SCHOOL OF ACCOUNTANCY

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A comparison of the application of the provisions in s 80A-80L with those of s 103(1) of the Income Tax Act 58 of 1962

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Abstract

Tax avoidance is a key international tax issue. Combating tax avoidance has been placed high on the agenda by the South African Revenue Service (SARS) and other tax authorities in the world. This research report will examine how the judgments of certain South African cases would have been different if the anti-avoidance provisions in sections 80A to 80L were applied instead of those in section 103(1).

Keywords: Anti-avoidance provisions, General anti-avoidance rule, Judgments, South African cases, South African Revenue Service, Tax authorities, Tax avoidance, Tax benefits, Tax evasion, Tax planning

Declaration

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

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Suk-Ching Ho

_____ day of _____, 2013

Dedication

To my parents, my husband and my children

with sincere thanks

for their love and encouragement

during the writing of this research report.

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1. INTRODUCTION

1.1. Background and motivation

Tax avoidance has been a challenge to most tax authorities in both developed and developing countries. To combat tax avoidance, tax authorities have included general anti-avoidance rules, specific anti-avoidance rules, and reporting procedures in the tax acts which they administered.

While tax avoidance is an activity that is legal, it is often referred to in words that reflect the negative view taken of it by tax authorities in different countries. Tax avoidance is referred to differently in different countries. In Australia, it is often referred to as 'aggressive tax planning' particularly by the Australian Tax Office (ATO). In South Africa, it is referred to as 'impermissible or abusive tax avoidance'. In New Zealand and the United Kingdom (UK), it is referred to as 'unacceptable tax avoidance' (Evans, 2006:1).

The meanings of the terms tax evasion and tax avoidance are different. The difference is explained by Haupt (2013:493) as follows:

> 'Tax evasion is the use of illegal means to reduce a tax liability'

which includes

> 'falsification of books, suppression of income, fraudulent non-disclosure of income, overstatement of deductions'.
>
> 'Tax avoidance is an attempt to minimise a tax liability using legal means'

and it includes regulating one's affairs in such a way that one pays

> 'the minimum tax imposed by the Income Tax Act 58 of 1962 (the Act) rather than the maximum' (Haupt, 2013:493).

The distinction between tax avoidance and tax evasion is that tax avoidance is legal, while tax evasion is not. Tax evasion constitutes a criminal offence in terms of section 235 of the Tax Administration Act No. 28 of 2011 (the Tax Administration Act). If a person is guilty of tax evasion, he or she is subject to a fine or imprisonment for a period not exceeding 5 years. In addition, a person may be subject to interest in terms of section 89*quat* of the Income Tax Act No. 58 of 1962 (the Act) and penalties in terms of section 210 and 213 of the Tax Administration Act. On the other hand, the Commissioner requires statutory provisions such as sections 80A to 80L as protection against tax avoidance.

The distinction between tax avoidance and tax mitigation or tax planning is generally recognised as not being as clear as the distinction between tax avoidance and tax evasion. The distinction between tax avoidance and tax mitigation was discussed in the *IRC v Willoughby* [1997] STC 995, [1997] 1 WLR 1071, [1997] 4 All ER 65, 70 TC 57 case, where Lord Nolan stated (at 73) that the hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability.

> 'The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option' (IMF, 2003:275).

Therefore, tax mitigation is concerned with the organisation of a taxpayer's affairs or the structuring of transactions, so that they give rise to the minimum tax liability within the law without resort to impermissible tax avoidance.

From SARS's point of view, tax avoidance has many negative impacts on society. These negative impacts of tax avoidance include the

> 'corrosive effect upon taxpayer compliance, the uneconomic allocation of resources, upward pressure on marginal tax rates, an unfair redistribution of

> the tax burden, and a weakening of the ability of Parliament and the National Treasury to set and implement economic policy' (SARS, 2005:1).

During the year 2006, the Act was amended to enable SARS to more effectively combat tax avoidance in South Africa by repealing section 103(1), the general anti-avoidance provision at the time and introducing the general anti-avoidance rule (GAAR). The GAAR is contained in the provisions in sections 80A to 80L of the Act and specifically applies to impermissible avoidance arrangements as defined in section 80A.

Section 103(1) was repealed as SARS viewed it as ineffective and inconsistent in combating complex tax avoidance structures as was evident from the judgements of certain cases that were held in favour of the taxpayers.

The 'Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962' ('Discussion Paper') discussed section 103(1) of the Act which was repealed as it

> '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. These products typically involve the use of circular or offsetting flows of cash and property, special purpose entities or other accommodating parties, and complex financial instruments such as derivatives. The tremendous flexibility of derivatives, together with the ease with which they may be combined with, or substituted for, other financial instruments or arrangements, made it extraordinarily difficult to combat these products through specific anti-avoidance legislation' (SARS, 2005:1).

1.2. The statement of the problem

This research will examine how the judgments of certain South African cases would have been different if the anti-avoidance provisions in sections 80A to 80L were applied instead of those in section 103(1).

1.3. Sub-problems

The first sub-problem is to elucidate the difference between tax evasion and tax avoidance; and the difference between tax mitigation and tax avoidance.

The second sub-problem is to examine what were the provisions of section 103(1) and why it was ineffective.

The third sub-problem is how the provisions that have been included in sections 80A to 80L may assist in countering tax avoidance structures.

The fourth sub-problem is to examine how the judgments in certain South African cases would be different if sections 80A to 80L of the Act were applied instead of section 103(1).

1.4. Research methodology and scope

1.4.1. Research methodology

A qualitative approach will be used in this research report. The second and third sub-problems will be answered by examining the provisions of section 103(1) and sections 80A to 80L of the Act in detail and how the provisions that have been included in sections 80A to 80L may assist in countering tax avoidance structures by reviewing journal articles, government publications and legislation. The fourth sub-problem will be answered by examining the issues raised and the interpretations made by the South African courts in certain cases by reviewing the judgments. The cases chosen for the examination includes those where key issues in the interpretation of the provisions of section 103(1) were considered. These cases were heard during the period 1971 to 2000. Further, the report will discuss whether the judgments would have been different if sections 80A to 80L were applied to these cases.

1.4.2. Scope and limitations

The tax legislation examined in this research report is that levied under sections 80A to 80L and section 103(1) of the Act, as amended up to and including the Taxation Laws Amendment Act, 22 of 2012.

2. THE DISTINCTION BETWEEN TAX EVASION AND TAX AVOIDANCE

2.1. Introduction

This chapter discusses the difference between tax evasion and tax avoidance; and the difference between tax avoidance and tax planning or tax mitigation. The objectives of tax avoidance, the problems created by the tax avoidance structures for society, the characteristics of tax avoidance structures and the risks faced by the participants in tax avoidance structures are discussed briefly.

2.2. Difference between tax evasion and tax avoidance

The terms tax avoidance and tax evasion are not defined in the Act. Therefore, the meaning and the difference between the terms are based on the interpretation of certain Judges and SARS.

In *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] 2 All ER 275 case, Lord Goff stated his view of tax avoidance and said

> 'unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed' (at 295).

Tax avoidance is lawful unless proscribed by the Act and tax evasion is unlawful. This is explained by De Koker and Williams (2012:19-1) as follows:

> '"Tax avoidance" connotes stratagems which are *prima facie* lawful, that is to say, which are lawful unless proscribed by the Act. By contrast, "tax evasion" connotes inherently unlawful methods, such as incorrect statements in income tax returns (such as the non-disclosure of income or the exaggeration of expenditure claimed as a deduction) and sham or disguised transactions' (De Koker & Williams, 2012:19-1).

Taxpayers who are guilty of tax evasion may be subject to interest according to section 187 of the Tax Administration Act, penalties according to section 210 and 213 of the Tax Administration Act or imprisonment according to section 235 of the Tax Administration Act. However, SARS may only attack a tax avoidance arrangement by using the general anti-avoidance rules in the Act if it is proved to be an impermissible tax avoidance arrangement.

> 'Tax evasion constitutes a criminal offence, the fiscus therefore does not require a statutory law to cope with this type of misdemeanour. The Income Tax Act does provide for interest and penalties to be charged, however, where tax has been evaded. Section 75 of the Income Tax Act also provides for a fine or to imprisonment of up to 24 months' (Haupt, 2013:493).

SARS has defined (at 4) the term 'impermissible tax avoidance' in the 'Discussion Paper' and the term 'impermissible tax avoidance arrangement' in section 80A of the Act. Providing a definition of the term 'impermissible tax avoidance arrangement' in the Act is important as this provides some clarity to the taxpayers, the Judges and the courts.

> 'The 'Discussion Paper' uses the term "impermissible tax avoidance", in general, to refer to artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived "loopholes" in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament' (SARS, 2005:4).

The courts have different attitudes towards tax avoidance. These attitudes were expressed in the *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA), 61 SATC 391 case and the *COT v Ferera* 1976 (2) SA 653, 38 SATC 66 case.

In the *CIR v Conhage (Pty) Ltd* case, Hefer JA indicated that

> 'within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If, for example, the same commercial result can be achieved in different ways, he may enter into the type of transaction which

> does not attract tax or attracts less tax. But, when it comes to considering whether by doing so he has succeeded in avoiding or reducing the tax, the Court will give effect to the true nature and substance of the transaction and will not be deceived by its form' (at 1155).

In the *COT v Ferera* case, the court has expressed disapproval of tax avoidance and MacDonald JP said that

> 'I endorse the opinion expressed that the avoidance of tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making proper contribution to the *fiscus*, but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set up the necessary tax-avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent arguments that it is only the rich, the astute and the ingenious who prosper in it and that "good citizens" will always fare badly' (at 70).

2.3. Difference between tax avoidance and tax planning or tax mitigation

There is a fine line between tax avoidance and tax planning or tax mitigation. Both tax avoidance and tax planning or tax mitigation are lawful, but an impermissible tax avoidance arrangement may lead to penalties according to sections 210 and 213 of the Tax Administration Act and interest according to section 187 of the Tax Administration Act, if the general anti-avoidance rules are invoked by SARS on a tax avoidance arrangement.

The judge in the *IRC v Duke of Westminster* [1935] All ER Rep 259; [1936] AC 1; 104 LJKB 383; 153 LT 223; 51TLR 467; 79 Sol Jo 362; 19 Tax Cas 490 case has expressed his view that tax planning or tax mitigation is lawful and the taxpayers may arrange their affairs to attract the minimal amount of tax.

In the *IRC v Duke of Westminster* case, Lord Tomlin said that

> ‘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. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax’ (at 19) .

The ‘Draft Comprehensive Guide to the General Anti-Avoidance Rule’ (‘Draft Comprehensive Guide’) stated that

> ‘older United Kingdom (UK) case law is often referred to as authority for the notion that a South African taxpayer may arrange his or her tax matters in the most tax-efficient manner’ (SARS, 2011: 2).

The ‘Draft Comprehensive Guide’ has pointed out that the South African courts in certain tax cases have made an effort to provide judgments that were equitable to both SARS and the taxpayer as follows:

> ‘South African courts have to a varying degree indicated acceptance of the taxpayer‘s right of choice in structuring his or her affairs. Certain tax cases indicate that the South African courts endeavour to decide tax matters in a manner that is equitable to both the taxpayer and the fiscus’ (SARS, 2011:2-3).

In the *CIR v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A), 45 SATC 241 case, the court held that

> ‘…there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus’ (SARS, 2011:3).

2.4. Objectives of tax avoidance

In the current market, reducing expenses is one of the key objectives of most companies, as the lower the company’s tax expense, the higher the company’s after tax income. Therefore, it is understandable why certain companies would want to enter into tax avoidance structures to reduce their

tax liabilities. If an arrangement can meet the business objective of the taxpayer i.e. obtain capital funding and also provide tax benefit to the taxpayer, the arrangement will be seen to be more attractive to the taxpayer and as a result, the arrangement will be more marketable by the promoter. The objective of tax avoidance is explained by Haupt (2013:493) as follows:

Tax avoidance is ‘an attempt to minimise a tax liability using legal means,’ i.e. to regulate one’s affairs in such a way that one pays ‘the minimum tax imposed by the Act rather than the maximum’ (Haupt, 2013:493).

2.5. Problems created by tax avoidance structures

The government relies on the taxes paid by the taxpayers in order to provide public services to the public. Therefore, anti-avoidance tax legislation is put in place to combat tax avoidance arrangements in order to protect the fiscus’s income. The harms of impermissible tax avoidance were stated in the ‘Discussion Paper’ as follows:

> ‘The harms caused by impermissible tax avoidance are varied and pervasive. They include short-term revenue loss, growing disrespect for the tax system and the law, increasingly complex tax legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden, and a weakening of the ability of Parliament and National Treasury to set and implement economic policy’ (SARS, 2005:9).

2.6. Characteristics of tax avoidance structures

The characteristics of tax avoidance structures identified by SARS were set out in the ‘Discussion Paper’ as follows:

> ‘the lack of economic substance (usually resulting from pre-arranged circular or self-cancelling arrangements); the use of tax-indifferent accommodating parties or special purpose entities; unnecessary steps and complexity; inconsistent treatment for tax and financial accounting purposes; high transaction costs; and fee variation clauses or contingent fee provisions.

> Schemes possessing most, if not all, of these characteristics are referred to herein as “abusive avoidance schemes”’ (SARS, 2005:19).

Anti-avoidance measures targeted at some of these characteristics mentioned above have been included in sections 80A to 80L of the Act. For example, section 80C(1) provides that

> ‘…an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party…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…’.

Characteristics of an avoidance arrangement that are indicative of a lack of commercial substance are listed in section 80C(2). These characteristics include

> (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
>
> (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’.

Section 80D(1) sets out characteristics that are indicative of round trip financing. It describes round trip financing as

> ‘any avoidance arrangement in which –
>
> (a) funds are transferred between or among the parties (round tripped amounts); and
> (b) the transfer of the funds would –

(i) result, directly or indirectly, in a tax benefit…and
(ii) significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement'.

Section 80E describes the characteristics of accommodating or tax-indifferent parties and the tax effect of having these parties in an avoidance arrangement.

Section 80E(1) provides that

'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

(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

(ii) the participation of that party directly or indirectly involves a prepayment by any other party'.

By describing the various characteristics of an impermissible tax avoidance arrangement in sections 80C, 80D and 80E in the Act, the sections provide some clarity to the taxpayers, the Judges and the courts as to the characteristics which SARS will look out for in identifying an impermissible tax avoidance arrangement.

2.7. Risks faced by the participants of tax avoidance structures

Participants of tax avoidance structures may face financial and reputational risks if they are subject to tax audits carried out by the tax authorities. Financial risks include fall in share price; legal and accounting costs resulting from investigation by the tax authorities. If the court's judgment is held in favour of the tax authority as a result of the litigation, the participant of the tax avoidance structure is liable to pay the tax that was avoided. In addition, a penalty according to sections 210 and 213 of the Tax Administration Act, and interest according to section 187 of the Tax Administration Act may be levied.

Reputation risk includes loss of reputation of the company. The impact can be significant especially if it is related to a listed company, as a reputation of a company will impact the shareholders' confidence, share price and credibility of a company.

2.8. Conclusion

The difference between tax evasion and tax avoidance is that tax evasion is illegal and tax avoidance is legal. These terms are not defined in the Act and therefore, their interpretations are based on court judgments. Various courts held different views of tax avoidance. The judge in the *CIR v Conhage (Pty) Ltd* case found (at 393) a taxpayer may arrange his affairs to pay the minimum tax while the court in the *COT v Ferera* case found (at 70) tax avoidance to be evil.

The main objective of a taxpayer in entering into a tax avoidance arrangement is to pay the minimum tax imposed by the Act rather than the maximum. However, in participating in tax avoidance arrangements, the participants are exposed to financial and reputation risks if SARS attacks the arrangements.

General anti-avoidance rules are used by SARS to combat tax avoidance arrangements. In the 'Discussion Paper', Section 103(1) was viewed (at 41) as inconsistent and ineffective by SARS, as various judgments of the courts were held in favour of the taxpayer. As a result, Parliament has repealed section 103(1) in 2006 and replaced it with sections 80A to 80L in the Act. The reasons why section 103(1) was ineffective is discussed in chapter 3 and how sections 80A to 80L may assist in countering tax avoidance arrangements is discussed in Chapter 4.

3. GENERAL ANTI-AVOIDANCE PROVISION

3.1. Introduction

Section 103(1) was the previous general anti-avoidance provision which was used by the Commissioner to combat tax avoidance arrangements. It was repealed in 2006 and the reason for its repeal was explained in the 'Draft Comprehensive Guide' as follows:

> 'As stated in the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006, the reason for its repeal and replacement with the GAAR was that section 103(1) "has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance" implemented, and it has not kept up with international developments' (SARS, 2011:5).

This chapter examines the provisions of section 103(1) of the Act, the three perceived weaknesses which were identified by SARS, and why it was ineffective in combating tax avoidance arrangements.

The three perceived weaknesses explained by De Koker and Williams (2012:23-24) were the subjectivity of the purpose requirement, the objective abnormality requirement, and the uncertainty of the powers of the Commissioner in section 103(1).

3.2. Provisions of section 103(1) of the Act

Prior to the repeal of section 103(1), the provision provided that

> '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) -

(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

(b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out -

(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; or

(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

(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,

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' (De Koker & Williams, 2012:19-4).

In order for SARS to invoke section 103(1) in respect of a tax avoidance arrangement, four basic requirements have to be met. SARS summarised the four requirements of section 103(1) in the 'Discussion Paper' as follows:

1. 'There must be a "transaction, operation or scheme" (the Arrangement Requirement);

2. The arrangement must result in the avoidance, reduction or postponement of a tax (the Tax Effect Requirement);
3. The transaction must have been entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit, having regard to the circumstances (the Abnormality Requirement); and
4. The transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the Purpose Requirement)'. (SARS, 2005:38)

3.3. The weaknesses of section 103(1) of the Act

The weaknesses of section 103(1) explained by De Koker and Williams (2012:23-24) were the requirement of concurrent presence of a subjective sole or main purpose, and an objective abnormality in a transaction, operation or scheme; and the uncertainty of the powers of the Commissioner in section 103(1).

Due to the subjectivity of the purpose requirement, it was possible for the court to conclude an arrangement had the effect of avoiding or postponing tax liability but tax avoidance was not the sole or main purpose of the arrangement.

> 'At the heart of section 103(1) were two inter-locking criteria: firstly, the subjective sole or main purpose of the taxpayer to avoid or reduce liability for tax; and secondly, the objective normality or otherwise of the means or manner in which the transaction was entered into or carried out or of the rights and obligations thereby created. For section 103(1) to apply to a "transaction, operation or scheme" both the subjective intention and the objective normality had to be concurrently present. In the result, a taxpayer could, with impunity, enter into any transaction, no matter how (objectively) abnormal, so long as he did not have a (subjective) sole or main purpose of tax avoidance; conversely, he could with impunity enter into any transaction with the (subjective) sole or main purpose of tax avoidance, provided that

the transaction was not (objectively) abnormal in the requisite sense' (De Koker & Williams, 2012:19-4).

3.3.1. Subjectivity of the purpose requirement

For section 103(1) of the Act to apply, the sole or main purpose of a transaction was required to be tax avoidance. A subjective purpose was not easy to prove and the court had to look at the intention or the mind of the taxpayer when the taxpayer entered into the tax avoidance arrangement.

In accordance with section 103(4) of the Act, a transaction, operation or scheme was presumed to have been entered into with the requisite sole or main purpose of avoiding or reducing tax rebuttably where it has had the effect of reducing tax. Therefore, a taxpayer had to provide evidence to the court to prove that tax avoidance was not the sole or main purpose of a transaction in order for section 103(1) not to apply. Therefore, section 103(4) had provided an advantage to the Commissioner.

De Koker and Williams (2012:19-4) highlights the importance of the onus of proof as follows:

> ‘A subjective purpose is often not easy to prove and for this reason, once the dispute reaches the tax court or superior courts, the question of whether the Commissioner or the taxpayer bears the onus of proof is of vital concern. Litigation between SARS and taxpayer (as with other litigation) is often decided on the basis that, on the evidence before the court, the party who bore the onus of proof has simply failed to discharge it. In this regard, section 103(4) provided that if a transaction, operation or scheme would result in the avoidance or postponement of tax, it was rebuttably presumed that it had been entered into with the requisite sole or main purpose of avoiding or reducing tax. The onus of rebutting this presumption (on

> a balance of probabilities) was on the taxpayer' (De Koker & Williams, 2012:19-4).

De Koker and Williams (2012:19-4) explains the weakness of the purpose requirement as follows:

> 'A perceived weakness of section 103(1), from the point of view of SARS, was that the requisite sole or main purpose of tax avoidance had to be determined subjectively. In other words, the court was required to look into the mind of the taxpayer and determine, as best it could, on the evidence laid before it, and with due regard for the incidence of the onus of proof, whether the requisite purpose was present when he entered into the transaction, operation or scheme in question. Or, to be precise, if the transaction, operation or scheme had the result of avoiding or postponing tax, it was presumed that it had been entered into for the requisite purpose unless the taxpayer proved otherwise. The *ipse dixit* of a taxpayer who stated on oath at the hearing that he did not have such an intention was of course not conclusive, but neither was it irrelevant. It was entirely possible that a scheme which did, in fact, avoid or postpone a tax liability, was not entered into for that sole or main purpose, but for some other purpose, such as to achieve a commercial objective or to put in place a family arrangement for the maintenance of the taxpayer's dependants' (De Koker & Williams, 2012:19-4).

The judgments of the *CIR v Conhage (Pty) Ltd* case and *CIR v Louw* 1983 (3) SA 551 (A), 45 SATC 113 case, have shown that SARS could not invoke section 103(1) if the court has held that tax avoidance was not the sole or main purpose of a transaction, operation or scheme.

In the *CIR v Conhage (Pty) Ltd* case, the Supreme Court of Appeal shared the view of the Special Court

> ‘that the agreements of sale and leaseback served the dual purpose of providing Tycon with capital and to take advantage of the tax benefits to be derived from that type of transaction' (at 1160).

In the *CIR v Louw* case, it was held that

> ‘the postponement of income tax, which the incorporation undoubtedly achieved, was not the sole or one of the main purposes of the scheme’ (at 576).

The subjectivity of the purpose requirement in section 103(1) was also examined in the *SIR v Gallagher* 1978 (2) SA 463(A), 40 SATC 39 case. Corbett JA stated (at 48) that

> ‘it is submitted in the heads of argument of appellant’s counsel that in determining the purpose of a transaction, operation or scheme an “objective” test should be applied. By an objective test in this context is evidently meant a test which has regard to the effect of the scheme, objectively viewed, as opposed to a “subjective” test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme. Although appellant’s counsel did not press this submission in argument before us, he did not abandon it. In the circumstances it is appropriate to state that, in my view, the test is undoubtedly a subjective one’

and (at 49)

> ‘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’.

The subjectivity of the purpose requirement created difficulty in predicting the outcome of a court case, as the outcome was based on the judgment of the court on the facts and circumstances relevant to the case and the evidence provided by the taxpayer

and SARS. Therefore, SARS had decided to remove the subjectivity of the purpose requirement when the new general anti-avoidance rules were being drafted (De Koker & Williams, 2012:19-4).

3.3.2. Abnormality requirement of a transaction, operation or scheme

De Koker and Williams (2012:19-4) indicates the abnormality requirement of a transaction, operation or scheme was another perceived weakness of section 103(1). If it had become normal for a transaction to be carried out in a certain manner in an industry or profession, it would be difficult for SARS to prove the transaction had been carried out in an abnormal manner, as shown by the extracts below.

> 'A second perceived weakness in section 103(1) lay in the requirement that the transaction, operation or scheme had to be objectively "abnormal" in the requisite sense. It seemed to be arguable that if a particular kind of transaction, operation or scheme became commercially commonplace, then would cease to be "abnormal", as envisaged in section 103(1)' (De Koker & Williams, 2012:19-4).

In the *CIR v Louw* case, the court held

> 'that there was no abnormality in the incorporation of the practice and the rights and obligations created under the scheme of incorporation'

(at 575). The reasons why Corbett JA has made (at 574-575) this conclusion were as follows:

Firstly, it was not abnormal for the payment of the purchase price to be made only as and when the company was in a financial

position to do so, as there is little else that the parties could have done.

Secondly, the non-payment of interest on the purchase price was not abnormal, as the non-payment of interest increased the profits of the company; and this enabled the company to pay off the purchase price more rapidly.

Thirdly, the conclusion of service contracts between the company and its shareholders where no set remuneration was stipulated was not considered to be abnormal as the shareholders being the controllers of the company could determine in their own interests what their salaries were to be from year to year.

In the *SIR v Geustyn, Forsyth & Joubert* 1971 (3) SA 567 (A), 33 SATC 113 case, the court held (at 119) that

> 'there is nothing abnormal in transferring an existing partnership business to a company: indeed, such a transaction may, I think, fairly be regarded as relatively commonplace in the commercial world. That professional men carrying on their profession in partnership should transfer their practice to an unlimited company may no doubt at first sight appear to be somewhat extraordinary...Not only has the South African Association of Consulting Engineers – of which, as already mentioned, the aforenamed three erstwhile partners are members – expressly sanctioned its members forming unlimited companies to conduct their practices, but more than half the Association's membership had already adopted that form of practice. Similarly, it is said that more than half of the twenty-eight known non-members of the Association who are practicing as consulting engineers are at present registered companies. Nor is this peculiar to the Republic; for, according to the stated case, the majority of consulting engineers in England, Canada, France, Switzerland and Japan practice in corporate form...'.

In the 'Discussion Paper', SARS has identified (at 42-43) two weaknesses of the abnormality requirement in section 103(1) as follows:

The first was

> 'the tax world is not neatly divided into two types of arrangements, one for "*bona fide"* business transactions and the other for impermissible tax avoidance schemes. To the contrary, scheme promoters routinely "hijack" techniques that were originally developed for *bona fide* business purposes' (SARS, 2006:42-43).

The second was that this hijacking of techniques makes it

> 'relatively easy for promoters to "manufacture" plausible sounding "business purposes"'

or, perhaps more precisely in the language of the abnormality requirement, to give their schemes an undeserved semblance of normality (SARS, 2006:42-43).

3.3.3. Uncertainty as to the extent of the powers of the Commissioner

De Koker and Williams (2012:19-4) have indicated that the third weakness of section 103(1) was the uncertainty as to the extent of the powers of the Commissioner. Section 103(1) gave the Commissioner the powers to determine the tax liability of the taxpayer as if the arrangement was not entered into. The provision was very broad and did not provide clarity as to the tax consequences of the transaction, operation or scheme should section 103(1) be invoked.

> 'A third perceived weakness in section 103(1) was uncertainty in regard to the extent of the powers of the Commissioner to act in

> relation to an offending transaction, operation or scheme in a way that would nullify the tax benefit. Section 103(1) said in this regard that where its provisions applied, the Commissioner was empowered to determine tax liability as though the transaction, operation or scheme had not been entered into or carried out or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction [of tax]' (De Koker & Williams, 2012:19-4).

The Commissioner has decided to eliminate this uncertainty in the new general anti-avoidance rules as explained by De Koker and Williams (2012:19-4) as follows:

> 'It was felt that, for greater clarity, the Commissioner's powers should be spelled in specific as well as general terms. One of the features of the new GAAR is the detailed setting out in section 80B of the powers of the Commissioner in this regard' (De Koker & Williams, 2012:19-4).

3.4. Conclusion

SARS could not invoke section 103(1) in certain cases as the courts have concluded that tax avoidance was not the sole or main purpose of the transaction or the objective abnormality requirement was not met.

The cases which the courts have held tax avoidance was not the sole or main purpose were the *CIR v Conhage (Pty) Ltd* case and the *CIR v Louw* case.

The cases which the courts have held the objective abnormality requirement was not met were the *CIR v Louw* case and the *SIR v Geustyn, Forsyth and Joubert* case.

De Koker and Williams (2012:19-4) have explained from SARS's point of view, the weaknesses in section 103(1) have resulted in judgments of certain

cases held in favour of the taxpayers and these weaknesses included the subjectivity of the purpose requirement; the objective abnormality requirement and the uncertainty of the powers of the Commissioner in section 103(1).

In order to eliminate these weaknesses, section 103(1) was repealed and new general anti-avoidance provisions were drafted by SARS with these weaknesses in mind. The new general anti-avoidance provisions are now provided in sections 80A to 80L of the Act. A comparison of the application of the provisions in sections 80A-80L with those of section 103(1) is discussed in Chapter 4.

4. SECTIONS 80A to 80L

4.1. Introduction

This chapter examines how the provisions that have been included in sections 80A to 80L of part IIA of the Act may assist in countering tax avoidance structures. As compared to section 103(1), sections 80A to 80L are more detailed and comprehensive.

Certain terms used in part IIA of the Act are clearly defined, the obligations of the Commissioner and taxpayers are listed, and the characteristics which may indicate an impermissible tax avoidance arrangement are provided, in sections 80A to 80L.

Section 80B provides the tax consequences of impermissible avoidance arrangements and gives the Commissioner the power to raise tax as if the impermissible tax avoidance arrangement has not been entered into. The methods which the Commissioner can use are set out by Haupt (2013:496) as follows.

> '- He can disregard the arrangement or any part of it
> - He can combine or recharacterise any steps in the arrangement
> - He can disregard any *accommodating party*
> - He can disregard any tax-indifferent party
> - He can treat any party as one person with the accommodating or tax-indifferent party
> - He can deem separate *connected persons* to be one person
> - He can reallocate income or expenditure from one person to another
> - He can recharacterise any receipt, such as treating a capital receipt as an income receipt
> - He can recharacterise expenditure
> - He can recharacterise or reconstitute the arrangement in a way that

cancels the tax benefit' (Haupt, 2013:496).

Section 80A defines the term 'impermissible tax avoidance arrangement'; section 80C sets out the characteristics of an arrangement which indicates a lack of commercial substance; section 80D describes round trip financing, section 80E defines an accommodating or tax-indifferent party and section 80F deals with the treatment of connected persons and accommodating or tax-indifferent parties.

Section 80G(1) presumes an avoidance arrangement to have been entered into for the sole or main purpose of obtaining a tax benefit unless the person who obtained a tax benefit proves otherwise; section 80H provides that the Commissioner may apply the provisions of Part IIA of the Act to steps in or parts of an arrangement; section 80I clarifies that the Commissioner may apply the provisions of Part IIA in the alternative or in addition to any other basis for raising an assessment.

Section 80J clarifies the obligation of the Commissioner in giving notice to a taxpayer and the obligation of a taxpayer who receives such notice from the Commissioner; section 80K clarifies that the Commissioner may not exercise his or her discretion to direct that interest is not payable in respect of that portion of any tax which is attributable to the application of Part IIA and section 80L defines the terms: 'arrangement'; 'avoidance arrangement'; 'impermissible avoidance arrangement'; 'party' and 'tax'.

4.2. Commissioner's discretion

The remedies that the Commissioner may apply against impermissible tax avoidance schemes are clarified in section 80B. Although it is still very wide, it is much clearer as compared to section 103(1). It provides that

> 'the Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by -
>
> - disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;

- 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;

- 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;

- reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;

- re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or

- 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.'

SARS indicated in the 'Draft Comprehensive Guide' that

> 'the GAAR clarifies that the tax benefits derived from a single step or part may therefore be adjusted under section 80B' (SARS, 2011:20).

4.3. Impermissible tax avoidance

Section 80A defines the term 'impermissible tax avoidance arrangements'. In comparison to section 103(1), section 80A is more objective as it is not based on the opinion of the Commissioner whether a transaction, operation or scheme was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit.

Section 80A provides that

> 'An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and -
>
> (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

(ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

(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

(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

(ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act…'

Section 80A is important as it indicates to the courts and the taxpayers the types of arrangements which SARS would consider to be impermissible.

> 'Section 80A, which is headed - "Impermissible tax avoidance arrangements" contains the important part of the anti-avoidance provisions. The heading of the section implies that tax avoidance itself is not impermissible. Only certain types of arrangements are impermissible' (Haupt, 2013:496).

The 'Draft Comprehensive Guide' has explained (2011:21) that section 80A has created a more objective standard by referring to the purpose of an avoidance arrangement as opposed to the purpose of the taxpayer in entering the avoidance arrangement. In the result, the subjectivity of the purpose requirement has been eliminated.

In the 'Draft Comprehensive Guide', SARS indicated that

> 'the purpose of an arrangement is fundamental to determine whether such arrangement constitutes an impermissible avoidance arrangement. Section 80A provides that the avoidance arrangement is an impermissible avoidance

> arrangement if, amongst other things, its sole or main purpose was to obtain a tax benefit…section 80A refers to the purpose of the avoidance arrangement itself, as opposed to the purpose of the parties in entering into or carrying on the avoidance arrangement. This difference moves towards a more objective requirement for the purpose' (SARS, 2011:20).

The 'Draft Comprehensive Guide' has compared section 103(1) and section 80A. It indicated that section 80A was drafted in such a way to create a more objective standard. Section 103(1) could be applied

> 'whenever the Commissioner is satisfied that any transaction, operation or scheme...was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit...'.

On the other hand, section 80A provides that 'an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit…'.

Section 80A

> 'creates a more objective standard, and provides a uniform basis for the tax treatment of transactions, by removing reliance purely on the subjective intention of a participant to an arrangement' (SARS, 2011:21).

Further, the 'Draft Comprehensive Guide' has stated that

> 'the creation of a more objective standard addresses the problem that existed under section 103(1) that plausible sounding business purposes were artificially manufactured to fit in with the subjective requirements of that section. By virtue of changes made to the wording of the purpose requirement in the General Anti-Avoidance Rule ("GAAR"), the purpose test under the GAAR is therefore a more objective test. Although the onus of proof has not changed substantially, the sole or main purpose of the arrangement itself is the relevant purpose and no longer the subjective purpose of the taxpayer' (SARS, 2011:21).

4.4. Purpose

> 'Section 80G(1) deems the taxpayer to have had a tax avoidance purpose if the arrangement in fact avoids tax. The onus is then on the taxpayer to show that his sole or main purpose was not to obtain tax benefits' (Haupt, 2013: 498).

Some of the requirements in section 80G(1) are similar to that of section 103(4). The main difference is the taxpayer is required to show that obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement in light of the relevant facts and circumstances in terms of section 80G(1).

In the 'Draft Comprehensive Guide', SARS stated that

> 'under section 80G(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 the tax benefit proves that, reasonably considered in the light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement. This is comparable to the previous wording which provided that it shall be presumed until the contrary is proved that the sole or main benefit is to derive a tax benefit. The inclusion of the words "reasonably considered in light of the relevant facts and circumstances" directs that the taxpayer‘s *ipse dixit* should be tested against the surrounding facts and circumstances. The onus of proof in relation to the purpose of the arrangement, however, does not differ significantly from the previous provision' (SARS, 2011: 20).

Section 80G(2) further provides that

> ‘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.’

In the result, the Commissioner may invoke sections 80A to 80L on a step or part of an avoidance arrangement rather than the whole arrangement as the

purpose of a step or part of an avoidance arrangement may be different from the purpose of a whole arrangement.

4.5. Tax benefit

The term ‘tax benefit’ is defined in section 1 of the Act as ‘including any avoidance, postponement or reduction of any liability for tax’.

The term ‘tax’ is defined in section 80L of the Act to include

> ‘any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner’.

These Acts include the

> ‘Value-Added Tax Act, the Customs and Excise Act, the Skills Development Levies Act, the Unemployment Insurance Contribution Act, the Securities Transfer Tax (STT) Act, the Transfer Duty Act and the Estate Duty Act’ (Haupt, 2013:498).

Haupt (2013:498) indicated that

> ‘the broad definition of "tax benefit" is important when one looks at the sole or main purpose of the arrangement. Therefore, if a person enters into an arrangement solely in order to avoid estate duty, but the side-effect is also the avoidance of income tax (even though the income tax avoidance is not a sole or main purpose) the Commissioner can apply section 80A to the income tax avoidance' (Haupt, 2013:498).

Section 80B clarifies that the Commissioner is empowered to

> ‘determine the tax consequences under this Act of any impermissible avoidance arrangement for any party…’.

The words ‘this Act’ in the provision clarified that the extent of the Commissioner’s power is limited to the Act.

4.6. Abnormality test

In order for Part IIA of the Act to apply, the purpose of the arrangement has to be avoidance of tax and the transaction must be entered into or carried out by means or in a manner which would not normally be employed or created rights or obligations that would not normally be created between parties dealing at arm's length. Abnormality is not defined in the Act. Therefore, its meaning is based on case law. The 'Draft Comprehensive Guide' (2011:24) has explained that although section 103(1) did have an abnormality test, it was replaced by section 80A, as SARS has intended to apply the test more objectively on the features and the rights or obligations of a transaction.

SARS stated in the 'Draft Comprehensive Guide' that

> 'the abnormality test contained in the GAAR retains certain conceptual components of the abnormality test previously contained in section 103(1)(b)(i), with the exception that it is now intended to be applied more objectively on the features of a normal transaction, as is evident from omitting the words "having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out", as previously contained in section 103(1)' (SARS, 2011:24).

The 'Draft Comprehensive Guide' (2011:24) indicated that the abnormality test is not applied by asking whether the transaction was entered into for *bona fide* business purposes in the context of business but whether the manner in which the transaction was entered into would not normally be employed for *bona fide* business purposes other than to obtain a tax benefit.

> 'The "business purpose test" in terms of the GAAR is not whether the scheme itself has a commercial purpose, but whether the manner in which the transaction is entered into or carried out is a manner which would normally be used for *bona fide* business purposes other than to obtain a tax benefit. This so-called business purpose test in essence therefore remains an "abnormality" test, as was the case under section 103(1). In this regard,

> Williams states in an article dealing with the 1996 amendment which introduced the “business purpose test” into section 103, that:
>
> “…the section does not say that the enquiry is into whether the transaction 'was entered into…for *bona fide* purposes’, but is expressed in the subjunctive, the operative phrase being 'would not normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit'. I believe, therefore, that the section does not mandate an enquiry into whether or not the particular taxpayer entered into the particular transaction for *bona fide* business purposes, but that it necessitates an enquiry into a hypothetical situation: whether the manner in which the transaction was entered into 'would not normally be employed' for bona fide business purposes”’ (SARS, 2011:24).

If the features of an arrangement are not found to be abnormal, there are two other tests that may apply in the alternative. The two other tests that can be applied are the test for the lack of commercial substance which is provided in sections 80A(a)(ii) and 80C, and the test in determining whether the arrangement has resulted in misuse or abuse of the provisions of the Act which is provided in section 80A(c)(ii).

4.7. Misuse or abuse concept

The onus of proof rests on the Commissioner to prove on the balance of probabilities that the participants have misused or abused the provision of the Act by entering into an avoidance arrangement. The concept is explained by the ‘Draft Comprehensive Guide’ (2011:44) as follows:

> ‘The misuse or abuse concept in the GAAR is not aimed at replacing or codifying the common law, but is rather aimed at creating a separate and new concept which exists alongside these well-established doctrines.
>
> The introduction of the misuse or abuse concept is intended to reinforce the emerging trend in South Africa (which mirrors similar trends in other jurisdictions) towards a “contextual and purposive” approach to tax statutes “in order to find a meaning that harmonises the wording, object and spirit

and purpose of [their] provisions". As there is no overriding presumption as to misuse or abuse, the onus of proof rests on the Commissioner to show on a balance of probabilities that such misuse or abuse exists' (SARS, 2011:44).

4.8. Lack of commercial substance

A test for lack of commercial substance has been included in section 80C. This test was not contained in section 103(1).

Section 80C describes the characteristics of an arrangement which indicate a lack of commercial substance.

In terms of section 80C(1), an avoidance arrangement lacks commercial substance if it results in a significant tax benefit for a party, but it does not have significant effect upon either the business risks or net cash flows of that party.

Section 80C(2) provides the characteristics of an avoidance arrangement that may indicate a lack of commercial substance. The characteristics include the following:

(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;

(b) the inclusion or presence of round trip financing as described in section 80D;

(c) the inclusion or presence of an accommodating or tax indifferent party as described in section 80E; or

(d) the inclusion or presence of elements that have the effect of offsetting or cancelling each other.

Haupt (2013:500) states that the characteristics provided in section 80C(2) are not conclusive and merely provide guidance as to what may indicate a lack of commercial substance.

> 'It seems that if any of the characteristics in section 80C(2) are present, it does not necessarily mean that the arrangement automatically lacks commercial substance. Section 80C(2) appears to merely be giving some guidance as to what should be looked for when trying to determine if an arrangement lacks commercial substance. If there were valid, non-tax, reasons for any of these arrangements, it would not lack commercial substance. Only if section 80C(1) applies is the arrangement deemed to lack commercial substance' (Haupt, 2013:500).

4.9. Round trip financing

Round trip financing has been used extensively in tax avoidance structures which were promoted by the banks. Some of the transactions include sale and leaseback transactions, convertible loan transactions and partnership deal structures.

The term ‘round trip financing’ was not contained in section 103(1), but it is now described in 80D. It is a characteristic which indicates a lack of commercial substance.

In terms of section 80D(1), round trip financing includes

> ‘any avoidance arrangement in which-
>
> (a) funds are transferred between or among the parties…; and
>
> (b) the transfer of the funds would-
>
> (i) result, directly or indirectly, in a tax benefit…and
>
> (ii) significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.’

If an arrangement involves round tripping, it does not automatically mean that it is a tax avoidance arrangement. The round tripping has to be looked at in the context of the transactions of which it is a part.

The 'Draft Comprehensive Guide' explained round trip financing by SARS as including

> '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, 2011:30).

Section 80D(2) of the Act provides that

> 'this section applies to 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;
>
> (b) the timing or sequence in which round tripped amounts are transferred or received; or
>
> (c) the means by or manner in which round tripped amounts are transferred or received.'

The provision was further explained by the 'Draft Comprehensive Guide' as follows:

> 'Section 80D(2)(c) applies to any round tripped amounts without regard to the means by or manner in which the round tripped amounts are transferred or received, and may include, for example, a loan arrangement whereby the original loan amount finds its way back to the lender by way of a security deposit' (SARS 2011:30).

In the result, the scope of transactions covered by section 80D(2) is very broad.

4.10. Accommodating or tax-indifferent parties

The term ‘accommodating or tax-indifferent parties’ was not contained in section 103(1), but it is now described in 80E. It is a characteristic which indicates a lack of commercial substance.

Section 80E of the Act provides the two requirements which must be met before a party is an accommodating or tax-indifferent party.

Section 80E(1)(a) of the Act provides the first requirement, that is met 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.'

Section 80E(1)(b) of the Act provides the second requirement is met if

> 'any one of the following applies:
>
> - An amount which would have been included as gross income or a capital receipt of one party is included, instead, in the hands of the accommodating/tax-indifferent party.
> - The participation of the accommodating/tax-indifferent party has made a non-deductible expense or loss deductible in the hands of the other party.
> - The participation of the accommodating/tax-indifferent party has had the result that what would have been taxable income of another party is either not included in its gross income, or is exempt from normal tax.

- Another party makes a prepayment as a direct or indirect result of the participation of the accommodating/tax-indifferent party'. (Haupt, 2013:502).

The tax consequence of proving the presence of an accommodating or tax-indifferent party in a tax avoidance arrangement was explained in the 'Draft Comprehensive Guide' as follows:

> 'The mere presence of an accommodating or tax-indifferent party in an avoidance arrangement is sufficient to render such arrangement impermissible, if the sole or main purpose of such arrangement was to derive a tax benefit, which means that the Commissioner may avail himself or herself of the remedies contained in section 80B' (SARS, 2011:30).

4.11. Application to steps in or parts of an arrangement

Section 80H of the Act has clarified that the Commissioner may apply sections 80A to 80L to steps in or parts of an arrangement. The application of section 80H to a tax avoidance arrangement is explained in the 'Draft Comprehensive Guide' as follows:

> 'Sections 80H and 80G(2) address the Commissioner's authority to apply the GAAR to steps in or parts of an arrangement. These provisions must be read with the definition of an "arrangement" in section 80L, which explicitly provides that the term includes, and applies to, all the steps in or parts of an arrangement, as well as to the entire arrangement itself, and with section 80B(1)(a) which authorises the Commissioner to disregard, combine or re-characterise steps in or parts of an impermissible avoidance arrangement in determining the tax consequences of that arrangement for any party' (SARS, 2011:46).

4.12. Use in the alternative

In terms of section 80I of the Act, the Commissioner may apply the provisions of sections 80A to 80L in the alternative or in addition to any other basis for raising an assessment. The purpose of including section 80I in the

general anti-avoidance rules was explained in the 'Draft Comprehensive Guide' as follows:

> 'Before the introduction of the GAAR the case law was inconclusive as to whether the general anti-avoidance provisions may be applied in the alternative to any other ground of assessment. Section 80I clarifies and confirms that the Commissioner may apply the GAAR in the alternative to or in addition to any other basis of assessment' (SARS, 2011:49).

4.13. Notice

The rights and obligations of the taxpayer and SARS with regard to notice was not provided in section 103(1). This is now provided in section 80J of the Act.

Section 80J(1) provides that SARS must give notice to the taxpayer if it believes that sections 80A to 80L may apply in respect of an arrangement and must set out in the notice its reasons.

Section 80J(2) provides that the taxpayer who receives the notice may within 60 days after the date of that notice or the period which SARS allows, submit reasons to SARS why sections 80A to 80L should not be applied.

Section 80J(3) provides that SARS must then within 180 days of receipt of the reasons, request further information, raise an assessment or advise the taxpayer that sections 80A to 80L will not be applied.

The 'Draft Comprehensive Guide' explains the reasons why the provisions in section 80J are important as follows:

> 'This provision therefore introduces a statutory safeguard to taxpayers against the arbitrary application of the GAAR. The Commissioner will also therefore, at this stage already, need to clearly identify the arrangement which he considers to constitute the impermissible avoidance arrangement, albeit a step or part or a composite arrangement as a whole. The taxpayer is given the opportunity to give reasons, before an assessment being raised.

> This requirement is intended to ensure that taxpayers are informed about the Commissioner‘s concerns at an early stage, and to ensure that they are given reasons for these concerns in all cases. A reasonable opportunity is given to respond to these concerns’ (SARS, 2011:48).

4.14. Interest

SARS explains in the ‘Draft Comprehensive Guide’ that

> ‘section 80K essentially retains the compulsory interest provision previously contained in section 103’

(SARS, 2011:50).

Interest on the underpayment of provisional tax is compulsory when a taxpayer is proved to have entered into an impermissible tax avoidance arrangement.

Section 80K of the Act provides that

> ‘where the Commissioner has applied this Part in determining a party’s liability for tax, the Commissioner may not exercise his or her discretion in terms of section 89*quat*(3) or (3A) to direct that interest is not payable in respect of that portion of any tax which is attributable to the application of this Part’.

4.15. Definitions

Section 80L of the Act provides definitions of the terms ‘arrangement’, ‘avoidance arrangement’, ‘impermissible avoidance arrangement’, ‘party’ and ‘tax’ used in Part IIA of the Act. These definitions were not provided in the Act previously.

Section 1 defines the term ‘tax benefit’ as ‘any avoidance, postponement or reduction of any liability for tax’. This definition corresponds with that used in the GAAR‘s predecessor, as the term was previously defined in section 103(7) as

‘any avoidance, postponement or reduction of liability for payment of any tax, duty or levy imposed by this Act or by any other law administered by the Commissioner’.

4.16. Conclusion

In comparison to section 103(1), sections 80A to 80L of the Act is more detailed and comprehensive as the sections provide definitions of various terms, rights and obligations of the Commissioner in sending notices, the requirements and the manner in which the general anti-avoidance rules may be applied, the meaning of important concepts such as ‘accommodating or tax-indifferent parties’, ‘round trip financing’; the characteristics which may indicate a lack of commercial substance in tax avoidance arrangements and the misuse and abuse test.

In order for sections 80A to 80L to apply, the sole or main purpose of an arrangement must be tax avoidance; and the means or manner in which the arrangement was entered into or carried out, or the rights or obligations created between the parties must be abnormal.

The purpose requirement in section 80A is more objective as compared to section 103(1), as it looks at the sole or main purpose of an arrangement to determine whether an avoidance arrangement is an impermissible avoidance arrangement rather than considering whether the Commissioner was satisfied that any transaction, operation or scheme was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit.

The abnormality requirement is intended to be applied more objectively on the features and the rights or obligations of a transaction in section 80A as compared to section 103(1). The test is not applied by asking whether the transaction was entered into for *bona fide* business purpose but whether the manner in which the transaction was entered into would not normally be employed for *bona fide* business purpose other than to obtain a tax benefit.

5. HOW THE JUDGMENTS OF CERTAIN SOUTH AFRICAN TAX CASES WOULD HAVE BEEN DIFFERENT IF THE ANTI-AVOIDANCE PROVISIONS IN SECTIONS 80A to 80L WERE APPLIED INSTEAD OF THOSE IN SECTION 103(1)?

5.1. Introduction

This chapter examines the issues raised and the interpretations made by the South African courts in the five selected South African tax cases.

The five selected South African tax cases are *CIR v Conhage (Pty) Ltd*; *CIR v Louw*; *SIR v Geustyn, Forsyth & Joubert*; *Hicklin v SIR* 1980 (1) SA 481 (A), 41 SATC 179; and ITC 1712 (2000) 63 SATC 499 (G).

These particular cases were chosen as the judgments of these cases provided insight as to the difficulty in invoking section 103(1) and the judgments were presented before sections 80A to 80L were legislated. Although the tax effect requirement was found to be present in these cases, the Commissioner could not successfully invoke section 103(1) in these cases as the purpose or abnormality requirements were not met.

This chapter discusses how the judgments in these cases would be different if sections 80A to 80L of the Act were applied instead of section 103(1). The requirements of section 103(1) were different from those of sections 80A to 80L. In order to apply sections 80A to 80L, certain requirements have to be satisfied. These requirements were explained by Kolitz (2007:2) as follows:

- ‘There must be an arrangement (s 80A). An arrangement is defined as a transaction, operation, scheme, agreement or understanding, whether enforceable or not and including any steps or parts of it (s 80L).

- The arrangement must be an avoidance arrangement (s 80A). An avoidance arrangement is defined as an arrangement that results in a tax benefit, that is, the avoidance, postponement or reduction of any liability for tax (s 80L).

- The sole or main purpose of the avoidance arrangement must be to obtain a tax benefit (s 80A). There is a presumption that an avoidance arrangement was entered into or carried out solely or mainly for the

purpose of obtaining a tax benefit unless or until the party that obtains the tax benefit proves that the tax benefit was not the sole or main purpose (s 80G).

- There must be an element of abnormality about the arrangement. If the arrangement is in the context of business, it must have been entered into or carried out by means or in a manner that would not normally be employed for bona fide business purposes, other than obtaining a tax benefit, or it must lack commercial substance in whole or in part, as set out in s 80C (s 80A(a)). If the arrangement is in a context other than business, it must have been entered into or carried out by means or in a manner that would not normally be employed for a bona fide purpose, other than obtaining a tax benefit (s 80A(b)). Irrespective of the context of the arrangement, it must either have created rights or obligations that would not normally be created between persons dealing at arm's length or it must have resulted directly or indirectly in the misuse or the abuse of the provisions of the Act, including the new GAAR provisions (s 80A(c))'.

Sections 80A to 80L are more comprehensive and detailed as compared to section 103(1). To successfully invoke section 80A, the purpose and abnormality requirements in section 80A are required to be met.

Whether the requirements in section 80A can be met, it would still be largely dependent on the facts and circumstances of the case and the evidence provided by the Commissioner and the taxpayer.

The chance of success may be improved by applying sections 80A to 80L as compared to section 103(1), as section 80C has now provided the characteristics which indicate a lack of commercial substance in an arrangement and section 80A(c)(ii) may be applied to tax avoidance arrangement that would result directly or indirectly in the misuse or abuse of the provisions of the Act.

If an avoidance arrangement is proved to include 'round trip financing' in terms of section 80D, 'accommodating or tax indifferent parties' in terms of section 80E, or 'elements that have the effect of offsetting or cancelling each other' in terms of section 80C(2)(b)(iii) or

> ‘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’

in terms of section 80C(2)(a), the possibility of proving an arrangement is ‘an impermissible avoidance arrangement’ in terms of section 80A is increased significantly.

Similar to section 103(1), section 80G(1) also provides that the taxpayer has the onus of proving that the sole or main purpose of the avoidance arrangement is not tax avoidance. The main difference is the taxpayer is required to show that obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement in light of the relevant facts and circumstance. Accordingly, the judge is required to determine the sole or main purpose of the avoidance arrangement in light of the relevant facts and circumstance.

Section 80G(2) provides that 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.

Section 80G may therefore cause the taxpayer to find it more difficult to discharge the onus of proving that obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

Section 80H provides that the Commissioner may apply the provisions of this Part to steps in or parts of an arrangement. The scope and extent which the Commissioner can invoke section 80A on an avoidance arrangement has therefore been largely extended by section 80H.

A brief description of the background of the cases, the arguments of the taxpayers and the Commissioner, the judgments of the courts and the reasons why certain parties lost the case are provided in this chapter.

5.2. *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA), 61 SATC 391

5.2.1. Background of the case

In the *CIR v Conhage (Pty) Ltd* case, the taxpayer, Tycon, and Firstcorp Merchant Bank Ltd (Firstcorp) entered into two sets of agreements which comprised 'a sale and leaseback of some of Tycon's manufacturing plant and equipment' to Firstcorp (at 1155).

The dispute arose between Tycon and the Commissioner

> 'when Tycon sought to deduct the rentals paid in terms of the leasebacks as expenditure in the production of income under section 11*(a)* of the Income Tax Act 58 of 1962, as amended. When the Commissioner refused to allow the deductions and in addition invoked section 103 of the Act, Tycon appealed to a Special Court. The appeal succeeded and the matter was remitted to the Commissioner for reassessment on the basis that the rentals were deductible' (at 1156).

The Commissioner then appealed to the Supreme Court of Appeal. Two issues that were considered by the Supreme Court of Appeal were 'the true nature and substance of the agreements' and 'whether the Commissioner correctly invoked section 103' (at 1156).

5.2.2. Arguments of the taxpayer and the Commissioner

The taxpayer argued that the sole or main purpose of entering into the sale and leaseback transactions was not reduction of tax liability, and testified that

> 'the purpose of the whole exercise was to obtain capital, not to reduce tax; and if the reduction of its tax liability can be regarded as a purpose of the transactions as envisaged in s 103 at all, it was not the main purpose' (at 1160).

The Commissioner disagreed with the taxpayer with regard to the purpose of entering into the sale and leaseback transactions by the taxpayer. The Commissioner argued that

> ‘although Tycon and Firstcorp might honestly have believed that it would be sufficient to go through the formality of concluding that kind of agreement in order to procure tax benefits for themselves, they had no real intention to enter into agreements of sale and leaseback’ (at 1156).

The Commissioner submitted that

> ‘despite the form of the agreements, Tycon did not sell and lease back its equipment, but in substance borrowed the 'purchase price' from Firstcorp’ (at 1156).

The Commissioner also submitted

> ‘that the only reason why sales and leasebacks were preferred to a straightforward loan was that a loan would not bring about such advantageous tax deductions’ (at 1160).

5.2.3. Judgment of the court, issues raised and the interpretations made by the court

Hefer JA held that a taxpayer may choose the transaction which minimises his tax liability and the court will look at the nature and substance of a transaction. He stated that

> ‘within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If, for example, the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax. But, when it comes to considering whether by doing so he has succeeded in avoiding or reducing the tax, the Court will give effect to the true nature and substance of the transaction and will not be deceived by its form’ (at 1155).

5.2.3.1. The true nature of the agreements

The Special Court and the Supreme Court of Appeal accepted that

> 'the parties did not act in *fraudem legis* by deliberately disguising their transactions' (at 1156).

The judgment of the Special Court was in favour of the taxpayer as the onus of the taxpayer to prove that both the taxpayer and the bank intended to give effect to the transactions were discharged. The court held that

> 'the onus was on Tycon to prove the authenticity of the agreements and that the onus had been discharged. The signatory on Tycon's behalf and two Firstcorp officials who had negotiated the transactions testified that the parties intended to give effect to the transactions according to their terms' (at 1157).

The Special Court indicated that it was not unusual to find terms and provisions in sale and lease back agreements which were not found in purchase and sale or lease agreements. It indicated that

> 'but it is by no means unusual to find provisions in a sale and leaseback which do not typically appear in a contract of purchase and sale or in a contract of lease' (at 1158).

5.2.3.2. Did the Commissioner correctly invoke section 103(1)?

The Special Court and the Supreme Court of Appeal found (at 1160) that section 103(1) may not be invoked by the Commissioner as the Commissioner has failed to prove that the terms of the sale and leaseback agreements have created abnormal rights and obligations and therefore, the abnormality requirement was not established by the Commissioner.

The taxpayer has succeeded in arguing that the purpose of the transaction was not tax avoidance but obtaining capital from the bank. Therefore, the purpose requirement of section 103(1) was also not met.

The Special Court found that ‘the Commissioner had not established the abnormality of the sales and leasebacks and that Tycon had established the absence of the purpose requirement’ (at 1160).

The Supreme Court of Appeal shared

> 'the Special Court's view that the agreements of sale and leaseback served the dual purpose of providing Tycon with capital and to take advantage of the tax benefits to be derived from that type of transaction' (at 1160)

and further held that

> 'it is not necessary to deal with the Special Court's finding that the abnormality of the transactions had not been established. Suffice it to say that what the Commissioner had to establish was the abnormality of the transactions as sales and leasebacks. To decide whether he had done so, the Court rightly took all the circumstances of the case into account and did not content itself with an examination of the typicality of the terms of the agreements' (at 1161).

5.2.4. How would the judgment in the case be different if sections 80A to 80L of the Act were applied instead of section 103(1)?

Application of GAAR to steps or arrangement as a whole

Section 80L provides that an arrangement includes ‘all steps therein or parts thereof’.

Kolitz (2007:47) explained the sale and leaseback scheme and the lease were tax avoidance arrangements according to section 80L as follows:

> ‘The application of the new GAAR provisions are examined in relation to the sale and leaseback scheme as a whole (‘the scheme as a whole’) and also to the sale and the lease separately. The scheme as a whole, the sale and the lease would each be an arrangement as defined in s 80L. The scheme as a whole and the lease itself would be avoidance arrangements, as they would result in the tax benefit arising from the full lease rental payments being tax deductible. The sale would, however, not be an avoidance arrangement. Rather than resulting in a tax benefit, it would result in tax becoming payable on a recoupment of previous allowances on the plant’.

Sole or main purpose test

Tax benefit was not the sole or main purpose of the steps or arrangement as a whole as the purpose of the scheme was to obtain fund capital and the purpose of the lease was to obtain the use of the plant. Therefore, the judgment with regard to the purpose requirement would not have been different if section 80A was applied.

> ‘The sole or main purpose of the sale was clearly not to obtain a tax benefit as the sale did not result in a tax benefit, but rather in tax becoming payable on a recoupment of previous allowances claimed on the plant.
>
> It is submitted that it can be argued that the sole or main purpose of the lease was also not to obtain a tax benefit. The lease was entered into because the taxpayer needed the use of the plant in its manufacturing facility, not simply because it wanted a tax benefit from the deduction of the lease rental payments’ (Kolitz, 2007:47).

Lack of Commercial Substance

In terms of section 80C(1) of the Act,

> ‘an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party… 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...’.

In this case, the taxpayer and the bank were aware of the significant tax benefit for the taxpayer by entering into the sale and leaseback transactions instead of a simple loan as the taxpayer would be able to claim higher tax deductions. Rentals were paid to the bank instead of interest and capital repayments in a sale and leaseback transaction.

Sale and leaseback transaction has resulted in significant tax benefit for the taxpayer as it could claim rental deductions in such a transaction as compared to interest deductions in a simple loan transaction.

> ‘It is submitted that the scheme as a whole, the sale and the lease all showed the presence of commercial substance. There was a significant effect on the business risks of the taxpayer as it no longer owned the plant. It had an obligation to meet monthly lease rental payments and on the termination of the lease it had to re-purchase the plant. There was also a significant effect on its cash flows, namely, the lump-sum receipt from the sale, the monthly lease rental payments, and the expenditure to re-purchase the plant on termination of the lease. It is also submitted that the scheme as a whole, the sale and the lease do not show any of the criteria that are indicative of a lack of commercial substance. The transaction was held not to be simulated as contended by the Commissioner, but genuine. There was no inclusion or presence of round trip financing. There was no inclusion or presence of a tax indifferent or accommodating party. There was no inclusion or presence of elements that offset or cancelled each other’ (Kolitz, 2007:48).

Abnormality test

The Special Court found (at 1152) the Commissioner has not established that the sale and leaseback transaction was abnormal after the court has taken all the circumstances of the case into account and performed an examination of the typicality of the terms of the agreements.

The Special Court further indicated (at 1158) that it was not unusual to find provisions in a sale and leaseback which did not typically appear in a contract of purchase and sale or in a contract of lease.

Based on the above, the agreement for the sale of the plant and the lease agreement for the plant have not created rights or obligations that would not normally be created between persons dealing at arm's length and further, in the context of business, the arrangement as a whole or the steps were not entered into or carried out by means or in a manner that would not normally be employed for *bona fide* business purpose other than obtaining a tax benefit.

Misuse and abuse test

The definition of the term 'misuse or abuse' is not provided in the Act. Based on the facts and circumstances of this case, it is unlikely that the scheme as a whole, the sale or the lease would be considered to be misuse or abuse of the provisions of the Act.

Conclusion

The judgment would not be different if sections 80A to 80L of the Act were applied instead of section 103(1). It was concluded by Kolitz (2007:48) as follows:

> 'It is submitted that the scheme as a whole, the sale and the lease would not be impermissible tax avoidance arrangements as defined in s 80A. The sole or main purpose requirement is not met, the means or manner are not abnormal, there is no lack of commercial

substance, there are no abnormal rights or obligations and there is no misuse or abuse of the provisions of the Act'.

5.3. *CIR v Louw* 1983 (3) SA 551 (A), 45 SATC 113

5.3.1. Background of the case

In the *CIR v Louw* case, the respondent and his partners have transferred the practice and business of the partnership to a company with unlimited liability in which they would hold shares.

'The unlimited company, Van Wyk and Louw, was incorporated on 27 May 1966; and on 7 June 1966 the company, duly authorized by a resolution of the board of directors, entered into a written agreement with the partners whereby the latter sold to the company the business of the partnership' (at 565).

'It was further agreed that the purchase consideration was to be paid to the sellers partly by way of an allotment of shares to them and partly by crediting loan accounts in their names in the books of the company. Until unanimously agreed to the contrary, the loan accounts were not to bear interest and the capital thereof was to be repayable to the sellers at such times and in such amounts as the financial position of the company permitted' (at 565).

'At first, after the transfer of the business from the partnership to the company, the directors' loan accounts were in credit. These credits represented the portion of the purchase price which, as I have indicated, was to be paid by crediting the loan accounts of the erstwhile partners. In about 1971/72 these loan accounts went into debit by reason of loans made by the company to its directors. The annual amounts advanced to directors by way of loans were very substantial' (at 567).

5.3.2. Arguments of the taxpayer and the Commissioner

The Commissioner wrote to the taxpayer's attorneys and stated (at 570) that the following transactions, operations or scheme would

be subject to the application of the provisions in section 103(1) in his view.

(a) 'The incorporation of the company known as Van Wyk & Louw (the company);

(b) The issue of shares in the company to the former members of the partnership of Van Wyk & Louw (the partnership);

(c) The transfer of the assets and business of the partnership to the company;

(d) The lending of money by the company to its directors and shareholders;

(e) All agreements, arrangements and transactions relating to (a) to (d) above; and

(f) Any combination of the above-mentioned transactions, operations or schemes or any constituent part thereof' (at 570).

The Commissioner has argued that the rights and obligations created from incorporation of the practice were abnormal by submitting (at 560) that no interest was charged to the company on the sale of the assets of the partnership to the company on credit and that no salaries were fixed between the company and its shareholders.

The Commissioner has also argued (at 571) that

> 'despite the lapse of time it must inevitably have been at least a possibility in the minds of respondent and his co-partners at the time of incorporation that loans would later be made to directors of the company. It was further submitted that in general the fact that there is a time lapse between the first steps in a transaction and the final implementation thereof is of no consequence'.

On the other hand, the taxpayer has argued (at 575 to 576) that

‘the main advantage of an unlimited company over a partnership lay in the continuity which the legal personality of a company provided. This obviated the problems which would otherwise (i.e. under a partnership) arise when a member of the firm died or retired from the practice and greatly facilitated the admission of new members. This continuity was also very advantageous when it came to the firm undertaking long-term assignments and entering into contracts, such as leases, which were to endure for some time. Other advantages were that incorporation enabled the firm to enter into consortium arrangements, such as that which occurred in the Orange River scheme, to provide a pension scheme for its employees and to give nonprofessional employees an interest in the practice by way of an issue of shares...there were also certain advantages as regards the personal liability of members of the firm, who had retired, for the obligations of the firm. Another advantage of incorporation was that it enabled the firm to build up reserves which were not taxable in the hands of the members of the firm. This was important because of the high capital expenditure which the firm had to incur in regard to the commercial side of its business’.

The taxpayer has (at 577) regarded the directors’ loan accounts

‘as a kind of reserve available at any time to the company. He stated that the total amount loaned to directors in this way represented the cost of running the practice for approximately six months’.

5.3.3. Judgment of the court, issues raised and the interpretations made by the court

The Appellate Division has found that the incorporation of practice and the granting of loans to directors should be treated as independent transactions.

‘The granting of loans to directors was not an integral part of such an incorporation scheme; nor would the granting of such loans be necessary in order to achieve these advantages. In my view, all the indications, including the lapse of time, lead to the conclusion that the loans were probably independent transactions’ (at 572).

With regard to the incorporation of practice conducted by the respondent, the Appellate Division agreed with the Court *a quo* that the abnormality and the purpose requirements of section 103(1) were not met.

In the Appellate Division's opinion, the Court *a quo* correctly found that

> 'there was no abnormality in the incorporation of the practice and the rights and obligations created under the scheme of incorporation' (at 575)

and further

> 'the postponement of income tax, which the incorporation undoubtedly achieved, was not the sole or one of the main purposes of the scheme' (at 576)

as the Court *a quo* concluded that (at 577) tax could have been a factor but not the major factor after weighing up all the advantages of the incorporation of practice.

The Appellate Division found the loans to the directors

> 'in the context of the amounts allocated to directors by way of salary and dividend, were "abnormal", both as to the means or manner employed in granting them and as to the rights and obligations created thereby' (at 582).

The conclusion of the Appellate Division was made from the following reasons.

> 'the so-called "liquid reserves", partly created by the relatively small annual amounts allocated by the directors by way of salary and dividend, were not kept in the coffers of the company, but advanced to the directors as interest-free, unsecured loans' (at 581);

> 'these loans were relatively large sums of money, e.g. in 1974 respondent's loan of R106 480 was more than double his combined salary and dividend pay-out of R43 466 (admittedly in the

subsequent two tax years the disproportion was not so marked)' (at 581);

'the salary and dividend received by a director was merely sufficient to cover his living costs and that the surplus income which he would otherwise and in the normal course have received and invested came to him in the form of a loan' (at 581);

'the loans were not made in specific amounts under specific authority, but were merely the amounts arrived at each year by deducting from the total of drawings and disbursements for the year the salary and dividend due to the director; and that it appeared to be unlikely that the loans would ever be called up or that they were ever intended to be called up' (at 581-582).

Therefore, the Appellate Division has concluded (at 582) that the avoidance or postponement of income tax 'was at least one of the main purposes' and the respondent did not rebut this presumption. The reason was as follows:

'The granting of the loans had the effect of avoiding or postponing liability for income tax, a rebuttable presumption arises that this was the sole or one of the main purposes of granting these loans, in effect in lieu of salary and/or dividend'

and that the respondent did not rebut this presumption (at 582). In the result, the Appellate Division held that the Commissioner

'was entitled to exercise the powers accorded to him by section 103(1) in regard to the directors' loans received by respondent from the company, but not in regard to the entire scheme whereby the practice was incorporated' (at 584).

5.3.4. How would the judgment in the case be different if sections 80A to 80L of the Act were applied instead of section 103(1)?

Application of GAAR to steps or arrangement as a whole

Sections 80A to 80L may be applied to steps or arrangement as a whole. Accordingly, the sale of the business from a partnership to a company by the partners and the directors' loans may be interpreted as individual steps of an arrangement.

The tax benefit from the incorporation of practice arose as

> 'companies are subject to a flat rate of normal income tax whereas individuals are taxed on a sliding scale' (at 560).

The tax benefit from the directors' loans arose as the payments made to the directors in the form of directors' loans were not subject to tax as opposed to salaries and dividends paid to the directors which would be subjected to income tax in the hands of the directors.

Therefore, the sale of the business from a partnership to a company by the partners and the directors' loans were tax avoidance arrangements in terms of section 80L.

Sole or main purpose test

Section 80G(1) is similar to section 103(1) that 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 obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

Tax benefit was not the sole or main purpose of the incorporation of practice as the taxpayer has provided evidence (at 575 to 576) that the main advantage of an unlimited company over a partnership resulted from the continuity which the legal personality of a company provided.

The respondent did not rebut the assumption that the sole or main purpose of the directors' loans was tax avoidance and the facts and circumstances of the case have shown (at 580) that had

> 'the respondent and his co-directors not received these amounts by way of loan, they would have received them, or at any rate a substantial portion thereof, by way of additional salary and/or dividend. For it seems very unlikely that respondent and his co-directors would have been content to receive as reward for their labours moneys which were only sufficient to meet living expenses, with no residue for investment, etc., and to leave large surplus cash reserves, which in fact represented the fruits of their labours, lying in the coffers of the company' (at 580).

Therefore, the judgments of both incorporation of practice and directors' loans with regard to the purpose requirement would not have been different if section 80A was applied.

Lack of Commercial Substance

In terms of section 80C(1) of the Act,

> 'an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party… 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...'.

The incorporation of business has resulted in tax benefit as the profit made by a business incorporated in the form of a company would be subject to a flat rate as compared to a sliding scale which the partners' income would be subjected to in the case of a partnership. Further, the tax payer indicated (at 576) that the tax liability of the shareholders of the company would be postponed if the company declared no dividends.

The incorporation of the practice in the form of an unlimited company has significant effect upon the business risks of the

business and the respondent as a company has the advantage of business continuity and also limited

> 'the personal liability of members of the firm, who had retired, for the obligations of the firm' (at 576).

There was also a significant effect upon the net cash flows apart from any effect attributable to the tax benefit that would be obtained. In the case of the company not declaring any dividend, the business could

> 'build up reserves which were not taxable in the hands of the members of the firm' (at 576).

The directors' loans have resulted in significant tax benefit for the directors, as no tax was paid on the loans lent to the directors. Where the amounts were paid to the directors as salaries or dividends, the amounts would have been subjected to income tax.

The directors' loans have significant effect upon the business risks of the directors as receiving loans from the company would be more risky for the directors than receiving salaries or dividends as the directors could be called upon by the company to repay the loans.

The directors' loans have no significant effect upon the net cash flows of the directors apart from any effect attributable to the tax benefit.

The incorporation of practice and the directors' loans do not show any of the criteria that are indicative of a lack of commercial substance. There was no inclusion or presence of round trip financing. There was no inclusion or presence of a tax indifferent or accommodating party. There was no inclusion or presence of elements that offset or cancelled each other. The legal substance or effect of the avoidance arrangement as a whole is not inconsistent with, or differs significantly from, the legal form of its individual steps. Accordingly, section 80C(2) could not be invoked on the incorporation of practice and the directors' loans.

Based on the analysis above, the incorporation of practice did not lack commercial substance as it has significant effect upon either the business risks or net cash flows of the shareholders of the company despite it resulted in reduction or postponement of tax liability.

On the other hand, the directors' loans lacked commercial substance as it resulted in significant tax benefits for the directors and there was no significant effect upon the net cash flows of the directors, although there was significant effect upon the business risks of the directors. Accordingly, section 80C(1) could be invoked on the directors' loans.

Abnormality test

The Appellate Division found (at 575) that 'there was no abnormality in the incorporation of the practice and the rights and obligations created under the scheme of incorporation'.

Section 80A can be invoked if the sole or main purpose of an avoidance arrangement was to obtain a tax benefit and–

> '(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…
>
> (c) in any context-
>
> (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length…'

The incorporation of practice have not created rights or obligations that would not normally be created between persons dealing at arm's length and further, in the context of business, the arrangement as a whole or the steps were not entered into or

carried out by means or in a manner that would not normally be employed for *bona fide* business purpose other than obtaining a tax benefit, for the following reasons as found by the Appellate Division. The abnormality requirements in sections 80A(a)(i) and 80A(c)(i) were therefore not met.

> 'As to the arrangement that the payment of the purchase price was to be made only as and when the company was in a financial position to do so, there is little else that the parties could have done. Initially the company had very limited capital and the idea was that it would pay off the purchase price out of profits. This it proceeded to do over a period of five to six years. Since the sellers were the persons mainly instrumental in earning those profits and were in complete control over the company, it was a perfectly sound and businesslike arrangement. It was not an arrangement that would not normally have been created by persons dealing at arm's length in this type of transaction. The same goes for the non-payment of interest on the purchase price. The non-payment of interest increased the profits of the company; and this directly benefited the erstwhile partners as shareholders in the company for it enabled the company to pay off the purchase price more rapidly. Likewise, in the particular circumstances, there was, in my view, no abnormality in the fact that the erstwhile partners gave their services to the company for no previously stipulated salaries. As controllers of the company they were able from year to year to determine in their own interests what their salaries were to be. The fact that in the tax years under review - and in previous years, it would seem – respondent received a salary which was much smaller than his income as a partner had been was again a matter of his own choice, in consultation with his co-directors and co-shareholders' (at 574-575).

The Appellate Division found (at 582) that

> 'the director's loans, seen in the context of the amounts allocated to directors by way of salary and dividend, were "abnormal", both as to the means or manner employed in granting them and as to the rights and obligations created thereby'.

Based on the following facts and circumstances found by the Appellate Division, the directors' loans have created rights or obligations that would not normally be created between persons dealing at arm's length and further, in the context of business, the arrangement were entered into or carried out by means or in a manner that would not normally be employed for *bona fide* business purpose other than obtaining a tax benefit. The abnormality requirements in sections 80A(a)(i) and 80A(c)(i) were therefore met by the directors' loans.

1) 'The amounts allocated to respondent by way of salary and dividend in the tax years under review were relatively small as compared with the amounts of income which accrued to him under the partnership' (at 579).

2) 'It is clear from respondent's own evidence…that the amount received by him each year by way of salary and dividend was sufficient to meet his normal living costs and that that portion of his income which otherwise (e.g. under a partnership system) he would normally have saved and invested was advanced to him by way of a loan by the company' (at 579).

3) 'In each of the tax years under review the company made large after-tax profits…the very substantial amounts advanced to the directors by way of loans represented cash reserves surplus to the requirements of the company' (at 579).

Misuse and abuse test

Based on the facts and circumstances of this case, it is unlikely that the incorporation of practice and the directors' loans would be considered to be misuse or abuse of the provisions of the Act.

Conclusion

The judgment would not be different if sections 80A to 80L of the Act were applied instead of section 103(1).

The directors' loans would be an impermissible tax avoidance arrangement as defined in section 80A, as the sole or main purpose requirement was met, the means or manner which the arrangement was carried out were abnormal, there were abnormal rights or obligations and there was a lack of commercial substance.

The incorporation of practice would not be an impermissible tax avoidance arrangement as the purpose, abnormality and lack of commercial substance requirements in section 80A were not met.

5.4. *SIR v Geustyn, Forsyth & Joubert* 1971 (3) SA 567 (A), 33 SATC 113

5.4.1. Background of the case

Similar to the *CIR v Louw* case**,** the *SIR v Geustyn, Forsyth & Joubert* case also dealt with the transfer of a business from a partnership to an unlimited company. The facts of the case were as follows.

> 'P.J. Geustyn, K. W. Forsyth and J. de B. Joubert - all of whom are qualified civil engineers and members of the South African Association of Consulting Engineers - had practised in partnership as consulting engineers. The partnership practice expanded fast, and by May, 1966, the firm employed a staff of 42 white persons, including 17 qualified engineers, and, in addition 18 non-white persons. Pursuant to a decision of the partners - arrived at for reasons hereinafter mentioned - to form an unlimited company to take over the partnership business, respondent company was on 25th May, 1966 incorporated with a share capital of R5 000 divided into 5 000 shares of R1 each. The assets and liabilities of the partnership were taken over by the respondent company at the figures reflected in the balance sheet of the partnership as at 25th May, 1966. In addition, the respondent undertook to pay the partnership R240 000 for goodwill and to employ the three partners at an annual salary of R10 000 each. All the shares in the respondent were issued to the three

former partners in equal shares. The three partners became the sole directors of the respondent company. In respondent's books the goodwill of R240 000 was credited to the directors' loan accounts in equal amounts of R80 000 each. Save for a shareholders' agreement imposing, in the event of a former partner ceasing to be a shareholder, a restraint against practice unless he forfeit his share of goodwill, no written agreements were concluded between any of the respective persons concerned. In particular, no service contract was entered into between the respondent and the former partners. The respondent furnished no guarantee for the payment of the goodwill, the former partners relying solely upon their control of respondent to secure such payment' (at 570).

5.4.2. Arguments of the taxpayers and the Commissioner

The Commissioner has argued (at 576) that the avoidance, postponement or reduction of tax liability must have been at least one of the main reasons of converting the partnership into a company. In the creation of the loan accounts, considerable tax advantages would have been possible for the three former tax partners together with the initial tax advantages from the conversion of the partnership into a company.

The Commissioner has also argued (at 573) that the scheme 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 scheme of the nature of the scheme in question and has created rights or obligations which would not normally be created between persons dealing at arm's length under a scheme of the nature of the scheme in question for the following reasons.

> The 'disparity between the partnership's earnings and the salary of R10 000 p.a. which each of the partners accepted from the respondent; the R240 000 goodwill; the absence of any security therefor or of any stipulation governing payment at any particular time; the absence of any service contracts binding the former partners to continue to work for respondent' (at 573).

The respondent has argued (at 575) that tax avoidance was not the sole or main purpose of converting the partnership into an unlimited company as the question of possible tax savings was considered and discussed with an accountant before the formation of the company. The partners were advised that

> 'although there would be an immediate advantage by forming the partnership into a company, in the long run there would be little tax advantage to the partners' (at 575).

Therefore, the tax savings were not a major factor in deciding whether to convert the partnership into a company.

Further, the partners have indicated that there were considerable advantages that could

> 'be derived from incorporation, as contrasted with partnership which was liable to dissolution consequent upon death, resignation and the like. Such advantages inter alia embraced the facility of participation in consortiums of engineers engaged upon large projects, the ability to increase the participation in profits by qualified engineer-employees while, at the same time, eliminating the necessity to restrict the number of partners to the legal limit of twenty' (at 574).

The respondent has also argued that the arrangement was not abnormal as the

> 'formation of a company for the purpose of transferring an existing business is a well-known method of arranging affairs in the business world' (at 569).

5.4.3. Judgment of the court, issues raised and the interpretations made by the court

The Special Income Tax Court has found (at 575) that avoidance, postponement or reduction of tax was not the sole or main

purpose of the conversion of the partnership into a company as it has agreed with the respondent's submission that

> 'it would be unreasonable to suppose that three professional men, each earning in excess of R30 000 per annum, would have regarded one year's tax saving of R1 456 as a prime motive for changing their partnership into a company with all the attendant cost' (at 575).

Tax avoidance was not the sole or main purpose of the arrangement was further illustrated by the fact (at 574) that the three partners have paid taxes on their director's fee of R7500 each, interest calculated at 8.5 percent on their respective loan accounts, and salary of R10 000 each.

The Special Court has found (at 573) that there was nothing abnormal either in the conversion of the partnership into an unlimited company or in relation to the unlimited company's undertaking to pay R240 000 for goodwill.

The following evidence was taken into account by the Judge in the Special Court in arriving at his decision that the abnormality requirement was not met.

> 'South African Association of Consulting Engineers - of which, as already mentioned, the afore-named three erstwhile partners are members - expressly sanctioned its members forming unlimited companies to conduct their practices, but more than half the Association's membership has already adopted that form of practice' (at 573).

> 'The absence both of any security furnished by respondent and of any service contracts binding the erstwhile partners to continue to work for respondent is explicable by reason of the inherent circumstances that the aforenamed erstwhile partners made over their practice to respondent, of which they remained in full control' (at 574).

The Appellate Division has concluded that it could not disturb the decision of the Special Court (at 577) that

> ‘tax avoidance was not a factor which was taken into consideration by the partners in deciding to practice as an unlimited company’

based on the evidence provided by the partner and the accountant to the Special Court that tax saving was not a major consideration in converting the business from a partnership to an unlimited company.

Therefore, it was not possible for the Appellate Division to conclude (at 577) that the judgment of the Special Income Tax Court was not reasonably reached and section 103(1) could not be invoked by the Commissioner.

5.4.4. How would the judgment in the case be different if sections 80A to 80L of the Act were applied instead of section 103(1)?

Application of GAAR to steps or arrangement as a whole

In this case, the conversion of the partnership into an unlimited company and the crediting of the directors’ loan accounts in relation to the company’s payment for the goodwill of the partnership are steps of an arrangement. Sections 80A to 80L may be applied to an arrangement as a whole or steps of an arrangement. Accordingly, sections 80A to 80L may be applied to these steps.

Tax benefit arose from the conversion of the partnership to an unlimited company were the ‘initial tax advantage’ of R1 456 (at 575) and the tax saving of R19 955 on tax income of R72 840 as a result of the flat income tax rate of an unlimited company as compared to the higher marginal income tax rate of an individual (at 576).

Tax benefit was resulted from the crediting of the directors’ loan accounts. The payment by the company to the directors for the goodwill would be considered as capital in nature and therefore, tax would not be payable whereas the income accrued to the partners from the partnership would be considered as revenue in nature and subjected to income tax.

In terms of section 80L, the conversion of the partnership to an unlimited company and the crediting of the directors' loan accounts in relation to the company's payment for the goodwill were tax avoidance arrangements.

Sole or main purpose test

The advantage of incorporation as compared to partnership was business continuity as a partnership was 'liable to dissolution consequent upon death, resignation and the like' (at 574) of the partners. Other advantages of incorporation also included

> 'the facility of participation in consortiums of engineers engaged upon large projects, the ability to increase the participation in profits by qualified engineer-employees while, at the same time, eliminating the necessity to restrict the number of partners to the legal limit of twenty' (at 574).

Tax avoidance was not a factor in deciding whether to convert the partnership into a company by the partners and it was illustrated (at 575) that the question of possible tax savings was discussed with the accountant before the partners decided to form a company and the accountant has advised the partners that any immediate tax advantages should be disregarded as such would merely be of a temporary nature.

Goodwill was resulted from the sale of the business from the partnership to an unlimited company. The Special Court has found (at 576) that the sole or main purpose of the conversion was not tax avoidance. Accordingly, the directors' accounts created from the sale of the business were also not tax avoidance.

In the result, tax benefit was not the sole or main purpose of the steps or the arrangement as a whole, as incorporation as a company has considerable advantages.

Therefore, the judgment with regard to the purpose requirement would not have been different if section 80A was applied.

Lack of Commercial Substance

The conversion from a partnership to an unlimited company has resulted in tax benefit in the hands of the directors of the company as there were the 'initial tax advantage' of R1 456 (at 575) and the tax saving of R19 955 on tax income of R72 840 as a result of the flat income tax rate of an unlimited company as compared to the higher marginal income tax rate of an individual (at 576).

The evidence of this case has (at 574) shown that the conversion from a partnership to an unlimited company has a significant effect upon the business risks of the respondent as a company had the advantage of business continuity and further, the possibility of dissolution of the business consequent upon death and resignation of the partners was eliminated in the case of a partnership. In the result, the business risk of discontinuity was reduced as a result of the conversion.

Another significant effect upon the business risks of the respondent was that by converting from a partnership into an unlimited company, the respondent undertook to pay goodwill to the directors in the form of directors' loans whereas the partnership did not have any liability to the partners for goodwill prior to the conversion. The creation of goodwill and the repayment of the directors' loans have a significant effect upon the net cash flows of the respondent.

The conversion from a partnership to an unlimited company did not show any of the criteria that were indicative of a lack of commercial substance. There was no inclusion or presence of round trip financing. There was no inclusion or presence of a tax indifferent or accommodating party. There was no inclusion or presence of elements that offset or cancelled each other. The legal substance or effect of the avoidance arrangement as a whole was not inconsistent with, or differs significantly from, the legal form of its individual steps. Accordingly, section 80C(2) could not be invoked on the conversion.

Based on the analysis above, the conversion would resulted in reduction of tax liability of the directors but it did not lack commercial substance as it has significant effect upon the business risks and net cash flows of the respondent apart from any effect attributable to the tax benefit that would be obtained. Accordingly, section 80C(1) could not be invoked on the conversion from the partnership to an unlimited company.

Abnormality test

The Appellate Division has found (at 573) that there was nothing abnormal in transferring an existing partnership business to an unlimited company or in relation to the company's undertaking to pay R240 000 for goodwill as the formation of a company for the purpose of transferring an existing business was a common practice in the Engineers' profession.

Further, the Special Court has (at 574) found that the conversion of the business from the partnership to an unlimited company was not entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out a scheme of the nature of the scheme in question and the conversion has not created rights or obligations that would not normally be created between persons dealing at arm's length illustrated as follows.

> 'The absence both of any security furnished by respondent and of any service contracts binding the erstwhile partners to continue to work for respondent is explicable by reason of the inherent circumstances that the aforenamed erstwhile partners made over their practice to respondent, of which they remained in full control' (at 574).

Based on the facts and circumstances of the case, it is unlikely that the conversion of the practice would be considered to have entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purpose in the context of business or have created rights or obligations that

would not normally be created between persons dealing at arm's length in any context as the majority of consulting engineers in the certain developed countries were practising in the corporate form (at 574).

The transfer of the business from a partnership to a company has resulted in the payment of goodwill in the form of directors' loans. The payment of goodwill in a sale of business of this nature is normal. Accordingly, the obligation in paying the loan repayments by the company and the right in receiving loan repayments by the directors would also be considered as not abnormal. Therefore, the directors' loans would not be considered to have entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purpose in the context of business or have not created rights or obligations that would not normally be created between persons dealing at arm's length.

Misuse and abuse test

Based on the facts and circumstances of this case, it is unlikely that the conversion from a partnership to an unlimited company or the crediting of the directors' accounts for the payment of goodwill would be considered to be misuse or abuse of the provisions of the Act.

Conclusion

The judgment would not be different if sections 80A to 80L of the Act were applied instead of section 103(1).

The sole or main purposes of the conversion from a partnership to an unlimited company and the crediting of the directors' accounts for the payment of goodwill were not tax avoidance, therefore the requirements in section 80A were not met and they are not considered to be impermissible tax avoidance arrangements.

5.5. *Hicklin v SIR* 1980 (1) SA 481 (A), 41 SATC 179

5.5.1. Background of the case

The appellant has appealed against the decision of the Transvaal Income Tax Special Court. The issue raised was (at 485) whether the Secretary has correctly invoked the tax avoidance provisions of section 103 by attributing tax liability to the appellant, based on the portion of the distributable profits of a dormant, private company of which he had been a shareholder.

The facts of the *Hicklin v SIR* case were summarised as follows:

5.5.1.1. Appellant and two others were the shareholders and directors of a company called Reklame Bestuur (Edms) Bpk, hereafter referred as Reklame (at 485). Reklame was managing an advertising agency company called Adverto (Pty) Ltd, hereafter referred to as Adverto. The appellant and the two other shareholders of Reklame also had interests in Adverto (at 486).

5.5.1.2. Since inception of Reklame, its income or profits were retained for use as working capital for Adverto or for investment. No dividends were declared or paid out by Reklame and the accumulated undistributed profits were never subjected to undistributed profit tax under the Act since they were within the exemption mentioned in section 50*(f)* of the Act at that time (at 486).

5.5.1.3. As at 1 March 1971, Reklame and Adverto sold their business to a new company in which an overseas advertising agency, appellant and his two co-shareholders acquired shares. Reklame received R150 000 for the sale of its business. This amount was recognised as a capital accrual and shown on its balance sheet as a non-distributable reserve (at 486).

5.5.1.4. The new company took over the name of Adverto. The original Adverto was renamed as P Viljoen Advertisers

(Pty) Ltd, hereafter referred to as Viljoen Advertisers. Viljoen Advertisers became a wholly owned subsidiary of Reklame. The balance sheet of Reklame has shown an investment in Viljoen Advertisers at a cost of R100 000. In consequence of the above mentioned transactions, both Reklame and Viljoen Advertisers became dormant companies. Thereafter, Reklame borrowed an interest-free loan from Viljoen Advertisers (at 486).

5.5.1.5. The appellant and his co-shareholders have also borrowed interest-free and unsecured loans from Reklame (at 486). At the annual general meeting of Reklame on 30 July 1973, it was resolved that a dividend of R30 000 should be paid out of its distributable profits. The purpose of the dividend was to set-off against the shareholders' loans. However, the shareholders as directors subsequently decided not to pay or give effect to the payment of the dividend as the shareholders would have become liable to income tax on the dividends (at 487).

5.5.1.6. In 1975, the appellant found a buyer, Ryan Nigel Corporation Ltd (Ryan Nigel), for Reklame. The buyer has drawn up an agreement for the purchase of the shareholders' shares in Reklame, hereafter referred to as the RN agreement (at 488). The purchase price of the shares was the net asset value of Reklame less 10% of the distributable reserves of Reklame as reflected on its balance sheet (at 489).

5.5.1.7. On 30 December 1975, the new directors of Reklame declared its distributable profits as a dividend and the non-distributable reserve as a pre-deregistration dividend. These dividends were paid out after Reklame has deregistered and no income tax was paid on these dividends (at 490).

5.5.1.8. The appellant argued that the shareholders were not interested in, concerned with, or informed precisely what the buyer would do with Reklame after the buyer purchased the shares. Therefore, the appellant and the other shareholders were not associated with the operation conducted by the buyer after it acquired the shares and accordingly, they were not liable for the tax on the dividend paid by Reklame (at 490).

5.5.2. Arguments of the taxpayer and the Commissioner

The Secretary argued that that the appellant's share of the total distributable reserve of Reklame should be regarded as a dividend received by the appellant and taxable in the appellant's hand and also argued that

> 'the conduct of the shareholders from 1971/2 onwards must be regarded as the scheme, i.e. their continual borrowing from Reklame out of its distributable profits, interest free and unsecured; their keeping Reklame, although dormant, in existence merely in order to preserve those loans; their abandoning all intention of declaring dividends out of those profits; their ultimately entering into and carrying out the RN agreement in 1975; and Reklame's subsequent dividend declarations' (at 491).

The advocate for the respondent has argued (at 484) that the scheme was not entered into or carried out by means or in a manner which would normally be employed and the rights or obligations that were created by the transactions were not those that would normally be created between persons dealing at arms' length. It was argued that it was not normal:

(a) For 'a dormant company to lend its total assets to its shareholders in accordance with their shareholding' (at 484);

(b) For 'directors to keep a dormant company in existence for the sole purpose of perpetuating directors' loans' (at 484);

(c) To 'de-declare dividends' (at 484);

(d) To ‘convert all the assets of a company into debit loan accounts for the purpose of the sale of shares’ (at 484);

(e) To ‘purchase a dormant company stripped of all assets’ (at 484);

(f) For ‘shareholders to pay to get rid of their shares, especially where their shareholding enabled them to utilise interest free loans amounting to approximately R250 000 at a cost of R90 per annum’ (at 484);

(g) To ‘sell shares at a discount calculated against the distributable reserves’ (at 484);

(h) To ‘pay and repay the purchase price of shares simultaneously’ (at 484); and

(i) For ‘shareholders agreed to sell the company at a purchase price of R236 419 against repayment of their loans amounting to R248 511 and representing the total amount of the accumulated reserves including the distributable profits of the company, thereby causing themselves to be out of pocket to the extent of R13 366'.

On the other hand, the appellant testified that

> ‘in negotiating and concluding the RN agreement, the shareholders were not interested in, concerned with, or informed precisely about what Ryan Nigel wanted to do with Reklame after it acquired the shares. He assumed that the discount of 10 percent would be Ryan Nigel's ultimate gain from the transaction’ (at 490).

5.5.3. Judgment of the court, issues raised and the interpretations made by the court

Judgment of the Special Income Tax Court

The Special Court has found that the sole or main purpose of the scheme was tax avoidance as the scheme was entered into in order for the appellant and his co-shareholders to use the unappropriated profits in Reklame ‘without incurring liability for tax’ (at 484).

The Special Court held (at 493) that ‘the distributable profits were in reality the income of the shareholders' in regard to the effect and purpose of the RN agreement’.

Judgment of the Appellate Division

The Appellate Division has found that the approach which was taken by the Special Income Tax Court was incorrect as

> ‘it ignored the factors that Reklame had its own juristic personality, separate and distinct from its shareholders and that in law therefore its distributable profits did not belong to the shareholders until declared as dividends’ (at 494).

The Appellate Division has indicated that as a

> ‘consequence of the RN agreement Reklame passed completely out of the hands of appellant and his co-shareholders. They did not retain any association with or interest in it or any control over its affairs. In particular they had nothing to do with the subsequent declaration of the dividends just mentioned’ (at 490).

The judgment of the Appellate Division was held in favour of the appellant. It held that the appellant and the buyer of Reklame have dealt with each other at arm’s length in entering into the RN agreement and the RN agreement has not created rights or obligations which would not normally be created between persons dealing at arm’s length under a transaction of the nature of the transaction in question. The decision of the Appellate Division was based on the facts that

> ‘neither Reklame nor its shareholders, as directors or otherwise, were associated with or interested in Ryan Nigel’

and the offer to purchase the shares of a company with capital and distributable reserves ‘was made in the ordinary course of that business’ of the buyer (at 495).

The Appellate Division held that the rights and obligations created by the RN agreement was normal as an attorney who was well-experienced in drafting agreements for the taking over of shares in private companies confirmed that

> ‘the form of the RN agreement was a normal one containing the rights and obligations that are to be ordinarily expected in an agreement of that kind’ (at 496).

The Appellate Division has held (at 496) that the interest-free and unsecured loan borrowed by the shareholders

> ‘for the purpose of fulfilling their obligations of clearing Reklame of its assets and liabilities’

which was ‘done with the knowledge and consent of Ryan Nigel’ was not abnormal as

> ‘a private company can make loans to its directors with the requisite consent of its Shareholders’

in terms of ‘section 226(1) of the Companies Act 61 of 1973’ at the time.

The Appellate Division has found (at 497) that

> ‘it was not only normal, but a sound business and common sense way of both sides fulfilling their respective obligations in an at arms’ length agreement’ in settling the indebtedness of the parties of an agreement with ‘simultaneous exchange of cheques’ (at 497).

The Appellate Division has agreed with the judgment of the Special Court (at 494) that

> ‘there could be no doubt that the scheme was entered into with the sole purpose of avoiding the payment of income tax. There can be no doubt that the sole purpose of the shareholders in not declaring dividends and in removing the assets of the company by means of so-called loans was the postponement of tax. The sale of the shares was a scheme perpetuating this position’. (at 494.)

The judgment of the Appellate Division was held in favour of the appellant even though the purpose requirement was met as the abnormality requirement was not met.

5.5.4. How would the judgment in the case be different if sections 80A to 80L of the Act were applied instead of section 103(1)?

Application of GAAR to steps or arrangement as a whole

Section 80L provides that an arrangement includes 'all steps therein or parts thereof' and avoidance arrangement means 'any arrangement that…results in a tax benefit'.

The scheme as a whole was (at 484) non declaration of dividends of a company which has accumulated distributable profits, removing assets of a company by means of shareholders' loans and the sale of a company's shares to another company which subsequently declared the distributable profits as a tax exempt dividend.

The application of the new GAAR provisions are examined in relation to the scheme as a whole and also to the interest-free and unsecured shareholders' loans, the sale of Reklame shares by its shareholders to Ryan Nigel and the dividend declared by Reklame on its distributable profit separately.

Tax benefit was resulted from the scheme as the dividend declared by Reklame to Ryan Nigel was exempt due to section 10(1)(k)(i) and the distributable profits received by shareholders of Reklame received in the form of the Reklame's selling price was also not taxable.

Dividend was not paid as 'the shareholders would have become liable to income tax on it' (at 487). Tax benefit was resulted from the shareholders' loans as these loans have removed assets from Reklame to the shareholders without the distribution of the distributable profits as dividends.

Tax benefit was resulted from the sale of Reklame shares as

> ‘by entering into and implementing the RN agreement, appellant and his co-shareholders in reality received the distributable profits of Reklame, even though they had not been declared as dividends’ (at 493).

The dividend declared by Reklame has not resulted in tax benefit in the hands of the shareholders as the Appellate Division has found (at 494) that

> ‘Reklame had its own juristic personality, separate and distinct from its shareholders’.

Therefore, it has found (at 494) that Reklame’s distributable profits belonged to it and not its shareholders and the shareholders have not received its distributable profits that were subsequently declared by Ryan Nigel as dividends to itself.

Therefore, the scheme as a whole, the shareholders’ loans, and the sale of Reklame shares were tax avoidance arrangements, but the dividend declared by Reklame on its distributable profit was not a tax avoidance arrangement in terms of section 80L.

Sole or main purpose test

Tax benefit was the sole or main purpose of the scheme as whole as the Appellate Division has agreed with the judgment of the Special Court (at 494) that

> ‘there could be no doubt that the scheme was entered into with the sole purpose of avoiding the payment of income tax. There can be no doubt that the sole purpose of the shareholders in not declaring dividends and in removing the assets of the company by means of so-called loans was the postponement of tax. The sale of the shares was a scheme perpetuating this position’. (at 494.)

The sole or main purpose of the scheme as a whole, the shareholders’ loans, and the sale of Reklame shares were tax avoidance.

Therefore, the judgment with regard to the purpose requirement would not have been different if section 80A was applied to the scheme as a whole, the shareholders' loans, and the sale of Reklame shares.

Lack of Commercial Substance

In this case, the appellant and his co-shareholders were aware of the significant tax benefit for them by not distributing dividends from Reklame and borrowing interest-free and unsecured loans from Reklame. To avoid income tax liability, they have abandoned

> 'all intention of declaring and paying dividends out of the distributable profits for the foreseeable future ('unless something unforeseen happened'). And indeed thereafter no dividends were declared while they still controlled Reklame' (at 487).

There was a significant effect on the business risks of the appellant and the co-shareholders from borrowing interest-free and unsecured loans from Reklame as they owed money to Reklame. There would be a significant effect on the net cash flows of the appellant and the co-shareholders apart from any effect attributable to the tax benefit that would be obtained when the loans were repaid.

The scheme as a whole and the sale of Reklame shares by its shareholders to Ryan Nigel have resulted in the transfer of ownership of Reklame and receipt of the purchase price by the appellant and his co-shareholders. These transactions have a significant effect on the business risks and net cash flows of the appellant and his co-shareholders.

Therefore, section 80C(1) would not be invoked on the scheme as a whole, the shareholders' loans, and the sale of Reklame shares.

There was no inclusion or presence of round trip financing. There was no inclusion or presence of a tax indifferent or accommodating party. There was no inclusion or presence of elements that offset or cancelled each other.

The legal substance or effect of the avoidance arrangement as a whole is not inconsistent with, or differs significantly from, the legal form of its individual steps.

Therefore, section 80C(2) would not be invoked on the scheme as a whole, the shareholders' loans, and the sale of Reklame shares as they did not have any criteria that would indicate a lack of commercial substance.

Abnormality test

The means or manner in which Reklame shares were sold by the shareholders was found to be normal as the means or manner in which the shareholders fulfilled their obligations were 'done with the knowledge and consent of Ryan Nigel' (at 496).

The Appellate Division found rights and obligations in the RN agreement were at arm's length as neither

> 'Reklame nor its shareholders, as directors or otherwise, were associated with or interested in Ryan Nigel' (at 495);

the agreement was drawn up by Ryan Nigel and tendered to the shareholders 'as an offer to purchase their shares on an accept-it-or-reject-it basis' (at 495); and it

> 'was part of Ryan Nigel's business to purchase the shares of companies with capital and distributable reserves, and this offer was made in the ordinary course of that business' (at 495).

Therefore, the abnormality requirement is not met by the sale of the Reklame shares.

The means and manner in which the shareholders' loans were lent to the shareholders would be considered to be abnormal as the

> 'amounts of the loans were roughly proportioned to the shareholding of each of them in Reklame'

(at 496) and the loans were made when Reklame was dormant. The rights and obligations created from the loans were not those that would be created between persons dealing at arm's length as the loans between Reklame and the shareholders were interest-free and unsecured.

Therefore, the abnormality requirement is met by the shareholders' loans.

Misuse and abuse test

In the same year which Ryan Nigel has purchased the Reklame shares from the appellant and his co-shareholders,

> 'the new directors of Reklame declared its distributable profits of R96 906 as a dividend'

(at 490). No tax was paid on this dividend declared and paid by Reklame to Ryan Nigel Corporation Ltd as

> 'dividends received by a company are exempt from tax under s 10 (1) (k) (i)'

according to the Act at the time (at 490). Therefore, it could be argued that section 10(1)(k)(i) was misused and abused by the scheme as a whole.

Conclusion

The judgment could be different if sections 80A to 80L of the Act were applied instead of section 103(1) on the shareholders' loans as the sole or main purpose was tax benefit, the means and manner in which the loans were lent to the shareholders were abnormal and the rights and obligations created from the loans were not at arm's length. Therefore, the shareholders' loans would be considered to be impermissible tax avoidance arrangements as the purpose and abnormality requirements in section 80A were met.

The judgment could be different if sections 80A to 80L of the Act were applied instead of section 103(1) on the scheme as a whole as the sole or main purpose of the scheme was tax benefit and the scheme would result directly or indirectly in the misuse or abuse of a provision of the Act.

The sole or main purposes of the sale of Reklame shares by its shareholders to Ryan Nigel were tax avoidance. However, the abnormality, the lack of commercial substance and the misuse or abuse requirements were not met therefore it is unlikely that section 80A would be invoked on them.

5.6. ITC 1712 (2000) 63 SATC 499 (G)

5.6.1. Background of the case

ITC 1712 (2000) 63 SATC 499 (G) is a case which dealt with a leasing transaction (at 501) which the appellant concluded a lease with the bank in February 1997 and the appellant in turn entered into an agreement with its lessee.

In terms of the main lease agreement, the appellant paid the bulk of the rental for the tank containers within the first two years. Therefore, there was an ‘uneven spread of the amounts of the rental’ (at 502).

The appellant has claimed (at 503) a deduction of the first year’s rental of R230 258.15 in his tax return for the 1997 year of assessment but the Commissioner had only allowed a deduction calculated by dividing the total lease rental amounts by the total number of months over the lease period and multiplied by the number of months which the tank containers were leased.

5.6.2. Arguments of the taxpayer and the Commissioner

The appellant argued (at 502) that the lease entered into by the appellant with the bank was a perfectly normal transaction

concluded at arm's length, on usual terms stipulated for by the bank for good commercial reasons and accepted by the appellant.

The Commissioner viewed that the lease agreement had no *bona fide* business purpose other than the obtaining of a tax benefit and in addition, the spread of the rental was abnormal.

The Commissioner submitted that the lease transaction had been

> '"in the context of business" and that the post 1996 normality test in section 103(1)(b)(i)*(aa)* therefore applied, *i.e.* he had to be satisfied "having regard to the circumstances" that the transaction "was entered into or carried out…in a manner which would not normally be employed for *bona fide* business purposes other than the obtaining of a tax benefit"' (at 501).

The Commissioner further submitted that

> 'the initial rental and the uneven spread of the amounts of the rental, as well as the timing of the transaction, constituted it abnormal' (at 502).

The Commissioner's representative submitted that the normality test required was

> 'the appellant's transaction *in casu* should be compared with the hypothetical model of the "normal" transaction and that the hypothetical model of the "normal" transaction is determined by asking: How would businessmen generally, not motivated by any tax considerations but rather by "*bona fide* business purpose", have structured that transaction?' (at 501).

5.6.3. Judgment of the court, issues raised and the interpretations made by the court

The issues examined by the Gauteng Special Court in this case was whether the transaction was abnormal and whether the appellant's sole or main purpose was to avoid, reduce or postpone liability for tax.

The court did not consider the timing of the transaction to be abnormal as the appellant was advised to enter into the transaction immediately if he wished to take advantage of the investment opportunity.

> 'The evidence before us was that there were ten containers available and that the appellant was advised to enter into the transaction immediately if he wished to take advantage of the availability of those containers. We find nothing sinister in this and we do not consider that the timing of the transaction, on the analysis of the law advanced by the Commissioner's representative, was abnormal. The investment opportunity was there for a limited and uncertain period of time and the appellant took it' (at 502).

Further, evidence was provided by the appellant to indicate that the higher initial rental claimed by the appellant was not abnormal.

Based on the evidence of the Managing Director of the appellant, who has been involved in the tank container industry for many years and who has been involved in countless tank container transactions (at 502), it was normal for the banks with whom the appellant has a loose business relationship to require payment up front of not less than 35% of the initial value of the contract and a substantial payment in the second year.

The judgment was held in favour of the appellant as the court has held (at 502) that

> 'the Commissioner had not discharged the onus which the Commissioner was obliged to discharge'

in regard to the abnormality of the transaction and that was

> 'fatal to the Commissioner's reliance on section 103(1)'

and

> 'accordingly not necessary for the court to consider appellant's purpose in entering into the transaction'.

5.6.4. How would the judgment in the case be different if sections 80A to 80L of the Act were applied instead of section 103(1)?

Application of GAAR to steps or arrangement as a whole

The scheme as a whole, the lease between the bank and the appellant, and the lease between the appellant and his lessee were arrangements in terms of the definition of 'arrangement' in section 80L.

In terms of the definition of 'avoidance arrangement' in section 80L, it means 'any arrangement…results in a tax benefit'.

Tax benefit was resulted from the lease between the bank and the appellant as the appellant was entitled to claim rental deductions from the lease payments made to the bank and significant portion of these lease payments were claimed upfront within the first two years by the appellant as a result the appellant's tax liability was reduced or postponed.

The Special Court has found the arrangement as a whole

> 'had the effect of at least postponing or reducing the appellant's liability for tax' (at 501).

Accordingly, the scheme as a whole and the lease between the bank and the appellant were avoidance arrangements in terms of section 80L.

Sole or main purpose test

The bank has purchased the tank containers and leased it to the appellant instead of lending appellant the money to purchase the tank containers. The appellant could claim a higher rental deduction if he leased the tank containers as compared to a lower interest deduction if he borrowed money from the bank.

The Commissioner has indicated (at 502) that the uneven spread of the rental payments over the period of the lease between the

bank and appellant has allowed the appellant to claim the bulk of the rentals for the tank containers within the first two years.

Based on the analysis above, tax benefit could be the sole or main purpose of the steps or the scheme as a whole and the purpose requirement in section 80A could have been met. The appellant's purpose in entering into the scheme was not considered by the court as the Commissioner has not (at 502)

> 'discharged the onus which the Commissioner was obliged to discharge'

with regard to the abnormality requirement.

Lack of Commercial Substance

The appellant has gained significant tax benefit by claiming higher rentals in the first two years of the lease between him and the bank.

If the scheme as a whole and the lease between the bank and the appellant did not have a significant effect upon either the business risks or net cash flows of the appellant, then section 80C(1) could be applied.

The appellant received lease rentals from his lessee and paid lease rentals to the bank. Therefore, the scheme as a whole and the lease between the bank and appellant have a significant effect upon the business risks of the appellant as the rentals received from the appellant's lessee were not guaranteed.

The payment of rentals upfront by the appellant and the receipt of rentals by him on a monthly basis have a significant effect on net cash flows of the appellant. Therefore, section 80C(1) would not be applied.

There was no inclusion or presence of a tax indifferent or accommodating party. There was no inclusion or presence of round trip financing. There was no inclusion or presence of

elements that have the effect of offsetting or cancelling each other.

Further, the legal substance or effect of the avoidance arrangement as a whole was not inconsistent with, or differs significantly from, the legal form of its individual steps.

The scheme as a whole and the lease between the bank and the appellant did not showed characteristics of an avoidance arrangement that were indicative of a lack of commercial substance and therefore, section 80C(2) would not be applied.

Abnormality test

The judgment was held in favour of the taxpayer as the Commissioner has failed to prove (at 502) that the transaction was abnormal in terms of section 103(1) of the Act.

The Special Court has found that the timing of the lease was not abnormal as the

> 'investment opportunity was there for a limited and uncertain period of time and the appellant took it' (at 502).

The Managing Director of the appellant's lessee has testified (at 502) that the higher upfront rental payment from a lessee was necessary if the bank has a loose business relationship with the lessee. He submitted (at 502) that the

> 'only exceptions are where the client is able to put up substantial security. The reason for this attitude on the part of the banks is that they wish their exposure to be reduced as soon as possible to an amount which can in the event of a default, be serviced by the rental income from the containers, in as much as the containers themselves provide very little security – they are sent all over the world, making it difficult for banks to repossess them in the event of a default' (at 502).

The appellant has submitted (at 502) that the rental payments were stipulated by the bank and that he had no choice but to accept the bank's terms.

Based on the evidence provided by the Managing Director of the bank and the appellant, it was unlikely that the Commissioner could successfully prove that the lease between the appellant and the bank as part of the scheme or the arrangement as a whole was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purpose in the context of business. Further, no evidence has indicated that rights or obligations that would not normally be created between persons dealing at arm's length were created.

The lease between the appellant and the bank as part of the scheme or the arrangement as a whole would therefore not met the abnormality requirement in section 80A(a)(i).

Misuse and abuse test

Section 11(a) provides that for the purpose of determining the taxable income derived by any person from carrying on any trade,

> 'expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature'

shall be allowed as deductions from the income of such person'.

The lease between the appellant and the bank as part of the scheme or the arrangement as a whole has resulted in an up-front deduction by the appellant. Therefore, it can be argued that it has resulted in misuse or abuse of section 11(a) of the Act.

Conclusion

The judgment would be different if sections 80A to 80L of the Act were applied instead of section 103(1). The sole or main purposes of the lease between the bank and the appellant and the

arrangement as a whole could have been tax avoidance and the upfront rental deduction has provided evidence that there was misuse or abuse of the provisions of the Act. Therefore, the lease between appellant and the bank as part of the scheme or the arrangement as a whole could be an impermissible tax avoidance arrangement as defined in section 80A.

5.7. Conclusion

The judgment of the *CIR v Conhage (Pty) Ltd* would not be different if sections 80A to 80L of the Act were applied instead of section 103(1), as the scheme as a whole, the sale and the lease would not be impermissible tax avoidance arrangements as defined in section 80A.

The judgment of the *CIR v Louw* case would not be different if sections 80A to 80L of the Act were applied instead of section 103(1). The incorporation of practice would not be an impermissible tax avoidance arrangement as the requirements in section 80A were not met. Similar to the judgment in terms of section 103(1), the directors' loans would be an impermissible tax arrangement as defined in section 80A as the purpose and abnormality requirements were met and they lacked commercial substance.

The judgment of the *SIR v Geustyn, Forsyth & Joubert* case would not be different if sections 80A to 80L of the Act were applied instead of section 103(1), as the sole or main purposes of the conversion from a partnership to an unlimited company and crediting of the directors' accounts for the payment of goodwill were not tax avoidance, and therefore they were not impermissible tax avoidance arrangements in terms of section 80A of the Act.

The judgment of the *Hicklin v SIR* case would be different if sections 80A to 80L of the Act were applied to the interest-free and unsecured shareholders' loans lent by the dormant company to its shareholders and the scheme as a whole instead of section 103(1). The sole or main purpose of these shareholders' loans was tax avoidance, the means and manner in which the shareholders' loans were lent to the shareholders were abnormal and the rights and obligations created from the loans were not at arm's length. The sole or main purpose of the scheme was tax avoidance and it would result in

the misuse or abuse of the provision of the Act. Therefore, it is likely that section 80A may be invoked on the scheme and the shareholders' loans and they would be considered to be impermissible tax avoidance arrangements.

The judgment of the *Hicklin v SIR* case could be different if sections 80A to 80L of the Act were applied instead of section 103(1) on the scheme as a whole as the sole or main purpose of the scheme was tax benefit and the scheme would result directly or indirectly in the misuse or abuse of a provision of the Act.

The judgment of the *Hicklin v SIR* case would not be different if sections 80A to 80L of the Act were applied to the sale of Reklame shares instead of section 103(1). The sole or main purpose of the sale of Reklame shares was tax avoidance. However, it is unlikely that the abnormality requirement would be met and the sale of Reklame shares does not lack commercial substance. Therefore, section 80A may not be invoked on the sale of Reklame shares.

The judgment of the ITC 1712 (2000) case would be different if sections 80A to 80L of the Act were applied instead of section 103(1). The sole or main purpose of the lease between the appellant and the bank could have been tax avoidance and there was evidence that there could be misuse or abuse of the provisions of the Act resulted from the upfront rental deduction by the appellant. In the result, it is likely that section 80A could be invoked on the lease between the appellant and the bank as part of the scheme or arrangement as a whole.

Sections 80A to 80L has provided higher chances of success in attacking a tax avoidance arrangement as section 80H provides that the Commissioner may apply the sections 80A to 80L to steps in or parts of an arrangement and section 80G(2) provides that the purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement.

If the steps in or parts of an arrangement were found to have a sole or main purpose of tax avoidance, and was entered into or carried out by means or in a manner which would not be normally be employed for *bona fide* business purpose, or have created rights or obligations that would not normally be

created between persons dealing at arm's length, section 80A can be invoked.

Based on the analysis of the five selected cases, the judgment of the *Hicklin v SIR* case and the ITC 1712 case would be different if sections 80A to 80L were applied instead of section 103(1). In conclusion, it is possible that the judgments of certain cases can be different if sections 80A to 80L of the Act are applied instead of section 103(1). However, the likelihood that a judgment would be different if sections 80A to 80L were applied instead of section 103(1) was not high, as the judgments of the cases were largely based on the evidence provided by the appellants and respondents and the facts and circumstances of the cases.

6. CONCLUSION

6.1. Summary of findings in respect of the research problems

Tax avoidance is legal while tax evasion is illegal. There is a fine line between tax avoidance and tax planning or tax mitigation. Tax mitigation is concerned with the organisation of a taxpayer's affairs or the structuring of transactions, so that they give rise to the minimum tax liability within the law without resort to impermissible tax avoidance.

To combat tax avoidance, the general anti-avoidance rules were drafted in the Act. The Commissioner has viewed section 103(1) as ineffective and inefficient in combating tax avoidance arrangements, as judgements in certain tax cases were held in favour of the taxpayers. In the result, the section 103(1) was repealed in the year 2006 and replaced with sections 80A to 80L in the Act.

As compared to section 103(1), the provisions in 80A to 80L are more objective. The purpose requirement in section 80A and 80G is more objective as compared to that in section 103(1) and 103(4).

The purpose requirement in section 80A is based on the sole or main purpose of the avoidance arrangement and not on whether the sole or main purpose of the transaction, operation and scheme is tax avoidance in the opinion of the Commissioner.

The repealed section 103(4) and section 80G both have the presumption that an avoidance arrangement was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit unless or until the party that obtains the tax benefit proves that the tax benefit was not the sole or main purpose. Section 80G is more objective as compared to section 103(4) as it requires the arrangement to be 'reasonably considered in light of the relevant facts and circumstance'.

The difference between the abnormality requirement in section 80A and that in section 103(1) is that the requirement is now intended to be applied more objectively on the features of an arrangement, as it is evident from the deletion of the words

> ‘having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out’

in sections 80A to 80L.

Sections 80A to 80L are also more detailed and comprehensive as it provides definitions of the terms used in 80L, descriptions of the concepts such as round trip financing and accommodating or tax-indifferent parties in sections 80D and 80E; characteristics which indicate a lack of commercial substance in section 80C, tax consequences of impermissible tax avoidance in section 80B and treatment of connected persons and accommodating or tax-indifferent parties in section 80F. Therefore, sections 80A to 80L may be more effective in combating tax avoidance arrangements as compared to section 103(1).

Five selected cases were discussed and analysed in the previous chapter. By analysing these cases, it was found that it is unlikely that certain judgments will be different if sections 80A to 80L were applied instead of section 103(1) in certain cases, due to the facts of the cases and the evidences that were presented to the courts. This was shown in the *CIR v Conhage* case, the *CIR v Louw* case, and the *SIR v Geustyn, Forsyth & Joubert* case. In these cases, the purpose and the abnormality requirements were not met by the scheme or the parts of or steps in the scheme, there was no lack of commercial substance and there was no misuse or abuse of the provisions of the Act. Therefore, section 80A cannot be invoked in these cases.

Due to the change in sections 80A to 80L, two additional tests may be applied to the tax avoidance arrangements. These tests include the lack of commercial substance test and the misuse or abuse test. Further, the Commissioner may apply sections 80A to 80L to steps in or parts of an arrangement in terms of section 80H. Therefore, the scope and extent of sections 80A to 80L are significantly broader than section 103(1). In terms of section 80G, 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. So, it may be more difficult for the taxpayer to discharge the onus of proving that the sole or main purpose of the arrangement or the step in or part of an avoidance arrangement is not tax avoidance.

Accordingly, it is possible for the judgments of certain cases to be different if sections 80A to 80L were applied instead of section 103(1). This was shown in the analysis of the *Hicklin v SIR* case and the ITC 1712 (2000) case in chapter 5. In the *Hicklin v SIR* case, the sole or main purpose of the arrangement as a whole and the shareholders' loans was tax avoidance. Further, the abnormality requirement was met by the shareholders' loans and the arrangement as a whole would also result directly or indirectly in the misuse or abuse of the provisions of the Act. Therefore, section 80A could be invoked on the arrangement as a whole and the shareholders' loans. In the ITC 1712 (2000) case, the sole or main purpose of the lease between the appellant and the bank was tax avoidance and there was evidence that there could be misuse or abuse of the provisions of the Act resulted from the upfront rental deduction by the appellant. Therefore, section 80A could be invoked on the lease between the appellant and the bank.

In conclusion, it is largely dependent on the facts and circumstances of a case whether its judgment may change if sections 80A to 80L were applied instead of section 103(1).

6.2. Potential areas of future research

The scope of this report is limited to a comparison of the application of the provisions in sections 80A to 80L with those of section 103(1) on South African cases which were heard under section 103(1).

One may conduct research into the effectiveness of sections 80A to 80L by analysing the South African cases heard in the future under the new GAAR or by comparing the GAAR with the corresponding legislation in other countries such as Australia, Canada, Germany and Ireland.

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