SCHOOL OF ACCOUNTANCY

## UNIVERSITY OF THE WITWATERSRAND

## FACULTY OF COMMERCE, LAW AND MANAGEMENT

# A critical analysis of the General Anti-avoidance rules as envisaged in sections 80A-80L of the Income Tax Act 58 of 1962.

**MATSHIDISO NGCOBO**

"A research report submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce specialising in Taxation".

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**Abstract**

The general anti-avoidance provisions commonly known as general anti-avoidance rules or "GAAR" exist in many jurisdictions around the world. Tax authorities, lawmakers and other stakeholders (such as the Organisation for Economic Co-operation and Development (OECD)) around the world introduced and continuously develop the anti-avoidance rules applicable in their respective jurisdictions.

The purpose of this report is to critically analyse the general anti-avoidance provisions in their old form (i.e. section 103(1) of the Income Tax Act prior to its repeal) and the current form (i.e. sections 80A to 80L of the Income Tax Act) in order to assess whether the current provisions are achieving the objective of protecting the fiscus against the non-payment/delayed payment of tax. This report will also analyse the Australian general anti-avoidance rules.

Such provisions or rules serve to protect a country's tax base or the fiscus from transaction(s) entered by taxpayers for the sole or main reason of obtaining a tax benefit. Anti-avoidance provisions aim at identifying these transactions and reversing whatever tax benefit that might have been derived from the transaction where such transaction(s) were entered into for the sole or main reason of obtaining the tax benefit.

Key words:

avoidance arrangement, tax benefit, general anti-avoidance rules, GAAR, South Africa, tax avoidance, impermissible avoidance arrangement, Australia

**Declaration**

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

___________________________________

**Matshidiso Ngcobo**

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# Chapter 1: Background and introduction

## 1.1. Introduction

With the ever-increasing tax burden, taxpayers have resorted to minimise their tax liability by entering structures that alleviate the amount of the tax liability due. In the court case *Inland Revenue Commissioners v. Duke of Westminster,* 1936 the following was noted:

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be". (Museka 2011: 1)

Lawmakers and tax authorities, who are the administrators and custodians of legislation have identified the need for anti-avoidance provisions that would assist in mitigating against the structures entered into by taxpayers in an effort to obtain a tax benefit (i.e. reduce or defer the tax burden imposed). Anti-avoidance provisions/rules, whether general or specific, exist to protect the integrity of a country's tax base and or the "fiscus" by reversing the tax benefit obtained by the taxpayer/parties to the transaction where such transaction was entered into solely or mainly for obtaining the tax benefit. Anti-avoidance rules do not take away the taxpayers right/ability to plan their tax affairs to their advantage as stated in the above case of *Duke of Westminster*. The rules exist to mitigate against structures entered by taxpayers for the sole or main benefit of the tax benefit. (Museka 2011: 2)

The terms tax evasion, tax avoidance and tax planning may be associated with anti-avoidance provisions. The three terms have different meanings however to a certain extent may mean the same thing or may be combined when a decision is required to be made as it was noted in the court case "*CSARS v NWK Ltd*, 2010". It is therefore important to define these terms and understand what they mean. (Benn 2013: 6)

**<u>Tax Evasion</u>**

Wallis JA said in *CSARS v Bosch,* 2014

> "Tax evasion is of course impermissible and therefore if a transaction is simulated, it may amount to tax evasion…"

Further, in the judgment in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*, 1941, the court contrasted two scenarios to tax avoidance and tax evasion as follows:

> "…A disguised transaction in the sense in which the words are used above is something different. In essence it is a dishonest transaction… The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a

> guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be in fraudem legis…"

Considering the above judgment, tax evasion may be defined as the illegal steps undertaken to reduce the tax liability payable. These would include fraud and/or deceit (i.e., non-disclosure of information or disclosure of incorrect/incomplete information etc.) as seen in *the Africa Cash & Carry (Pty) Ltd v Commissioner for the South African Revenue Service*, 2019 court case. (Benn 2013: 6)

An online article by Oberholzer & Els 2020 defines tax evasion as follows:

> "Tax evasion is illegal activities where a taxpayer frees himself from a tax burden".

Tax evasion "usually relates to conduct involving less than full disclosure and the suppression of relevant information (illegal, often fraudulent and criminal conduct)*"*. (Kraamwinkel 2019: 5)

The authors of International Tax A South African Perspective define tax evasion as

> "an action by a taxpayer to escape legal obligations by fraudulent or other illegal means" and note that "tax evasion may encompass a reckless or negligent failure to pay taxes legally due, even if no deliberate concealment of income or information exists". (Olivier & Honiball 2011: 509)

It may be said that tax evasion are activities or actions taken by a taxpayer (illegal and most probably criminal) whether deliberate or not to pay less or no tax at all. Such illegal actions include incorrect disclosure or the non-disclosure of information.

**<u>Tax Avoidance</u>**

Wallis JA said in Commissioner *SARS v Bosch*, 2014

> "…Tax evasion is of course impermissible and therefore if a transaction is simulated, it may amount to tax evasion. But there is nothing impermissible about arranging one's affairs so as to minimize one's tax liability, in other words in tax avoidance".

Considering the above judgment, tax avoidance are the steps taken in order to reduce the tax liability payable. However, these steps are well within the law. In other words, tax avoidance is the legal steps undertaken to reduce the tax liability. This includes utilising and exploiting loopholes in the legislation. (Satumba 2011: 13)

The anti-avoidance rules as envisaged in sections 80A to 80L of the Income Tax Act are centred around the concept of an impermissible tax avoidance arrangement.

**<u>Tax planning</u>**

In the court case *CSARS v NWK Ltd*, 2010, it was said that

> "It is trite that a taxpayer may organize his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective". (Benn 2013. 7)

In her lecture slides, Pidduck defines tax planning as the structuring of one's tax affairs in an effort to minimize the tax liability applicable. Such structuring is within the confines of the law. (Pidduck 2020:6)

There are similarities between tax planning and tax avoidance. Benn states that

> "… Tax planning is where the taxpayer takes advantage of a more attractive option offered to him by the legislation and arranges his or her tax affairs in the most tax efficient manner, where he will be liable to a reduced tax burden". (Benn 2013:7)

From the above, it may be deduced that although tax planning and tax avoidance are essentially the same, tax avoidance becomes tax planning when the taxpayer takes advantage of the more attractive option offered to him and organises their tax affairs accordingly. (Benn 2013:7)

Considering the various definitions provided by court cases for the terms tax evasion, tax avoidance and tax planning, there is a difference between the terms. The difference lies in whether the steps taken by the taxpayer are legal or illegal and where such steps are legal, whether the various legal steps afforded to the taxpayer are structured in the most efficient tax manner thus resulting in a reduced tax liability/burden. (Benn 2013:7)

In South Africa, the general anti-avoidance rules have seen their fair share of amendments since their enactment in South African legislation. The most recent major amendment was effective from 2 November 2006, where the whole of section 103(1) of the Income tax Act, 58 of 1962 (Income Tax Act) which envisaged the then general anti-avoidance rules was repealed and replaced by sections 80A to 80L of the Income Tax Act. With the amendment, the South African Revenue Service (SARS) issued a document titled the Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) in which it details the reason/s for the amendments and various other considerations. (Benn 2013: 9)

### 1.2. Problem Statement

What are and were the general anti-avoidance rules as envisaged in the Income Tax Act, 58 of 1962 and how do they compare with the Australian general anti avoidance rules?

This research will critically analyse the general anti-avoidance rules as envisaged in sections 80A -80L of the Income Tax Act as well as provide a comparison between the current rules and the old general anti avoidance rules (i.e. section 103(1) of the Income Tax Act). This report will include an analysis of the Australian general anti-avoidance rules (The South African general anti-avoidance legislation reads similar to the legislation adopted by Australia).

**The Sub questions**

In order to answer the main research question, the following sub questions will be addressed:

1.2.1. An analysis of the old general anti-avoidance rules envisaged in section 103(1) of the Income Tax Act, 58 of 1962 (prior to its repeal).

1.2.2. An analysis of the current general anti-avoidance rules envisaged in sections 80A - 80L of the Income tax Act, 58 of 1962.

1.2.3. A comparison of the general anti-avoidance rules envisaged in the Australian legislation to the South African legislation.

### 1.3. Research Methodology

The research method to be used will be qualitative in nature. The main sources to be analysed will include South African and Australian pieces of tax legislation and relevant case law. These sources are a critical part of the foundation of the anti-avoidance rules as envisaged. These sources will provide important meaning and understanding to the anti-avoidance rules and the different concepts included thereof.

Other source material to be analysed includes publicly available research papers, journal articles, reports, online articles, dictionaries, SARS and other tax authorities" publications in order to obtain further meaning and understanding to the anti-avoidance rules.

### 1.4. Limitations

The special anti-avoidance rules envisaged in the Income Tax Act will not be examined in this research report.

### 1.5. Chapter outline

**Chapter 1: Background and introduction**

The introductory chapter will introduce the research problem and sub problems identified, the research methods used and the limitations of the study.

This chapter will also provide definitions of the various terms used in the reduction of tax regime (i.e., tax evasion, tax avoidance and tax planning). Where legislation does not provide clear definitions of what the various terms may mean, various case law (locally and internationally) and online articles and/or dictionaries will be consulted to assist in providing definitions and understanding of the terms. The publications issued by SARS (The Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962, the Draft Comprehensive Guide to the GAAR and the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006) will also be consulted to aid with providing an understanding on how the revenue authority defines the terms (i.e., whether the tax authority defines the tax terms like the courts or defines the tax terms differently).

It must be noted that the Income Tax Act does not provide definitions for the terms tax evasion, tax avoidance and tax planning. Case law and other resources will be considered to provide definitions for the said terms.

The discussion paper issued by SARS relating to section 103(1) states that

> "In its current form, the GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly complex and sophisticated tax "products" that are being marketed by banks, "boutique" structured finance firms, multinational accounting firms and law firms". (SARS 2005:1)

**Chapter 2: Old general anti-avoidance rules envisaged in section 103(1) of the Income Tax Act, 58 of 1962.**

This chapter will look at section 103(1) of the Income Tax Act before the 2 November 2006 amendment (old anti-avoidance rules) and SARS" and National Treasury's publications will be considered.

**Chapter 3: Current general anti-avoidance rules envisaged in sections 80A – 80L of the Income Tax Act, 58 of 1962.**

- **Chapter 3.1: Requirement 1 - Is there an arrangement or scheme?**

The general anti-avoidance rules envisaged in sections 80A – 80L apply to an impermissible avoidance arrangement as defined.

This sub-chapter will explore the first requirement – that is the arrangement requirement. Section 80L of the Income Tax Act, SARS publications and case law will be considered.

- **Chapter 3.2: Requirement 2 - Is there a tax benefit and was the arrangement or scheme entered solely or mainly for the tax benefit?**

This sub-chapter will explore whether the arrangement results in a tax benefit (which makes it an avoidance arrangement) as per section 80L Income Tax Act. It will also explore whether the arrangement was entered into solely or mainly for the purpose of obtaining the tax benefit. The Income Tax Act, SARS publications and case law will be considered.

- **Chapter 3.3: Requirement 3 - Does the arrangement or scheme include tainted element/s?**

This sub-chapter will explore the various tainted elements envisaged in section 80A (a) –(c) of the Income Tax Act, SARS publications and case law will be considered.

- **Chapter 3.4: Conclusion**

The sub-chapter will detail the reason/s given for the repealing of Section 103(1) of the Income Tax Act.

**Chapter 4: A comparison between the Australian and South African general anti-avoidance rules.**

Various countries around the world have general anti-avoidance rules. Some may be written and are similar to the South African general anti-avoidance rules and some may be very different to the South African general anti-avoidance rules.

This sub-chapter will analyse the Australian general anti-avoidance rules and draw out the similarities and differences (if any) between the Australian and South Africa general anti-avoidance rules. As stated, the South African legislation reads similar to the Australian legislation.

**Chapter 5: Conclusion**

The concluding chapter will draw out the main points made in the preceding chapters and sub chapters, which will be used to summarise the findings of the report. Areas into which further research may be conducted, which were not addressed in this research report, may be identified in this chapter.

## Chapter 2 Old general anti-avoidance rules envisaged in section 103(1) of the Income Tax Act, 58 of 1962

### Introduction and Background

As noted in chapter 1 above, there is a difference between tax avoidance and tax evasion. Such difference lies in the fact that one (tax evasion) is illegal and one (tax avoidance) is to an extent legal and permissible. Taxpayers are afforded the ability to order their tax affairs "so as to minimize one's tax liability", as stated in the judgment of Wallis JA in *the* court case *CSARS v Bosch*, 2014. This principle was confirmed in the case "*Commissioner for Inland Revenue v Conhage (Pty) Ltd*, 1999", where the court reiterated that:

> "… a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner however it has to be within the bounds of any anti-avoidance provisions in the relevant legislation". (Museka 2011: 10)

Considering the above cases, it is safe to say that a taxpayer may indeed pursue ways in which to minimise their tax liability, however the ways employed by such taxpayer must be well within the confines of the relevant legislation (i.e. must be legal). It may be said that the taxpayer has a "right to arrange their tax affairs in such a way that minimises the tax liability payable and the responsibility to ensure that the arrangement of the tax affairs is well within the confines of the law". (Pamela 2011: 10)

Where the arrangement of a taxpayers tax affairs in order to minimise the tax liability payable is not within the confines of the law, this may lead to impermissble tax avoidance and/or tax evasion which may/will ultimately result in the erosion of the integrity of the tax base/fiscus.

In an effort to protect the tax base/fiscus against such arrangements that erode its integrity, the South African legislature enacted "General Anti-avoidance Rules". The general anti-avoidance rules set out in the Income Tax Act seek to address schemes that are entered into by taxpayers to avoid or reduce the tax liability. (Pamela 2011: 3)

The general anti-avoidance rules were first introduced in South Africa under section 90 of the old Income Tax Act 31 of 1941 ("old Income Tax Act"). Since then, the general anti-avoidance rules have seen several amendments over the years. Section 90 of the old Income Tax Act was repealed and replaced by section 103(1) of the Income Tax Act, 58 of 1962. (Benn 2013: 9)

According to Museka, section 90 of the old Income Tax Act was "found to create confusion and it was regarded as having a very restricted interpretation". The court in the court case *CIR v King*, 1947 held that,

> "The fundamental difficulty, in dealing with section 90 is to avoid, on the one hand, giving it a meaning which, because of its absurd, and indeed revolutionary, consequences, the Legislature could not have intended, and, on the other hand, giving it no effect at all, in view of the already existing power of the Court to strip disguises from transactions and declare what the real act was. A sphere of operation, reasonable and at the same time effective, must, if possible, be discovered for the section". (Museka 2011: 3)

To overcome the said restrictive interpretation of section 90 of the old Income Tax Act, section 103(1) of the Income Tax Act was enacted to replace section 90 of the old Income Tax Act.

There was very little deviation by section 103(1) of the Income Tax Act from its predecessor section 90 of the old Income Tax Act. However, section 103(1) of the Income Tax Act was repealed by the Revenue Laws Amendment Bill, 2006. (Benn 2013: 10)

The following reason/s were given for the repeal:

> "The GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance that certain and because it has not kept up with international developments, the GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance that certain advisors and financial institutions are putting forward and some taxpayers are implementing. In addition, it has become clear that the GAAR has not kept up with international developments. Finally, uncertainty has arisen with respect to the application of the GAAR in the alternative due to conflicting Court decisions in this regard". (National Treasury 2006: 62)

Prior to its repeal section 103(1) reads as follows:

> "103. Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amount of taxes on income. – "(Benn 2013: 10)
>
> (1). "Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)— "(Benn 2013: 10)
>
> *(a)* "has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof; and" (Benn 2013: 10)
>
> *(b)* "having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out—" (Benn 2013: 11)
>
> I. "was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question"; (Benn 2013: 11)
>
> II. "has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and" (Benn, 2013, p. 11)
>
> *(c)* "was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax, duty or levy (whether imposed by this Act or any previous Income Tax Act or any other law administered by the Commissioner) or the reduction of the amount of such liability", (Benn, 2013, p. 11)
>
> "the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out or in such a

> manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction". (Benn 2013: 10

The discussion paper issued by SARS notes that "in the context of business", the general anti-avoidance rules envisaged in the now repealed section 103(1) of the Income Tax Act were built upon four elements namely: (SARS 2005: 38)

- The Scheme Requirement: "There must be a transaction, operation or scheme entered into or carried out"; (SARS 2005: 38)
- The Tax Effect Requirement: "Such transaction must have the effect of avoiding or postponing or reducing the liability for the payment of any tax"; (SARS 2005: 38)
- The Abnormality Requirement: "The transaction was entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit; and"
- The Purpose Requirement: "The transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit". (SARS 2005: 38)

The discussion paper further states that where a transaction satisfies all of the above listed elements,

> such transaction falls within the ambit of section 103 of the Income Tax Act and the Commissioner is empowered to determine the tax liability as if the transaction had not been entered into or carried out, or, alternatively, in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction. (SARS 2005: 39)

**The Scheme Requirement**

Section 103(1) of the Income Tax Act, prior to its repeal, "stated that an arrangement includes a transaction, operation or scheme involving the alienation of property which has been entered into or carried out which has the effect of avoiding or postponing liability". (Benn 2013: 12)

It is important to note that section 103(1) starts off by stating the "Commissioner must be satisfied that a transaction, operation or scheme had been entered into or carried out. It is therefore imperative to determine whether a transaction, operation or scheme has indeed been entered into or carried out by a taxpayer". (Benn 2013: 12)

In determining whether a transaction, operation or scheme exists, the following cases were considered:

*"Meyerowitz v Comissioner for Inland Revenue*, 1963"

In this case, it was considered whether various transactions entered into by taxpayers were to be considered as "schemes" within the meaning of section 90 of the old Income Tax Act. The counsel provided the following view with regards to a scheme: (Benn 2013: 12)

> "a scheme may consist of several transactions, but they must be connected in the sense of being parts of a preconceived plan, whatever the object of such plan may be". (Benn 2013: 12)

In the above court case, the court in its judgment "held that a transaction which did not form part of the scheme when it was entered into can become part of the scheme if it is later *pressed into the service of the scheme"*. (Benn 2013: 12)

*'CIR v Louw*, 1983'

The court 'approved and applied the interpretation that the term "scheme" is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset". (Benn 2013: 12)

*"Ovenstone v SIR*, 1980"

The court analysed the term "entered into" and stated that

> "It was held that entered into does not mean formulated because of its context it has, I think, a connotation of implementation that is similar to carried out ". Probably both expressions were used because it was considered that carried out "is more appropriate to connote the implementation of a scheme ", while entered into" is more apposite to connote the implementation (i.e. the taxpayer's actually engaging in) of a transaction" or operation …" (Benn 2013: 12)

Based on the above cases, it may be concluded that the term scheme is wide enough to include all forms of transactions, operations or schemes entered. By virtue of the above cases, it seems that all transactions, schemes and operations entered into by taxpayers fall within the ambit of the now repealed section 103(1) of the Income Tax Act. It is important to note that such transaction, operation or scheme must be entered into and not formulated as per the *Ovenstone* case above. (Benn 2013: 12)

**The Tax Effect Requirement**

Once it has been established that a transaction, operation or scheme exists, it must be determined whether such a transaction, operation or scheme has the effect of avoiding or postponing or reducing the liability for the payment of any tax, duty or levy imposed by the Income Tax Act or any previous Income Tax Act.

To assist in determining whether a transaction, operation or scheme has the effect of avoiding or postponing or reducing the liability payable, the following cases will be considered:

- *"CIR v King*, 1947": The court stated that the "tax liability referred to in section 90 of the old Income Tax Act, is not an existing liability for tax, but an anticipated liability". The court considered the meaning of the phrase "which has the effect of avoiding or postponing liability for any tax, duty or levy on income of section 90(1) of the old Income Tax Act and held that the section refers to anticipated liabilities for tax either in respect of a current tax year or in respect of future tax years". (Benn 2013: 13)
- *"Smith v CIR*, 1964": The court reiterated the principle from the *CIR v King* case and held that

  "The ordinary natural meaning of avoiding liability for a tax on income is to get out of the way of, escape or prevent an anticipated liability …. The Afrikaans rendering of the phrase is wat die uitwerking het dat die aanspreeklikheid vir die betaling van "n belasting … op inkomste vermy". The ordinary meaning of "vermy" is "ontwyk" or "voorkom". That wider meaning is the meaning to be ascribed to the phrase, unless it is clear that a different meaning is intended". (Benn 2013: 13)

From the above cases, it is important to note that section 103(1)'s reference to "which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed …" refers to an anticipated liability. (Benn 2013: 13)

**The Abnormality Requirement**

Once it has been established that a transaction, operation or scheme has been entered into and such transaction, operation or scheme has the effect of avoiding or postponing liability (anticipated liability), it must be determined whether such transaction, operation or scheme was entered into "by means or in a manner which would not normally be employed" or it has "created rights or obligations which would not normally be created between persons dealing at arm's length". Benn notes in his report that the wording of section 103(1) may be interpreted as an objective test. (Benn 2013: 13)

The wording of the section provides that the transaction, operation or scheme entered to must be tested against the following aspects:

- "The means and/or manner in which such transaction, operation or scheme was entered into or carried; and" (Benn 2013: 14)
- "The rights and obligations not normally created between persons" dealing at arms" length under such a transaction, operation or scheme". (Benn 2013: 14)

To assist in determining whether a transaction, operation or scheme entered into has the effect of avoiding or postponing or reducing the liability payable has been entered into or carried out in a manner or means that would not normally be employed or has created rights and obligations that would not normally be created between persons" dealing at arms' length. In the case of "*Hicklin v Secretary for Inland Revenue*, 1980", the court dealt with the phrase "dealing at arm's length". (Benn 2013: 14)

The court stated that

> "in an arm's length transaction/agreement, each party was independent of each other and would strive to get the uttermost possible advantage out of the transaction for themselves. The rights and obligations that are created are most likely to be regarded as normal as would the manner and means employed also be regarded as normal".

The evidence presented as well as a factual enquiry into the facts would be needed to establish whether the parties to a transaction, operation or scheme are dealing at arm's length or not. (Benn 2013: 14)

**The Purpose Requirement**

As the final step, once it has been established "that a transaction, operation or scheme has been entered into and such transaction, operation or scheme has the effect of avoiding or postponing liability (anticipated liability) and such transaction, operation or scheme was entered into by means or in a manner which would not normally be employed or it has created rights or obligations which would not normally be created between persons dealing at arm's length", it must be determined whether such transaction was entered into solely or mainly for purposes of obtaining a tax benefit. Once again Benn's report notes that this was a subjective requirement. (Benn 2013: 14)

To assist in determining whether the sole or main purpose of the transaction, operation or scheme entered into was for obtaining the tax benefit (i.e., "avoiding or postponing or reducing the liability payable"), the case of "*CIR v Bobat and Other*, 2005" can be considered. The court stated that "a main purpose is obviously one which is dominant over any other".

Considering the above case, it may be interpreted that where a taxpayer had "two or more purposes of equal importance or significance", the general anti-avoidance provisions as per section 103(1) of the Income Tax Act could not find application. (Benn 2014: 14)

**Section 103(1) seems effective, why repeal it?**

The discussion paper issued by SARS notes that the "Margo Commission issued its report in

1986, where is recognized that section 103(1) of the Income Tax Act as it then stood suffered from serious deficiencies". (SARS 2005: 39)

The Margo Commission report stated as follows:

> "The test of abnormality presents difficulties. If a particular form of transaction is widely used for tax avoidance purposes, it may gain a commercial acceptability to the extent that its utilization becomes normal. The concept of abnormality must therefore be qualified to this extent". (SARS 2005: 40)

The discussion paper further states that parliament "did not act upon" the recommendation of the Margo Commission. The concerns raised by the Margo Commission were further reiterated by the Katz Commission in 1995. The Katz Commission "recognized that the abnormality requirement was the Achilles heel of section 103(1) of the Income Tax Act". (SARS 2005: 39)

Apart from the difficulties already identified and raised by the Margo Commission regarding the test of abnormality, the Katz Commission identified and raised a further concern that

> "…there is ambiguity as to whether it is objective, that is whether there exists an objective test to be applied despite the context of specific circumstances". (SARS 2005: 40)

The Katz Commission recommended the following to remedy the problems:

> *"where a transaction occurs in the context of trade, a business purpose test should be substituted for the normality test".* (SARS 2005: 40)

Following the recommendation of the Katz Commission, section 103(1) was amended to read as follows: (SARS 2005: 40)

> "(1) Whenever the Commissioner is satisfied that any transaction, operation or scheme . . ."
>
> (b) "having regard to the circumstances under which the transaction, operation or scheme–"
>
> (i) "was entered into or carried out – "(SARS 2005: 40)
>
> "(aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit . . . "(SARS 2005: 40)

Following the amendment of the section 103(1) of the Income Tax Act, the following commentary was received:

- Williams noted:

> "In my view, the only clear terrain for the amended section 103(1) to apply is where the particular transaction had no bona fide business purpose at all, only a tax benefit. There may be some highly artificial "tax schemes" which fall into this category". (SARS 2005: 41)

- Olivier observed:

> "The purpose in amending section 103(1) of the act was to clarify some of the issues. The legislator did not succeed in this. Instead of addressing some of the existing problems, the amendment created even more problems, and this is regrettable". (SARS 2005: 41)

Benn's report (Benn 2013: 15) noted the following regarding the purpose requirement:

- "The subjective nature of the purpose requirement was one of the weaknesses in the eyes of the Commissioner"; (Benn 2013: 15)
- "The court was required to investigate the mind of the taxpayer to determine whether the requisite purpose was present at the time the taxpayer entered into the transaction, operation or scheme"; (Benn 2013: 15)
- "This proved very difficult to do and it was thus presumed that the transaction was entered into for the purpose of avoiding or postponing tax (i.e. obtaining the tax benefit), unless the taxpayer proved otherwise"; (Benn 2013: 15)
- "It meant that even if there was a tax purpose for entering into a transaction, it would not be in conflict with general anti-avoidance rules, if this tax purpose was not the sole or main purpose of the transaction"; (Benn 2013: 15)
- "As a result, if a "transaction, operation or scheme had a commercial or business purpose as its main purpose, it would have been sanctioned by the courts as the parties are allowed to structure transactions in the most beneficial manner (see the *CSARS v Bosch*, 2014 and *Commissioner for Inland Revenue v Conhage (Pty) Ltd*, 1999 cases)". (Benn 2013: 15)

The discussion paper discusses the concerns regarding the purpose requirement. It states that "the purpose requirement can only be met if obtaining a tax benefit is the sole or main purpose of a transaction". The discussion paper further states that the "term main has generally been construed to mean predominant". Where for example, a taxpayer has entered into a transaction, operation or scheme that has both a tax purpose and a commercial purpose, the purpose requirement will only be met only if the reason for the transaction, operation or scheme is predominantly for the tax purpose. This means that the Commissioner will have to disprove a taxpayer's allegations that the dominant reason for the transaction, operation or scheme is for commercial purposes. (SARS 2005: 43)

Benn's report notes that the "purpose requirement" was criticized in the judgement of *Commissioner for Inland Revenue v Conhage (Pty) Ltd*, 1999 where the court held that

> "a transaction entered into with a dual purpose, would not satisfy the "purpose requirement" if the main reason for the transaction was a commercial or business purpose". (Benn 2013: 15)

The discussion paper notes that the problems raised regarding the purpose requirement were further exasperated "*by the fact that it entails a subjective test – one that looks to the purpose the taxpayers purportedly intended to achieve when they carried out their scheme".*

RC Williams stated the following:

> "In essence . . . a taxpayer could with impunity enter into a transaction with the (subjective) sole purpose of avoiding tax provided that there was no (objective) abnormality in the means or manner or in the rights and obligations which it created. Conversely, a taxpayer could with impunity enter into a transaction which was objectively "abnormal" provided that he did not, subjectively, have the sole or main purpose of tax avoidance". (SARS 2005: 44)

Subparagraph 8.3.4 of the discussion paper issued by SARS in 2005 notes the further concerns regarding the scope and applicability of section 103(1) of the Income Tax Act. The following concerns were raised:

- Uncertainty regarding "*the extent to which section 103(1) may be applied to steps within a larger transaction or scheme"*; (SARS 2005: 44)
- Uncertainty regarding "*the Commissioner's authority to assert or apply section 103(1) "in the alternative" where another provision, such as section 11(a), is also in dispute"*. (SARS 2005: 44)

Further concerns are raised in the discussion paper under paragraph 9. It is stated that

> "any attempt to strengthen the general anti-avoidance rules brings with it legitimate countervailing concerns. One is that such a move would result in increased uncertainty for taxpayers. A second, and closely related, concern is that a stronger section 103 would inhibit innovative financial arrangements and/or interfere with legitimate business transactions". (SARS 2005: 44)

Section 103(1) of the Income Tax Act was enacted to protect the integrity of the fiscus against transaction/s entered into by taxpayers who seek to minimize the tax liability applicable. When drafting the provisions of section 103(1), the legislature would not draft and enact ineffective provisions. However, due to the complexities of the various transactions entered into by taxpayers in an effort to minimize the tax liability, section 103(1) was rendered ineffective. The wording of the section presented difficulties that made its applicability inadequate.

"As such section 103(1) cannot be conceived to be completely defective as it paved way for the current anti-avoidance rules as envisaged in sections 80A-80L of the Income Tax Act". (Benn 2013: 16)

**Conclusion**

In this chapter, the old general anti-avoidance rules as envisaged in section 103(1) of the Income Tax Act and the various requirements were discussed. This chapter included a discussed on the brief history of the general anti-avoidance rules (i.e. first introduced by section 90 of the Income Tax Act 31 of 1941 which was repealed and replaced by section 103(1) of the Income Tax Act 58 of 1962) which was also repealed and replaced by sections 80A - 80L of the Income Tax Act 58 of 1962. The reasons provided for the various repeals and replacements were also discussed in this chapter.

# Chapter 3: Current general anti-avoidance rules envisaged in sections 80A – 80L of the Income Tax Act, 58 of 1962

### 3.1: Requirement 1 - Is there an arrangement or scheme?

The general anti-avoidance rules apply to an avoidance arrangement which is an impermissible avoidance arrangement as envisaged in section 80A of the Income Tax Act. It is imperative to establish whether an avoidance arrangement is an impermissible avoidance arrangement as defined.

The Income Tax Act defines an arrangement, an avoidance arrangement and an impermissible avoidance arrangement. Based on the above, it is important to determine the following in terms of a transaction/s entered into by taxpayers:

- Does the transaction constitute an arrangement as defined?
- Is the arrangement entered into an avoidance arrangement as defined?
- Is the avoidance arrangement an impermissible avoidance arrangement as defined?

(Benn 2013: 18)

**What is an arrangement?**

Section 80L of the Income Tax Act defines an arrangement as follows:

> "… means any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property"

The above definition of an arrangement is a wide net and catches all forms of transactions (whether enforceable or not). The term arrangement seeks to include "*almost all forms of arrangements*". (Satumba 2011:21)

It is important to note that though it may look different, but the arrangement requirement encompassed in section 80A of the Income Tax Act was also included in the now repealed section 103(1) of the Income Tax Act. It seems that the legislator has kept the arranagement requirement from the old general anti-avoidance rules to the current general anti-avoidance rules. (Satumba 2011: 21)

The Income Tax Act does not define the terms transaction, operation, scheme etc. Various judgments will be considered in order to interpret/define the terms transaction, operation, scheme. It is important to note that the cases discussed below are the same cases that were used to interpret the meaning of the terms transaction, operation, scheme for the now repealed section 103(1) of the Income Tax Act (see chapter 2 above). The same cases will be looked at once again for purposes of providing a complete analysis of the general anti-avoidance rules envisaged in sections 80A to 80L of the Income Tax Act (i.e. title of the research).

In the judgment of *Meyerowitz v Comissioner for Inland Revenue*, 1963, the court said:

> "the word scheme is a wide term and that there can be insignificant apprehension that it is amply broad to include a series of transactions" (Benn 2013: 21)

Considering the above judgment and definition, it may be said that the terms transaction, operation, scheme include all transactions, operations, schemes, agreements or understandings entered by taxpayers. This means that all transactions, operations, schemes etc. entered by taxpayers satisfy the so-called arrangement requirement of the general anti-avoidance rules applicability.

In "*CIR v Louw*, 1983", the court approved and applied the interpretation that,

> "… the term scheme is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset" (Benn 2013: 21)

In "*Ovenstone v SIR*, 1980", the court analysed the term "entered into" and stated that;

> "It was held that entered into does not mean formulated because of its context it has, I think, a connotation of implementation that is similar to carried out ". Probably both expressions were used because it was considered that carried out "is more appropriate to connote the implementation of a scheme", while entered into" is more apposite to connote the implementation (i.e. the taxpayer's actually engaging in) of a transaction" or operation …" (Benn 2013: 21)

From the abovementioned cases, the following may be deduced:

- All transactions, operations, schemes etc. entered by taxpayers are arrangements as defined in the cases and section 80L above;
- The term scheme is "wide enough to cover" subsequent steps of such transactions, operations, schemes etc.; and
- It can be said that taxpayers must be engaging/engaged in the transaction, operation scheme etc.

It is important to note that the section 80L definition of arrangement includes "all steps therein or parts thereof". *(*Benn 2013: 21)

Both terms (i.e. steps and parts) are not defined in the Income Tax Act. In the absence of expressed definitions, it becomes difficult to determine which step/steps or part/parts of a transaction, scheme or operation is an arrangement as defined.

However, Clegg & Stretch: 2013 "suggests that each term (step and part) relates to a distinct transactional element of the whole transaction". (Benn 2013: 21)

In the court case *Commissioner for Inland Revenue v Conhage (Pty) Ltd*, 1999, it was held *that*

> "the courts would look at the whole of the transaction as opposed to reviewing its individual steps to ascertain if tax avoidance has taken place". (Satumba 2011: 24)

The current wording of section 80L of the Income Tax Act moves away from the principle established in the above court case. (Satumba 2011: 24)

"Section 80H of the Income Tax Act states that",

> "The Commissioner may apply the provisions of this part to steps in or parts of an arrangement."

As per the discussion paper issued by SARS, one of the proposed changes to the general anti-avoidance rules at that time was to provide clarity that the "Commissioner may apply the rules to steps or part within a larger arrangement/scheme and that a general business purpose for a larger scheme is not sufficient to shield each and every step in that scheme from that review". (SARS 2005: 48)

The discussion paper further notes that due to uncertainty regarding the applicability of section 103(1) to steps/parts of an arrangement/scheme that may be inserted for the purpose of avoiding tax, it is necessary to include such clarity in the legislation and to bring the South African legislation in line with the Australian and New Zealand pieces of legislation. (SARS 2005: 56)

The "*Hicklin v Secretary for Inland Revenue*, 1980" case states that "where a composite transaction was entered into, it was held that a single agreement (the RN agreement) constituted the scheme for purposes of applying the provisions of section 103(1)". (Museka 2011: 23)

If a "step or part of an arrangement will result in an impermissible avoidance arrangement" as defined, then the Commissioner may apply general anti-avoidance rules as envisaged. (Museka 2011: 23)

The following court cases are referenced in the discussion paper with regards to the step/part requirement:

- *"Meyerowitz v Comissioner for Inland Revenue*, 1963":

> "…from beginning to end, the transactions constituted a scheme even though they were not all contemplated at the outset. The test is whether the different steps, upon examination in retrospect,

appear to be so connected with one another that they could ultimately lead to the avoidance of taxation". (SARS 2005: 56)

— *"ITC 1606*, 1995":

"…where a scheme consists of separate transactions which together in substance make up one composite transaction, it would be artificial only to look at each independent step and not to have regard to the transaction as a whole". (SARS 2005: 56)

The "*CIR v Louw"* court case may also be considered with regards to the step/part requirement. The court in the" *CIR v Louw*, 1983" found that,

> "…the ultimate step in a scheme need not be in contemplation from the outset, it may be decided upon later. However, if there is existence of sufficient unity amongst the various steps, having regard to the ultimate objective, they may together be regarded as being part of a single scheme".

Considering the judgments above, the different steps will have to be examined to determine whether they are connected to one another ultimately leading to the avoidance/reduction of tax. Where the different steps considered are connected to each other in such a way that leads to the avoidance or reduction of tax, then the general anti-avoidance rules will find application. (Museka 2011: 23)

There is a view that with the inclusion of section 80H, the Commissioner must now inform the taxpayer of the parts of the arrangement/s are which are being questioned. This requirement to inform such taxpayer may prove to provide some sort of an advantage for the taxpayer. (Satumba 2011: 25)

This subsection dealt with the first requirements of the general anti-avoidance rules as envisaged in sections 80A-80L of the Income Tax Act, which is the so-called arrangement requirement. (Museka 2011: 24)

This subsection started off by establishing the meaning of the term arrangement using various sources (i.e. the Income Tax Act and case law).

Considering the discussion above, the terms arrangement or scheme are catch all terms which include all transactions, operations, schemes etc. entered by taxpayers. It is important for the taxpayer/s to be engaged in the arrangement as noted in the *Ovenstone* case.

Section 80H of the Income Tax Act permits the Commissioner to apply the general anti-avoidance rules to a step/steps or part/parts of the arrangement. The Commissioner must consider the steps or parts of the arrangement from beginning to end and whether such steps or parts are connected in such a way that results in the avoidance/reduction of tax.

Where such steps or parts of the arrangement entered lead to the avoidance/reduction of tax, the general anti-avoidance rules as envisaged will find application.

### 3.2: Requirement 2 - Is there a tax benefit and was the arrangement or scheme entered solely or mainly for the tax benefit?

Once it has been established that an arrangement as defined has been entered into by a taxpayer, the next part of the process would be to establish whether the arrangement or part of the arrangement in question was entered into sole or mainly for obtaining the tax benefit. (Museka 2011: 26)

In order to determine the above (i.e. that the arrangement was entered into for the sole or mail purpose of obtaining the tax benefit), this section will analyse the various terms used in the wording of section 80A of the Income Tax Act. The important terms to note are:

- Tax;
- Tax Benefit; and
- Solely or mainly.

(Museka 2011: 26)

The tax benefit requirement now included in section 80A of the Income Tax Act was also included in the now repealed section 103(1) of the Income Tax Act. The inclusion was somewhat different as the current general anti-avoidance rules include the words tax benefit and the old old general anti-avoidance rules (i.e. the now repealed section 103(1) of the Income Tax Act) included the words "…any avoidance, postponement or reduction of any liability for tax". Essentially the legislator took the section 103(1) wording and defined the section 80A words.

**What is a tax benefit?**

Tax is defined in section 1 of the Income Tax Act to mean "…any tax or a penalty imposed in terms of this Act".

As per section 80L, the definition of tax is defined to include "…any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner".

Tax benefit is defined in section 1 of the Income Tax Act to include"…any avoidance, postponement or reduction of any liability for tax"

Over and above the definition/s provided for in the Income Tax Act, various court cases have provided guidance regarding the definitions of various terms used. (Mvuyana 2014: 19)

As per the "*Smith v CIR,* 1964" case, the court held the following:

> "The ordinary natural meaning of avoiding liability for a tax on income is to get out of the way of, escape or prevent an anticipated liability …. The Afrikaans rendering of the phrase is wat die uitwerking het dat die aanspreeklikheid vir die betaling van "n belasting … op inkomste vermy". The ordinary meaning of "vermy" is "ontwyk" or "voorkom". That wider meaning is the meaning to be ascribed to the phrase, unless it is clear that a different meaning is intended" (Mvuyana 2014: 20)

The court had the following to say in the "*CIR v King* case":

> "a tax benefit occurs when there are transactions and operations which if a taxpayer carries them out would have the effect of reducing the amount of his income to something less than it was in the past or freeing himself from taxation from some part of his future income". (Museka 2011: 27)

From the above definitions and case law, it may be said that a tax benefit involves the avoidance, postponement or reduction of any tax or levy. It is "getting out of the way" or escaping or preventing an anticipated tax liability.

The two court cases (i.e. *Smith v CIR* and *CIR v King*) can be summarised as follows:

- "A taxpayer can only avoid an **anticipated liability** for tax";
- "A tax benefit will arise where the taxpayer has effectively **stepped out of the way of such anticipated liability";** and
- "In determining whether a tax benefit exists, the courts applied the ***but for*** **test**, which essentially asks **"Would the taxpayer have suffered tax but for the transaction?"**

(Pidduck 2020: 24)

With regards to the "but for" test mentioned above, the following cases are applicable:

- *"ITC 1625*, 1996" case which held that

> "..if the transaction had not been entered into, the appellant would not have acquired the property, it would not have earned the income and it would not have incurred the interest expenditure". (Pidduck 2020: 24)

- *"CIR v Louw*, 1983" case which held that

> "…had it not been for the transactions..., the dividend by the IMC to the SA company and the letter to the Rhodesian company, would have come into the appellants hands and he would have been liable to tax thereon". (Pidduck 2020: 24)

Considering the above cases, it may be concluded that the courts have established a "but for" test to assist determining whether an arrangement was entered into solely or mainly for the tax benefit. (Museka 2011: 28)

It is important to note that in *"ITC 1625*, 1996", it was held that *"*the onus of proving that there was a tax benefit rests with the Commissioner"*. (*Mvuyana 2014: 21)

**Was the arrangement entered into solely or mainly for the tax benefit?**

The preceding sections of chapter three have established the meaning of an arrangement and whether the said arrangement results in a tax benefit. For the general anti-avoidance rules to find application the said arrangement must have been entered into solely or mainly for obtaining the tax benefit.

The solely or mainly wording now included in section 80A of the Income Tax Act was also included in the now repealed section 103(1) of the Income Tax Act. The inclusion remains the same from the old general anti-avoidance rules to the current general anti-avoidance rules.

This part of the sub section will consider the meaning of the terms solely or mainly. The terms solely or mainly are not defined in the Income Tax Act. Various court cases will be considered to assist with defining the terms in question. The following court cases are considered when determining the meaning of solely or mainly:

- *"CIR v Bobat and Others*, 2005": the court held that

  > "… a main purpose is obviously one which must be dominant over any other, because in ordinary language "mainly" means for the most part, principally or chiefly". (Museka 2011: 29)

- *"SIR v Gallagher*, 1978": the court held that

  > "…If the subjective approach be adopted (as it must) then it is obvious that of prime importance in determining the purpose of the scheme would be the evidence of respondent, the progenitor of the scheme, as to why it was carried out.". (Mvuyana 2014: 22)

- *"SBI v Lourens Erasmus (Edams) Bpk*, 1966": The court held that

  > "… in the context under consideration, the word "mainly" establishes a purely quantitative measure of more than 50% and the associated use of the word "solely or mainly is inserted, ex abundante cautela, to circumvent the possibility that what may be described as being "solely" of a particular character would not qualify as being "mainly" of that character". (Museka 2011: 29)

From the above court cases, it is understood that the term main or mainly speaks of dominance over another, it speaks of being the most important, the chief. The term mainly is associated with more than fifty percent. The use of the word mainly in the legislation relates to an arrangement or part thereof where the taxpayer has more than one purpose with the dominant purpose being to obtain the tax benefit. The use of the word solely in the legislation relates to an arrangement or part thereof whether the only reason the taxpayer entered the arrangement was to obtain the tax benefit. (Museka 2011: 29)

The term purpose is not defined in the Income Tax Act. The following court cases may be consulted when defining purpose:

- *"Newton v FCT* , 1958": the court held that

> "…the word purpose used in the context of an arrangement; regard must be had to the objective effect of the arrangement. Purpose in this sense means not intention, but the effect with which it sought to achieve the end accomplished or achieved" (Museka 2011: 30)

The above case provides some clarity with regards to the meaning of purpose. Purpose in the context of the general anti-avoidance rules does not mean intention of the taxpayer (i.e., the taxpayers "ipse dixit") but objective effect, the objective result of the arrangement. (Mvuyana 2014: 22)

Previously, "*ITC 1625*, 1996" held that "*the onus of proving that the arrangement did in fact contain a tax benefit rests with the Commissioner".* With the introduction of the new general anti-avoidance rules in 2006, there onus of proof was shifted from the Commissioner to the taxpayer. Mvuyana is of the view that, the previous stance on the onus of proof "*appeared to be to the detriment of the Commissioner".(*Mvuyana 2014: 21)

Section 80G of the Income Tax Act has the heading "presumption of purpose". The section reads as follows:

1) "An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement". (Museka 2011: 32)
2) "The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole". (Museka 2011: 32)

The section basically states that where it has been proven that an avoidance arrangement as defined has been entered into by a taxpayer, a presumption is made regarding the purpose. The presumption made is that the avoidance arrangement entered, has been entered into for the sole or main purpose of obtaining the tax benefit.

The presumption of purpose as provided in section 80G may provide the taxpayer with a level of difficulty in proving that the arrangement was "*not entered into solely or mainly for the purpose of acquiring a tax benefit". (*Museka 2011: 32)

In other words, this puts the taxpayer at a disadvantage.

The explanatory memorandum issued by the National Treasury regarding section 80G:

> "…provide for a rebuttable presumption that an arrangement that provides a tax benefit was entered into or carried out for the sole or main purpose. It also makes it clear that a step in or part of an avoidance arrangement may have a different purpose from the arrangement as a whole. A step or part with the sole or main purpose of obtaining a tax benefit may thus no longer be "camouflaged" by a legitimate purpose of the arrangement as a whole" (The National Treasury, 2006, 65)

The discussion paper issued by SARS states that

> …there is an expectation that it will be quite difficult for a taxpayer to rebut the presumption of a "tax avoidance purpose in any case in which a tax effect has been established and the taxpayer has been unable to rebut a presumption of abnormality arising… (SARS 2005, 56)

**3.3: Requirement 3 - Does the arrangement or scheme include tainted element/s?**

So far, the following elements have been discussed and established:

- What is an arrangement as defined;
- Is there a tax benefit; and
- Was the arrangement entered into sole or mainly for purposes of obtaining the tax benefit.

The explanatory memorandum issued by National Treasury provides an equation for an impermissible avoidance arrangement as per section 80A of the Income Tax Act. The equation can be summarised as follows:

- where it has been established that an avoidance arrangement has been entered into (i.e. the taxpayer has entered into a transaction, operation, scheme, agreement or understanding solely or mainly for the purpose of obtaining the tax benefit), such an avoidance arrangement becomes an impermissible avoidance arrangement when it includes a "tainted element/s". (National Treasury 2006: 62)

The explanatory memorandum further states that there are three tainted elements included in section 80A and the said tainted elements are structured differently depending on the context in which the arrangement relates. The explanatory memorandum does not provide further guidance regarding the various contexts. (National Treasury 2006: 63)

The tainted elements are encompassed in paragraphs a, b and c of section 80A of the Income Tax Act. The tainted elements in Section 80A are also referred to as the "abnormality requirement" of the general anti-avoidance rules. (Satumba 2011: 35)

Sibisi's report states that the abnormality requirement is "the something is bad, harmful or offensive requirement" of the general anti-avoidance rules. (Sibisi 2016: 24)

Section 80A of the Income Tax Act reads as follows:

> **"80A. Impermissible tax avoidance arrangements.** —An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and— "(Museka 2011: 37)
>
> (*a*) "in the context of business— "
>
> > (i) "it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or" (Museka 2011: 37)
> >
> > (ii) "it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C"; (Museka 2011: 37)
>
> (*b*) "in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit; or" (Museka 2011: 37)
>
> (*c*) "in any context—"
>
> > (i) "it has created rights or obligations that would not normally be created between persons dealing at arm's length; or" (Museka 2011: 37)
> >
> > (ii) "it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part)". (Museka 2011: 37)

The various tainted elements will now be discussed.

**<u>In the context of business</u>**

The "avoidance arrangement becomes an impermissible avoidance arrangement in the context of business when it was entered into or carried out by means or in a manner not normally employed for bona fide business purposes, other than obtaining the tax benefit or in whole or in part, the avoidance arrangement lacks commercial substance". (Satumba 2011: 36)

Section 80A(a)(i) – (ii) presents two elements to be considered (i.e. the business purposes also referred to as the business purpose test and the commercial substance or the lack thereof also referred to as the lack of commercial substance test). (Museka 2011: 38)

**Business Purpose Test**

The term business is not defined in the Income Tax Act. The term business is included in the definition of trade in section 1 of the Income Tax Act. Trade is defined as follows:

> "…every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or granting of permission to use certain other assets". (Satumba 2011: 44)

Business as defined in section 1 may mean "*any business is a trade, but a trade as defined if not necessarily a business"*. (Satumba 2011: 44)

The court case *Smith v Anderson*, 1880 held the following with regards to the term business:

- "*The word business means anything that occupies the time and attention and labour of a man for the purpose of profit or improvement"*; and (Satumba 2011: 37)
- "*A business is carried on if the activity is being repeated…if there is an intention to repeat the transaction, the parties would be carrying on a business"*. (Satumba 2011: 37)

Essentially the business purposes test looks at the manner or mean in which the avoidance arrangement was entered into and not that the avoidance arrangement was entered. It questions whether the means and/or way the avoidance arrangement was carried out or entered would not be considered as normal in the context of business. (Mvuyana 2014: 26)

Based on Mvuyana's notion above, it may be said that the business purpose test basically looks at the vehicle used to carry out that avoidance arrangement. The test zeros in on whether the vehicle used to carry out the avoidance arrangement in question was for bona fide business purposes or not.

The section includes the phrase "bona fide business purposes". The meaning of this phrase will need to be considered to establish what the legislator wanted to accomplish with the inclusion of the phrase. The term "bona fide" is not defined in the Income Tax Act. Satumba's report states that the following with regards to the term bona fide

- the term bona fide may be interpreted similar to how the phrase good faith is interpreted from a juridical perspective; and
- the phrase "means that a transaction must be real and not imaginary". (Satumba 2011: 36)

Sibisi's report supports Satumba's notion above and states the term bona fide means that "the transaction in question must be non-fictitious and not mythological". (Sibisi, 2016, 25)

As per "*ITC 1712*, 2000", the court held that:

> "the business purpose test includes comparing between transactions entered into or carried out and a hypothetical enquiry of how the transaction should have taken place". (Satumba 2011: 36)

**Lack of commercial substance test**

The phrase commercial substance is not explicitly defined in the Income Tax Act. Section 80C of the Income Tax Act does provide a general test of when an avoidance arrangement lacks commercial substance and characteristics that are indicitive that an avoidance arrangement lacks commercial substance. (Satumba 2011: 38)

Section 80C of the Income Tax Act reads as follows:

**80C. Lack of commercial substance.**— (Museka 2011: 44)

> (1) "For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part". (Museka 2011: 44)
>
> (2) "For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to—"
>
> > (*a*) "the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or" (Museka 2011: 44)
> >
> > (*b*) "the inclusion or presence of—"
> >
> > i. "round trip financing as described in section 80D; or"
> > ii. "an accommodating or tax indifferent party as described in section 80E; or"
> > iii. "elements that have the effect of offsetting or cancelling each other".
> >
> > (Museka 2011: 45)

Subsection 1 of section 80C may be referred to as the "presumptive test"and subsection 2 of section 80C may be referred to as the "indicative test". (Museka 2011: 45)

The presumptive test (subsection 1) seems relatively easy to understand and interpret. The avoidance arrangement in question is presumed to lack commercial substance if it results in a significant tax benefit and has no significant effect on the business risks or net cash flow of the taxpayers. (Sibisi 2016: 26)

The wording of the presumptive test above includes the words significant tax benefit and significant effect. The Income Tax Act does not provide a definition for the word significant nor does it provide guidance on how to determine when a tax benefit is considered to be significant. The absence of a definition or guidance may create difficulties in determining what makes a tax benefit significant (i.e. is the tax benefit significant if it has an effect on the business risk or net cash flow.. (Museka 2011: 45)

According to the document issued by SARS, an avoidance arrangement lack commercial substance where there is:

> (i). "A disproportionate relationship between the actual economic expenditure or loss incurred by a part and the value of the tax benefit that would have been obtained by that party but for the provisions of the GAAR; or"
>
> (ii). "A loss claimed for tax a purpose that significantly exceeds any measurable reduction in that party"s net worth". (SARS 2010: 26)

The above statement by SARS and subsection 1 create somewhat of a comparable relationship between the tax benefit and change in business risk or net cash flow.

The indicative test (subsection 2) also seems relatively easier to understand. The indicators provided are non-exhaustive and can be summaried as follows:

- "The legal substance of the arrangement differs from the form of the arrangement; or" (Benn 2013: 33)
- "The inclusion or presence of round trip financing (section 80D of the Income Tax Act); or" (Benn 2013: 33)
- "The inclusion or presence of an accommodating or tax indifferent party (section 80E of the Income Tax Act) or" (Benn 2013: 33)
- "The inclusion or presence of elements that have the effect of offsetting or cancelling each other". (Benn 2013: 33)

The indicators will be discussed below.

<u>The legal substance of the arrangement differs from the form of the arrangement</u>

The book, International Tax A South African Perspective notes that as per the "maxim plus valet quod agitur quam quod simulate concipitur rule" which means what is actually done is more important than that which seems to have been done rule, "the court will consider the legal substance of an agreement over the form the agreement takes". Agreements where the form of the agreement takes precedence over the substance are called sham or stimulated agreements. (Olivier & Honiball 2011: 514)

The terms legal substance may refer to the actual legal rights and obligations stemming from the avoidance arrangement. (Museka 2011: 48)

In "*Zandberg v Van Zyl*, 1910", the court said that,

> "Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose) the parties to a transaction endeavour to conceal its true character. They call it by a name or give it a shape, intended not to express but to disguise its true nature. And when a court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be… But the words of the rule indicate its limitations. The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same subject might have been attained in another way will not necessarily make the arrangement other than what it purports to be". (Olivier & Honiball, 2011: 514)

From the above, it may be said that when considering the legal substance of the arrangement, more regard must be had to the actual legal right (i.e., what is actually happening, what are the actual intentions of the parties in relation to the arrangement) than the form in which the arrangement takes. (Museka 2011: 48)

<u>The inclusion or presence of round trip financing</u>

"Section 80D of the Income Tax Act reads as follows:"

> **"80D. Round trip financing.**—"
>
> (1). "Round trip financing includes any avoidance arrangement in which— "(Museka 2011: 54)
>
> > (*a*)" funds are transferred between or among the parties (round tripped amounts); and" (Museka 2011: 54)
> >
> > (*b*) "the transfer of the funds would—" (Museka 2011: 54)
> >
> > > (i) "result, directly or indirectly, in a tax benefit but for the provisions of this Part; and" (Museka 2011: 54)
> > >
> > > (ii) "significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement". (Museka 2011: 54)
>
> (2). "This section applies to any round tripped amounts without regard to—"
>
> > (*a*) "whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement"; (Museka 2011: 54)
> >
> > (*b*) "the timing or sequence in which round tripped amounts are transferred or received; or" (Museka 2011: 54)
> >
> > (*c*) "the means by or manner in which round tripped amounts are transferred or received". (Museka 2011: 54)
>
> (3). "For the purposes of this section, the term "**funds"**includes any cash, cash equivalents or any right or obligation to receive or pay the same". (Museka 2011: 54)

Considering section 80D above, the section will find application where funds as defined are transferred between/among the parties and the transfer of such funds results in the signifcant reduction, elimination or offset of business risk or will result directly or indirectly in a tax benefit. (Museka 2011: 55)

The draft guide issued by SARS defines round trip financing as follows:

> "any situation involving circular cash or paper flows (such as cheques, promissory notes or wire transfers) that leave little real capital at risk and little or no net cash for investment or use in a party"s underlying business or investment activities" (SARS 2010: 30)

It is important to note that it is not just the transfer of funds that amounts to round trip financing but the transfer of funds that has a significant effect effect of business (i.e., indirectly or "directly result in a tax benefit or significantly reduce, eliminate, offset business risk incurred)". (Museka 2011: 55-56)

The explanatory memorandum issued by SARS notes that the provided description of round trip financing is non-exclusive and further notes the the concept of round trip financing is similar to Australia's "round robin financing" and the United States of America's "circular cash flows". (National Treasury 2006: 64)

<u>The inclusion or presence of an accommodating or tax indifferent party</u>

"Section 80E of the Income Tax Act reads as follows":

**80E.** "**Accommodating or tax-indifferent parties.**— "

(1) "A party to an avoidance arrangement is an accommodating or tax-indifferent party if—"

(*a*) "any amount derived by the party in connection with the avoidance arrangement is either -"

(i) "not subject to normal tax; or"

(ii) "significantly offset either by any expenditure or loss incurred by the party in connection with that avoidance arrangement or any assessed loss of that party; and" (Benn 2013: 33)

(*b*) "either—"

(i) "as a direct or indirect result of the participation of that party an amount that would have—"

(*aa*) "been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts or accruals of a capital nature of that party; or"

(*bb*) "constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party; or"

(*cc*) "constituted revenue in the hands of another party would be treated as capital by that other party; or"

(*dd*) "given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or" (Benn 2013: 33)

(ii) "the participation of that party directly or indirectly involves a prepayment by any other party".(Benn 2013: 33)

(2) "A person may be an accommodating or tax-indifferent party whether or not that person is a connected person in relation to any party". (Benn 2013: 33)

(3) "The provisions of this section do not apply if either—"

(*a*) "the amounts derived by the party in question are cumulatively subject to income tax by one or more spheres of government of countries other than the Republic which is equal to at least two-thirds of the amount of normal tax which would have been payable in connection with those amounts had they been subject to tax under this Act; or"

(*b*) "the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months: Provided these activities must be attributable to a place of business, place, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment as defined in section 9D (1) if it were located outside the Republic and the party in question were a controlled foreign company". (Benn 2013: 33)

> (4) "For the purposes of subsection (3)(*a*), the amount of tax imposed by another country must be determined after taking into account any applicable agreements for the prevention of double taxation and any assessed loss, credit or rebate to which the party in question may be entitled or any other right of recovery to which that party or any connected person in relation to that party may be entitled". (Benn 2013: 33)

This section provides a description of an accommodating or tax indifferent party. Subsection 2 above states that the parties to an arrangement may or may not be connected in relation to each other and includes exceptions. (Museka 2011: 59)

The explanatory memorandum summarises subsection 1 and subsection 2 as follows:

> "The provisions in subsections (1) are widely drawn to cover as wide a range of possible mechanisms for achieving this status, while subsection (2) focuses upon the ways in which these parties are typically used in impermissible avoidance arrangements in order to refine the scope of the section. In addition, two safe harbours are provided". (National Treasury 2006: 64)

Subsection 3 of section 80E may be summarised as follows:

- The amounts derived is subject to income tax in any other country/countries other than the South Africa
    - "This exception relates to where the amount of income tax paid in any other country/jurisdiction other than South Africa amounts to atleast two thirds of the normal tax that would have been payable in terms of the South African Income Tax Act". (National Treasury 2006: 64)
- The party continues to engage directly in substantive active trading activities
    - "This exception basically states that the accommodating or tax indifferent party will not be an accommodating or tax indifferent party if the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months provided the trade activities are attributable to a substantial business establishment located in South Africa or elsewere". (National Treasury 2006: 64)

The Income Tax Act and explanatory memorandum do not provide a definition or guidance on what substantive active trading activities are. (Museka 2011: 60)

As per the explanatory memorandum, section 80F of the Income Tax Act grants the Commissioner the power to

> "…combine connected persons and disregard an accommodating or tax indifferent party or combine it with another party for the purposes of determining whether an avoidance arrangement lacks commercial substance or whether a tax benefit exists". (National Treasury 2006: 65)

The inclusion or presence of elements that have the effect of offsetting or cancelling each other

The Income Tax Act does not provide clear guidance regarding this inclusion nor does it provide a list of transctions or elements that offset or cancel each other. (Museka 2011: 61)

The explanatory memorandum does however state the following:

> "This indicator draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called "fiscal nullity" doctrine. It is targeted primarily at complex schemes, typically involving complex financial derivatives, that seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another leg effectively neutralises the first leg for non-tax purposes". (National Treasury 2006: 64)

From the above, it seems that the inclusion of this indicator is specifically to target complex schemes entered into for the purpose of avoiding tax. (Museka 2011: 61)

**In a context other than business**

The section makes reference to "in the context other than business". This means that "an avoidance arrangement is an impermissible avoidance arrangement where the sole or main purpose of the arrangement was to obtain the tax benefit and in the context other than business was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit". Of importance is the legislature's use of the phrase bona fide. (Museka 2011: 63)

As discussed above, the term bona fide means that the transaction in question must be non-fictitious and not mythological. (Museka 2011: 63)

**In any context**

Upon reading subsection (c), it seems that this part is wider in nature and acts as a "catch all net" where subsections (a) and (b) cannot find application from a context perspective. (Satumba 2011: 53)

The South African Tax guide website said that this subsection is pivotal to the functionality of section 80A and can be described as the "heart of section 80A". (Musviba n.d.)

With regards to the subparagraph (i) of section 80A (c) of the Income Tax Act, the "*Hicklin v Secretary for Inland Revenue*, 1980" case is considered to determine the meaning of "dealing at arms length". The Hicklin case stated the following:

> "…in an arm's length transaction/agreement, each party was independent of each other and would strive to get the uttermost possible advantage out of the transaction for themselves. The rights and obligations that are created are most likely to be regarded as normal as would the manner and means employed also be regarded as normal". (Sibisi 2016: 26)

The above case highlights the independent status of the parties to the arrangement. The parties to the arrangement must be independent of each other and such arrangement must not create rights or obligations not normally created by parties who are independent of each other. The court highlights that the rights and obligations created in an arrangement where the parties are independent of each are mostly likely to be considered as normal. (Museka 2011: 65)

Arm's length may be interpreted to mean "what would unconnected persons have done in the same situation". (Pidduck 2020: 37)

Subparagraph (ii) of section 80A (c) of the Income Tax Act relates to the misuse or abuse of the provisions of the Income Tax Act. The Income Tax Act and the explanatory memorandum do not provide guidance or definitions for the terms misuse and abuse. The explanatory memorandum does however mention that the inclusion of the element was "inspired by the Canadian and other European countries approaches to impermissible tax avoidance". (National Treasury 2006: 63)

"The misuse or abuse requirement in found under section 245 of the Canadian Federal Income Tax Act". (Canadian Income Tax Act). (ITR Correspondent 2014)

"Section 245(4) of the Canadian Income Tax Act provides the starting point for determining the difference between legitimate tax planning and abusive tax avoidance". (van Schalkwyk & Geldenhuys 2009)

"Section 245(4) reads as follows":

> "… (4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction
>
> (a)would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
>
> (i) this Act …" (Canadian Government 2021)

The discussion paper issued by SARS notes that

> …a transaction is considered to be an "abusive transaction" if that transaction would result directly or indirectly in a misuse of the provisions of the Canadian Income Tax Act or an abuse having regard to the provisions of the Canadian Income Tax Act, other than [section 245], read as a whole.

and states that "… identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated…". (SARS 2005: 31)

Where an avoidance arrangement has been entered into by a taxpayer solely or mainly for the tax benefit and such an avoidance arrangement is an impermissible avoidance arrangement where the said avoidance arrangement includes a tainted element (i.e. presumed to lack commercial substance etc.).

Section 80B provides the Commissioner with discretionary powers to determine the tax consequence of the impermissible avoidance arrangement. The tax consequences provided in section 80B are as follows:

> **"80B. Tax consequences of impermissible tax avoidance.** — "SAICA, February 2010.
>
> (1). "The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by— "SAICA, February 2010.
>
> > (*a*) "disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement "; SAICA, February 2010.
> >
> > (*b*) "disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person "; SAICA, February 2010.
> >
> > (*c*) "deeming persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount "; SAICA, February 2010.
> >
> > (*d*) "reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties "; SAICA, February 2010.
> >
> > (*e*) "re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or" SAICA, February 2010.
> >
> > (*f*) "treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit". SAICA, February 2010.
>
> (2) "Subject to the time limits imposed by sections 99, 100 and 104 (5) (*b*) of the Tax Administration Act, the Commissioner must make compensating adjustments that he or she is satisfied are necessary and appropriate to ensure the consistent treatment of all parties to the impermissible avoidance arrangement". SAICA, February 2010.

Section 80I also provides the Commissioner with discretionary powers to apply the general anti-avoidance rules "as an alternative basis for raising an assessment". (National Treasury 2006: 65)

Section 80J requires that the Commissioner must give notice, with reasons, of an intention to invoke the general anti-avoidance rules and provides the taxpayer with generally 60 days to respond (i.e., request an extension of the 60 days or submit the requested reasons) with reasons why the Commissioner should not invoke the general anti-avoidance rules. The Commissioner has 180 days to respond (i.e. request further information or give notice of withdrawing the intention to invoke the general anti-avoidance rules or determine the tax liability applicable). Where further information comes to the knowledge of the Commissioner, the Commissioner may revise or modify the reasons for applying the general anti-avoidance rules and where the notice issued is withdrawn, the Commissioner must provide notice of the withdrawal. (National Treasury 2006: 65)

Section 80K was included to carry over the provisions that "provide that interest may not be waived in terms of section 89quat (3) or (3A) if the general anti-avoidance rules have been invoked." (National Treasury 2006: 66)

**Conclusion**

In this chapter, we looked at the various requirements of the current general anti-avoidance rules as provided in sections 80A-80L of the Income Tax Act. The first requirement that must be met is the arrangement or scheme requirement. The term arrangement is defined in the Income Tax Act and essentially includes just about all forms of arrangements. (Satumba 2011:21)

Various court cases have defined the term arrangement. It is important to note that an arrangement includes all the steps applicable or parts of the arrangement. (Benn 2013: 21)

The second requirement is whether there is a tax benefit applicable and where such arrangement was entered into solely of mainly for the tax benefit. Tax benefit is defined in the Income Tax Act and includes any advantageous change (avoidance, postponement or reduction) to a tax liability.

The existence of a tax benefit does not necessarily satisfy the requirement. The arrangement would need to be entered into solely or mainly for the tax benefit. Much was said about the inclusion of the phrase solely or mainly (i.e., the main purpose must obviously be dominant, mainly speaks to a measure of more than 50%.). An arrangement satisfies this requirement if such arrangement was entered into only for the tax benefit applicable or the dominant reason for entering into the arrangement is to obtain the tax benefit (where there are multiple reasons for the arrangement). Thus far, if an arrangement satisfies all the requirements, it is considered to be an avoidance arrangement as per National Treasury's equation. An avoidance arrangement becomes an impermissible avoidance arrangement when it includes a tainted element/s. Various tainted elements are discussed in paragraphs a, b and c of section 80A of the Income Tax Act.

Once it is determined that the avoidance arrangement includes a tainted element/s it is an impermissible avoidance arrangement and section 80B of the Income Tax Act provides the Commissioner with powers to determine the applicable consequence.

# Chapter 4: A comparison between the Australian and South African general Anti-avoidance rules.

**Introduction**

A report authored by Bauer and published by North-West University states that there are "similarities between the South African and Australian general anti-avoidance rules". The report further notes that although the general anti-avoidance rules applicable in each country are designed differently, both pieces of legislation are aimed at common goal. (Bauer 2018: 2)

This chapter details the comparison between the General Anti-avoidance Rule as envisaged in the Income Tax Act 58 of 1962 and the General Anti-avoidance rules as envisaged in the Australian legislation.

The general anti-avoidance rules in South Africa and Australia are said to have similar characteristics and requirements that must be met before an arrangement is considered an avoidance arrangement. (Satumba 2011: 60)

To avoid a repetition of information, please refer to chapter 2 of this report for the discussion on the South African general anti-avoidance rules as envisaged in section 80A-80L of the Income Tax Act.

**Australian general anti-avoidance rules**

The Australian Tax Authority's website boasts of being "among the few countries to have the benefit of general anti-avoidance measures" and having a "robust income tax general anti-avoidance rule". (Australian Government 2021)

It is noted on the Australian Tax Authority's website that the general anti avoidance rules are

> "a last resort measure used to protect the integrity of the tax system". The general anti avoidance measures provide assurance of the failure of "blatant, artificial or contrived arrangements to obtain tax benefits". (Australian Government 2021)

The Australian general anti-avoidance measures apply where a taxpayer enters a scheme for the sole or dominant purpose of obtaining a tax benefit. In order to determine whether a tax benefit exists, the facts and circumstances of each case are objectively considered as well as the tax position of the taxpayer under the scheme. "The taxpayer's position under the scheme is then compared to the tax position that would arise, or may reasonably be expected, if they had not entered into the scheme". (Australian Government 2021)

The website further notes that in previous years, there have been "some Full Federal Court of Australia cases that revealed a weakness in the capacity of the general anti-avoidance rules to determine a tax advantage gained from an arrangement". (Australian Government 2021)

It is stated on the website that in several cases,

> "the Australian courts found that a taxpayer would have abandoned its commercial project altogether if it could not avoid the tax on it – so there was no tax benefit."

These cases have demonstrated that there is a gap in the general anti-avoidance ability to address "arrangements that, when objectively viewed and considered, have been carried out with a relevant tax avoidance purpose". As a result of this identified gap and to strengthen the measures, the Australian general anti-avoidance measures were amended in 2013. (Australian Government 2021)

Following the amendment, the tax benefit component is determined using one of two ways: (i) the annihilation approach, and (ii) the reconstruction approach. The website notes the following regarding the annihilation approach and the reconstruction approach:

> The annihilation approach simply ignores the steps that comprise the scheme. The reconstruction approach provides the ability to reconstruct a transaction rather than erase it. It compares the tax consequences of the scheme with those of an alternative reasonably capable of achieving the same tax results and consequences as those achieved by the scheme.

(Australian Government 2021)

The Australian general anti-avoidance measures have three distinct requirements namely:

i. "There must be a scheme"; (Pidduck 2020: 10)
ii. "A tax benefit must be derived from the scheme; and" (Pidduck 2020: 10)
iii. "The scheme must have been entered into for the sole or dominant purpose of obtaining the tax benefit. (Pidduck 2020: 10)

The abovementioned requirements are also noted in a report published by the North-West University. (Bauer 2018: 16)

Section 177D of the Australian Income Tax Assessment Act 1936 (Australian Income Tax Act) provides that the anti-avoidance measures apply to a "scheme for purpose of obtaining a tax benefit".

"Section 177D(1) reads as follows:

> "This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of": (The Australian Government 2010)
>
> a) "enabling a taxpayer (a relevant taxpayer) to obtain a tax benefit in connection with the scheme; or"

b) “enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit in connection with the scheme“; (The Australian Government 2010)

“whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers“. (The Australian Government 2010)

The Australian Income Tax Act defines the following words:

- Scheme;
- Person; and
- Taxpayer.

The term “scheme” is defined in section 102AAB of the Australian Income Tax Act as follows:

***"scheme"** means:*

a) “any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and“ (The Australian Government 2010)
b) “any scheme, plan, proposal, action, course of action or course of conduct, whether there are 2 or more parties or only one party involved“. (The Australian Government 2010)

The term “person” is defined in section 202A of the Australian Income Tax Act as follows:

“**"person" “**includes a partnership, a company and a person in the capacity of trustee of a trust estate”. (The Australian Government 2010)

The term “taxpayer” is defined in section 177A of Australian Income Tax Act as follows:

“**"taxpayer"** “includes a taxpayer in the capacity of a trustee”. (The Australian Government 2010)

<u>There must be a scheme</u>

In addition to the provided definition of scheme (see above), the court case “*FCT v Peabody*, 1994“ provides a further definition of the term scheme by introducing a requirement that the “facts that constitute the alleged scheme must be capable of standing on their own without being robbed of all practical meaning”. (Satumba 2011: 64) It should be noted that as a result of this added requirement, “the narrower the factual arrangement that is the purported scheme, the less likely it will be capable of standing on its own within the High Court’s test”. (Satumba 2011: 64)

The following was said regarding the added requirement:

> "This is a major limitation to the application of Part IV because the narrower the formulation of the scheme, the more likely that factual scenario will also satisfy the other elements of Part IVA". (Satumba 2011: 64)

In determining whether a transaction entered into is a scheme as defined, the facts and circumstances must be considered on a case-by-case basis. The characteristics of the transaction entered into, the connection between surrounding events of the transaction and the apparent rationale must be considered. (Satumba 2011: 65)

The report published by the University of Pretoria notes the following regarding what was said by Cooper J in the court case *Spotless Services Ltd v FCT*, 1995 with regards to the definition of scheme:

> "… requires that the parties to the scheme, insofar as they are known, must be identified and the terms or content of any agreement, arrangement, understanding, promise or undertaking and the steps or stages of any course of action or proposal insofar as they are relevant, be identified. In addition, the courts held that all the relevant facts had to be included in the relevant formulation before the factual scenario could be said to be capable of standing on its own and thus constituting a scheme ". (Satumba 2011: 65)

Following what was said in the court case *Spotless Services Ltd v FCT,* the counsel in the case of "*Hart v FCT*, 2004" had different opinions regarding the "capable of standing on its own test" established in the *FCT v Peabody* court case (see above). The counsel said that

> "a broad formulation of the scheme, including all the facts, had to be adopted for the application of Part IVA". (Satumba 2011: 66)

Counsel also said that it was inappropriate to "exclude the fact of borrowing from the putative scheme".

The other opinion given by counsel regarding the "capable of standing on its own test" was that the Comissioner could not

> "… seize upon and isolate one event, or a series of events, which, standing alone may appear to have a complexion which it or they cannot truly bear when other relevant connected events are taken, as they should be, into account".

Still with the *Hart v FCT* case, counsel did not agree with the suggestion that

> "the reference to circumstances being robbed of all practical meaning was a criterion for the application of Part IVA, asserting that it finds no support in the statutory language of Part IVA". (Satumba 2011: 66)

Considering the above, it may be deducted that the term scheme is wide enough to include all forms of transactions, agreements, understandings promises etc. whether these are enforceable or not. It seems that the various court cases have different views and opinions regarding the "capable of standing on their own without being robbed of all practical meaning" requirement established in the *FCT v Peabody* case. This has created a grey area for the courts. (Satumba, 2011: 66)

A tax benefit must be derived from the scheme.

In introducing the tax benefit requirement of the general anti-avoidance legislation in their report, Satumba acknowleges that the existence of a

> "...definition of tax benefit reflects an appreciation that tax benefits stem not only from the non-declaring of assessable income or manufacturing of deductions, but also making use of any concessions that might be provided under the legislative tax framework". (Satumba 2011: 71)

Section 177C (1) (a)-(bd) of the Australian Income Tax Act states the following regarding a tax benefit:

> (a) "an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out; or"(*Australian Government 2010)*
>
> (b) "a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out; or"(*Australian Government 2010)*
>
> (ba) "a capital loss being incurred by the taxpayer during a year of income where the whole or a part of that capital loss would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out; or "(*Australian Government 2010)*
>
> (baa) "a loss carry back tax offset being allowable to the taxpayer where the whole or a part of that loss carry back tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or"(*Australian Government 2010)*
>
> (bb) "a foreign income tax offset being allowable to the taxpayer where the whole or a part of that foreign income tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or"(*Australian Government 2010)*
>
> (bbaa) "an innovation tax offset being allowable to the taxpayer where the whole or a part of that innovation tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or" *(Australian Government 2010)*
>
> (bba) "an exploration credit being issued to the taxpayer where the whole or a part of that exploration credit would not have been issued, or might reasonably be expected not to have been issued, to the taxpayer if the scheme had not been entered into or carried out; or" *(Australian Government 2010)*
>
> (bc) "the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out; or"(*Australian Government 2010)*

> (bd) “a refundable R&D tax offset, or a non-refundable R&D tax offset, being allowable to the taxpayer in relation to a year of income where the whole or a part of the offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out“. (Australian Government 2010)

The Australian Income Tax Act requires that there must be a nexus between the scheme under consideration and the alleged tax benefit and that the wording “would not have been or might reasonably be expected not to have been” is used to emphasis this nexus. (Satumba 2011: 72)

It was held by the “Full Court of the Federal Court and the High Court “in the case of *Peabody v FCT*, 1994“ that

> “…section 177C(1)(a) requires a reasonable probability, not a mere possibility, that the taxpayer would have derived the income, but for the scheme”.

It is quite interesting that the courts refer to “reasonable probability” and not just “possibility”. This means that the prediction of the occurance or non-occurance of the events must be reliably sufficient to be considered as reasonable. (Satumba 2011: 73)

In summary, section 177C (1) requires that there must be a causal link between the scheme under consideration and the tax benefit arising from the scheme.

<u>The scheme must have been entered into for the sole or dominant purpose of obtaining the tax benefit.</u>

It is quite interesting to note that the requirement is that the scheme must have been entered into for the **sole or dominant** purpose of obtaining the tax benefit. This requirement and section 177A (5) of the Australian Income Tax Act acknowledge that a scheme may have been entered into for various purposes where the dominant purpose of the scheme was to enable the taxpayer to obtain the tax benefit. It must be noted that the courts in Australia have held that the dominant purpose is the “most influential and prevailing or ruling purpose”. (Satumba 2011: 74)

Section 177D (b) of the Australian Income Tax Act provides a list of the eight criteria to be applied to test whether the sole or dominant purpose of a scheme was to obtain a particular tax benefit. (Bauer 2018: 14)

Section 177D (2) reads as follows:

a) “the manner in which the scheme was entered into or carried out“; *(Australian Government 2010)*
b) “the form and substance of the scheme“; *(Australian Government 2010)*
c) “the time at which the scheme was entered into and the length of the period during which the scheme was carried out“; *(Australian Government 2010)*

d) "the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme"; *(Australian Government 2010)*

e) "any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme"; *(Australian Government 2010)*

f) "any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme"; *(Australian Government 2010)*

g) "any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out"; *(Australian Government 2010)*

h) "the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f) ". (Australian Government 2010)

Bauer's report states that the test determining whether the sole or dominant purpose of the scheme was to obtain the tax benefit is objective in nature considering the eight criteria list above. The ipse dixit of the taxpayer (i.e. the taxpayers view) are subjective and will only be taken into account in support of the objective evidence presented. (Bauer 2018: 14)

The court in "*FCT v Spotless Services Ltd*, 1996" stated that

> "… the conclusion to be drawn under s 177D depends upon objective facts, and is not concerned with subjective motivation. The conclusion must relate to the dominant purpose of a person who either entered into or carried out the scheme or a part of it".

One of the reasons given for making section 177D depend upon the objective factors listed in the section "*was to avoid the consequence that the operation of Part IVA depends upon the fiscal awareness of a taxpayer"*. (CT v Consolidated Press Holdings Ltd, 2001)

**Conclusion**

In summary, in order to determine whether a scheme was entered into for the sole or dominant purpose of obtaining the tax benefit, the courts will objectively consider the eight requirements listed in section 177D. It is possible for the courts to either not consider the subjective factors (i.e. facts and circumstances provided by the taxpayer) or consider the subjective factors only if they support the objective factors.

Much like the South African general anti-avoidance rules, the Australian general anti-avoidance rules are reliant upon three elements namely:

- "There must be a scheme";
- "A tax benefit must be derived from the scheme; and"
- "The scheme must have been entered into for the sole or dominant purpose of obtaining the tax benefit".

Portions of these elements are defined in the Income Tax Acts applicable to each country and where no definition exists, the various court cases provide guidance on the interpretation of the various terms/phrases. The Australian general anti-avoidance rules use the word scheme whereas the South Africa general anti-avoidance rules use the word arrangement. (Satumba 2011: 63)

The terms scheme and arrangement in the Income Tax Acts of both countries (i.e. South Africa and Australia) are defined and are wide enough to include all forms of transactions, schemes, arrangements, agreements etc. whether these are enforceable or not. It is important to note that both pieces of legislation include the "whether enforceable or not" requirement. Both the South African general anti-avoidance legislation and the Australian anti-avoidance legislation acknowledge that it is possible to apply the general anti-avoidance rules to either the whole arrangement or scheme or to a part/parts of the arrangement or scheme. (Satumba 2011: 65)

Both the South African general anti-avoidance rules and the Australian general anti-avoidance rules have a tax benefit requirement. (Bauer 2018: 53)

The Australian legislation provides a list of what it considers to be a tax benefit for the purposes of its general anti-avoidance rules whereas the South African legislation provides a definition of the phrase tax benefit for the purposes of its general anti-avoidance rules. Bearing in mind that the Australian legislation provides a list of the tax benefits as opposed to the South African legislation that provides a definition of the phrase tax benefit, it may be concluded that the South African legislation is relatively wider in scope than its Australian counterpart as the South African legislation is not confined to the boundaries of a list of tax benefits. (Satumba 2011: 72)

Both the South African and Australian legislation have a "more than 50%" requirement with regards to the purpose of obtaining the tax benefit requirement. The South African and Australian pieces of legislation word this requirement differently. The South African legislation speaks of the arrangement being entered into solely or mainly for the purpose of obtaining the tax benefit and the Australian legislation speaks of the scheme being entered into for the sole or dominant purpose of obtaining the tax benefit. (Bauer 2018: 53)

Both pieces of legislation include guidance on how to determine the purpose of the arrangement/scheme. The guidance provided in each respective piece of legislation is worded differently. The Australian general anti-avoidance rules provide the eight criteria that is to be considered when determining the purpose of a scheme and the South African general anti-avoidance rules refers to tainted elements. It may be said that the provisions pertaining to the determination of purpose is the most significant difference between the two jurisdictions. (Bauer 2018: 53 – 54)

## Chapter 5: Conclusion

The following question was posed at the start of the research report:

What are and were the general anti-avoidance rules as envisaged in the Income Tax Act, 58 of 1962 and how do they compare to the Australian general anti-avoidance rules?

This report attempts to answer the research question by looking at the reason various aspects of the general avoidance rules as envisaged in the Income Tax Act. It was noted that general anti-avoidance rules exist to protect a country's fiscus or tax base against aggressive structures entered by taxpayers in order for the avoidance, postpone or reduce a tax liability. It is important to note the use of the word aggressive structures and not just structures which implies that the anti-avoidance rules are not applicable to all structures but to specific structures that meet the requirements as envisaged in the various general anti-avoidance rules applicable to various countries around the world. This follows the principle established in the *Inland Revenue Commissioners v Duke of Westminster*, 1936 case which basically says that everyone has the right to order their tax affairs in such a way that attachs less tax than would otherwise would have been attached. SARS acknowledged the principle established in the *Inland Revenue Commissioners v. Duke of Westminster* case in its discussion paper. SARS essentially stated that "the taxpayer"s right to minimise their liabilities within the bounds of the law is not to be denied…". (SARS 2005: 15)

Organising one's tax affairs in order to reduce, avoid or postpone a tax liability within the bounds of the law and outside of the bounds of the law is the difference between tax avoidance/tax planning and tax evasion. The various sources considered in providing a meaning for the terms tax avoidance, tax evasion and tax planning all agree that the difference between tax avoidance/tax planning and tax evasion is that two are legal (i.e., tax avoidance/tax planning) and within the bounds of the law and one is illegal (i.e., tax evasion) and outside the bounds of the law.

The South African legislation first introduced the general anti-avoidance rules in section 90 of the old Income Tax Act 31 of 1941 which was repealed and replaced by section 103(1) of the Income Tax Act, 58 of 1962. Following some difficulties, section 103(1) was also repealed and replaced with the current sections 80A – 80L. SARS issued a discussion paper in which it laid out the reasons for the amending and repealing section 103(1) and replacing it with sections 80A – 80L of in the Income Tax Act. SARS noted that the general anti-avoidance rules as envisaged in section 103(1) of the Income Tax Act "has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance…" and that there has been uncertainty regarding the application of the general anti-avoidance rules "due to conflicting court decisions…". (National Treasury 2006)

Regardless of the fact that the legislator has repealed section 103(1) of the Income Tax Act and replaced with sections 80A to 80L, some established elements and principles have been carried forward to the current general anti-avoidance rules.

Section 80A of the Income Tax Act states that an avoidance arrangement which is an arrangement that results in a tax benefit becomes an impermissible avoidance arrangement where the sole or main purpose of entering into such an arrangement was to obtain the tax benefit in question and includes a tainted element/elements. The various tainted elements are discussed in sub-chapter 3.3 above. Where it has been proven that a taxpayer/taxpayers have entered into a transaction for the sole purpose of obtaining the tax benefit and such arrangement lacks commercial substance, section 80B of the Income Tax Act provides the Commissioner with discretionary powers to determine the tax consequence applicable to the impermissible avoidance arrangement entered into. Section 80I and section 80J provide guidance to both the Commissioner and the taxpayer on what to do from an administrative perspective (i.e. the issuing of notices, the period applicable etc.).

Tax avoidance is not just a South African phenomenon but a phenomenon that also occurs on an international scale. This has led many other countries around the world to put in place measures that will as previously stated, protect a country's fiscus or tax base against aggressive structures entered into by taxpayers in order to avoidance, postpone or reduce a tax liability. (Benn 2013: 5)

Australia is one of those countries that have adopted amongst others, a general anti-avoidance regime in order to mitigate the risk of tax avoidance. Chapter 4 above discusses the Australian general anti-avoidance rules and how they compare to the South African general anti-avoidance rules. There are identified differences and similarities between the South African and Australian pieces of legislation. Much like the South African general anti-avoidance rules, the Australian general anti-avoidance rules are built upon fundamental elements that are required to be present in order for the general anti-avoidance rules to be invoked. (Bauer 2018: 2)

The Australian general anti-avoidance rules also rely on the interpretation of the courts of the various terms similar to its South Africa counterpart. (Bauer 2018: 3)

The general anti-avoidance rules have been a part of the South African legislation for many years and have seen several amendments, repeals, introductions and substitutions. The amendments made to the general anti-avoidance rules are necessitated by the ever changing and evolving world we live in today. Taxpayers are constantly looking for complex ways to minimise the tax liability applicable whether within or outside the boundaries of the law.

It would not be a fair conclusion to say that the general anti-avoidance rules are completely redundant or ineffective. Rutendo concluded in their report that the general anti-avoidance rules on their own "do not provide a solution" and that "no jurisdiction has yet found a perfect solution". (Satumba 2011: 92-93)

Despite the fact that the general anti avoidance rules are not perfect, jurisdictions that have introduced the general anti-avoidance have not shown signs or indicated the need to completely do away with the regime but rather continue to introduce new and stronger versions of the general anti avoidance rules. (Museka 2011: 82) There are complexities to the general anti-avoidance rules and such rules are "difficult to apply" however the "legislature should provide further clarity to ensure tax compliance by taxpayers. (Museka 2011: 83)

Considering the conclusions above, it is safe to say that although the general anti-avoidance rules are not perfect and do not provide a clear solution, they do however provide some level of mitigation against adverse tax structures that seek to erode the integrity of the fiscus/tax base by placing the onus of proof onto the taxpayer to prove irrefutable evidence that an avoidance arrangement is not an impermissible avoidance arrangement to which the section 80B tax consequences are applicable. The legislature should continue to use the general anti-avoidance rules and provide further clarity and possible definitions. (Museka 2011: 83)

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