Onlangse regspraak/Recent case law

A (Pty) Ltd v The Commissioner for the South African Revenue Service
ITC 12644 (2012)

Capital loss incurred on the redemption of redeemable shares: a clogged loss or not?

1 Introduction

It is said that the reasons for the taxation of capital gains are enthused by the fundamental notions of fairness, a need for economic efficiency and the improvement of tax administration (Brooks *Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration* (2001) 2). This report was drafted for the Portfolio Committee on Finance and presented before Parliament. It is used to substantiate the introduction of CGT in the *Comprehensive Guide to Capital Gains Tax*). The Income Tax Act 58 of 1962 (ITA) provides for the inclusion of capital gains or the limited deduction of assessed capital losses made by a taxpayer in determining its tax liability. The determination of such capital gains or assessed capital losses is governed by the Eighth Schedule to the ITA (the Eighth Schedule). The Eighth Schedule sets out provisions that determine a taxpayer's capital gains or capital losses (De Koker *Silke on South Africa Income Tax* (2011) par 24.1).

Brooks stated in his report that the then draft South African Capital Gains Tax Legislation was impressively clear, precise and comprehensive. However, tax legislation is inherently abounded with complexities and controversy as to its application, interpretation and purpose. The interpretation of the Eighth Schedule has led to a degree of uncertainty where the tax treatment of the redemption of redeemable preference shares is concerned. This matter was dealt with in the recent case of *A (Pty) Ltd v Commissioner for the South African Revenue Services* ITC 12644 (2012). In this matter, the court addressed the nature of a disposal and the essential nature of the redemption of redeemable preference shares. Due to the nascence of the taxation of capital gains in South Africa, it was the first time that the courts dealt with this aspect of the taxing statute. In this case the application of Paragraph 39(1) of the Eighth Schedule to the redemption of redeemable preference shares was placed under scrutiny. It is worth noting that this case is of importance not only for taxation purposes, but also for the purpose of the statutory interpretation.

2 The Law

Paragraph 39(1) was introduced at the inception of the capital gains tax as an anti-avoidance provision to prevent a taxpayer from avoiding tax

liability, by creating a capital loss through the disposal of an asset to a connected person (a connected person is defined in s 1 ITA as a company that holds more than 50 per cent of the equity shares or voting rights in another company, and forms part of the same group of companies). Were it not for Paragraph 39(1), a taxpayer would be able to avoid CGT by disposing of an asset to a connected person at a loss (whilst effectively still retaining control of the asset and its benefit through the relationship with the said connected person). Paragraph 39(1) provides for the "clogged-loss" rule in respect of capital losses incurred as a result of disposals made to certain connected persons. This clogged loss rule disallows a set off or deduction of losses on disposals to connected persons or group companies. The salient provisions of Paragraph 39(1) state as follows:

> A person must, when determining the aggregate capital gain or aggregate capital loss of that person, disregard any capital loss determined in respect of the disposal of an asset to any person –
>
> (a) who was a connected person in relation to that person immediately before that disposal; or
>
> (b) which is immediately after the disposal –
>
> (i) a member of the same group of companies as that person ...

The capital loss disregarded in terms of this paragraph can only be set off against capital gains made on the disposal which was made to the same person in that year or a subsequent year if the person to whom the asset is disposed is still a connected person to the taxpayer (par 39(2)).

3 Facts

The appellant was a company, part of a group of companies (a group of companies is defined in s 1 ITA as companies where at least one of the companies holds 70 per cent of the equity shares or more in another company), which held shares in a second company (the issuer company) that was part of the same group of companies. The shares held by the appellant were redeemed by the issuer company and as a result thereof, the appellant suffered a capital loss. In its 2003 year of assessment, the appellant claimed the capital loss incurred as a deduction from its tax liability and the Commissioner for the South African Revenue Services (the Commissioner) disallowed the deduction on the grounds that the capital loss suffered was a clogged loss as envisaged in Paragraph 39(1). Consequent to the disallowance, the appellant raised an objection against the Commissioner's assessment which the Commissioner dismissed. The appellant then lodged an appeal against the Commissioner's assessment to the Tax Court. The Commissioner sought to have the assessment confirmed and contended that Paragraph 39(1) was applicable to the transaction and the redemption of the preference shares was a disposal as contemplated by the said Paragraph. The appellant, however, expressed the view that because the redemption of the shares was not a disposal "to any other person", as contemplated by

Paragraph 39(1), it did not amount to a clogged loss and thus the deduction should have been allowed. The Commissioner also sought to have the preference dividend and the redemption premium received by the appellant deducted from the base cost of the preference shares on the grounds that these amounts constituted a recovery in terms of Paragraph 20(3) of the Eighth Schedule.

There were therefore two primary issues brought before the court. The first being the interpretation of Paragraph 39(1) and whether that Paragraph applied to the redemption of preference shares and accordingly, rendered the appellant's capital loss a clogged loss due to the fact that the appellant and the said company were connected persons. The second issue before the court was whether the preference dividend and premium received in the redemption of the redeemable shares amounted to a recovery of the base cost (the cost at which the appellant acquired the preference shares).

4 Judgment

In relation to the first issue, the court held that the word "disposal" had to be given a narrow meaning in light of its context, particularly because it was used in conjunction with the preposition "to" (11). The court made reference to *Van Heerden v Joubert* (1994 4 SA 793 (A) 795) where it was held that the golden rule of statutory interpretation was that words had to be given their ordinary literal meaning and if it is clear and unambiguous, it is this grammatical meaning that must be adhered to. Departure from such a grammatical interpretation is only permissible if not doing so would lead to an absurdity that could never have been envisioned by the legislature.

The court also referred to *Cape Brandy Syndicate v England Revenue Commissioners* (1 KB 64 71), where the court stated that: "… one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied" (par 12). Further, reference was made to the *Concise Oxford Dictionary* which stated that the word "to" means "in the direction of" and "so as to reach" (par 19). In light of its reasoning, the court held that in order for a transaction to amount to a disposal as envisaged in Paragraph 39(1), the asset represented therein had to be transferred to the connected person. Since, in the transaction in question, no shares were transferred to the connected person but were extinguished instead, the redemption did not amount to a disposal and thus Paragraph 39(1) did not apply.

With regard the second issue the court held that the same principles of interpretation which applied to the first issue also applied in the interpretation of Paragraph 20(3) of the ITA. The court further held that when the company paid the appellant the dividend and the redemption premium, it did not intend for the amounts to constitute a reimbursement for the expenditure incurred for the acquisition of the

preference shares. In calculating the appellant's capital loss, the respondent had erred in treating the dividend portion and the redemption premium portion as recoveries of the acquisition cost as envisaged in Paragraph 20(3) of the ITA. As a result, the appeal was upheld.

5 Analysis of the Court's Judgment

The effect of the court's decision is that Paragraph 39(1) does not apply to the redemption of shares. As a result any loss incurred due to the redemption transaction upon a disposal to a connected person is not ring-fenced. Therefore, a taxpayer is allowed to take into account any capital loss determined in respect of the redemption of preference shares held in a connected company when calculating its aggregate capital gain or loss for the year of assessment. It should be noted that a redemption does constitute a disposal as a general matter; however, it is not a disposal "to any person" for the purposes of Paragraph 39(1).

5 1 Application of Paragraph 39(1) to a Redemption of Shares

5 1 1 Statutory Interpretation

As stated above, Paragraph 39 was introduced as an anti-avoidance measure to combat the avoidance of tax by loss making transfers of capital assets between connected parties. In applying the anti-avoidance provisions, the courts should look at the objectives of the provision and give effect to what the provision seeks to achieve.

The courts have predominantly accepted the practise of applying a grammatical interpretation to legislation in order to determine its meaning. However, regard must be had to the fact that the purpose of interpreting statutes is to ascertain the intention of the legislature. This principle was affirmed in *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975 4 SA 715 (A) 727), where the court confirmed the view in the *Commissioner for Inland Revenue v Delfos* (1933 AD 242), and stated "… even in the case of fiscal legislation the true intention of the Legislature is of paramount importance, and, I should say, decisive". In *R v Hildrick Smith* (1924 TPP 68 81) the court stated "[t]here is only one kind of interpretation with one definite object, and that is, to ascertain the true intention of the legislature as expressed in the Act".

It is notable that in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012 (4) SA 593 (SCA) 605) the court stated that in interpretation, the expression "intention of the legislature" should be avoided because this creates the misnomer that interpretation entails an enquiry into the mind of the legislature. However, what remains significant is that the judge recognised the necessity of taking the purpose for which the legislation was created into account in

interpretation, despite his caution against the use of the phrase "intention of the legislature". (As for instances where the intention of the legislature is in inconsistent with constitutional provisions see *Matiso v The Commanding Officer, Port Elizabeth Prison* 1994 4 SA 592 (SE) 596 in which the court states that in a constitutional state and in constitutional matters, it is not the intention of the legislature that should prevail but the constitutionality of the particular provision in question).

Notwithstanding the fact that the "golden rule" of adopting the grammatical interpretation of statutes is a widely accepted practice in our courts, the development of law has seen a progression in methods of interpretation which are far more effective in the pursuit of ascertaining the intention of the legislature. This progression from the use of a narrow grammatical method of interpretation of statutes to a more holistic approach that encompasses the use of a wider range of interpretative methods can be depicted in the South African Law Reform Commission's Discussion Paper 112 *Statutory Revision: Review of the Interpretation Act 33 of 1957* (Discussion Paper 112 (Project 25)) (the Discussion Paper). This paper was drafted during the Law Reform Commission's task of revising the Interpretation Act 33 of 1957 in order to align it with the Constitution and contains the Commission's research results. The Discussion Paper encompasses a draft Interpretation of Legislation Bill (the Bill). Chapter Two of the Bill attempts to codify a comprehensive method of interpretation that should be adopted in the interpretation of legislation. Clause 5 of Chapter Two currently reads as follows:

> (1) When interpreting legislation –
>
> (a) the meaning of a provision in that legislation must be determined by –
>
> (i) its language; and
>
> (ii) its context in the legislation read as a whole and
>
> (b) any reasonable interpretation of a provision in accordance with paragraph (a) that is consistent with the purpose and scope of that legislation must be preferred over any alternative interpretation of that provision that is inconsistent with the purpose and scope of legislation.

The clause read with the rest of Chapter Two recognises all the interpretative methods of the classical Von Savigny quartet (Du Plessis "Learner Staatsrecht from the Heartland of the Rechtstaat" 2005 *PELJ* 3 paragraph III), which are; grammatical interpretation, systematic interpretation, purposive interpretation and historical interpretation (Le Roux "The Law Reform Commission's Proposed Interpretation of Legislation Bill: Critical Comments" 2007 *SAPL* 528). It is evident in clause 5(1)(a) of the Bill that even where a grammatical interpretation is adopted, the court is required to interpret the provision in light of the legislation read as a whole.

In Du Plessis & Corder *Understanding South Africa's Transitional Bill of Rights* (1994), the authors recognise that there are several principles of interpretation which must be used collectively in order to truly interpret statutes in accordance with the legislature's intention. These principles of

interpretation, similar to the Von Savigny quartet, are (in no particular hierarchical order); a grammatical interpretation which encompasses giving words their ordinary meaning, a systematic interpretation which entails the interpreting of statutes as a whole and not interpreting a provision in isolation, a teleological interpretation which entails the consideration of the purpose and values that underpin the legislation, a historical interpretation which encompasses the interpretation of statutes in light of the historical background they were created in, and also a comparative interpretation in instances where such an interpretation would be appropriate (73-74).

These principles of interpretation identified by Du Plessis were also given recognition in our courts in *Minister of Land Affairs v Slamdien* (1999 4 BCLR 413 (LCC) 422) where the court stated that in interpreting legislation it is imperative that its purpose be analysed, regard must be had to the historical origin of the statute, the statute's broad objects and values which underlie it must be considered and regard must also be given to the part of the statute to which the provision appears or those provisions with which it is interrelated. The principles were further entrenched by the Constitutional Court in *S v Makwanyane* 1995 3 SA (CC) 154 where Mahomed J stated:

> What the Constitutional Court is required to do in order to resolve an issue, is to examine the relevant provisions of the Constitution, their text and their context; the interplay between the different provisions; legal precedent relevant to the resolution of the problem both in South Africa and abroad; the domestic common law and public international law impacting on its possible solution; factual and historical considerations bearing on the problem; the significance and meaning of the language used in the relevant provisions; the content and the sweep of the ethos expressed in the structure of the Constitution; the balance to be struck between different and sometimes potentially conflicting considerations reflected in its text; and by a judicious interpretation and assessment of all these factors to determine what the Constitution permits and what it prohibits.

The interpretation principles entrenched in *Makwanyane* apply, not only where the interpretation of the Constitution is at issue but, also to instances where other forms of statute are interpreted. This *dictum* in *Makwanyane* re-enforces the subsequent contention that a grammatical approach on its own, as adopted by the Tax Court in *A (Pty) Ltd*, is insufficient to truly ascertain the true meaning of Paragraph 39(1).

It is submitted that the Tax Court erred in its finding that Paragraph 39(1) did not apply to the redemption of shares. Albeit the relevance of a grammatical interpretation is recognised, such an interpretation should not result in the fragmentation of the legislative instrument as a whole (Du Plessis *Re-interpretation of statutes* (2002) 224). In the *Executive Council of the Western Cape v Minister for Provincial Affairs and Constitutional Development of the RSA; Executive Council of KwaZulu Natal v President of the RSA* (1999 12 BCLR 1360 (CC) 33), the court stated that it is an accepted principle of interpretation that where two subsections of

an Act deal with the same subject matter, these subsections should be read together.

In *A (Pty) Ltd* the court failed to interpret Paragraph 39(1) in light of Paragraph 11(1). Paragraph 11(1)(b) of the Eighth Schedule expressly includes a redemption in its definition of a disposal. It clearly states that a disposal includes the redemption of an asset. When the legislature included "a redemption" in its definition of a disposal, it was fully aware of the nature of a redemption and that it could not result in the shares, or the rights attached thereto, transferred to the redeeming company because a company cannot hold shares in itself. The court failed to take into account that in interpreting statutes, the statute must be read in its entirety and thus the construction of the word "to" should have been interpreted in light of the entire Eighth Schedule, and particularly, the expressed inclusion of redemptions in Paragraph 11(1).

5 1 2 Reasons Behind Introduction of CGT

It cannot be said that the court's interpretation of the word "to" and thus the entire Paragraph 39(1) provision was consistent with the legislature's intention. In the Briefing by the National Treasury's Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance on Wednesday, 24 January 2001, reasons for the introduction of the CGT system are provided. Amongst others, the reasons stated for the introduction of the CGT system are in order to attain "horisontal" and "vertical" equity. The system sets out to achieve "horisontal equity" by ensuring that individuals in similar economic circumstances bear a similar tax burden irrespective of the form of accretion the economic power takes. *Id est*, irrespective of the fact that the economic accretion takes the form of wages or capital gain. Thus the exclusion of the CGT system would essentially undermine the "horisontal equity" of the tax system (10).

The CGT system aspires to achieve "vertical equity" by imposing a greater tax burden on individuals with a greater capacity to bear such a burden of tax. The introduction of CGT is also aimed at creating a disincentive for taxpayers who would opt to characterise their income as capital in order to avoid a tax burden. Lastly, CGT was introduced to enable the tax base to be broadened in an attempt to eventually lower the overall tax rates. It was introduced in order to bring more taxpayers within the "taxation net" (Briefing by the National Treasury's Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance on 20010124 2).

As discussed above, it is imperative that in interpretation of legislation, the legislature's intention should be ascertained. In light of the reasoning for the introduction of the CGT system, it is clear that the court's construction of Paragraph 39(1) is inconsistent with the legislature's intention. The interpretation of the word "to" as stated by the court, has the effect of excluding a capital loss incurred as a result of the redemption

of redeemable shares from the ambit of Paragraph 39(1). This in turn limits the "taxation net" by allowing taxpayers to deduct from their taxable income every capital loss made from the redemption of shares. This is in direct contradiction to the intention of the legislature as indicated in the *Comprehensive Guide to Capital Gains Tax*.

If merit is given to the court's argument that the word "to" means "in the direction of" and that this implies that the shares must have been transferred to the connected person for the redemption to constitute a disposal, as envisaged by Paragraph 39(1), then it is submitted that in order for the asset to be able to move "in the direction of" a connected person, it must surely first "move away from" the other party. It is common knowledge that the taxpayer, after the redemption of the shares, no longer held shares in the company and in return, acquired a capital loss. It is the taxpayer's state of affairs that must be considered in determining its tax liability and not the effect a particular transaction has on the reciprocating party.

5 1 3 Contra Fiscum-rule

It is worth mentioning that in the case of ambiguity arising during the interpretation of fiscal legislation, the *contra fiscum* rule will be applicable. The *contra fiscum* rule is a common law principle stipulating that should a taxing statutory provision reveal an ambiguity, the ambiguous provision must be interpreted in a manner that favours a taxpayer (*Badenhorst v CIR* 1955 (2) SA 207 (N) 215). In other words, when a provision of ITA is reasonably capable of two constructions, the court will adopt the construction that imposes the smaller burden on the taxpayer. In *Glen Anil Development Corp* (1975 4 SA 715 (A) 727), the court held that an anti-avoidance provision must be interpreted in a robust manner in order to "… suppress the mischief against which the section is directed." In *Commissioner for Taxes v Ferreira* (1976 2 SA 653 (RAD) 657), the court held that a wide interpretation that gives effect to the legislature's intention should be employed when interpreting anti-avoidance legislation "… in order to suppress subtle inventions and evasions for the continuance of mischief and add force and life to the … remedy". Therefore, as to whether the *contra fiscum* rule could be applied in this case in favour of the taxpayer, the answer has to be in the negative. This is because Paragraph 39(1) is essentially an anti-avoidance provision; the *contra fiscum* rule will not be of assistance to the taxpayer. Furthermore, the rule would not find application if, as it appears, the court finds that there is no ambiguity as to the interpretation of Paragraph 39(1).

5 1 4 Steps in a Redemption

The court avoided analysing the distinction between a redemption and a share buy-back. The distinction could have changed the decision that the court arrived at. A buy-back of shares entails a two-step event. The first step is a reacquisition of the shares followed by a cancellation of those

shares. In a redemption, the company reacquires the shares, however, the shares revert back to authorised but unissued shares. The first step, the reacquisition, is a common characteristic between a redemption and a buy-back. In a buy-back, the reacquisition of the share is followed by a cancellation thereof. On the other hand, in a redemption, the company may retain the shares in the authorised unissued share capital account. The distinction is thus, in what follows after the reacquisition (s 48 Companies Act 71 of 2008, which sets out requirements for the reacquisition by a company of its own shares, specifically excludes a redemption from its operation. This is an indication that the Companies Act recognises a distinction between a redemption and a share buy-back). What the company does with the shares does not determine whether the shares have been transferred to the issuer company or from the shareholder company. It is therefore submitted that the reacquisition of the shares by the company is a transfer by A to B, and therefore Paragraph 39(1) would apply regardless of what the second leg of the transaction requires, that is what company B does with the shares post acquisition of the shares in question.

5 1 5 Result of the Redemption

As stated in the decision a "redemption of shares *results in the extinction* and not in the transfer of rights embodied in the states to the company redeeming them, or to any other person" (emphasis added). The court refers to the *result* of the redemption. This does not necessarily mean that a redemption is a cancellation. An action happens, which is a disposal of the shares by the shareholder to the company and a result of that disposal is that the company extinguishes the rights by cancelling the shares. These are two actions by two different entities. The determining factor should be whether the shareholder disposed of the share.

If the decision in *A (Pty) Ltd* is to be followed, unintended tax consequences would result. Connected persons would be able to redirect transfers using various contracts. In this regard an illustration can be made with regards to a cession. Suppose the transaction required that B would transfer the shares to C, an unrelated third party in terms of a cession agreement between A and C. The first part of the transaction would be that B transfers the shares to A, but due to the cession agreement the transfer then passes on to C (*Grobler v Oosthuizen* [2009] ZASCA 51 12). If C compensates A at market value, then A and B would be able to manipulate the process to generate a loss by A compensating B at an amount that would generate a loss in the hands of B.

5 1 6 No Purpose Requirement

In the language of Paragraph 39(1) a person must "disregard any capital loss determined in respect of the disposal of an asset to any person" who is a connected person. A disposal is an action that results in the creation, variation, transfer or extinction of an asset by the person disposing of the

asset. Paragraph 39(1) makes no reference to what the person receiving the asset should do with the asset upon receipt thereof. Should the person to whom the asset is disposed order the asset to be destroyed at or prior to delivery, the person disposing of the asset would still have disposed of the asset. Once again, the determination of whether the asset has been disposed of or not should be based on the action of the person disposing of the asset and not what the recipient of the asset does with it.

By its very nature, and as used in the salient parts of Paragraph 39(1), the word "to", is a preposition. A preposition is "a word or group of words used before a noun or pronoun to relate it grammatically or semantically to some other constituent of a sentence" (*Collins Concise Dictionary*). The purpose of the word "to" in "disposal of an asset to any person" is to introduce the counterparty to the transaction. There is no reference to what the counterparty should do with the asset in order for Paragraph 39(1) to apply. Therefore, the fact that the asset, being the share, is cancelled and ceases to exist is of no impact on the transaction transferring the share to a connected person.

5 2 Redemption Premium

Regarding the second issue before the court, it is submitted that the court correctly held that the redemption premium and dividend declared did not amount to the recovery of the base costs. It is notable that the *Comprehensive Guide to Capital Gains Tax* clearly states that the post-acquisition of a dividend does not constitute a recovery as contemplated by Paragraph 20(3) of the Eighth Schedule (148). The Commissioner's contention that the dividend and premium received constituted a recovery of the base cost was contradictory to the *Guide* issued by SARS. Section 1 of the ITA defines a dividend as including a redemption premium. Therefore, it is submitted that the court correctly decided that the redemption premium and dividend acquired by the taxpayer did not amount to a recovery of the base cost. Therefore, the second issue before the court will not be discussed any further.

5 2 1 Substance Over Form?

The facts of the case provide several factors to indicate that the transaction was entered into with the purpose of resulting in a return of the acquisition price of the preference shares to company A. The Commissioner submitted that it was important to take into account the following five aspects of the transaction:

(a) the purchase agreement for the shares was entered into on the 5th of November 2003;

(b) B Ltd's preference dividend was payable, in arrears, on or about the 30th of June and 31st of December every year; at the time of the conclusion of the purchase agreement the preference dividend for 31 December 2003 was not due and payable, but the parties agreed that this would be deducted from the purchase price;

(c) the purchase price (in terms of the agreement) was only paid on the 25th of February 2004, but the parties had already agreed that that amount (i.e. the December dividend) which was not due and payable at the time of the conclusion of the agreement, would be deducted from the purchase price;

(d) the evidence (i.e. given by Mr X) established that the benefits referred to in clause 7.1.2 of the purchase agreement were limited to dividends which would accumulate from 1 January 2004 onwards as well as the premium which accumulated on the nominal redemption value of the preference shares and it was those benefits which the appellant wished to acquire in terms of the purchase agreement;

(e) it was no co-incidence that the preference shares were redeemed within a short period after the implementation date; the directors (i.e. of B Ltd) only passed a resolution on the 12th of March 2004, but there is a very close connection between that date and the implementation date (i.e. even if one accepts for the purpose of argument that the implementation date was the 5th of February 2004) and that this is confirmed by the language used in the letter of the 8th of November 2004.

Based on the above, a question arises as to whether the intention of the parties was to ensure that company A effectively receives the purchase price of the preference shares. In this regard, if the intention of the parties as reflected in the substance of the transaction is different from the form of the transaction, the substance over form principle would apply. The Commissioner did not attempt to apply the substance over form principle in this case. The substance over form doctrine entails two elements: The label principle and the simulation principle (Surtees & Millard "Tax Avoidance" November/December 2004 *Accountancy SA* 14). In terms of the label principle parties attach a wrong label to a transaction but act in good faith and intend to give effect to the transaction. On the other hand, in terms of the simulation principle parties enter into a sham transaction or a transaction that is *in fraudem legis* (Surtees & Millard 15). In terms of the simulation principle the transaction is designedly disguised to escape the tax, whilst in truth it falls within the provisions (*Dadoo Limted v Krugersdorp Municipal Council* 1920 AD 530 547).

The Appellate Division elaborated in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* (1941 AD 369 395-396) that (emphasis added):

> [a] transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, *if the parties honestly intend it to have effect according to its tenor, is interpreted by the Court according to its tenor*, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax.

The court has recently extended the application of the substance over form doctrine in *Commissioner, South African Revenue Service v NWK Limited* 2011 (2) SA 67 (SCA), 73 SATC 55 2010. The effect of this decision is that a transaction will be regarded as a sham if the transaction

lacks commercial sense. The mere fact that a transaction was implemented in accordance with its terms would not preclude a finding that it was a sham. If there is no real commercial reason for a particular arrangement other than the additional tax benefit obtained, the transaction would be regarded as a sham. It could be argued that the five aspects of the transaction in *A (Pty) Ltd* referred to above are irregular in their nature as well as the manner in which they are executed. Therefore, the Commissioner should have at least pondered the application of the doctrine.

6 Conclusion

In interpreting fiscal legislation it is imperative that the correct methods of interpretation be applied in order to truly ascertain the intention of the legislature. A restrictive interpretation method could lead to a resolution that the legislature could not have intended in light of the circumstances prevailing when the legislation was created. Taxation should not be viewed as a peril towards a taxpayer's financial comfort. Instead, tax legislation should be construed in a manner that realises the objects for which it was created, which are often beneficial to the tax system as a whole.

In *Venter v R* (1907 TS 910 915), the court held that words must be given their ordinary meaning unless such an interpretation would lead to a result contrary to the legislature's intention or a glaring absurdity that could never have been contemplated by the legislature. It is clear that the introduction of the CGT regime was introduced in order to broaden the "taxation net". The court's interpretation of the provision in the Eighth Schedule in this instance is contradictory to the legislature's intention and thus amounts to a glaring misconstruction as a result of the narrow approach of interpretation it imposed on itself. Such a misconstruction of Paragraph 39(1) results in the absurd consequence that a taxpayer may elect to have its shares redeemed at a loss in order to reduce its taxable capital gains without actually incurring an economic loss due to the fact the taxpayer and the redeeming company are connected persons or part of the same group of companies. It may elect to reduce its taxable liability by creating what is essentially a fictitious loss.

The tax treatment of the redemption of redeemable shares should thus be in accordance with the provisions set out in the Act and in accordance with the proper interpretation of those provisions. It is therefore a capital loss incurred in the redemption of redeemable shares and thus amounts to a clogged loss as envisaged by the legislature in Paragraph 39(1) of the Eighth Schedule to the ITA and should therefore not be deductible in determining a taxpayer's taxable capital gains.

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Modjadji Florah Mayelane v Mphephu Maria Ngwenyama [2013] ZACC 14

The effect of lack of consent of a spouse of a customary marriage on the validity of a further or subsequent customary marriage of her husband. Lack of such consent renders the subsequent marriage invalid in terms of Xitsonga customary law.

1 Introduction

The effect of failure to comply with the provisions of section 7(6) of the Recognition of Customary Marriages Act 120 of 1998 (RCMA) on the validity of a subsequent or further customary marriage has been finally settled by the Constitutional Court in *Modjadji Florah Mayelane v Mphephu Maria Ngwenyama* ([2013] ZACC 14), which will hereinafter be referred to as *Mayelane*. The court held that failure to comply with these provisions did not lead to the invalidity of a subsequent or further customary marriage and that the said marriage must be regarded as being out of community of property (*Mayelane* 41 par 83). It was further held that the consent of an existing first wife of a customary marriage was a requirement for the validity of the second or further customary marriage, that is, in the absence of such consent, the subsequent customary marriage wold be invalid (*Mayelane* 21 par 41).

Before the decision in *Mayelane*, conflicting decisions were reached by the North Gauteng High Court and South Gauteng High Court respectively as to the effect of failure to comply with the provisions of section 7(6) of the RCMA. The North Gauteng High Court had held that non-compliance with these provisions led to the invalidity of the subsequent customary marriage (*MM v MN* 2010 4 SA 286 (GNP) 290 parr 24-25). In *MG v BM* (2012 2 SA 253 (GSJ)), the South Gauteng High Court concluded that failure to comply with these provisions did not lead to the invalidity of the subsequent customary marriage (264-268 parr 18-23). An appeal was lodged with the Supreme Court of Appeal against the decision of the North Gauteng High Court (*MM v MN* (GNP)). On appeal, it was held that the subsequent customary marriage was valid despite failure to comply with section 7(6) of the RCMA and that this marriage was out of community of property (*MN v MM* 2012 4 SA 527 (SCA) 533-534 parr 16-18, 536-537 parr 21-23, 543 par 38).

2 Questions for Determination by the Constitutional Court

The main issue for determination before the North Gauteng High Court and the Supreme Court of Appeal was the validity of a further customary marriage entered into by a husband who was already married by

customary law to another wife where such husband had failed to obtain a written contract aimed at regulating the future matrimonial property system of his marriages in terms of section 7(6) of the RCMA.

On appeal, the Constitutional Court indicated that two other legal issues, which were closely related to the dispute in this case, had to be dealt with in order to provide an answer as to the validity or otherwise of a further or subsequent customary marriage entered into in terms of the RCMA. These legal issues were:

(i) Whether the consent of an existing wife in a customary marriage has a role to play in the determination of the validity of her husband's subsequent polygynous customary marriage; and

(ii) The manner in which the content of an applicable rule of customary law has to be ascertained and, if necessary, developed in a manner that gives effect to the Bill of Rights (*Mayelane* 2 par 1).

It has to be noted that the court *a quo* in *MM v MN* (GNP) did not decide whether the consent of the existing spouse of a customary marriage was a requirement for the validity of her husband's subsequent customary marriage (*Mayelane* 3-4 par 5). Although this was the position, the applicant in this case had alleged that "she was unaware of the fact that her husband had entered into another marriage according to customary law until after his passing" (*MM v MN* (GNP) 287 par 111). With regard to this issue and the question of consent as a requirement, the court *a quo* remarked that:

> The Act is silent on the question whether the consent of the first or earlier spouses to the proposed further marriage is required, or whether their views on the proprietary and economic considerations only need to be considered by the court. The absence of a specific reference to the consent of an earlier spouse would at first glance, suggest that the legislature intended to leave this question to the determination by the provisions of the relevant customary legal system in this respect. If so, the compatibility with the Bill of Rights enshrined in the Constitution of such an approach may in future have to be considered – it clearly does not arise in this case.
> (*MM v MN* (GNP) 291-292 par 29).

The court *a quo* did not therefore determine whether the relevant applicable customary law in this case required the consent of the existing wife to be obtained as, in its opinion, this question did not arise. The matter was therefore determined on the basis of the effect of failure to comply with the provisions of section 7(6) of the RCMA. It was thus found that non-compliance with these provisions led to the invalidity of the subsequent customary marriage (*MM v MN* (GNP) 290 par 24, 292 par 31).

The South Gauteng High Court on the other hand, although dealing with the validity of a second or subsequent customary marriage contracted before the coming into operation of the RCMA went on to determine the question relating to the validity of a customary marriage entered into without complying with the provisions of section 7(6)

thereof (*MG v BM* 2012 2 SA 253 (GSJ) 265-267 parr 20-21), The second or subsequent customary marriage was held to be valid on the ground that it had complied with all the requirements for a valid customary marriage (*MG v BM* 260-262 parr 12-14). After finding this customary marriage valid, the court dealt with "... what appears to be the most contentious aspect of the matter," namely, failure to comply with the provisions of section 7(6) of the RCMA (*MG v BM* 262 parr 15-17). The court then held that this failure did not affect the validity of the second or subsequent customary marriage (*MG v BM* 264 par 18). It is, however, clear from this case that the first wife appears to have granted consent to her husband to enter into a second customary marriage (*MG v MB* 262-264 parr 16-17).

The decision in *MM v MN* (GNP) was reversed on appeal (*MN v MM* 2012 4 SA 527 (SCA)). The Supreme Court of Appeal held that non-compliance with the provisions of section 7(6) of the RCMA did not lead to the invalidity of the subsequent or further customary marriage but that the said marriage was out of community of property while the matrimonial property system of the first customary marriage remained or continued (*MN v MM* (SCA) 543 par 38).

The determination by the Constitutional Court of the disputes or legal issues mentioned above is dealt with below.

3 Requirements for Validity

A customary marriage entered into after 15 November 2000 must comply with the requirements prescribed by the RCMA (s 3). The second customary marriage in *Mayelane* was entered into on 26 January 2008 while the first was contracted on 1 January 1984 (*Mayelane* 3 par 4). A customary marriage entered into after this date (which was the case with the second customary marriage) therefore has to comply with the following requirements:

(a) the prospective spouses –

(i) Must both be above the age of 18 years; and

(ii) Must both consent to be married to each other under customary law; and

(b) the marriage must be negotiated and entered into or celebrated in accordance with customary law

(s 3(1) RCMA).

The validity of the first customary marriage was not in dispute. The dispute in *Mayelane* concerned the question as to whether the requirements for a valid customary marriage were complied with in relation to the second customary marriage which was entered into on 26 January 2008 (*Mayelane* 3-4 parr 4-5). This customary marriage was entered into after 15 November 2000 and therefore had to comply with the requirements prescribed by the RCMA (*Mayelane* 16-17 par 28-29).

Compliance with the requirements laid down in section 3(1)(a) of the RCMA was not in dispute (*Mayelane* 51 par 102). There was as such no doubt that the parties to this marriage were above the age of eighteen years and had consented to be married to each other under customary law (s 3(1)(a) RCMA). The other question dealing with consent as a requirement related to whether the consent of an existing spouse of a customary marriage was a requirement for the validity of a subsequent or further customary marriage with another woman (*Mayelane* 35 par 71, 51 par 102). The answer to this question, according to the court, entailed determining whether the RCMA or Xitsonga customary law prescribes consent as a requirement for validity (*Mayelane* 18 par 34, 21 par 42). Flowing from this, that is, if consent is not prescribed as a requirement by the RCMA and Xitsonga customary law, the next question was whether the Constitution required that customary law be developed so as to include the consent of an existing wife as a requirement for a subsequent valid customary marriage (*Mayelane* 6-7 par 12).

There was no doubt that the dispute in this case, that is, the validity of the second customary marriage with the first respondent (Mrs Ngwenyama) was to be determined by the application of customary law in light of the Constitution and legislation that specifically deals with customary law. The principles of customary law regarding consent as a requirement for the validity of a polygynous customary marriage in Xitisonga customary law also had to be explored (*Mayelane* 7-8 par 13).

A distinction was made between the provisions dealing with the requirements for the validity of customary marriages on the one hand and their proprietary consequences (*Mayelane* 21 par 41). This distinction was made in an earlier judgment of the South Gauteng High Court where it was held that the provisions dealing with failure to obtain a written contract envisaged by section 7(6) of the RCMA had nothing to do with the requirements for the validity of a subsequent customary marriage and that failure to comply therewith did not lead to the invalidity of such marriage (*MG v BM* 264-268 parr 18-22). The Supreme Court of Appeal also made this distinction in *MN v MM* (SCA) (536-538 parr 22-24).

The Constitutional Court found that the consent by the existing wife of a customary marriage to a second or subsequent customary marriage of her husband could be interpreted as a requirement for validity from the provisions of section 3(1)(b) of the RCMA, which state that "the marriage must be negotiated and entered into or celebrated in accordance with customary law" (*Mayelane* 16-17 par 29). Therefore, besides the requirements relating to consent as prescribed in section 3(1)(a) of the RCMA, the validity of a customary marriage would depend on whether or not it was "negotiated and entered into or celebrated in accordance with customary law" as required by section 3(1)(b) of the RCMA. Among the essential requirements envisaged by this subsection would be the negotiations relating to *lobolo* and its delivery in anticipation of a customary marriage and any other ceremony or tradition that normally

precedes the entering into of a customary marriage (Jansen "Family Law" in *Introduction to Legal Pluralism in South Africa* (eds Rautenbach, Bekker & Goolam) (2010) 53-54).

According to *Mayelane* (16-17 par 29), section 3(1)(b) of the RCMA has to be interpreted as meaning that:

> Customary law may thus impose validity requirements in addition to those set out in subsection (1)(a). In order to determine such requirements a court would have to have regard to the customary practices of the relevant community.

The interpretation aforementioned, it was pointed out, would make it possible for the development of customary law in accordance with the changing circumstances and the values enshrined in the Constitution to make it (customary law) living law among the communities in which it is observed (*Mayelane* 17-18 par 32).

Relying on section 3(1)(b) of the RCMA, the Constitutional Court concluded that the consent of an existing spouse of a customary marriage was a requirement for the validity of a subsequent customary marriage of her husband with another woman in accordance with living Xitsonga customary law (*Mayelane* 41 par 83, 43 par 87). This conclusion was reached by interpreting section 3(1)(b) of the RCMA in light of the provisions of the Constitution dealing with the right to equality and dignity (*Mayelane* 32-35 parr 62-69; ss 9, 10 Constitution). It was also concluded that if the applicable Xitsonga customary law did not prescribe consent as a requirement for a further customary marriage, such law "… [m]ust be developed … to include a requirement that consent of the first wife is necessary for the validity of a subsequent customary marriage" which "[i]s in accordance with the demands of human dignity and equality" (*Mayelane* 37 par 75).

The above is a brief exposition of the approach of the main judgment of Froneman J, Khampepe J and Skweyiya J with whom Moseneke DCJ, Cameron J and Jacoob J concurred (*Mayelane* 1-44). Zondo J penned down a separate but concurring judgment, as did Jafta J (*Mayelane* 44-81). Although both addressed the main issue in this case, namely, the consent of the existing spouse of a customary marriage as a requirement for the validity of a subsequent or further customary marriage, they adopted different approaches in coming to the conclusion that such consent was a requirement. These approaches are hereinafter discussed.

4 Ascertainment, Proof and Development of Customary Law

It was common cause in this case (*Mayelane*) that customary law had to be applied to determine whether the consent of the existing spouse of a customary marriage was a requirement for the validity of a subsequent customary marriage (*Mayelane* 11-15 parr 21, 25). The court therefore had to look at all the provisions of the Constitution which affect the

application of customary law in order to arrive at a decision (ss 211(3), 9, 10, 39(2) Constitution; *Mayelane* 12-15 parr 23-25, 32 parr 62-69). As the RCMA is legislation that specifically dealt with the issues raised in this case, its relevant provisions to these issues were also considered (ss 3,6, 7 RCMA). The main judgment also relied on additional evidence which was presented in the form of affidavits deposed by individuals who were involved in polygynous customary marriages under Xitsonga customary law, evidence from an advisor to traditional leaders, evidence from various traditional leaders, expert evidence as well as affidavits that were prepared for the proceedings in the court *a quo* (*Mayelane* 27-32 parr 54-61). Further evidence relating to the role of living Xitsonga customary law to determine whether the consent of the existing spouse of a customary marriage was a requirement for the validity of a subsequent customary marriage was also explored (*Mayelane* 21-27 parr 42-53, 35-44 parr 70-84). The court therefore had to ascertain the existence of the rule of customary law relating to consent as a requirement for the validity of a subsequent customary marriage by means of evidence relating to such rule.

After finding that the consent of the existing spouse of a customary marriage was a requirement for the validity of a subsequent customary marriage from the evidence contained in all the affidavits before it, the court considered whether the RCMA could be interpreted as providing this as a requirement (*Mayelane* 31-32 par 61). Reference was made to various sections of the RCMA, *inter alia*, sections 3(1)(a) and (b), 6 and 7 before concluding (*Mayelane* 41 par83) that:

> The Recognition Act is thus premised on a customary marriage that is in accordance with the dignity and equality demands of the Constitution. A customary marriage where the first wife has consented to the further marriage conforms to the principles of equality and dignity as contained in the Constitution. Where the first wife does not give consent, the subsequent customary marriage would be invalid for non-compliance with the Constitution.

The development of customary law was also considered in determining its consistence with the Constitution (s 39(2)). It was concluded that Xitsonga customary law had to be developed, to the extent that it did not as yet do so, to include a requirement that the consent of the first wife was necessary for the validity of a subsequent customary marriage (*Mayelane* 37 par 75).

The separate concurring judgment of Zondo J relating to the determination of the consent of the existing spouse of a customary marriage as a requirement for the validity of a subsequent customary marriage is also instructive (*Mayelane* 44-67 parr 90-131). The question for determination was phrased as whether "... that marriage was valid despite the fact that the first respondent did not give her consent to that marriage" (*Mayelane* 46 par 93). According to this judgment, it was not necessary to call for additional evidence to determine whether the consent of the first wife was a requirement for validity but that the matter

could be dealt with by having regard to the effect of the definitions of "customary law" and "customary marriage" as well as the provisions dealing with the recognition of and requirements for the validity of customary marriages (*Mayelane* 55 par 111, 47-55 parr 95-109).

In the same manner as in the main judgment, it was pointed out that the provisions of section 3(1)(a)(i) and (ii) of the RCMA could not be used to determine whether the consent of an existing spouse of a customary marriage was a requirement for the validity of a further customary marriage. Instead such interpretation could be justified by section 3(1)(b) of the RCMA, that is, to arrive at the conclusion that such consent was a requirement for the validity of a further customary marriage (*Mayelane* 51 par 102). The second or further customary marriage was thus held to be invalid on the basis of the allegations contained in the applicant's founding affidavit, the supporting affidavit of the deceased's older brother as well as the fact that the respondent had failed to challenge the allegations that the applicant did not consent to the said customary marriage (*Mayelane* 52-54 parr 104-107). The conclusion was therefore that the respondent had failed to prove the existence of a valid customary marriage between herself and the deceased (*Mayelane* 65-66 par 128). Although disagreeing with the relevance of the additional evidence, Zondo J concluded that even if regard is had to this evidence the same conclusion could still be reached, namely, that no valid customary marriage existed between the respondent and the deceased at the time of the latter's death (*Mayelane* 55-65 parr 110-127). The effect of the approach to this judgment is best captured by the following (*Mayelane* 67 par131):

> Whether I deal with the matter on the basis of the affidavits that were before the High Court and the Supreme Court of Appeal or on the basis of those affidavits plus additional affidavits, I would grant leave to appeal, uphold the appeal, set aside the relevant part of the Supreme Court of Appeal and replace it with an order declaring that there was no valid customary marriage between the first respondent and the deceased at the time of the latter's death.

Jafta J, with whom Mogoeng CJ and Nkabinde J concurred, also delivered a separate concurring judgment concerning the determination of whether the consent of a spouse of an existing customary marriage was a requirement for the validity of a subsequent customary marriage of her husband (*Mayelane* 68-81). He held that the subsequent customary marriage was invalid as it was not "negotiated and entered into or celebrated in accordance with customary law that applied to the community to which the 'spouses' in that marriage belong" (*Mayelane* 68 par 132). According to this judgment, it was not necessary to develop customary law to include the consent of an existing spouse of a customary marriage as a requirement for a subsequent valid customary marriage (*Mayelane* 68 par 133). The reason for the refusal to do so was that the issue of the development of customary law was not raised before the High Court and the Supreme Court to Appeal and none of the parties had shown any special circumstances which could justify such

development by the Constitutional Court as a court of first and last instance (*Mayelane* 72-77 parr 142-150). Jafta J therefore held that it was not necessary to embark upon such development to come to a decision in this case.

5 Proprietary Consequences and Requirements for Validity

The proprietary consequences of customary marriages entered into after 15 November 2000 are regulated in terms of the RCMA. Such consequences are the same as those of civil marriages (Jansen 63). Except as may otherwise be provided for in an ante-nuptial contract, monogamous customary marriages are in community of property (s 7(2) RCMA). This applies also to monogamous customary marriages contracted before 15 November 2000 (*Gumede v President of the Republic of South Africa* 2009 3 BCLR 243 (CC)). It is possible, however, to change or alter these consequences (Jansen 62).

The RCMA provides that the proprietary consequences of polygynous customary marriages contracted before 15 November 2000 shall continue to be regulated in terms of customary law (s 7(1)). This implies that these marriages are presumed to have created "houses" where each "house" has its own separate and distinct property (Jansen 61-62). For polygynous customary marriages entered into after 15 November 2000, the procedure prescribed in section 7(6) of the RCMA may be used to settle or determine their proprietary consequences. Where section 7(6) of the RCMA is not adhered to, that is, where no contract was approved by a court to regulate proprietary consequences, the resultant customary marriage remains valid but is out of community of property (*Mayelane* 21 par 41; *MN v MM* (SCA) 543 par 38; *MG v BM* 266-268 parr 21-23).

Proprietary consequences of customary marriages, monogamous or polygynous, entered into before or after 15 November 2000, may be changed or altered (s 7(4)(a), (b) RCMA). To achieve this, spouses to such customary marriages have to apply jointly for leave to change the matrimonial property system applicable to their marriage or marriages and the court may order that such matrimonial property system will no longer apply and authorise the parties to the said marriage or marriages to enter into a written contract which will govern the future matrimonial property system of such marriage or marriages on conditions determined by the court (s 7(4)(a) RCMA). In the case of a polygynous marriage, all persons having a sufficient interest in the matter (especially the existing spouse or spouses) have to be joined in the proceedings (s 7(4)(b) RCMA). The proprietary consequences of customary marriages entered into after 15 November 2000 may, in the same manner, be altered in terms of section 21(1) of the Matrimonial Property Act 88 of 1984 (s 7(5) RCMA).

Proprietary consequences of polygynous customary marriages entered into after 15 November 2000 are dealt with in terms of section

7(6) of the RCMA. The section requires a husband who wishes to enter into a further customary marriage to apply to court to have a written contract approved which will regulate the future matrimonial property system of his marriages. Before the decision in *Mayelane*, the effect of failure to comply with this provision was uncertain. It is now clear that the effect of failure to comply with it does not affect the validity of the subsequent or further customary marriage. The Constitutional Court expressed this as follows (*Mayelane* 21 par 41):

> On a more fundamental level, section 7 does not deal with the validity requirements for a marriage at all – it deals with the applicable matrimonial property regime. To interpret it as imposing validity requirements over and above those set out in section 3 would undermine the scheme of the Recognition Act. For these reasons we endorse the Supreme Court of Appeal's interpretation of section 7(6).

These provisions are therefore not additional requirements for the validity of a further marriage in the case of polygynous customary marriages.

6 Decision

The main issue for determination in *Mayelane* was the question of the role that the consent of an existing spouse of a customary marriage plays in the determination of the validity of her husband's further or subsequent customary marriage (*Mayelane* 2 par 1, 46 par 93, 68 par 132). The North Gauteng High Court had earlier declared a further customary marriage entered into without complying with the provisions of section 7(6) of the RCMA as invalid (*MM v MN* (GNP) 290 par 24). The invalidity of this marriage was confirmed on appeal by the Supreme Court of Appeal (*MN v MM* (SCA) 542 par 38). In a further appeal to the Constitutional Court, the main issue for determination was whether the consent of an existing spouse of a customary marriage was a requirement for the validity of a subsequent or further customary marriage of her husband (*Mayelane* 2 par 1). A further issue related to the manner in which a rule of customary law had to be ascertained and, if necessary, developed to give effect to the Bill of Rights (*Mayelane* 2 par 1, 67 par 130, 68 par 132).

The Constitutional Court held that the consent of the existing wife of a customary marriage was a requirement for the validity of a customary marriage of her husband according to Xitsonga customary law (*Mayelane* 43-44 par 89, 67 par 131, 79 par 153). The main judgment was reached by having regard to the provisions of section 3 of the RCMA and interpreting it in light of the equality and dignity provisions of the Constitution (ss 9, 10 Constitution). The court also pointed out that if the said law was not as yet developed to prescribe this consent as a requirement for the validity of a subsequent customary marriage, it had to be developed to give effect to the Bill of Rights (*Mayelane* 37 par 75).

All the judges of the Constitutional Court concurred that a further customary marriage entered into without the consent of the first wife was invalid as a result of failure to comply with section 3(1)(b) of the RCMA. This means that such customary marriage was not "negotiated and entered into or celebrated in accordance with customary law" (*Mayelane* 37-38 par 76. See also *Mayelane* 57 par 102, 77-78 par 151).

The above decision was reached, as pointed out earlier, by invoking the equality and dignity provisions of the Constitution and developing customary law in accordance with the Bill of Rights (*Mayelane* 44 par 89). The separate concurring judgment did not, however, deem it necessary to develop customary law to reach the same conclusion that the consent of the existing spouse in a customary marriage was a requirement for the validity of a further customary marriage in Xitsonga customary law but relied on the evidence that was placed before both the High Court and the Supreme Court of Appeal (*Mayelane* 67 par 131, 68 parr 133-134).

The effect of failure to comply with the provisions of section 7(6) of the RCMA was also dealt with. A distinction was made between the requirements for the validity of customary marriages and their proprietary consequences (ss 3, 7 RCMA). It was then held that failure to comply with the provisions of section 7(6) does not lead to the invalidity of the subsequent or further customary marriage but that such marriage was out of community of property (*Mayelane* 21 par 41).

7 Conclusion

Before the Constitutional Court decision in *Mayelane*, it was uncertain as to whether the consent of the existing spouse of a customary marriage was a requirement for the validity of a further customary marriage of her husband. The effect of failure by a husband of a customary marriage to comply with the provisions of section 7(6) of the RCMA when entering into a further or another customary marriage was also not certain. It is now clear that failure to comply with these provisions has nothing to do with the validity of a further customary marriage as they relate only to proprietary consequence of a polygynous customary marriage. The consent of the wife of a customary marriage as a requirement for the validity of a second or further customary marriage of a husband in Xitsonga customary law has been placed beyond doubt. Although this is the position, the decision in *Mayelane* does not have retrospective effect and the validity of Xitsonga customary marriages contracted before 30 May 2013 is not affected if such consent was not obtained (*Mayelane* 43-44 par 89).

The *Mayelane* decision has far reaching implications and considering the reasons advanced for the decision, it can be concluded that the consent of the existing wife of a customary marriage as a requirement for the validity of a subsequent customary marriage will apply to the whole field of customary law and not only Xitsonga customary law. It is submitted that this conclusion is justified by the duty of the South African

courts to interpret and develop customary law in accordance with the "spirit, purport and objects of the Bill of Rights" (s 39(2) Constitution; see also *Bhe v Magistrate, Khayelitsha* (*Commission for Gender Equality as amicus curiae); Shibi v Sithole; South African Human Rights Commission v President of the Republic of South Africa* 2005 1 SA 580 (CC) 656-657 parr 215-219).

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Baker Tilly (a firm) v Makar [2010] EWCA Civ 1411

Tacit terms and the common unexpressed intention of the parties to a contract

1 Introduction

When parties conclude a contract, there is a glimmer of consensus and when that contract is reduced to writing, at least in the English tradition, elaborate terms are crafted with much care and precision from established precedents and the skilled use of language to reflect the agreement reached by the parties. But the glimmer of consensus obscures the fact that there can hardly ever be complete agreement on every minute detail of the contract and no matter how carefully or with how much elaboration a contract is drafted, the ideal of a perfect contract remains eternally beyond the reach of the drafter. No matter how clearly the parties express themselves and no matter how well drafted a contract may be, it is never beyond the realm of possibility that the contract may yet contain some omission. There are various reasons why an omission may occur: Unforeseen circumstances may arise; circumstances change; parties change; needs change; conflicts of interest are ever present. Whatever the reason, omissions arise with sufficient frequency to warrant the existence of legal rules which explain in which circumstances a court may supply an omission. This is often done by the implication of certain unexpressed terms in a contract. The aim with this analysis is to consider the various kinds of unexpressed terms that can be implied in a contract from a comparative perspective against the backdrop of the judgment of the England and Wales Court of Appeals (Civil Division) in *Baker Tilly (a firm) v Makar* ([2010] EWCA Civ 1411).

2 Facts

The defendant was the chief executive officer, executive deputy chairperson and finance director of Triad Group PLC and held almost 30 per cent of the shares in Triad. In 2005, a major boardroom dispute arose

because the defendant believed that there had been serious financial irregularities in the company and breaches of fiduciary duties by officers of the company. This eventually led to her removal from the positions she had held in the company. As a result, she instituted action in the Employment Tribunal against Triad, claiming unfair dismissal and victimisation. Triad eventually accepted that the defendant had reasonable grounds for her concerns and that the circumstances of her dismissal were unfortunate. As a result, the claim in the Employment Tribunal was settled shortly before proceedings were to commence (par 2).

The defendant had engaged the services of the claimant, a firm of accountants, to provide forensic accounting services in support of her claim in the Employment Tribunal. The claimant agreed to conduct a forensic investigation, prepare an independent expert report and, if necessary, present expert evidence before the Employment Tribunal. The contract was formed by two letters, the formal instruction sent by the defendant's solicitors to the claimant and the letter of acceptance returned by the claimant on the same day. The fee payable was, however, not specified in the letters, but negotiated directly between the defendant herself and the claimant (par 3 *et seq*).

The claimant claimed payment for services rendered on the grounds that the contract came to an end as soon as it was informed of the settlement, since the occasion for providing a report to the Employment Tribunal had disappeared. The defendant, however, resisted the claim on the basis that this was not a contract merely to provide an expert report for the Employment Tribunal, but a contract to provide a report in accordance with the solicitors' instructions. In other words, the defendant's case was that the claimant was still contractually bound to provide the independent expert report and that it had not fulfilled this duty yet (parr 4-5).

3 Judgment

The Queen's Bench, per Seymour J, held that the contract contained an implied term to the effect that the contract would be terminated if the claim was settled and that the defendant would be liable for reasonable fees incurred up to that time. In the Court of Appeal, Hughes LJ upheld the judgment of Seymour J and explained (parr 15-16) that

> [h]is critical holding ... is his conclusion that the contract contained the implied term, representing the common unexpressed understanding of the parties, that the client commissioning the report could terminate the engagement at any time, on the basis that she would be liable for reasonable fees incurred up to that point. ... [T]his critical holding of the judge cannot stand with the existence of an entire contract. This, I am quite satisfied, was not an entire contract.

4 Discussion

The judgment in *Baker Tilly* is significant in a South African context, since the South African law relating to the unexpressed terms of a contract is based on English law (*Minister van Landbou-Tegniese Dienste v Scholtz* 1971 3 SA 188 (A); *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A)). The way in which the English courts deal with the implication of terms can therefore also provide some insight into our own law regarding implied terms in South Africa.

The law with regard to the implication of terms in English law has been restated by the courts repeatedly. In *Equitable Life Assurance Society v Hyman* ([2000] 3 All ER 961 (HL) 970) Steyn LJ explained that

> a term can be implied by law in the sense of incidents annexed to particular forms of contracts. Such standardised implied terms operate as general default rules; ... If a term is to be implied it could ... [also] be a term implied from the language ... in its particular commercial setting. Such implied terms operate as *ad hoc* gap fillers. ... Such a term may imputed to the parties: It is not critically dependent on proof of an actual intention of the parties. The process 'is one of construction of the agreement as a whole in its commercial setting': ... This principle is sparingly and cautiously used and may never be employed to imply a term in conflict with the express terms of the text. The legal test for the implication of such a term is a standard of strict necessity.

The consensus among English judges seems to be that a term can be implied in a contract in one of two instances only: Firstly, a term can be implied *ex lege* as a general default rule which applies to all contracts of a particular form. Secondly, a term can be implied on an *ad hoc* basis in a contract between particular parties if it is strictly necessary to fill a gap in order to arrive at the objective meaning of the contract. (See also *McCarthy v McCarthy & Stone Plc* [2006] 4 All ER 1127 (Ch); *Hilton v Barker Booth and Eastwood (a firm)* [2005] 1 All ER 651 (HL); *Crest Nicholson Residential (South) Ltd v McAllister* [2003] 1 All ER 46 (Ch); *Ashworth Frazer Ltd v Gloucester City Council* [2002] 1 All ER 377 (HL).)

This also seems to be the predominant view amongst the authors of textbooks on the interpretation of contracts in English law. Lewison (*The Interpretation of Contracts* (2011) 269) explains that

> [t]he implication of terms into a contract depends on the presumed intention of the parties. In some cases that intention is collected merely from the express words of the contract or from a combination of the express words of the contract and the surrounding circumstances; in others it is collected from the nature of the legal relationship into which the parties have entered.

(For a comprehensive discussion of English law relating to the implication of terms, see Austen-Baker *Implied Terms in English Contract Law* (2011). See also McMeel *The Construction of Contracts – Interpretation, Implication, and Rectification* (2007) 113 *et seq*, 225 *et seq*.)

This distinction between a term implied *ex lege* as a general default rule which applies to all contracts of a particular form and a term implied

on an *ad hoc* basis in a contract between particular parties if it is strictly necessary to fill a gap in order to arrive at the objective meaning of the contract, has also apparently found favour in South Africa. In *Seven Eleven Corporation of SA (Pty) Ltd v Cancun Trading No 150 CC* ([2005] 2 All SA 256 (SCA)), Lewis JA explained (265) that

> [t]he distinction between implied and tacit terms is now trite. The former is a term implied by the law, the latter a term implied by the facts. ... The principle applied over many years is that the term to be incorporated in the contract must be necessary, not merely desirable. The classic tests used to give effect to this principle do not, however, take into account the actual intentions of the respective parties. They require the court to consider whether the term contended for would give 'business efficacy' to the contract or to ask what the 'officious bystander' – a person who is not a party to the contract but asked whether the term is necessary – would say. These are objective tests. On either test, when one asks whether it was necessary to incorporate a term in the franchise contract ... the answer must be that such a term was not necessary [in this case]. ... Whether one looks at the matter on a subjective basis – what the parties actually thought at the time of entering into the contract – or on the objective tests applied over many decades, the answer is clear. There was no tacit term that the respondent was entitled to the benefit of early settlement discounts or of rebates.

But the clause implied in *Baker Tilly* does not fit into either of these categories. Neither the Queen's Bench, nor the Court of Appeals seem to have based the implication of the term concerned on the principle that the term can be implied *ex lege* as a general default rule which applies to all contracts for the commissioning of forensic reports. It is not a term which one would necessarily read into every contract for the rendering or commissioning of forensic reports. Not all reports are commissioned when the dispute is already heading to court. Often, a forensic report is commissioned to uncover any impropriety and determine whether any legal action is in fact warranted. Furthermore, the term implied was not strictly necessary to fill a gap in order to arrive at the objective meaning of the contract – the contract would have been perfectly operational and executable in the absence of such a term. Instead, both the Queen's Bench and the Court of Appeals based the implication of the term on the common unexpressed understanding of the parties, and this seems to fly in the face of common wisdom as explained above.

There is, though, according to *Chitty* (Beale *Chitty on Contracts Volume 1* (2012) 992) in the case of an incomplete contract

> yet another situation where a term may be implied. This is where the court is simply concerned to establish what the contract is, the parties not having themselves fully stated the terms: 'In this sense the court is searching for what must be implied'.

The contract in *Baker Tilly* seems to fit squarely into this category of an incomplete contract and the term concerned was implied to complete the contract. This also seems to accord with the view of Salmond and

Williams (*Principles of the Law of Contracts* (1945)), expressed almost eighty years ago, when they explained (36) that

> implied terms of a contract, meaning thereby the terms devised and implied by the law itself and imported into the contract as supplementary to the express terms which have their origin in the actual intention of the parties, must be distinguished from those terms inferred as a matter of fact to have been actually, though tacitly, declared or indicated by the party or parties whose declared will constitutes the contract. These latter terms may be described as tacit terms. It is regrettable that the word *implied* is ambiguous and is frequently applied not only to terms implied in law but also implied in fact, *i.e.*, tacit terms.
>
> ... Indeed, a complete contract may be made by such conduct, as when a purchaser takes a newspaper from a bookstall and thereby incurs an obligation to pay for it. In such cases the contractual intention or will is considered to be an actual fact inferable from the conduct of the persons concerned. Such cases, therefore, do not differ in essence from those where the intention or will is expressed in spoken or written words, for speaking and writing are themselves merely particular forms of human conduct. In both kinds of case, the essential thing is that there is considered to be in the minds of the parties an actual intention or will manifested or declared by the parties by their overt acts, whether those acts take the form of written or spoken words, or other conduct. Both tacit and express terms are considered to represent the actual intention of the parties. Implied terms, on the other hand, are introduced by the law in default of the manifestation by the parties of any such actual intention ...

Around the same time, the position in English law was summarised by Williams ("Language and the law" 1945 *LQR* 71 401), where he explained that there are three kinds of unexpressed terms that may be implied in a contract:

(i) terms that the parties probably had in mind but did not trouble to express;

(ii) terms that the parties, whether or not they actually had them in mind, would probably have expressed if the question had been brought to their attention; and

(iii) terms that, whether or not the parties had them in mind or would have expressed them if they had foreseen the difficulty, are implied by the court because of the courts view of fairness or policy or in consequences of rules of law.

Lewison (271-272) seems to dismiss the distinction between the first and second kind of terms mentioned by Williams since

> the actual intention of the parties is not what the court is trying to ascertain. What the court seeks to ascertain is the presumed intention of the parties (or more accurately the meaning that the contract would convey to a reasonable reader). It is, therefore, more accurate to describe case (i) as an effort to arrive at the presumed intention of the parties, rather than their actual intention; or what the reasonable reader would understand the contract to mean. Both case (i) and case (ii) involve a search for the presumed intention of the parties,

> although case [(i)] requires the further assumption that the subsequent difficulty was foreseen at the date of the contract.

(There seems to be an error in the text which I have corrected above. Case (i) refers to terms which the parties probably had in mind, while case (ii) (as referred to in the original text) refers to terms which the parties would probably have expressed if the question had been brought to their attention.)

Although it is often said that the purpose of interpretation is to ascertain the intention of the parties, it is trite that it is the objective meaning of the contract, rather than the subjective intention, which is being determined. In *Attorney General of Belize v Belize Telecom Ltd* ([2009] 2 All ER 1127 (PC) 1132) the Privy Council, per Hoffmann LJ, explained that

> [t]he court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed ... It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to have been the author of the instrument.

Lewison is therefore correct in stressing that case (i) involves a search for the presumed intention of the parties, rather than an attempt to arrive at their actual subjective intention. But there is an important difference between case (i) and case (ii). In case (ii), the contract completely reflects the consensus between the parties, but the contract fails to address an unforeseen eventuality. A term is then implied, if it is strictly necessary to give business efficacy to the contract, on the basis of what the parties, as reasonable people, would have agreed to if that eventuality had been brought to their attention at the time when the contract was concluded. In case (i), on the other hand, there is clearly an incomplete expression of consensus in the contract. The unexpressed consensus must then be gathered objectively from the conduct of the parties and the background knowledge which is reasonably available, and one or more terms are implied to complete the contract. In case (i), the reader looks at the various verbal and non-verbal expressions of consensus to ascertain the terms that have been omitted, whereas in case (ii), the reader looks beyond the expression of consensus to find a solution for an unforeseen eventuality.

In South Africa, there is similarly authority for the view that there are three kinds of unexpressed terms that can be implied in a contract. Firstly, there are implied terms. These terms are inferred *ex lege* in a contract, despite the fact that the parties did not reach or would not have reached agreement on the matters involved. These terms, often referred

to as *naturalia*, are derived from the common law, statute, precedent, custom or trade usage and are not dependent on the actual or presumed intention of the parties (*AA Farm Sales (Pty) Ltd (t/a AA Farms) v Kirkaldy* 1980 1 SA 13 (A) 17C). They are duties imposed by law.

Implied terms must be distinguished from tacit terms. But not all tacit terms are alike. In *Wilkins NO v Voges* (1994 3 SA 130 (A)) Nienaber JA explained that

> [a] tacit term, one so self-evident as to go without saying, can be actual or imputed. It is actual if both parties thought about a matter which is pertinent but did not bother to declare their assent. It is imputed if they would have assented about such a matter if only they had thought about it – which they did not do because they overlooked a present fact or failed to anticipate a future one.

Secondly, therefore, there are actual tacit terms. For reasons that will become apparent below, these terms can also be referred to as "consensual tacit terms". These are terms relating to matters concerning which the parties had actually reached agreement or with regard to which the parties had some common expectation, but failed to express in writing or speech. According to McEwan J (*Cardoso v Tuckers Land and Development Corporation (Pty) Ltd* 1981 3 SA 54 (W) 61G) a consensual tacit term "is found, if at all, in the unexpressed common intention of the parties as determined from the surrounding circumstances or any other proper source". Because consensual tacit terms are derived from the actual intention of the parties, the test to determine whether a consensual tacit term can be read into a contract is subjective. It is a question of fact decided by analysing the conduct of the parties and other indicators of their actual states of mind.

Thirdly, there are imputed tacit terms. These are terms concerning matters which the parties had not considered, but they would have agreed to the term concerned had their attention been drawn thereto at the time when they concluded the contract. Terms of this nature are based on the assumed intention of the parties. The officious bystander test is often applied to determine whether or not a term should be implied into a contract. The classic formulation of this test remains the dictum of Scrutton LJ in the English case of *Reigate v Union Manufacturing Co (Ramsbottom)* (1 KB 592) (cited in *Alfred McAlpine* (533B) and *Seven Eleven* (266A)):

> [I]f at the time the contract was being negotiated someone had said to the parties, 'What will happen in such a case', they would both have replied, 'Of course, so and so will happen; we did not trouble to say that; it is too clear'.

The test to determine whether an implied term can be inferred in a contract, is objective – what would the parties, as reasonable people have agreed to? (*Trollope & Colls v NWMR Hospital Board* [1973] 1 WLR 601 613C.) Inferring an implied term into a contract is based on a legal fiction and is consequently a question of law.

The distinction between consensual and imputed tacit terms was eloquently explained by Wunsh J in *Bezuidenhout v Otto* (1996 3 SA 339 (W) 344A-E).

> What is not always appreciated in some of the books is the difference between the following:
>
> 1. A tacit term, which is sometimes called an implied term
>
> In earlier cases also described as an implied term, which a court will find to exist when:
>
> (a) it is necessary to import it to give business efficacy to the contract; or
>
> (b) the parties did not, in fact, apply their minds to it, but if an officious bystander had asked them if it should have been in the contract, they would unhesitatingly have responded in the affirmative. ...
>
> 2. A tacit term proper
>
> That is to say one which the parties actually agreed upon, but did not articulate; a term they did agree to, as distinguished from one they must have agreed to. The inquiry is whether on the basis of the proved facts and circumstances it was probable that a tacit agreement had been reached.

Consensual tacit terms, therefore, are based on fact – what the parties had actually intended with regard to a matter which they had considered, but failed to express. Imputed tacit terms are based on fiction – what the parties would have agreed to if they had considered the matter at the time when the contract was concluded.

This threefold approach is also generally followed in other jurisdictions with a Common law tradition. In *Byrne v Australian Airlines Ltd* (185 CLR 410) the High Court of Australia distinguished between different kinds of terms that can be implied in a contract. The court firstly referred to terms that can be implied into a contract in terms of the officious bystander test (440). Secondly, there are terms that can be implied if it is necessary to give business efficacy to a contract (441). However, the court questioned whether there is any real distinction between these two kinds of terms (447). Thirdly, the court referred to incidental terms which the law imports into contracts of a particular kind irrespective of the parties' intention (447). Lastly, an Australian court can imply into a contract a "'tacit term' to identify the latent unexpressed intentions of the parties" (447). (See also *Shepherd v Felt & Textiles of Australia Ltd* 45 CLR 359 378).

In *Canadian Pacific Hotels Ltd v Bank of Montreal* (77 NR 161) the Supreme Court of Canada distinguished between terms that can be implied by law and are incidental to a particular kind of contract, as opposed to terms that are necessary to give business efficacy to a contract. A further distinction was made by the British Columbia Court of Appeal in *Petro-Canada v Disco Oil & Gas Ltd* (96 BCLR (2d) 174) where the court indicated that a term can firstly be implied where it is necessary to give business efficacy to the contract and secondly, where the term implied represents the obvious, but unexpressed, intention of the parties.

In the United States, the Supreme Court of Texas explained in *Danciger Oil & Refining Co of Texas v Powell* (154 SW 2d 632) that an implied term (635)

> must appear that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it, and therefore omitted to do so, or it must appear that it is necessary to infer such a covenant in order to effectuate the full purpose of the contract as a whole as gathered from the written instrument. ... However, covenants will be implied in fact when necessary to give effect to the actual intention of the parties.

In *Grimes v Walsh & Watts Inc* (649 SW 2d 724) the Texas Court of Appeals refined the position somewhat when it explained that "a court can declare implied covenants to exist only where it appears such covenants were clearly contemplated by the parties or were necessary to effect the purpose of the contract". (For terms actually contemplated by the parties, see also *Universal Health Services Inc v Renaissance Women's Group PA* 121 SW 3d 742; for terms necessary to effect the purpose of the contract, see also *WesternGeco LLC v Input/Output Inc* 246 SW 3d 776.)

A similar approach is followed in other US states (see eg *Percoff v Solomon* 67 So 2d 31 (Alabama); *Walgreen Arizona Drug Co v Plaza Center Corp* 647 P 2d 643 (Arizona); *Kroger Co v Bonny Corp* 216 SE 2d 341 (Georgia); *Bobenal Investment Inc v Giant Super Markets Inc* 260 NW 2d 915 (Michigan); *Tuttle v WT Grant Co* 171 NYS 2d 954 (New York); *Mercury Investment Co v FW Woolworth Co* 706 P 2d 523 (Oklahoma)).

A seminal aspect of the implication of terms which is emphasised in all Common law jurisdictions, is that courts only have a limited discretion to compliment the terms of a contract with implied terms. Courts cannot imply terms into a contract merely because it would be reasonable, fair or expedient. In addition, courts are generally reluctant to interfere with the terms of a contract which parties had entered into freely.

5 Conclusion

The significance of *Baker Tilly* lies in the apparent recognition of a kind of unexpressed term other than those mentioned by Steyn LJ in *Equitable Life Assurance* or Lewis JA in *Seven Eleven*. It is a kind of term which occurs seldom in the context of written contracts, because, as Hughes LJ stressed (par 16) it "cannot stand with the existence of an entire contract". This is firstly because the parol evidence rule would exclude evidence to add to, vary or detract from the terms of a contract, but secondly, because most well-drafted written contracts contain "entire contract" clauses which would exclude the possibility of reading consensual tacit terms into the contract (for more in this regard, see my previous discussions in Cornelius "Background Circumstances, Surrounding Circumstances and the Interpretation of Contracts" 2009 *TSAR* 767; "Die toelaatbaarheid van ekstrinsieke getuienis by die uitleg van kontrakte" 2013 *TSAR* 805). As a result, this kind of unexpressed

term is also frequently ignored by courts and authors writing on the construction or interpretation of contracts. But not all written contracts are entire integrated contracts. The seminal aspect of the judgment in *Baker Tilly* (and, for that matter, in *Wilkins*) is that it is to a substantial extent based on inclusion of an implied (or tacit) term in the contract, representing the common unexpressed understanding of the parties. It is not a term which the law implies as general default rule in a particular kind of contract. Nor is it a term which is strictly necessary to give business efficacy to the contract. It is a term implied in the contract simply because it reflected the actual intention or common understanding of the parties which they had failed to express where the written contract did not constitute a complete integration of the agreement between the parties.

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