-bearing materials and repayment of advance payments. The July 2010 agreement acknowledged A1's total outstanding indebtedness to MIR for excess advance payments, whilst the June 2012 agreement superseded previous agreements and explicitly recorded and disclosed A1's indebtedness as Loans A, B, and C.

[36] The dispute arose when A1 stopped delivering materials to the taxpayer and making repayments to discharge of the advance payments from late 2012. Consequently, MIR terminated the agreements, pursuant to A1's repudiation of the SAs in April 2013 and initiated arbitration proceedings to recover its financial losses sustained due to non-performance detailed herein. The arbitration awarded MIR amounts in respect of Loans A, B, and C as recorded and disclosed in the June 2012 agreement.

[37] As stated in the preceding sections, the transactions between MIR and A1 were governed by the MPAs and SAs, which were effective between the 2009 and 2013 years of assessment. On their terms, the MPAs were to be "governed by and construed in accordance with the laws of England".

[38] The dispute as to the nature of the payments must thus be determined on a proper construction of the relevant agreements. The true dispute is whether the advanced payments could be recorded and disclosed as expenditure actually incurred in the production of income which is deductible from the income because it is derived a revenue nature or as capital in nature because it derived from the loans advanced. In other words, the court was called upon to determine whether the expenditure was actually incurred to perform income-earning

operations which is income or revenue in nature or whether the expenditure was actually incurred to establish, improve, add to the income-earning structure which is capital in nature.

[39] The relevant PMA and SAs should now be interpreted and considered to establish the contractual relationship between the parties, what they objectively considered or wanted to achieve when these agreements were concluded. It should be considered whether the SAs changed the character of advanced payments to be something else. Were the advanced payments loans all along or became as such when the SAs were concluded? This should provide the answer to the relevant question whether advanced payments, and other payments, were made as part of expenditure to acquire trading stock or whether these advance payments should be recorded and disclosed as loans of a capital nature.

[40] For purposes of this judgment the court will have due regard to all relevant agreements, with particular focus on the following agreements:

a. The DGA agreement already referred to as part of the introduction
b. The SA entered into between the parties on 19 July 2010 (the "July 2010 agreement")
c. The SA entered into between the parties on 21 June 2012 (the "June 2012 agreement")

Which law should be applied when the Metal Purchase Agreements (MPAs) and the Special Agreements (SAs) are interpreted?

[41] The MPAs provided that these agreements were to be "governed by and construed in accordance with the laws of England". The SAs provided that the MPAs continued to apply, save as adjusted. No adjustments were made pertaining to the applicability of the laws of England. The court will accept that the parties to the MPAs and SAs agreed that their contractual relationship would be governed by the laws of England. Consequently, when these agreements are interpreted it should be interpreted according to the laws of England.

[42] In terms of the section 1 of the Law of Evidence Act,[3] a court can take judicial notice of the law of a foreign state in so far as such a law can be ascertained readily and with sufficient certainty, but this shall not preclude any party from adducing evidence of the substance of a legal rule which is in issue at the proceedings concerned.

[43] It is an issue before this court what the rules of contractual interpretation in England are and whether it differs from the rules applied in South Africa. On behalf of MIR, it was submitted that evidence pertaining to conduct on how the agreements were implemented

3 Act 45 of 1988.

subsequent to its formation was not permissible, whilst in South Africa evidence pertaining to subsequent conduct is admissible for interpretation purposes, to ascertain, having regard to the wording of the contract, what the parties intended to agree upon. On behalf of CSARS, it was contended that the rules of interpretation of these two countries are the same.

[44] SARS's objection can be summarised as follows:

a. The essential principles governing the interpretation of contracts under South African law have recently been restated by the Constitutional Court in *University of Johannesburg v Auckland Park Theological Seminary and Another*[4] which endorses the objective approach of interpretation with reference to KPMG,[5] emphasising that interpretation is a matter for the court and not witnesses including expert witnesses.

b. Both English law and South African law recognise the objective nature of the interpretive enquiry and that interpretation is a matter of law. MIR called an expert witness Mr Matthews KS (Mr Matthews). Mr Matthews indicated that because an English court would not be instructed by an expert on English law, such an expert would never appear to interpret an agreement using English principles of interpretation to an English court.

c. The principles of South African law and English law are congruent save for what MIR considers to be an important point of distinction, namely, that under English law *inter partes* post or subsequent contractual conduct is inadmissible whilst under South African law post and subsequent contractual conduct are admissible to determine the nature, extent and substance of the contract. Moreover, under South African law, where a third party contests the interpretation placed on a contract by the contracting parties, it is entitled to challenge that interpretation and call into aid post-contractual conduct.

d. Mr Matthews, in relation to the issue of the exclusion of subsequent conduct, confined his opinion to the position of the contracting parties. There was no evidence to suggest that the same principle applied to the position of the third-party contesting interpretation thereof to suggest that a third party is bound by the interpretation placed on the agreement by the contracting parties. So, even if English law applies, it is presumed in the absence of proof to the contrary, that it is the same as South African law and that evidence of subsequent conduct in relation to a third party contesting the meaning of the contract, is admissible.

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4 [2021] ZACC 13; 2021 (8) BCLR 807 (CC); 2021 (6) SA 1 (CC).

5 *KPMG Chartered Accountants (SA) v Securefin Ltd and Another* [2009] ZASCA 7; 2009 (4) SA 399 (SCA) at [39].

e. There is no evidence before the court that there is any difference in the principles of novation as applied by South African courts and those applied by English courts and so, it would follow again, that South African law in relation to novation is the same as English law and each of the July 2010 and June 2012 agreements must be construed and interpreted in accordance with principles of South African law.

f. But even if the evidence of Mr Matthews is admissible in relation to the interpretation of the agreements, it is unsatisfactory and should be rejected out of hand, because he had no regard to the facts and circumstances known or assumed by the contracting parties at the time that the agreements or documents were approved and executed.

[45] Despite the fact that this court is dealing with a dispute between a taxpayer and SARS, the interpretation of the contractual relationship between a taxpayer and its supplier remains relevant to ascertain what the contracting parties to the various agreements intended when advance payments and other payments were made to A1 by MIR. The contracting parties concluded the agreement with the actual knowledge that the English law will apply if the need should arise to interpret the agreements.

[46] It should at this stage be noted that where contracting parties in their performances, deviated from their own contractual obligations, the contract might have been simulated or simply not implemented by the contracting parties according to the agreed upon terms and conditions. What a contracting party subjectively intended may differ from what objectively considered, was, agreed upon if the wording of the contract is interpreted.[6] In this matter it was not the case of SARS that the relevant agreements constituted simulated transactions or a sham.

[47] In my view, MIR was entitled to lead the evidence of an expert to inform this court on the rules of contractual interpretation in England as the determination of foreign law is a question of fact.[7]

[48] Mr Matthews's expertise was not placed in dispute. To some extent his independence was questioned by SARS.

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6 *Anglo-Platinum Management Services (Pty) Ltd v Commissioner South African Revenue Service* 2016 (3) SA 406 (SCA) at [10]; *ERF 3183/1 Ladysmith (Pty) and Another v Commissioner for Inland Revenue* 1996 (3) SA 942 (A) at 950I-951A.

7 *Schlesinger v Commissioner for Inland Revenue* 1964 (3) SA 389 (A) at 396G. *Approved in Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* 1983 (1) SA 276 (AD) at 294G.

[49] The court is satisfied that he has the necessary experience and knowledge to have informed this court regarding the rules of interpretation of contracts under the laws of England. Also, regarding leading case law pertaining to interpretation of contracts in general and with specific reference to the characterisation of words “advances” and “loans” used in contracts. His independence on these issues should be accepted.

[50] The admissibility of his evidence was challenged on the basis that it was irrelevant. It was argued that the court was dealing with a tax dispute between a South African taxpayer and CSARS and therefore South African law should be applied. Despite this stance taken upfront by CSARS, the court ruled that the evidence can be led, and the court will rule on its admissibility as part of this judgment.

[51] The content of Mr Matthews’s evidence was not challenge as far as he provided evidence on what the rules of interpretation are, but rather whether he had proper regard to the factual matrix underpinning the relevant agreements, and the relevance of his opinions given that it was for the court to interpret these agreements and not for a witness.

[52] The evidence of Mr Matthews could be divided into three categories. First, he dealt with the English law on the interpretation of contracts. Second, he dealt with English precedent on the interpretation of words used in contracts referred to as “advances” versus “loans”. In this category he gave evidence of the rule of interpretation regarding labelling of certain concepts. Thirdly, he dealt with the interpretation of the relevant MPAs and the SAs.

[53] Even though this court is dealing with a tax dispute between a taxpayer and CSARS, the interpretation of the contractual relationship between a taxpayer and its supplier remains relevant, to ascertain what the contracting parties to the various agreements intended when advanced payments and other payments were made to the supplier. For the determination of a tax liability, the contractual arrangements between a taxpayer and third parties will be a relevant consideration to determine the nature and extent of payments made, in this instance, whether the advanced payments were made to purchase trading stock or whether these payments constituted loans which are capital in nature. The true nature of these payments should be ascertained and certainly a starting point would be to interpret the contract by applying the laws of the country which were rendered applicable by the contracting parties in their agreements.

[54] If a party who bears the onus on any issue, which is dependent on the application of foreign law, elects to lead expert evidence to inform the court regarding the foreign law, such evidence should be received by the court as admissible evidence. In such a case a court should not apply the *lex fori.*

[55] The expert evidence in this matter has shown that it would have been an unfair and unreasonable assumption to have accepted that the South African and English law on the interpretation of contracts were on all fours. There are differences as was pointed out by Mr Matthews.

[56] In my view, MIR was entitled to lead the evidence of an expert in this regard to inform this court on the rules of contractual interpretation in England as such determination of foreign law is a question of fact. The interpretation itself, applying foreign law is a matter of law.

[57] In my view, an expert only providing evidence concerning what the laws of a foreign country are in relation to contractual interpretation, needs limited documents or references to agreements to express an expert opinion. As long as the expert is aware of the nature and purpose of the agreements, for instance, that it is a commercial contract, it would suffice. Expert evidence pertaining to the laws of a foreign country is an exercise whereby the expert uses his knowledge about what the legal position in a foreign country is to inform a court what the current legal position in the foreign country is. What the law of a foreign country is, is a factual question but is provided by an expert expressing his opinion as to what the factual position is. Insight into documents and the factual matrix which prevailed when the agreements were executed would only become relevant when the expert starts to interpret specific agreements, applying the laws of a foreign country. Whether evidence is admissible as to how the relevant agreements should be interpreted, with reference to foreign law, the court will deal with later in this judgment.

[58] There is no reason why the evidence of Mr Matthews dealing with the applicable laws pertaining to contractual interpretation, without reference to the relevant agreements, should not be regarded as admissible evidence. This will also include evidence pertaining to English case law in general terms dealing with the construction of contracts.

[59] The summary of his evidence provided by MIR in its heads of argument correctly reflects the evidence of Mr Matthews as to what the English law principles governing the construction of contracts are and, for that reason I quote the summary:

> "60. Mr Kerns' evidence was that the Court would seek to identify what, objectively, a reasonable person would understand the parties to have intended by the relevant provision. That meaning will be assessed in light of: (i) the natural and ordinary meaning of the clause; (ii) any other relevant provisions of the contract; (iii) the overall purpose of the clause and the contract; (iv) the facts and circumstances known or assumed by both the parties (i.e. 'crossed the line') at the time that the document was executed; and (v) commercial common sense as at the time of entry into the contract, but (vi) disregarding subjective evidence of any party's intentions.

61. Mr Kerns emphasised that the facts taken into account in construing the agreement had to:

61.1 'cross the line' i.e. be known to both parties; and

62.2 have occurred prior to the agreement being concluded.

62. Conduct of the parties after the contract was made was not used as an aid to construction of the contract (*James Miller v Whitworth*). Mr Kerns referred to *James and Miller* (footnote deleted) which stated:

> '…I had thought it now well settled that it is not legitimate to use as an aid in the construction of the contract anything which the parties said or did after it was made.'

and also emphasised that the leading authorities only permitted that regard had to be had to facts and circumstances known by the parties at the time that the contract was concluded.

63. Where the construction of a contract is required it to be characterised for the purposes of the law (for example: as an advance or a loan), the agreement must be regarded as a whole, and its substance takes precedence over the labels which the parties have chosen. Mr Kerns cited the example of a five-pronged instrument being a fork, albeit that the parties may have called it a spade."

[60] Comparing these English law principles with the South African law of interpretation of commercial and other contracts as stated in various cases,[8] it can be concluded that these principles are similar with one material exception, i.e. the conduct of the parties after the contract was concluded may not be used as an aid to the construction or interpretation of the contract in English law.

[61] Under South African law of contractual interpretation, the post-contractual behavior of contracting parties can be used to interpret contracts, the terms of which, are unclear and/or ambiguous.[9]

[62] The evidence of Mr Matthews went much further than providing the court with the English law principles governing the construction of contracts. He provided the court with comprehensive evidence explaining English precedent on "advances" versus "loans". Reference was made to various leading reported cases from foreign jurisdictions. He went ahead to interpret the MPAs and SAs applying English law with reference to the specific agreements.

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[8] *Natal Joint Municipality Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA); *University of Johannesburg* Id n 4 at [63].

[9] *Unica Iron Steel (Pty) Ltd and Another v Mirchandani* [2015] ZASCA 150; 2016 (2) SA 307 (SCA) at [21].

[63] On behalf of MIR it was argued that this evidence is admissible on the basis that the interpretation of agreements and the application of law to interpret agreements are both matters of law. In this case they are both matters of English law.

[64] The objection of SARS, as referred to hereinabove, included an objection to the admissibility of the expert evidence which related to the interpretation of the MPAs and SAs.

[65] As found by this court, the evidence of Mr Matthews dealing with the rules of interpretation and precedents in English law is admissible evidence and should be accepted as such. However, the interpretation of the MPAs and the SAs is in my view, not admissible evidence. If Mr Matthews was permitted to interpret the agreements applying English law, the question can rightly be asked why did he bother to inform this court about the English Laws governing the construction of contracts? He could have just provided his interpretation applying English law. If Mr Matthews evidence relating to the interpretation of specific contracts is admissible and accepted, which to large extent stood uncontradicted, then the expert witness would have effectively usurped to function of this court. The role of this court to interpret the agreements would have fallen away and the only question would have been whether the witness was credible.

[66] The prime function of Mr Kerns was to guide the court to a correct decision on questions found within his specialised field.[10] *In casu,* the specialised field of Mr Matthews was his knowledge as to what the English principles governing the construction of contracts are. When it comes to law, a court is presumed to be an expert. If the foreign law was to be applied, an expert can provide evidence about what the foreign law entails, but a witness cannot take over the task of interpretation of an agreement, albeit, when foreign law is to be applied. In his evidence, Mr Matthews applied his own expert knowledge to interpret the relevant contracts and concluded what was likely or unlikely to be the interpretation of English Courts, applying English law. In my view, this is inadmissible evidence. The court will not have regard to the portion of Mr Matthews's evidence dealing with the interpretation of the MPAs and SAs.

[67] Accordingly, this court will interpret the MPAs and SAs to objectively establish what the contracting parties, *inter partes,* intended when they concluded the relevant agreements on the basis that conduct after the date of entry of these agreements, would be inadmissible considerations.

[68] I, however, agree with SARS submission as referred to above. It should be emphasised, that it is a different question whether SARS, not being a contracting party to the agreements, in its determination of a tax liability, could consider how a taxpayer implemented agreements it has entered into, how the taxpayer dealt with advanced payments made in its

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[10] See *S v Gouws* 1967 (4) SA (EC) at 528D.

audited annual financial statements and what other steps the taxpayer took to recoup payments or loans made from a contracting party. SARS will not only be concerned with the terms of the various agreements, interpreted applying the English laws, but also with, objectively considered, the subsequent conduct of the taxpayer dealing with the "advances" or "loans".

[69] This issue relates to SARS not being a party to the MPAs and SAs. The current dispute is a tax dispute between MIR and SARS and not between the contracting parties, *viz*, MIR and A1. It was submitted, that for consistency it would seem both logical and sensible that this issue be resolved in accordance with South African law. The reasons which were advanced and presented by SARS in it heads of argument are as follows:

> "152.1. The duty to collect tax is imposed on the Commissioner in terms of the Act, which regulates both the rights and obligations of the Commissioner and taxpayer;
>
> 152.2 The entitled to the deduction depends on the true nature and substance of the MPAs and the June 2012 Agreement. The Commissioner, in investigating the true nature and substance of the MPAs, the July 2010 Agreement and June 2012 Agreement, cannot be impeded in this pursuit simply because the contracting parties to the agreement under consideration have agreed that any dispute between them should be determined in accordance with a foreign system of law. If this were permitted, it would give rise to uncertainty and the obligation to pay tax could possibly depend on the happenstance of a choice of system of law which might favour the taxpayer. This is undesirable."

[70] I agree with these submissions. In *Rane Investments Trust v Commissioner South African Revenue Service*,[11] the SCA after setting out general principles of contractual interpretation and the entitlement to rely on post-contractual conduct of the parties, emphasised that post-contractual conduct was admissible in a dispute not between the contracting parties but a third person such as the Commissioner who sought to place a different interpretation on the agreements. Post-contractual conduct is admissible when the third party (the Commissioner) is seeking to establish the intention of the contracting parties and was contesting the meaning of that contract.

[71] I agree with the submissions of SARS that when the tax liability of MIR is to be determined, the court can apply South African law which would mean that post-contractual conduct is admissible when SARS is seeking to establish the true intention of the contracting parties for purposes of a possible tax liability.

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[11] [2003] ZASCA 60; 2003 (6) SA 332 SCA.

Interpretation of the Metal Purchase Agreements

[72] In my view, irrespective of whether English law or South African law is applied when the DGA agreement, dated 25 August 2008, is interpreted the outcome would remain the same.

[73] The DGA agreement is a sale agreement in terms of which PGMs were sold by A1 to MIR. MIR would become owner and risk bearer upon delivery of the materials. The value of the PGMs could not accurately be estimated upon delivery for the simple reason that the PGMs first needed to be refined to extract the metals, at what stage the value could be determined. The establishment of the purchase price was delayed but a formula was in place for the determination. This process to establish the price could take up to five (5) months. When the PGMs were refined, and the guaranteed returns could be established, the settlement date arrived. This would mean that A1 parted with its property without payment. It only became entitled to payment shortly after the settlement date, which occurred after some five (5) months had elapsed.

[74] To deal with this situation of delayed payment, A1 became, in terms of clause 11.2, entitled to receive an advance payment in respect of each lot. If an advance payment is paid, interest becomes payable on the advanced payment. Clause 11.2.1 then provides as follows: "Payment of the interest charge and repayment of the advance payment shall be made on any date prior to or on the settlement date." Only one advance per lot can be requested.

[75] Important for a decision in this matter is clause 11.2.5 which determines that:

> *"*An amount representing the value of the advance payment plus interest due in terms of clause 11.2.1 shall be deducted from the payment due for that lot pursuant to clause 11.1, or in the event that the advance payment plus interest for any lot exceeds the purchase price for that lot, from payments due in terms of clause 11.1 for subsequent lots provided that such excess shall be subject to an interest charge at the same rate as provided for in clause 11.2.1."

[76] Considering these clauses in context and with the agreement holistically, it is my view, that the reference to "repayment of the advance" referred to in clause 11.2.1, read with clause 11.2.5, which provides that the advance payment "shall be deducted from the payment due", what was intended by the parties was that the advance payment could stand as part pre-payment for the purchase price of the specific lot. The reference to "repayment" in clause 11.2.1 of the advance payment "which shall be made on any date prior to or on the settlement date" is in fact contradictory to the tenor of the agreement as a whole, as the advance payment could be deducted when payment of the lot becomes due, or it could have stood as an advance payment in relation to future lots.

[77] Clause 11.3 provided that *in lieu* of payment for any lot, A1 was entitled to elect to receive the guaranteed return of refined metals. If such an election is made, which according to the evidence often happened, then the advance payments would have escalated. Clause 11.3.2 catered for such a situation and provided as follows: “In the event that A1 elects to take the guaranteed return of any lots, any advance payments plus interest made against that lot shall be applied to subsequent lots, against which no advance payments have been made.” Thus, advance payments could only be deducted from the purchase price in relation to lots in respect of which no advance payments were made. Point is, advance payments were not repaid but stood as advance payments for future lots. Only in the event that no lot became available to apply such advance, the advance plus interest would have become immediately repayable.

[78] The issue to be considered is whether the advance payments were in substance loans or pre-payments or advanced payments. To ascertain this the wording use in the DGA agreements is a departure point but not determinative. The word “advance” is ambiguous and may either refer to prepayments of what will become due in future or be a “polite euphemism for loans”.[12]

[79] In my view, the reference to “advance” in the DGA agreement refers to a pre- payment in relation to an obligation to pay the full amount due when such amount could be determined. If the payment for whatever reason does not become due it can be recovered by MIR.[13]

[80] It should be remembered that the determination whether a prepayment or a loan was intended by the contracting parties should be made at the time when the DGA agreement was concluded. At that time, it was uncertain whether A1 would be a debtor or a creditor at the stage when the purchase price of a lot was calculated, after the date when the advance was paid. Consequently, when the advance payment was made the parties did not know with certainty at the moment the contracting parties’ obligations were crystallised, whether A1 would in fact have been provided with credit.[14] This is an indicator that the intention of the contracting parties was not that MIR was providing credit in the form of a loan to A1.

[81] What needs to be determined when considering the character of an agreement it is necessary to construe the DGA agreement and analyse the legal effect of the transaction, as opposed to whether the transaction had an economic or commercial substance or effect of a loan. The substance of the contracting parties’ agreement had to be found having regard to

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[12] See *Smart v Lincolnshire Sugar Co Limited* [1937] A.C. 697 (HL).

[13] *Bronester Ltd v Priddle* [1961] 1 W.L.R. 1294 (CA) where Holroyd Pearce LJ at 1301 found as follows: “It seems to me that ‘advance’ means: ‘I will pay now what I may have to pay in the future. I am paying before due time. If, after the advance, some event in the future upon which payment becomes due does not occur, you can recover it back.’ ”

[14] *McMillan Williams (a firm) v Range* [2004] EWCA Civ 294, [2004] 1 W.L.R. 1858.

the language that they used, but its characterisation was determined by its legal effect. If the language used by the parties was inconsistent with its legal effect, the Court should disregard the parties' terminology in characterisation of the transaction.[15] These guidelines which this court accepts should be utilised to consider the substance of the DGA agreement.

[82] The substance of the DGA agreement was one of a purchase and sale of PGM-bearing materials, which included how the purchase price would be determined, when payment would finally be due, what interim arrangements were in place before final payment and how advances would be dealt with. In substance the terms and conditions of the DGA agreement does not provide for a loan which is considered to be capital in nature for the income tax purposes. In fact, the wording of the DGA agreement is commensurate with its substance where refences are made to "advance payments".

[83] The DGA agreement does not refer to "*set-off*" of the advance against the purchase price but refers to "*deduction*". In my view, this is an indication that the advance payment is exactly what it is called, an advance payment on a purchase price of the trading stock which stood as a prepayment in relation to the purchase price. It was not a loan as contended by SARS. The fact that interest was charged on the deposit does not change the character of the advance payment. The fact that an advance payment could become repayable when there was no future lots against which the advance payment could be applied does not render the excess advance payment a loan when it was paid. Also, not the fact that the advance payments were secured by the value of the pipeline.

[84] The *ratio* behind the advance payment was clearly as a result of a delay between transfer of ownership and the final settlement date, which lasted about five months. The intention all along is to pay for the purchase of trading stock which is deductible because it is revenue or income earning in nature. All that was envisaged is to bring forward a payment of the purchase price of the trading stock that would be made at some point in the future. The roll-over of advances served the same purpose. What is important to note is that payments were closely linked or connected to specific lots, or future lots, against which no advance payments were made. Consequently, it is clear to me that the agreements created a custom of a trade or business in terms of which the taxpayer made advances or prepayments for the purchases of trading stock to its supplier as an integral part of the business carried out on for securing business, which is deductible in nature from the income because it leads to income-earning operations or revenue.

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[15] See: *Secretary for Justice v Global Merchants Funding Ltd* (2016) 19 HKCFAR 192.

[85] In my view, the substance of the DGA agreement was not for MIR to provide a loan to A1, which contradicts the views expressed and advanced by SARS in this court. An advance pre-payment was made to purchase PGM-bearing materials, which is a trading stock as envisaged and defined under sections 1 and 22 of ITA. Section 1 defined "trading stock" to mean anything produced, manufactured, constructed, assembled, purchased, or in any other manner acquired by a taxpayer to use in manufacturing, to be sold or exchanged or on the taxpayer's behalf. The tax treatment of trading stock is as follows: (i) less opening stock (section 22(2)), (ii) less purchase price (section 11(*a*)), and (iii) plus closing stock (section 22(1)) to arrive at the total deduction from taxable income.

[86] When the advanced payment is not repaid in circumstances where it could not be applied as advanced payments in relation to future lots this would constitute a breach of purchase-sale contract, but this would not change the substance of the DGA agreement. A damages claim could be instituted by MIR against A1 to reclaim the advanced payment. In this case, the quantum of the settlement reached by the contracting parties is not deductible for income tax purposes in terms of section 23(*c*) of ITA because it is recoverable expenditure.

[87] The next question would be whether this situation prevailed leading up to the conclusion of the SAs.

[88] The context in which these SAs were entered into becomes important to ascertain the substance of these agreements as part of the interpretation process. The outstanding balance of the advance payments were not substantially reduced. MIR elected at that stage, not to take action. This does not mean that MIR could not have insisted on the repayment of excess advances. This was done because there were insufficient lots available against which excess advances could be applied as advance payments. This was caused by A1's continued insistence that MIR had to pay further advances. This caused an increase of MIR's exposure which, in my view, was caused by MIR leniency towards A1 in its attempt to secure the supplies of PGM-bearing materials during the financial crisis. By not taking action to force repayment of excess advances, the character of the advanced payments when made was not altered, but what transpired was that MIR was providing financial assistance to A1 not to reclaim what it was entitled to do. This, according to correspondence, left MIR concerned that it might have acted in breach of current authority provided by the Reserve Bank in relation to foreign currency law.

The Special Agreements (SAs)

[89] Various SAs were concluded. The correspondence between the parties and the SAs which were concluded prior to the July 2010 agreement and the July 2012 agreement provided context for the interpretation of these agreements. The SAs were concluded to find solutions for the situation where the excess advances, plus interest, were not reduced through metal price escalations, coupled with the increase in lots delivered. The factual matrix which presented itself at the time when the SAs were entered into would provide the context in which these agreements were concluded.

[90] The metal in the pipeline was worth much less that the advances already accumulated. The price of PGMs fell to below the value of advances when paid. Importantly, the reduction in value was not temporary and continued. On the one hand, MIR was eager to get more trading stock, but on the other hand, A1 still required and needed advances to purchase its PMGs from its suppliers.

[91] The discussions and arrangements at the time was underpinned by a believe or expectation that the excess advances would be settled by delivery of future lots of PGM-bearing materials, and that the recovery of the metal prices would result in A1 extinguishing its indebtedness by further supplies.

[92] A1, however, insisted on continuing to take advance payments and also resisted refunding the excess advances in cash. It would have been difficult to cut back on advances without impacting on further deliveries. A1 insisted that the excesses be rolled over to be set-off against further deliveries and that MIR had to allow time for the excess advances to be recovered in due course. Needless to say, this could only have transpired, if and when, the price for PMGs substantially increased. MIR' management believed that the situation would correct when the metal prices recovered. According to the testimony of Ms. Barney (the former senior executive management of the taxpayer) the mantra was, "the prices caused the problem and the prices will solve the problem".

[93] Initially, after the 2008 sudden decline in prices, MIR paid no advance payments during July to September 2008. A1 insisted on an arrangement in terms of which the payment of advance payments would continue and even threatened MIR that if a solution is not found then it would stop deliveries to MIR and would start to supply refineries closer to it. This would have been against MIR' interests and MIR had to negotiate a solution which guaranteed the supply of PGM-bearing materials.

[94] This then led to the conclusion of the SAs, which provided for the reduction of the maximum amount of advance payments, the increase in the volumes that A1 had to supply and special once-off advance payments - either in cash or in the form of metal leases – against a specific lot of allocated materials that A1 undertook to deliver.

[95] Two SAs were concluded on 16 October 2008 and 30 March 2010, respectively. In the October 2008 agreement, MIR undertook to make a $50 million advance to A1 for the purchase of PGM materials to be allocated to MIR, separated and held by A1 at its factory on behalf of MIR and to be delivered to MIR on demand. Two tranches of $20 million were advanced to A1, but A1 reneged on its obligation and failed to deliver the materials. In fact, A1 failed to deliver the minimum quantities in terms of the DGA agreement. This increased the extent of the excess advance payments.

[96] The March 2010 SA provided for a further advance of $50 million in cash pending the outcome of joint venture negotiations. This amount was payable from the hedge of metals equivalent to at least 50% of the advance maturing on 30 June 2010 and the balance was to be payable within nine (9) months. There was an option to convert the $50 million special advance to working capital of the possible joint venture. These advances were paid against the security of metal hedges and was recovered from settlement of the hedges on the dates of their maturity.

[97] In my view, this evinces a strategy by MIR to provide funding to A1 to keep its business afloat and to secure the supply of PGM-bearing materials to it. Ms Barney referred to the conundrum which faced MIR. The quickest way to swing the advances position, from excess advances back to headroom, was by reducing new advances whilst increasing the volume of materials delivered into the pipeline, but, A1 required more advances to enable it to buy more catalyst in order to produce greater volumes of PMG-bearing materials to supply the pipeline.

[98] There was a clear break-away from applying excess advances directly to specific lots. MIR considered that the only way of ensuring that the excess advances for previous deliveries were gradually reduced was to retain A1's business. This gave rise to the 2010 to 2012 SAs.

[99] For purposes of this case, the 19 July 2010 agreement is important as this might have brought about a novation of the previous regime as agreed in terms of the MPAs, with particular reference to the DGA agreement dated 25 August 2008. I use the word "might" as this issue requires decision by this court. On behalf of SARS, it was contended that payments could not, upon interpretation of the July 2010 agreement, be interpreted to be advance payments but constituted loans by MIR to A1. On behalf of MIR, it was contended that properly interpreted the payments previously made by MIR to A1 constituted advance payments for stock. This was carried forward into the new order established by way of the SAs.

[100] Ms Barney testified on behalf of MIR that prior to the conclusion of the July 2010 agreement, the excess advances were immediately repayable in terms of the MPAs in the MIR's accounting books. Despite this breach, MIR elected to continue with its contractual relationship with A1 because of its strategic importance to the business and survival of MIR. Ms Barney testified that MIR was still hoping for a substantial price increase which might have created a situation whereby the excess advances could have been reduced or discharged. The July 2010 agreement permitted an extension of time in which the excess advances was repayable.

[101] This agreement requires closer scrutiny. It recorded the "old order" position as at 1 July 2010, which was accepted by A1, as follows:

a. metal in the MIR pipeline valued at $164 196 890;

b. cash advanced to A1 in the amount of $240 223 074;

c. 69 000 ounces platinum leased to A1 valued in the amount of $103 500 000;

d. total of excess advances: $343 723 074.

[102] The cash was advanced in terms of the MPAs. The leases were not provided for in the MPAs. This was confirmed by Ms Barney in cross-examination. Leases was a form of repayment of advanced payments in metal.

[103] The key concept that underpinned the July 2010 agreement was to create a mechanism to settle the "old order" business and to start a fresh or new contractual mechanism as from 1 July 2010, described as the "new order". Ms Barney testified that she used a schedule of advanced payments to persuade A1 to acknowledge its indebtedness, which A1 did. Before this date, MIR could have claimed repayment of the excess advanced payments in terms of the MPAs. After this date, MIR could no longer reclaim immediate payment, provided that A1 met its financial obligations as provided for in the 1 July 2010 agreement. The concept further allowed for the value of the underlying metal in the "old order" pipeline to be leveraged via potential metal price increases to facilitate quicker reduction of the over advanced position.

[104] In terms of the July 2010 agreement:

a. The excess advances were divided into A, the equivalent of the pipeline value of $164 196 890, and B, the amount owed by A1 after deducting A from the excess advance total of $343 723 074, an amount of $179 528 184 represented the outstanding amount. The "new order" business was referred to as C.

b. In relation to A, all refined metal from lots in the pipeline delivered before 30 June 2010, would be retained by Company A at IL for a period not exceeding 1 July 2012. During this period, A1 could purchase these metals and use the proceeds to settle its debt towards A. The concept behind this was again premised on a potential that the metal prices would increase. If A1 could purchase the metal at the fixed price but could sell it at an increase amount, the excess amount could have been utilised to pay excess advances incurred in the "old order". On 30 June 2012, the full value of the remaining metal held at IL shall become due for purchase by A1 from MIR at the 2010 fixed metal price.

c. The repayment plan for the amount owed under B was divided into Part 1 and Part 2. Part 1 represented the metal leased in the amount of $103 500 000. The repayment of this amount had to occur over a period of 15 years from 1 July 2010 at a fixed interest rate of 2,5%. Part 2 of B consisted of the remainder of the cash advance of $240 223 074 less A which amounted to $76 026 000. This latter amount was repayable by A1 over 15 years at a fixed interest rate of 2,5%.

[105] The effect of this July 2010 agreement was that the MPAs no longer applied to the "old order" business pertaining to excess advances and their repayment terms. Ms Barney conceded this in cross-examination. Only the terms relating to the new order business implicated the MPAs. The MPAs were amended to some extent not relevant at this stage.

[106] The agreement was aimed at repayment of the "old order" debt, the extent of which was known to the parties. There were an identifiable debtor and a creditor that were known with certainty by all contracting parties at this stage. How repayment of the $164 196 890 was to be achieved was based on an expectation that metal prices were going to increase. If so, A1 would be in a better financial position to service the debt. Metal in the pipeline was fixed on a certain price, placed in an IL-account and made available to A1 to purchase at the fix price. If there was a price increase A1 could buy at the fixed price and resell at a higher price, which translate to profit. The profit could then be used to repay debt owing to MIR.

[107] As far as the $103 500 000 for metal leases was concerned the repayment plan was more straight forward. The balance of the advances owed to MIR shall be repaid by A1 over 15 years at a fixed interest rate of 2,5%. This was a higher interest rate as was originally applicable in terms of the DGA-agreement.

[108] As far as the $76 026 000 is concerned, the balance of the advanced payments owed to MIR shall be repaid over 15 years at a fixed interest rate of 2,5%. Again, higher that the interest rate pertaining to advanced payments in terms of the DGA-agreement. A capital repayment holiday for a period not exceeding one year was instituted with immediate effect

while the option of vending the million into a new joint venture between the parties was concluded.

[109] The July 2010 agreement also dealt with "new order" business terms, referred to as "C" in the agreement. Advance payments could be requested as previously under the DGA agreement. Certain percentages were changed but the interest rate remained at 1,5% on advances made. Provision was also made for metal leases.

[110] On behalf of MIR, it was argued that the July 2010 agreement did not change the characteristics of the advance payments into capital loans. It was argued that the SAs were concluded in the context of the precipitous drop in metal prices. This left a balance of excess advanced payments. The SAs constructed a system designed to enable and secure the continued trading relationship with A1, whilst reducing the balance of the excess advanced payments.

[111] On behalf of SARS, it was argued that context is provided for the interpretation of the SAs if regard is had to the correspondence between the parties before entering into the SAs. Repeated references were made to the outstanding loans. For instance, on 10 March 2009, Mr Sunner of MIR wrote to Mr June of A1 and made proposals how to reduce the "outstanding loan balance". In my view, not much can be read into the choice of words by the contracting parties in correspondence as this court already found that the escalated excess advanced payments under the 2008 DGA agreement did not constitute loans, but rather trading debt.

[112] Question remains, however, had the situation changed from when the DGA-agreement was concluded? Under the DGA-agreement advances paid for lots could be deducted from payments due for specific lots or could be rolled-over to be utilised to be deducted from payments due by MIR for future lots. Only if this was not possible, the advance payments became repayable. In terms of the DGA-agreement there was a close *nexus* between advances and lots. Excess advanced payments did not become repayable upon demand. When the excess advanced payments could not be deducted from payments due such advanced payments became due and payable by A1 to MIR. The effect of the July 2010 agreement changed the situation as the excess advanced payments were no longer immediately repayable but subject to the repayment terms of the July 2010 agreement.

[113] In my view, the wording and substance of the July 2010 agreement indicated that the existing trading debt was converted into long term loans. In other words, the refinancing or repayment plan of the existing trading debt occurred and not the original source of the underlying transaction. Reference was made to a repayment term of 15 years and interest of 2,5% per annum. The agreement was based on the concept of assisting A1 to repay the advanced payments, not necessarily by way of delivery of lots against which the access

advances could be reduced. This agreement converted existing debt into what in substance or effect constituted a lending or refinancing transaction. In essence, credit was provided coupled with mechanisms to assist A1 to repay the trade debt. The placing of the value of the pipeline metal at IL was to create an opportunity for A1 to take advantage of a possible price increase in metal prices.

[114] If this transpired it would have placed A1 in a better financial position to repay its trade debt. But this opportunity was limited in time. After two (2) years, MIR could sell the metal at the price of metal at that stage and deduct that amount from outstanding trade debt. This in my view, objectively considered, having regard to the wording of the July 2010 agreement, interpreted holistically and against the prevailing factual matrix at the time of conclusion of the agreement is indicative of a conversion of existing trade debt into loans. The fact that advanced payments were previously made which resulted in the trade debt is not to say that a conversion into a loan could not have taken place. I find that the conversion came about when the July 2010 agreement was concluded.

[115] After the conclusion of the July 2010 agreement, the problems continued. A1 shipped insufficient volumes of materials to MIR. MIR responded by withholding or reducing new advance payments. This led to a further SA dated June 2011 which to some extent amended the July 2010 agreement, but A1 refused to make any cash payments to reduce or discharge the excess advanced payments which are recorded and disclosed as overpayments.

[116] To ensure that A1 continue to deliver PGM-bearing materials, further SAs were concluded when necessary to temporarily alleviate A1's position. This included an SA dated 11 October 2011 which provided for a $20 million special advance against specific further lots. Interest was payable against this advance. The payment was made but the lots were not delivered. A1 undertook to repay the amount, but only repaid $10 million in two tranches of $5 million each. A1 undertook to repay this amount once the metal prices recovered and MIR accepted this. Ms Barney conceded in cross-examination that this was a loan transaction.

[117] The problems with the extent of advances to be paid by MIR and the repayment of existing advanced payments continued and this culminated in the June 2012 agreement, signed on 5 July 2012.

[118] The June 2012 agreement superseded all previous agreements dealing with the old order business, the repayments of the excess advanced payments and variations of the MPAs in relation to the new order business and varied the terms of the MPAs. References are now made to "loans".

[119] The June 2012 agreement recognised the long-term advances, now referred to as "loans", created in the July 2010 agreement, as modified by further SAs, as follows:

a. In terms of an agreement dated 19 July 2010 and amended on 14 June 2011, A1 owed MIR an amount of $164 196 890 which amount was defined as Loan "A". It was recognised that in terms of two SAs A1 withdrew metal from the Vale account. The balance on Loan "A" amounted to $95 976 869 and the metal still in the Vale account was noted.

b. In terms of an agreement dated 19 July 2010 and amended on 14 June 2011, A1 owed MIR an amount of $76 026 184 (Previously Part 2 of B but now referred to as Loan B) and an amount of $103 500 000 (Previously Part 1 of B but now phrase as Loan C).

c. The June 2012 agreement also recorded and disclosed that A1 owed $10 million in relation to a $20 million cash advanced payment.

[120] Clause 2 deals with the repayment of Loan A. In short, the metal in the Vale account would become the property of MIR and will be sold to reduce the amount owed to MIR. An arrangement was put in place that MIR would take full ownership in all nett metal outturns from July 2012. Hedges would be taken out by MIR and the hedge proceeds would be utilised to reduce Loan A. Any surplus individual metal due to A1 will be retained by MIR until the full quantum of all metals, the subject of the special advance payments and special purchases have been replenished. Clause 2.4 of the June 2012 agreement specifically refers to the servicing of debt. This, in my view, is an acknowledgement of the fact that a loan was prepaid. The way in which a loan was to be repaid should not on its own lead to a conclusion that in substance credit granted is not a loan.

[121] Clauses 3 and 4 of the June 2012 agreement provided for the repayment of these loans as follows:

a. Loan B ($76 026 000) would be repaid in monthly cash instalments of $536 806.15 terminating on 1 July 2023 and bore interest;

b. Loan C ($103 500 000) would be repaid in monthly cash instalments of $690 126.83 terminating on 1 July 2025 and bore interest;

c. The $10 million debt would be repaid in monthly cash instalments of $1 million commencing on 31 July 2012 and finishing on 30 April 2013.

[122] Ms Barney conceded that the way the repayment of the excess advanced payments was determined by the July 2010 and the June 2012 agreement. She agreed that the June 2012 agreement was novel, in that A1 had undertaken to settle the excess advanced

payments by way of cash instalments, whereby A1 previously insisted that it would repay the excess advanced payments by the delivery of future lots of metal over time.

[123] Even if I was wrong in my finding pertaining to the characterisation of the July 2010 agreement as a loan, in my view, the June 2012 agreement removes any doubt as to the character of the amounts advanced to A1 by MIR. The references in the agreement to monthly instalments in specific amounts and to “loans A, B and C” are telling.

[124] In my view, even without reference to conduct after the June 2012 agreement, but with reference to the wording of the agreement itself, considered holistically with due regard to the prevailing context, the June 2012 agreement removed any doubt that the existing debt was converted into long term loans. Not only was the debt now referred to as “loans” but also the outstanding amounts were not payable on demand but over long periods by way of instalments. The nomenclature used by the parties in my view, expressed their intentions correctly and was not, as Ms. Barney testified, mere labels used to define the outstanding amounts. I emphasise that the original transaction was the purchase of the trading stock (inventories) which is deductible from the income for the income tax purposes.

[125] An important contextual consideration in aid to interpret the June 2012 agreement is the fact that the roll-over mechanism of advances failed over a period. Special advances were not repaid and a different direction to repay these amounts had to be taken.

[126] I find that the July 2010 and June 2012 agreements, either individually and/or cumulatively, novated, superseded and replaced all previous agreements in relation to the “old order” business advance payments and created a new obligation in the form of loan obligations, which MIR was entitled to enforce against A1.

[127] The true substance of the July 2010 and June 2012 agreements were to convert existing trade debt into a loan refinancing and was far removed from expenditure incurred by MIR to purchase and obtain trading stock. Bulk advances were made before June 2012 with the aim to support A1 financially. According to MIR, the method of redemption or payment of the balance of excess advances was amended from setoff against the next available lot in the pipeline to instalments over an extended period. This, in my view, is not the position. Existing debt was converted into long term loans with specific repayment terms, which attract interest at a higher rate than provided for in the DGA agreement.

[128] As found hereinabove the tax liability of MIR is created in terms of the Income Tax Act and the tax dispute does not involve A1. In terms of the agreement between MIR and A1, the tax disputes between these contracting parties would be adjudicated with reference to the laws of England. The current dispute is a dispute between MIR and SARS. To resolve this dispute South African law would apply. In determination of this dispute SARS may have regard

to how the taxpayer implemented its agreements with A1 to establish what the taxpayer intended when it concluded the agreements with its supplier.

[129] In the AFS's of MIR the recurring theme is that the advanced payments are reflected as non-current assets which are congruent with long-term loan accounts. The AFSs for the 2009 to 2013 years, show that MIR advanced loans to A1. The explanatory notes in the AFSs makes it even clearer. These included references to Loans A, B and C as per the June 2012 agreement. For instance, in the 2012 AFSs the explanatory note stated: "The repayment terms on the loan receivable from a customer (A1) were negotiated during current year due to liquidity difficulties being experienced."

[130] In the arbitration proceedings before the LCIA the majority of MIR's claim was in respect of repayments for interest-bearing loans advanced by MIR to A1. In evidence before this court Ms. Barney conceded that what was claimed in the arbitration was the amounts that were payable in terms of the July 2012 agreement and not for under-delivery of metal. In her statement prepared for the arbitration Ms Barney stated as follows and I quote:

> "9 Loan A, Loan B and Loan C as those terms are used in this statement relate to the amount of $343 723 074 which was agreed to be due by A1 by reason of cash advances and metal leases as at the time of the 2010 Agreement. The 2010 Agreement divided the $343 723 074 owing by A1 to MIR arising out of business up to and including 30 June 2010 into three parts. The first is Loan A in the approximate amount of $164 million (referred to herein also as "Loan A"). <u>The remaining approximately $179 million was converted into long term debt of two parts: one part in the amount of approximately $76 million (referred to herein as "Loan B") and a second part in the amount of $103 500 000 (referred to herein as "Loan C")</u>.The amounts which are owed by A1 in reference to Loans A, B and C are set out in the first three parts of Schedule A as described in more detail below."

[Emphasis Added.]

[131] The subsequent conduct referred to above, reflects how MIR, unilaterally, dealt with the amounts owing by A1 to it, and not necessarily how the contracting parties implemented the agreements. The manner how these agreements were implemented can, accordingly, be of little assistance to interpret the agreements itself. What it does show is how MIR, as a taxpayer, claiming a deduction from income in terms of section 11(a) of the ITA, dealt with the rights and obligations created by the agreements. The subsequent conduct of MIR buttresses my view that a loan obligation was created with the conclusion of the July 2010 and June 2012 agreements.

[132] The effect of this judgment is that I do not have to deal with the deferral provisions, sections 22, 23(F)(1)(*c*) and/or 24(M)(2) of the ITA.

[133] We find unanimously that the tax appeal should be dismissed.

[134] In terms of section 130(1)(b), the tax court may grant an order for cost in favour of SARS if the appellant's grounds of appeal are held to be unreasonable. I find that it cannot be found that the grounds of appeal are unreasonable. Some of the grounds were upheld, albeit, that these grounds did not cause a favourable outcome for MIR.

[135] The following order is made:

a. The additional assessment dated 16 December 2018 is confirmed with the amendments as referred to in paragraph 1 of this judgement.

b. No order as to costs.

R STRYDOM
JUDGE OF THE HIGH COURT
TAX COURT OF SOUTH AFRICA

Heard on: 19 February to 01 March 2024

Delivered on: 8 July 2024