TAX

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WHAT IS SIMULATION REALLY?

Since the judgment of the Supreme Court of Appeal (SCA) in *CSARS v NWK 73 SATC 55* there has been a bone of contention as to the real meaning of a simulated arrangement. In the *NWK* case it was indicated that *"[i]f 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. And the mere fact that the parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation."*

The SCA had occasion to consider the meaning of simulation in a non tax-related matter in *Roschon (Pty) Ltd v Anchor Auto Body Builders CC [2014] (4) SA 319 (SCA)*. However, everybody waited with bated breath for the judgment of the SCA in the matter of *CSARS v Bosch 75 SATC 1*.

On 19 November 2014, in the judgment of the SCA in the matter of *CSARS v Bosch 75 SATC 1*, the SCA held in favour of the taxpayer. Apart from a number of other issues that were dealt with in the judgment (which will be considered in other articles), it was indicated that the approach of the Commissioner, to the effect that dishonesty is not a requirement for simulation and that a transaction is simulated if it results in a significant tax benefit, was not correct. It was indicated that simulation is a question of the genuineness of the transaction. If it is genuine it is not simulated. If it is simulated then it is a dishonest transaction, whatever the motives of the parties to the transaction may be. It was stressed that a court will examine the entire transaction, including all surrounding circumstances and any unusual features of the transaction, as well as the manner in which the parties intended to implement it. One of the features will be the income tax consequences of the transaction.

It was impliedly acknowledged that the reference to the evasion of tax in the *NWK* case may have been unfortunate. It was indicated that tax evasion is impermissible and, if a transaction is simulated, it may amount to tax evasion. However, there is *"nothing impermissible about arranging one's affairs so as to minimise one's tax liability, in other words, in tax avoidance."* To the extent that any particular form of tax avoidance may be seen to be undesirable by the South African Revenue Services (SARS), the legislation should be amended.

In the current instance it was indicated that there was no advantage that the parties would gain by entering into a conditional contract of purchase to the extent that they were free to enter into an unconditional contract. The judgment of the SCA should thus be welcomed in clarifying the principles pertaining to simulation and the fact that one can still rely upon prior case law in establishing whether a transaction is simulated. Taxpayers are free to structure their affairs so as to minimise their tax liability for so long as they intend to give effect thereto. However, in entering into a transaction, one should guard against unusual features or provisions that may be indicative of a simulated arrangement.

Emil Brincker

DLA CLIFFE DEKKER HOFMEYR

THE TREATMENT OF FOREIGN PENSIONS

In terms of s10(1)(gC)(ii) of the Income Tax Act, No 58 of 1962 (Act) a pension received by or accrued to a resident from a source outside South Africa as consideration for past employment outside South Africa is exempt from the payment of tax. In terms of s9(1)(i) of the Act it is indicated that an amount is deemed to be sourced within South Africa if the amount constitutes a pension or annuity and the services in respect of which the amount is received or accrued were rendered within South Africa. However, if an amount is received or accrued in respect of services which were rendered partly within and partly outside South Africa, only so much of the amount as bears to the total of the amount the same ratio as the period during which the services were rendered in South Africa bears to the total period during which the services were rendered must be regarded as having been received by or accrued to the person from a source within South Africa.

In a number of instances the South African Revenue Service (SARS) has argued that the location of the fund paying the pension or annuity is decisive. To the extent that the fund is located in South Africa, it was argued that the source is in South Africa and therefore that the total amount is taxable in South Africa irrespective of the fact that the pension may relate partly to services that were rendered outside South Africa.

In terms of a Binding General Ruling No 25 (14 November 2014) SARS has now indicated that the reference to source in s10 of the Act refers to the originating cause that gives rise to the pension income, ie where the services have been rendered. Accordingly, a pension will be exempt to the extent that the services were rendered outside South Africa. A formula is used that divides the total pension between foreign services rendered and total services that have been rendered. To the extent that a portion of the pension thus relates to foreign services that have been rendered, it will be exempt irrespective of the fact that the fund is located in South Africa.

Emil Brincker

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Andrew Lewis
Director
T + 27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Tessmerica Moodley
Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.com

Carmen Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.holdstock@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

Lisa Brunton
Senior Associate
T + 27 (0)21 481 6390
E lisa.brunton@dlacdh.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG
1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN
11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

cliffedekkerhofmeyr.com

DLA CLIFFE DEKKER HOFMEYR