

Media Releases 2010

Supreme Court of Appeal Judgment

Pretoria 15 December 2010 – The South African Revenue Service (SARS) welcomes the clarification of a number of important principles by the Supreme Court of Appeal on 1 December 2010 in the case of SARS versus NWK Ltd.

The SCA considered a set of transactions entered into by a company with little or no trade or commercial substance. These transactions attempted to artificially increase the expenses the taxpayer claimed. These simulated or artificial transactions were effectively ignored in determining the actual expenses that should be allowed.

Among the principles the SCA clarified were—

- The test to determine simulation is not simply whether there is an intention to give effect to a contract in accordance with its terms. The test goes further and requires an examination of the commercial sense of the transaction, that is, of its real substance and purpose; and
- Section 103(1) of the Income Tax Act, 1962, the general anti-avoidance rule that was in force until 2 November 2006, may be applied as an alternative to SARS's argument that a transaction is simulated or falls foul of other provisions of the Act.

In the matter of SARS vs NWK a capital amount of outstanding tax of more than R30 million is involved, which included penalties but excludes interest.

SARS is also of the view that a simulated transaction generally involves an element of misrepresentation or non-disclosure. Under these circumstances an assessment reflecting the transaction is not subject to the three year prescription period set out in section 79 of the Income Tax Act, 1962. The assessment may, therefore, be reopened despite the fact that the date of assessment may be more than three years in the past.

SARS is aware that a number of other taxpayers have entered into simulated transactions, including compulsorily convertible loans similar to the one at issue in the NWK case, with the effect of artificially reducing their tax liabilities. Starting from 15 February 2011 SARS will commence audits of these taxpayers.

Taxpayers are invited to make use of the current Voluntary Disclosure Programme (VDP) prior to the commencement of an audit.

Should taxpayers choose not to take advantage of the VDP then additional tax and interest are likely to be levied in issuing assessments in respect of the simulated transactions.