Faculty of Commerce, Law and Management

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

The consequences of tax avoidance in South Africa for taxpayers

ABSTRACT

South African companies use tax planning to structure their tax affairs.

Tax avoidance entails the use of legitimate means to reduce the taxpayer's income tax, and this can be done through tax planning. This will ensure the taxpayer arranges his tax affairs in a manner that allows the taxpayer to reduce their tax liability.

Tax avoidance consists of permissible and impermissible tax avoidance.

> 'Permissible tax avoidance is the avoidance of tax in a manner that is consistent with statutory purposes and the limits imposed by a GAAR. Impermissible tax avoidance, on the other hand, is tax avoidance that is inconsistent with statutory purpose and is forbidden by a GAAR' (Kujinga 2014).

The General anti-avoidance rules ('GAAR') of the Income Tax Act 58 of 1962 ('the Act') s 80A to s 80L deals with impermissible tax avoidance.

This report investigates the tax consequences of tax avoidance for the taxpayer in South Africa by analysing the new GAAR (ss 80A- 80L). This will be done by focusing on the remedies in s 80B of the Act and penalties in s 222 and s 223 of the Tax Administration Act 28 of 2011 ('Administration Act').

Key Words

General Anti-Avoidance Rules (GAAR), tax avoidance, tax evasion, tax planning, transaction, tax effect, Impermissible tax avoidance arrangement, tax benefit, onus of proof, arrangement, sole or main purpose, purpose, lack of commercial substance, abnormality, business context, business purpose test, Significant tax benefit, Substance over form

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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TABLE OF CONTENTS

1 CONSEQUENCES OF TAX AVOIDANCE IN SOUTH AFRICA

1.1 INTRODUCTION

Tax avoidance has been an extensively researched topic (Devereux, Freedman & Vella 2012).

> 'Taxpayers around the world are finding ways to be more tax efficient by structuring their businesses to create a tax benefit for the company therefore resulting in a tax reduction' (Stiglingh, Koekemoer, Van Heerden, Wilcocks & Van der Zwan 2022).

> 'While in theory a taxpayer is allowed to arrange his tax affairs in the most optimal manner, where arrangements are entered into for the sole or main purpose of obtaining a tax benefit (which is any avoidance, reduction, or even postponement of any liability for any SA tax), the GAAR rules will apply and classify such arrangement as an impermissible tax arrangement. In other words, a taxpayer that enters such an arrangement will be at risk of the South African Revenue Service ("SARS") challenging the arrangement and enforcing remedies' (Van Rooy 2022).

This research is aimed at investigating the consequences of tax avoidance for the taxpayer. In 2006, SARS introduced the new the general anti- avoidance rules ('GAAR') which is set out in ss 80A – 80L of the Income Tax Act 58 of 1962 ('the Act'). The new GAAR replaced s 103 of the Act, which can be referred to as the old GAAR. In the process of this investigation, the anti-avoidance provisions in the Act, being ss 80A – 80L, will be discussed. The aim of the new GAAR is to combat impermissible tax avoidance (SARS 2006). The new GAAR has provided for a general remedy for tax avoidance in s 80B(1)(f) of the Act.

> 'The Commissioner is also provided with specific remedies to impermissible tax avoidance arrangements. The specific remedies are contained in s 80B(1)(a) to (e). These specific remedies allow the Commissioner to, for example, disregard or combine any steps in the arrangement, deem different parties as one and the same person, or to re-allocate or re-classify any receipts or accruals, expenditure or rebates' (Musviba).

> 'Tax avoidance is seen to be a legal way of structuring your tax affairs in order to have a reduced tax liability' (Stiglingh *et al.* 2022).

Taxpayers sometimes enter into disguised transactions where they believe the transactions are in good faith, however it later turns out that the transaction constitutes a disguised transaction, therefore the transaction could be seen as a tax avoidance arrangement. (Stiglingh *et al.* 2022).

> 'If a specific anti-avoidance provision cannot be applied to deal with a transaction that avoids tax, SARS may as a last resort attempt to apply the provisions on impermissible tax avoidance arrangements to prevent the avoidance of tax.' (Stiglingh *et al.* 2022).

In the *Absa Bank Limited v C:SARS* case, that will be discussed in chapter 3, the crux of the case lies in a controversy about whether or not an impermissible tax avoidance arrangement was conceived to evade a tax liability (83 SATC 401 p 407).

One of the remedies that the Commissioner applies before the tax consequences of impermissible tax avoidance can be applied, according to s 80B, can be seen in the Absa case, where the Commissioner issued Absa with a s 80J notice. The Commissioner must, prior to determining the liability of the taxpayer, issue the taxpayer with a s 80J notice, notifying the taxpayer that it is believed that an impermissible tax avoidance arrangement has been entered into.

This research will also investigate penalties in s 222 and s 223 of the Tax Administration Act ('Administration Act'), in the event the taxpayer deliberately ignores tax laws, resulting in tax evasion or in the event the taxpayer has been seen to have entered into a impermissible tax avoidance arrangement. The penalties in s 223(1)(iv) also apply to tax avoidance. Section 222 of the Administration Act constitutes what happens to the taxpayer in the event of an understatement by the taxpayer. Section 223 of the Administration Act contains the penalty percentage in the event the taxpayer is liable for an understatement penalty.

Section 222 of the Administration Act states the following.

> '(1) In the event of an "understatement" by a taxpayer, the taxpayer must pay, in addition to the "tax" payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the 'understatement' results from a bona fide inadvertent error'

GAAR was first introduced in section 90 of the Income Tax Act No. 31 of 1941. It was later introduced in s 103 of the Act. In 2006, It was replaced with the current GAAR with ss 80A to 80L. One of the reasons why there has been a constant improvement and change in the legislation relating to GAAR is due to taxpayers constantly trying to find loopholes in the tax legislation (Stiglingh *et al.* 2022).

The new general anti-avoidance provisions were inserted in ss 80A - 80L and apply to any arrangement entered into on or after 2 November 2006.

> 'South Africa received a world-class new GAAR in 2006, which drew heavily on experiences of and provisions in other jurisdictions' (Kruger, Stein, Dachs & Davey 2012).

To address what could be the consequences of tax avoidance, a distinction will need to be made between tax avoidance and tax evasion.

> '**Tax avoidance**, usually means a situation which the taxpayer has arranged his affairs in a perfectly legal or lawful manner, with the result that he has either reduced his income or has no income which is taxable. Tax avoidance is generally seen as the legitimate and legal process of protecting a person's property from unnecessary erosion by taxation' (Stiglingh *et al.* 2022).

> '**Tax Evasion** refers to illegal activities deliberately (wilfully) undertaken by a taxpayer to free himself from a tax burden. In an income tax context, it typically involves the non-payment of a tax that would properly be chargeable if the taxpayer made a full and true disclosure of income and allowable deductions' (Stiglingh *et al.* 2022).

> 'It is still difficult to distinguish between permissible and impermissible tax avoidance arrangements, it would have been equally difficult to compile an exhaustive list of possible impermissible tax avoidance arrangements' (Robbertze 2018).

Section 80A defines impermissible tax avoidance and list the requirements and s 80B lists the consequences of impermissible tax avoidance, which are the powers that the Commissioner has with respect of an impermissible tax avoidance arrangement.

Section80A Impermissible avoidance arrangements.

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

a) In 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—

(iii) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or

(iv) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).

[S. 80A inserted by s. 34 (1) of Act No. 20 of 2006 deemed to have come into operation on 2 November 2006 and applicable to any arrangement (or any steps therein or parts thereof) entered into on or after that date]'.

Section 80B- Tax consequences of impermissible tax avoidance.

This section sets forth the remedies the Commissioner may apply in order to determine the tax consequences to any party of any impermissible avoidance arrangement. It replaced the remedy provisions that were found in section 103(1).

Section 80B deals with tax consequences of impermissible tax avoidance. These are powers that the Commissioner has in respect of an impermissible avoidance arrangement.

1.2 OBJECTIVE OF THE RESEARCH

1.2.1 THE RESEARCH QUESTIONS

This research report will analyse what are the consequences of tax avoidance for the taxpayer in South Africa. This will be determined by addressing the below questions.

1.2.2 THE SUB RESEARCH QUESTIONS

- What is tax avoidance
- What is the difference between impermissible and permissible tax avoidance?
- What are the remedies for impermissible tax avoidance in terms of s 80B.
- What are the penalties in place to address tax avoidance in s 222 and s 223 of the Administration Act.

1.3 THE SIGNIFICANCE OF THIS STUDY

The significance of this research is to investigate the consequences of tax avoidance in South Africa.

> 'To this day, the [A]ct does not provide a clear distinction between impermissible tax avoidance and permissible tax avoidance' (Lelope 2016).

This research investigates the remedies of impermissible tax avoidance outlined in s 80B of the Act. The application of these remedies in s 80B, which are vested to the Commissioner, allow the taxpayer to be placed in a position they should have been, had they not been involved in an impermissible tax avoidance arrangement. The research further looks at the penalties in s 222 and s 223 of the Administration Act to address tax avoidance in South Africa.

1.4 THE RESEARCH METHODOLODY

This research will be conducted using the qualitative methodology. The analysis will be based on the current legislation and on literature review.

The literature used for this research report will be, online articles, books, journals, legislation, court cases, the Income Tax Act 58 of 1962 and publications.

The objective of this research report will be achieved through analysing the new provisions of GAAR and s 80B.

2 TAX EVASION AND TAX AVOIDANCE

2.1 INTRODUCTION

This chapter will distinguish the difference between tax avoidance and tax evasion. The difference between tax evasion and tax avoidance are important concepts to understand. The focus will however be on tax avoidance. It will also define tax planning as it could arise in tax avoidance.

Furthermore, we need to understand how far a taxpayer can go with structuring their transactions by applying creativity. In order to get guidance on how far the taxpayer can go, one needs to distinguish the difference between permissible and impermissible tax avoidance.

2.2 WHAT IS TAX PLANNING

TAX PLANNING

According to Vorster (n.d), in his article defining tax planning, he mentioned the following;

> ‘Tax planning can be defined in short as an arrangement of one's financial and economic affairs by taking complete legitimate benefits of all deductions, exemptions, allowances and rebates according to laws and regulations to ensure that tax liability reduces to a minimum. Tax planning imply compliance with the taxing provisions in such a manner that full advantage is taken.’

Taxpayers often leave out tax planning. It is imperative to scope in tax planning in your business as this assists the taxpayer to make educated decisions about their business. (Vorster)

> ‘Tax planning can be defined as the analysis of a financial situation or plan to ensure that all elements work together to allow you to pay the lowest taxes possible. A plan that minimizes how much you pay in taxes is referred to as tax efficient. Tax planning should be an essential part of an individual investor's financial plan’ (Kagan, Brocks, Jasperson 2023).

Furthermore, In *IRC v Duke of Westminster*, Lord Normand stated:

> ‘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’ (Stiglingh *et al.* 2022).

Many multi- national enterprises ('MNE') have become more sophisticated over the years and have structured their companies in a way that assists them to pay less tax within their group structures to tax revenue services (Stiglingh *et al.* 2022).

> 'Tax planning allows the MNE's to find effective ways to pay less taxes, however this has a direct impact on the fiscus of the country' (Stiglingh *et al.* 2022).

> 'Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. [The General Anti-Avoidance Rule] does not apply to tax mitigation because the taxpayer's advantage is not derived from an arrangement but from the reduction of income which he accepts or the expenditure which he incurs' (*CIR v Challenge Corporation* [1987] AC 155).

> 'Timing of a transaction is a key part of planning, as the relevant tax is often payable before the assessment for that tax year is issued, such as provisional tax or employees' tax. Also, the timing for payment of taxes such as Secondary Tax on Companies ("STC") or donations tax is triggered by the transaction' (Retief 2011).

Before 01 April 2012, STC was levied on distribution of dividends to its shareholders, by companies at a flat rate. STC was replaced by dividends tax on 01 April 2012.

2.3 THE DIFFERENCE BETWEEN TAX EVASION AND AVOIDANCE

2.3.1 TAX EVASION

In the PwC Synopsis (n.d), the following was said about tax evasion and tax avoidance.

> 'On the hoary issue of the distinction between legitimate "tax avoidance" and impermissible "tax evasion", SARS says that the term "tax avoidance" has become hopelessly ambiguous in today's world, and whether or not a simple dichotomy between "tax evasion" and "tax avoidance" has ever existed anywhere in the world, it certainly has not been the case for many, many years'.

Tax evasion is not defined in the Act, however it can be defined as follows, according to SILKE:

> 'Tax evasion can be defined as illegal activities deliberately (wilfully) undertaken by a taxpayer to free himself from a tax burden. In an income tax context, it typically involves the non-payment

> of a tax that would properly be chargeable if the taxpayer made a full and true disclosure of income and allowable deductions' (Stiglingh *et al.* 2022).

> 'Tax evasion can include but is not limited to, the creation of falsified financial statements, deliberate failure to disclose correct amounts of revenue received by a business receiving cash and presenting false information on a tax return' (Benn 2013).

> 'Tax evasion can also be seen as disclosing incorrect or false information or not declaring any income potentially received from local or offshore accounts. Therefore, tax evasion constitutes fraud and can be seen to be a criminal offence' (National Treasury 2021).

The National Treasury defines Tax Evasion as, 'when individuals or businesses illegally reduce their tax liability' (National Treasury 2021).

De Koker and Williams (2021) quote that Lord Templeman in *CIR v Challenge Corp Ltd* said,

> 'Evasion occurs when the Commissioner is not informed of all the facts relevant to an assessment of tax. Innocent evasion may lead to a reassessment. Fraudulent evasion may lead to a criminal prosecution as well as reassessment.'

Tax evasion is illegal, and any taxpayer found guilty faces criminal charges which may result in imprisonment (SAIPA 2018).

> 'Below are examples of what could considered to be tax evasion.
>
> 1. People don't declare income to evade paying tax on that income.
> 2. People lie about their expenses to reduce the tax they pay or to obtain an undue refund. For example, they may lie about their business mileage, business expenses or even medical contributions.
> 3. People just don't submit a tax return to SARS or fail to truthfully respond to our questions.
> 4. Employers sometimes deduct tax from employees and never pay it over to SARS
> 5. Vendors, whether registered for VAT or not, sometimes charge VAT and never pay it over to SARS.
> 6. Entities submit fraudulent invoices in an attempt to pay less tax or obtain undue (*fraudulent*) refunds (*Income Tax and VAT*).
> 7. Individuals do not register for tax purposes to evade paying their dues
> 8. People do not submit returns as and when required to evade paying taxes due to SARS.

9. Employers withhold employees' tax (*PAYE*) and do not pay it over to the SARS' (Stiglingh *et al.* 2022).

In the event the taxpayer is found to guilty of any of the above examples considered as tax evasion, penalties in s 235 of the Administration Act, would apply. These penalties have been passed by legislation, in order to deal with taxpayer who is found guilty of a tax evasion offence.

To manage and monitor tax evasion, SARS works with other government agencies with regards to investigating corruption and money laundering. Examples of the government agencies are Multi-Agency Working Group (MAWG) and Anti-Corruption Task Team in combating government corruption that assists SARS to confront complex international schemes (SARS annual report 2012-2013).

2.3.2 PENALTIES FOR TAX EVASION

There are legislation provisions put in place, which have been passed by Parliament to deal with taxpayers who are found guilty of any tax evasion. When taxpayers are found guilty of tax evasion, they could be subject to a fine or imprisonment for a maximum period of five years. Section 235 of the Tax Administration Act No 28 of 2011 ("TAA"), addresses Evasion of tax and obtaining undue refunds by fraud or theft (Section 235, Tax Administration Act 2011).

In the *R v Myers* 1948 (1) SA 375 (A) court case, Greenberg JA ruled the following at 382;

> 'quoting Halsbury's Laws of England, a belief is not honest (and is therefore fraudulent) which though in fact entertained by the representor may have been itself the outcome of fraudulent diligence in ignorance ─ that is, of a wilful abstention from all sources of information which might lead to suspicion, and a sedulous avoidance of all possible avenues to the truth, for the express purpose of not having any doubt thrown on what he desires and is determined to, and afterwards does (in a sense) believe'.

Section 235 of the Tax Administration Act is as follows:

> '**Evasion of tax and obtaining undue refunds by fraud or theft** – a person who with intent to evade or to assist another person to evade tax or to obtain an undue refund under a tax Act**:**

a) Makes or causes or allows to be made any false statement or entry in a return or other document, or signs a statement, return or other document so submitted without reasonable grounds for believing the same to be true;
b) Gives a false answer, whether orally or in writing, to a request for information made under this Act;
c) Prepares, maintains or authorises the preparation or maintenance of false books of account or other records or falsifies or authorises the falsification of books of accounts or other records;
d) Make use of, or authorises the use of, fraud or contrivance; or
e) Makes any false statement for the purposes of obtaining any refund of or exemption from tax,

is guilty of an offence and, upon conviction, is subject to a fine or to imprisonment for a period not exceeding five years.'

These offences may be separated as per the SARS guide;

'Offences may be separated into tax offences and serious tax offences. Serious tax offences relate to intentional tax evasion and are distinguished from "non-compliance" offences in that the period of imprisonment for a serious tax offence is a sentence of up to five years. The investigation of a serious tax offence will be carried out, with regard to the rights that a suspect has, by suitably qualified and experienced SARS officials. An investigator must have authority from a senior SARS official to investigate, and only a senior SARS official may lay a complaint with the police concerning an offence related to tax evasion' (SARS Short Guide to the Tax Administration Act, 2011).

There are also penalties imposed on any tax evasion, that is disclosure of false information. A penalty of 100% is levied on intentional tax evasion or gross negligence and further penalties can be levied. If a taxpayer is found guilty of Intentional tax evasion, a penalty of between 150% to 200% can be levied for any of the tax evasion transactions (Section 223, Professional Tax Handbook. 2022/2023).

Section 210 of the Administration Act refers:

'Non-compliance subject to penalty -

(1) If SARS is satisfied that noncompliance by a person referred to in subsection (2) exists, SARS must impose the appropriate "penalty" in accordance with the Table in section 211.

(2) Noncompliance is failure to comply with an obligation that is imposed by or under a tax Act and is listed in a public notice issued by the Commissioner, other than—

(a) the failure to pay tax subject to a percentage-based penalty under Part C;

(b) non-compliance in respect of which an understatement penalty under Chapter 16 has been imposed; or

(c) the failure to disclose information subject to a reportable arrangement penalty under section 212'

The penalties in s 210 apply when a natural person which is a taxpayer fails to submit an income tax return (which is the ITR12 form) (Stiglingh *et al.* 2022). The penalties applicable to the taxpayers are a fixed- amount, see table below. The penalties came to effect from 01 December 2022 on any outstanding income tax return for years of assessment commencing on or after 01 March 2007 (SARS website).

The below table is provided in section 211 of the Tax Administration Act. The below penalty table applies to non-compliance referred to in s 210 of the Administration Act.

Item	Assessed loss or taxable income for preceding year	Penalty
(i)	Assessed loss	R250
(ii)	R0 - R250 000	R250
(iii)	R250 001 - R500 000	R500
(iv)	R500 001 - R1 000 000	R1 000
(v)	R1 000 001 - R5 000 000	R2 000
(vi)	R5 000 001 - R10 000 000	R4 000
(vii)	R10 000 001 - R50 000 000	R8 000
(viii)	Above R50 000 000	R16 000

Section 215 of the Administration Act allows the taxpayer to request for remission in the event the taxpayer is aggrieved by the penalty imposed.

2.3.3 TAX AVOIDANCE

Tax avoidance can be seen as a way where the taxpayer arranges his affairs in a legal manner (Lelope 2016). The Act does not define tax avoidance; however, tax avoidance can be divided into impermissible tax avoidance (which is defined in s 80A) and permissible tax avoidance but the wording contains uncertainties. Section 80B lists the consequences of impermissible tax avoidance. The Act does not define permissible tax avoidance.

The National Treasury defines Tax Avoidance as occurring,

> 'when individuals or businesses legitimately use provisions in the law to reduce their tax liability.' (National Treasury 2021)

Tax avoidance is also defined in the case of *CIR v Willoughby*, where Lord Nolan stated 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'.

The above case deals with an example of tax avoidance; however, it is then further looked at In *Lord Vestey's Executors v IRC*, Lord Normand stated the following:

> 'Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to stretch the language of statute in order to subject to taxation people of whom they disapproved.'

In *C: SARS v NWK Ltd* the Supreme Court of Appeal, stated that:

> 'It is trite that a taxpayer may organise his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective. But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has a purpose of tax evasion or of the avoidance of a peremptory rule of law. However, as Hefer JA said in Ladysmith, one must distinguish between the principle that one may arrange one's affairs so as to 'remain outside the provisions of a particular statute', and the principle that a court 'will not be deceived by the form of the transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance'

> ‘In *Smith v CIR, it* was held that the ordinary meaning of avoiding liability for a tax on income was ‘to get out of the way of, escape or prevent an anticipated liability’ (Williams 2001).

In *Hicklin v SIR,* the Appellate Division acknowledged that such liability may vary from ‘an imminent, certain prospect to some vague, remote possibility’ and Trollip JA said that

> ‘it is unnecessary and hence inadvisable to decide here whether a vertical line should be drawn somewhere along that wide range of meanings in order to delimit the connotation of an anticipated liability’ (de Koker & Williams 2021).

Michau v Maize Board and *CIR v Sunnyside Centre (Pty) Ltd* are good examples of cases that provide distinction between tax avoidance and tax evasio*n.*

In *Michau v Maize Board,* the Supreme Court of Appeal held:

> ‘. . . parties are free to arrange their affairs so as to remain outside the provisions of a particular statute. Merely because those provisions would not have been avoided had the parties structured their transaction in a different and perhaps more convenient way does not render the transaction objectionable’ (de Koker & Williams 2021).

In *CIR v Sunnyside Centre (Pty) Ltd* the Appellate Division held:

> ‘a taxpayer is entitled to order his affairs so as to pay the minimum of tax and in *CIR v Conhage (Pty) Ltd* the Supreme Court of Appeal said 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’ (de Koker & Williams 2021).

In *Commissioner v Newman* 159 F2d 848 (1947)*,* Judge Learned Hand, in a dissenting opinion, said that;

> ‘Over and over again courts have said that there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant’ (de Koker & Williams 2021).

2.3.4 TAX AVOIDANCE AND TAX EVASION – COURT CASES

The court cases below illustrate the distinctions between tax avoidance and tax evasion.

In *R v Mears case,* It was held:

> 'the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using illegal means to escape payment of tax. (*R v Mears* 1947 (2) SA 196 14 SATC 184)' (Williams 2001).

Furthermore, in *CIR v King* case, the court held:

> 'There [is] a real distinction between the case of one who so [orders] his affairs that he had no income which would expose him to liability for income tax, and that of one who [orders] his affairs in such a way that he escaped from liability for taxation which he ought to pay upon the income which in reality is his. Similarly there [is] a distinction between reducing the amount of tax from what it would have been had the transaction not been entered into and reducing the amount of tax from what it ought to have been in that year of assessment' (Williams 2001).

2.4 CONCLUSION

As per the tax avoidance definition and tax evasion definition, there is a distinction between the two definitions. Tax evasion refers to illegal activities undertaken by the taxpayer. Tax avoidance is whereby a taxpayer has arranged their tax affairs in a legal manner (Stiglingh *et al.* 2022).

It is also clear from above court case rulings that there is a clear distinction between tax evasion and tax avoidance. In the *R v Mears* court ruling it clearly stated that the difference between tax evasion and tax avoidance is simple and clear.

Tax planning creates an opportunity for tax avoidance, or it may lead to tax evasion. Although tax planning permits taxpayers to arrange their taxes in a manner that allows them to save tax or create tax benefits, it could be seen that other taxpayers might structure their taxes in a manner that will allow them to intentionally not pay tax or pay less tax, leading to tax evasion.

The legislation, according to the s 222 of the Administration Act, deems tax evasion as a criminal offence, when the taxpayer who acts with intent to evade tax. Therefore, the Administration Act, has penalties imposed on a taxpayer when found guilty of tax evasion. These penalties are addressed in s 223 of the Administration Act.

The consequences for impermissible tax avoidance are discussed in s80B of the Act. These consequences will be discussed in detail, in the GAAR provisions in the chapter 3 below.

3 THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE (GAAR)

3.1 INTRODUCTION

This chapter will focus on the provisions of GAAR in South Africa. We will re-visit the previous general anti-avoidance rules that was addressed in s 103(1) of the Act before it was replaced with ss 80A - 80L of the Act.

The new GAAR provisions in s 80A – s 80L are the third GAAR provisions since the introduction of GAAR in South Africa in 1941. This is as a result of taxpayers continuously finding loopholes in the tax Act for creative transactions in their structuring (Stiglingh *et al.* 2022).

This chapter will further examine ss 80A- 80L which are the current GAAR provisions in the Act. This will further explore the difference between permissible tax avoidance and impermissible tax avoidance but with a deeper focus on impermissible tax avoidance.

The focus will also be on case law and how SARS has managed or tried to curb any impermissible tax avoidance by referring to case law.

3.2 GENERAL ANTI-AVOIDANCE RULES – SECTION 103(1)

3.2.1 THE HISTORICAL GAAR PROVISIONS IN SOUTH AFRICA

The GAAR Part IIA provisions ('current GAAR') were introduced to provide effective and consistent guidelines to impermissible tax avoidance arrangements. The purpose of this was to assist the taxpayer to distinguish between the differences between permissible and impermissible tax avoidance and to provide Commissioner powers with respect to an impermissible tax avoidance arrangement (Stiglingh *et al.* 2022).

The First anti-avoidance provision was introduced in s 90 of the old Income Tax Act 31 of 1941. It was later replaced by s 103(1) of the Act.

> 'The inconsistency in the s 103 proved, at times to be ineffective deterrent to the increasingly complex and sophisticated tax "products" that were being marketed by the banks, 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' (Discussion Paper on Tax Avoidance 2005).

It is known that s 103(1) of the Act was amended to include a 'business purpose' test, that was similar to that of s 72 of the Value Added Tax Act No 89 of 1991. (Kruger, Stein & Dachs 2012). According to the South African Tax Guide (n.d), there were many inherent weaknesses in s 103(1) and therefore was replaced by ss 80A - 80L, which came into effect on 02 November 2006.

The below paragraph makes reference to the old s 103(1) in order to understand the changes in the new GAAR ss 80A to 80L.

3.2.2 THE GENERAL ANTI-AVOIDANCE RULES - SECTION 103(1)

In order to examine the changes in the new GAAR provisions and also investigate the tax consequences in the provisions that replaced s 103(1), it is important that we revisit s 103(1) that was contained in the Act.

The provisions of s 103 were as follows:

' Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amount of taxes on income.-

(1) Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)—

(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.' (SARS Tax Avoidance Revised Proposals, 2006)

The below requirements all had to be met, in order for the Commissioner to rely on the GAAR:

- 'There must have been a transaction, operation or scheme entered or into carried out (the Scheme Requirement);
- with the effect of avoiding or postponing or reducing the liability for the payment of any tax (the Tax Effect Requirement);
- and was entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit (commonly referred to as the Abnormality Requirement/Arm's Length Test); and
- the transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the Purpose Requirement)' (Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised Proposals, 2006)

'Two major elements in this provision are the taxpayer's purpose and concept of abnormality in relation to the rights and obligations created by a transaction or the means and manner in which it was carried out. Section 103(1) does not come into operation unless a sole or main purpose of tax avoidance and abnormality are both present. Hence, if a taxpayer has a purpose of tax avoidance but the transaction was not abnormal, s103(1) does not apply. Conversely, if the transaction was abnormal, but the taxpayer did not have a sole or main purpose of a tax avoidance, s 103 (1) does not apply.' (Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised Proposals, 2006)

For the purposes of this research report, one will not go into further details of the four above requisites that needed to be met for a Commissioner to rely on s 103(1). However, this report will refer to a case that provides an indication that certain factors must co-exist for an arrangement or transaction to fall under the provisions of s 103(1).

In *SIR v Gallagher*, the taxpayer formed a company on the 15 February 1968 and named it SPH Holdings (Pty) Ltd ('SPH'). On the 27 February 1968, the taxpayer formed three trusts, one for the benefit of each of his three children and donated all his shares in SPH the three trusts (Williams 2001).

> 'The Commissioner invoked s 103(1) and included in the taxpayer's income the dividends earned by SPH on the shares sold to it by the taxpayer' (Williams 2001).

In the *SIR v Gallagher* case, the issue was whether the Commissioner was empowered, in the circumstances stated above, to act in terms of s103(1), (Williams 2001).

In *SIR v Gallagher*, Corbett JA stated:

> 'The various requisites which must co-exist in order to justify the Commissioner in invoking his powers under s103(1) were enumerated in *SIR v Geustyn, Forsyth and Joubert*' (Williams 2001).

In *SIR v Gallagher*, Corbett JA, in his judgement, held the following:

> '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 rather 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… In the circumstances it is appropriate to state that, in my view, the test is undoubtedly a subjective one' (Williams 2001).

Weaknesses in s 103

> 'The Abnormality Requirement itself suffers from two fundamental weaknesses. First, 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' (Discussion Paper on Tax Avoidance 2005).

> 'Second, this dynamic often gives impermissible avoidance arrangements an undeserved patina of normality. These weaknesses contribute directly to the practical problems that have been encountered under s 103. The Commissioner is often forced to proceed on a case-by-case basis despite the common features of many impermissible avoidance arrangements. In addition, expert testimony is often required to pierce the semblance of normality that is created by the use of "normal" elements. Finally, as several commentators noted, the lack of objective yardsticks continues to leave the Abnormality Requirement open to an "everyone's doing it" defence. In light of these comments, the revised proposals would strengthen and expand the current Abnormality Requirement by adding a new element or test explicitly targeting avoidance arrangements that lack commercial substance.'

In 1996, Parliament amended section 103 to read in pertinent part as follows,

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

The current GAAR, applies to genuinely intended transactions which meet the various requirements of an "impermissible avoidance arrangement", and SARS has far more incisive powers in this regard (ENS 2022).

3.3 THE GENERAL ANTI-AVOIDANCE RULES – SECTION 80A – 80L OF THE ACT

In 2006, the Act was amended to include the new provisions of GAAR which replaced s 103(1) of the Act. This was mainly because of the inherent weaknesses that were identified as discussed above in s 103(1) of the Act, according to the South African Tax Guide (n.d) *General anti-avoidance rule*.

The new GAAR provisions were inserted as Part IIA of Chapter III of the Act. The new GAAR starts off by defining what an 'impermissible avoidance arrangement' is in s 80A. The powers that the Commissioner has with respect to an impermissible avoidance arrangement are set out in s 80B. The remaining provisions expand on these first two provisions and deal with certain procedural issues that arise. (National Treasury, 2006)

Section 80A to 80L, target impermissible tax avoidance arrangements. These provisions apply to any arrangement entered into on or after 2 November 2006.

Section 80A lists the requirements that must be met in order for an avoidance arrangement to be considered as an impermissible tax avoidance arrangement.

Section 80B outlines the guidelines that the Commissioner may use to determine if an arrangement is a impermissible tax avoidance arrangement.

Section 80C - 80G expand on the requirements listed in S80A and S80H to 80K contains general provisions. 'S80L defines the terms "arrangement", avoidance arrangement, impermissible avoidance arrangement, party and tax' ((Stiglingh *et al.* 2022).

The new GAAR introduced the following definitions in s 80L of the Act ;

> –' **arrangement means**, any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including any or all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property.
> **avoidance arrangement'** means any arrangement that results in a tax benefit.
> **impermissible avoidance arrangement** means any avoidance arrangement described in the section 80A;
> **party** means any
> (a) person;
> (b) permanent establishment in the Republic of a person who is not a resident;
> (c) a permanent establishment outside the Republic of a person who is a resident;
> (d) partnership;
> (e) or joint venture,
> that participates or takes part in an arrangement' (Professional Tax Handbook 2022/2023).

The above definitions are discussed in detail below.

- 'the criterion of "commercial substance" in an arrangement; (stated in section 80A(a)(ii) and expanded on in detail in section 80C);
- the criterion of whether the arrangement in issue "would result directly or indirectly to the misuse or abuse of the provisions of this [the Income Tax] Act" (including the provisions of section 80A(c)(ii));

- new powers given to the Commissioner in relation to an "impermissible avoidance arrangement" (section 80B) and to determine whether parties are "accommodating or tax indifferent parties" (section 80E) and whether there has been a "tax benefit"(section 80F)' (SAICA March 2007).

3.4 HOW IMPERMISSIBLE TAX AVOIDANCE IS ADDRESSED IN SOUTH AFRICA

Chapter one of the research report, outlines s 80A to 80L, chapter one sets out the GAAR rules.

Section 80A defines an impermissible tax avoidance arrangement. The provisions of impermissible tax avoidance arrangements can only be applied when the below four requirements are met.

1. There must be an arrangement.
2. The arrangement results in a 'tax benefit'
3. The sole or main purpose is to obtain a tax benefit
4. The avoidance arrangement is in the context of business or is in the context other than a business. (Stiglingh *et al.* 2022)

'Tax benefit and purpose requirements are the most important in an impermissible tax avoidance arrangement' (Musviba).

In the Sasol case below, Sasol was successful in proving the commercial rationale in their arrangement.

***Sasol Oil v CSARS (2018)* ZASCA 153 A**

'The matter concerns contracts of sale between Sasol Oil (Pty) Ltd (Sasol Oil), Sasol International Services Ltd (SISL) and Sasol Oil International Ltd (SOIL). In terms of these agreements, SOIL agreed to procure crude oil and deliver it to SISL, where SISL would sell and deliver this crude oil to Sasol Oil. As a result of these contracts, that SARS considered to be simulated, additional assessments were issued in relation to the 2005 to 2007 years of assessment.

The basis of the dispute may be traced back to 1991, when the Sasol group commenced purchasing oil directly from foreign suppliers in the Middle East and Western Africa. At that point, the Sasol group established businesses in different locations, including Sasol Trading

International Ltd (STI) in the Isle of Man (IOM) and Sasol Trading Services Limited in the United Kingdom (UK) (whose name changed to SISL in 1998). Both STI and SISL were wholly owned subsidiaries of Sasol International Holdings (Pty) Ltd (SIH), which was incorporated in South Africa. Prior to 2001, the Sasol group had for many years purchased crude oil from suppliers under term contracts negotiated by STI. The oil was delivered to Sasol Oil in Durban, South Africa. In 2001, the procurement structure was amended and STI purchased oil from the suppliers, but then sold it to SISL on a free on-board port-of-loading basis, which then resold and arranged shipment of the oil to Sasol Oil in Durban on a delivered ex ship basis. Thereafter, SIH underwent a name change and became known as Sasol Investment Company and SOIL was formed in IOM as a subsidiary of Sasol Oil. Following this, the acquisition of crude oil remained the responsibility of SOIL, who resold this oil (on a free on-board basis) to SISL, who, as before, sold and delivered the oil to Sasol Oil. The dispute arose in 2010 when SARS claimed that the contracts of oil sales in the 2005, 2006 and 2007 years of assessment were simulations. SARS contended that there was no reason for SOIL to sell the oil to SISL and for SISL to sell it back to back to Sasol Oil, and that the real intention of the parties was the sale of oil to Sasol Oil by SOIL. The view taken was that SISL was not intended to assume any commercial risk or purpose in the transaction. On this basis, SARS imputed the profits derived by SOIL to Sasol Oil (invoking section 9D of the Act to do so) and additional assessments were raised. In the alternative, SARS asserted that the transactions were entered into for purposes of tax avoidance as contemplated by the preceding GAAR (as set out in section 103(1) of the Act at the time). Sasol Oil raised objections which were disallowed. Following this, the Tax Court (*Income Tax Case No. 1910 (2018) 80 SATC 353*) held in favour of the Commissioner, finding that the contracts were a sham and that the real contract was for SOIL to sell the oil directly to Sasol Oil' (*Sasol Oil v CSARS (2018)* ZASCA 153 A).

The Tax Court had previously found that the transactions were simulated and that SISL's role in the scheme was a sham. This was before SASOL took the matter to the Supreme Court of Appeal.

In the PwC November to December 2018 Synopsis, in the Sasol case discussion, the following was said,

> 'Sasol had objected against the additional assessment and appealed to the Tax Court against the disallowance of the objection. The Tax Court dismissed the appeal, holding that the contracts between Sasol Oil International Ltd ("SOIL") and Sasol International Services Ltd ("SISL") and between SISL and Sasol were a sham and that the real contract was for SOIL to sell the oil directly to Sasol'.

Furthermore, the Synopsis summarised the argument of the case by stating,

> 'In effect, the argument was that SISL was a device placed into the operational structure solely as a conduit and that the real transaction consisted of Sasol purchasing the oil from SASOL Trading International Limited ("STI")'.

In paragraph 3.5, there will be a discussion on the tax consequences of Impermissible tax avoidance.

3.4.1 THERE MUST BE AN ARRANGEMENT

The word 'arrangement' is defined in the Act as follows:

> 'Any transaction, operation, scheme, agreement or understanding (whether enforceable or not) including all steps therein or parts thereof and includes any of the foregoing involving the alienation of property' (s 80L of the Act, definitions).

> 'An "arrangement" has been interpreted as requiring a conscious involvement of two or more participants who arrive at an understanding. It cannot exist in a vacuum and presupposes a meeting of minds, which embodies an expectation as to future conduct between the parties; that is, an expectation by each that the other will act in a particular way' (*FCT v Newton (*1958) 2 All ER 759 (PC).

The words 'transaction, operation or scheme' are not new in the current GAAR provisions as they were also contained in the previous GAAR in s 103(1).

> 'In the case of *Meyerowitz v CIR (*25 SATC 287)93 which dealt with s 103(1), it was held that the term "scheme" is a wide term covering a series of transactions and that it is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset. The terms "agreement" and "understanding" are new components, and the meaning and scope of these terms must still be determined by the courts' (Pidduck 2018).

> 'The criteria to determine what constitutes a 'step in or part of' an arrangement are not defined, and it is suggested that each implies a distinct transactional element of the whole' (Stiglingh *et al.* 2021).

In the PwC March 2021 Synopsis, Mandy mentioned that the judgment on the *Absa Bank Limited and United Towers (Pty) Ltd v CSARS case* has provided guidance on a part of the Income Tax Act that has not been deeply interpreted since its enactment. The relevant principles are*:*

- ‘A series of transactions will not constitute an “arrangement” purely because they have occurred in a chronological sequence, there must be a unity indicating a deliberate chain.
- By being a party to a single transaction, a person does not, without more, “participate or take part” in an arrangement.
- The purpose of tax avoidance must be established subjectively by reference to the taxpayer and not objectively by reference to the “arrangement”.
- The avoidance of tax must be established subjectively using the “but for” test. If a person would not have incurred a liability to tax through entering into the same transaction in other circumstances, it is difficult to assert that the person has derived a tax benefit.

‘It is likely that this matter may be appealed by SARS given the importance of the substantive issues. If it is taken on appeal, we will have the opportunity of obtaining binding guidance on some of the issues of interpretation. That said, the chances of SARS succeeding on appeal appear slim. The bottom line is that SARS appears to have made a strategic blunder by invoking the GAAR against the wrong taxpayer.’ (PwC March 2021 Synopsis)

The identification of the transaction, operation or scheme, agreement or understanding, or the steps or parts addressed by the Commissioner must be of utmost importance to the taxpayer in order to avoid any misunderstanding in defending it. In other words, the obligation placed on the Commissioner to set out the reasons for his conclusion provides the necessary mechanism. (de Koker & Williams 2021)

3.4.2 TAX BENEFIT REQUIREMENT

Impermissible tax avoidance arrangements as per s80A of the Act states the following:

> ‘Impermissible tax avoidance arrangements - An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose of entering into an arrangement was to obtain a tax benefit’ (Professional Tax Handbook. 2022/2023).

Both ‘solely’ and ‘mainly’ are not defined in the Income Tax Act. In the *SBI v Lourens Erasmus (Edms)* below court case,

> ‘in the context of an exemption for the previously applicable undistributed profits tax, the word “mainly” prescribed a purely quantitative standard of more than 50%’ (SARS Interpretation note 28, March 2022).

To understand that word solely in the context of impermissible tax avoidance, it is the only reason the taxpayer entered into an arrangement was for a tax benefit. It must also be proved by the taxpayer that the purpose was mainly to derive a tax benefit.

One of the requirements for an impermissible tax avoidance arrangement is that there must be a tax benefit and that the purpose of entering into the arrangement is for a tax benefit (S 80A, Income Tax Act, Professional Tax Handbook. 2022/2023).

Section 1 of the Income Tax Act defines a tax benefit as follows:

> "It includes any avoidance, postponement or reduction of any liability for tax".

When determining the tax benefit requirement, reference can be made to the judgement in *CIR v King* court case.

In *CIR vs King*, the court held the following:

> 'There are many . . . ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income. For example, a man can sell investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in buying shares which produce no income but may increase in value … He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation. If he is a professional man he may reduce his fees or work for nothing … He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that Parliament intended by the provisions of section 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out'
>
> 'Trollip JA said in *Hicklin v CIR 1980 (1) SA 481 (A)* that "the ordinary meaning of avoiding liability for a tax ... is to get out of the way of, escape or prevent an anticipated liability" which means a liability for a tax that the taxpayer anticipates will or may fall on him in the future' (Myburgh & Conje).

The tax benefit requirement can also be confirmed in ITC 1625 59 SATC 383 were the "but for" test was applied in the courts and held that "a feasible test to determine the existence of a tax benefit was whether the taxpayer would have suffered tax but for the transaction.

> 'The *Absa Bank Limited v C:SARS* (21825/19) (11 March 2021) case, in the High Court, confirmed the "but for" test. SARS was granted leave to appeal the *Absa case* directly to the Supreme Court of Appeal' (ENSight).

The Supreme Court of Appeal ruled in favour of SARS, the summary of the judgment is as follows:

> 'On 29 September 2023, the SCA handed down judgment in the long-awaited case now cited as *The Commissioner for the South African Revenue Service v Absa Bank Limited and Another* (596/2021) [2023] ZASCA 125. In this case, SARS had indicated its intention to apply the general anti-avoidance rules (GAAR) in the Income Tax Act 58 of 1962, which were not the tax provisions at issue. In *Absa Bank Limited*, the SCA has now also found in SARS' favour and overturned the High Court decision' (CDH, Tax and Exchange Control Alert).

In the *Absa Bank Limited v C: SARS* (21825/19) case*,* SARS had issued a s 80J notice. SARS issues a s 80J when they believe the taxpayer has implemented an impermissible tax arrangement. Absa Bank Limited ('Absa') requested SARS to withdraw the s 80J notice, however SARS did not comply with the request, instead it determined a tax liability for Absa as contemplated in s 80J(3)(c) (83 SATC 401, p 408).

The question was whether Absa received a tax benefit as defined in s 80A (83 SATC 401, p 416).

The PWC March 2021 Synopsis, makes reference to the tax benefit question. This question was dealt with briefly and succinctly (at [42] to [43]) of 83 SATC 401. The PWC Synopsis quoted the Absa court case as follows:

> '[42] Whether a tax liability was evaded is determined by the 'but for' test applied to a future anticipated tax liability. (ITC 1625 59 SATC 383*; Hicklin v CIR* 1980 (1) SA 481 (A) at 492ff). [43] SARS' rationale was articulated in the passages cited above. In my view, there is no plausible link demonstrated between Absa and the supposedly nefarious transactions. On the but for test the question must be posed: but for the purchase of preference shares in PSIC 3, how might an anticipated tax liability be evaded? No foundation is set out that demonstrates such a result. Thus, the conclusion is irrational' (83 SATC 401, p 416).

Three interpretations of the term "tax benefit" have been used for the purposes of applying the current GAAR to the facts of the Sasol case:

1. 'A tax benefit only arises if a taxpayer avoids an anticipated liability for tax (*Commissioner for Inland Revenue v King (*1947) 14 SATC 184 (A*)).* This may be contrasted with avoiding an existing liability for tax as this would constitute tax evasion and not tax avoidance
2. A tax benefit arises where the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability (*Smith v Commissioner for Inland Revenue (1964) 26 SATC 1 (A)).*
3. The "but for" test should be applied in determining whether a tax benefit exists and requires the following question to be asked: Would the taxpayer have suffered tax but for the transaction*? (*Income Tax Case No. 1625 (1996) 59 SATC 383*; Smith v Commissioner for Inland Revenue (*1964) 26 SATC 1 (A*); Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A*))'* (Pidduck 2018).

Clegg submits that, for the Commissioner to prove that there is a tax benefit, it is necessary for him to establish and show that the transaction or arrangement would otherwise have been entered into or, possibly, to produce the commercial consequences concerned and the tax consequences thereof. It is not enough, he suggests, for the Commissioner simply to aver that a tax benefit has arisen – he must be sufficiently clear in his mind as to the nature of the alternative position in order to quantify the benefit. (Stiglingh *et al.* 2021)

From the Absa *Bank Limited v C:SARS* (21825/19) court case it can be said the court have adopted the "but for" test.

3.4.3 SOLE OR MAIN PURPOSE THE OBTAINING OF A TAX BENEFIT

According to Meyerowitz, 'a purpose arrangement is essential to any general anti-avoidance rule' (Meyerowitz et al. 2005).

> In s 80A, 'an "impermissible avoidance arrangement" exists where, inter alia, the "sole or main" purpose of the avoidance arrangement was to obtain a tax benefit' (de Koker & Williams 2021).

'In the context of business

- 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
- it lacks commercial substance, in whole or in part, taking into account
- the provisions of section 80C' (de Koker & Williams 2021).

The tests under s 80A and 80G are, respectively, 'its sole or main purpose' and 'the sole or main purpose'. This requires the identification of a singular purpose, rather than one of a number of purposes. Thus, it is significant that the legislation requires the ascertainment of 'the' rather than 'a' sole or main purpose (Satumba 2011).

Section 80G(1) states the party obtaining the tax benefit must prove that ,

> 'reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.'

> De Koker, has the view that, '… to discharge the s 80G onus, a taxpayer is required to give affirmative evidence that satisfies a court, upon a preponderance of probability, that 'reasonably considered in light of the relevant facts and circumstances', the obtaining of the tax benefit was not the sole or main purpose' (de Koker *at el,* 2009).

> 'There is a well-established principle known as the "choice principle" which was introduced into South African law by *CIR v Conhage 61 SATC 391* and was also referred to by the Supreme Court of Appeal in the *Sasol Oil* case. This principle is well-entrenched in South Africa's constitutional democracy. The "choice principle" essentially provides that a taxpayer is entitled to structure a transaction in a manner which results in the least tax liability. If, for example, the same commercial result can be achieved in different ways, a taxpayer may enter into a transaction which does not attract tax or attracts the least amount of tax.' (ENSight)

The Income Tax Act does not provide a test to determine the existence of a tax benefit, but it was held by the court in *Copthorne Holdings Ltd v Canada* (2011 SCC 63), referring to *Canada Trustco Mortgage Co v Canada* (2005 SCC 54) that the existence of a tax benefit can be established by a comparison of the taxpayer's situation with an alternative arrangement. If a comparison approach is used, the alternative arrangement must be the one that 'might reasonably' have been carried out but for the existence of the tax benefit. The 'but for' test simply ask whether, but for the existence of an arrangement, would tax have been suffered. (Stiglingh *et al.* 2021)

> 'Given that the operative purpose envisaged in s 80A is the objective purpose of the arrangement itself and not the subjective purpose of the taxpayer, a critical issue in any litigation between SARS and the taxpayer in relation to the GAAR will be what evidence, other than the terms of the arrangement itself (and also, according to Denning, 'the overt acts by which it was implemented') is admissible to rebut the presumption of a sole or main purpose of obtaining a tax benefit. Where the arrangement is not in writing, or not wholly in writing, but is oral or tacit, it seems that the terms of the arrangement will have to be laid before the court by way of oral testimony by the parties – but they will have to scrupulously avoid any reference to their subjective purpose in entering into the arrangement. Where the arrangement was in writing and was intended to be the exclusive memorial of the agreement, the common law parole evidence rule will bar any evidence being led to contradict the written agreement. All of this is going to lead to very fine lines being drawn in tax litigation in regard to evidentiary issues' (de Koker & Williams 2021).

3.4.4 TAINTED ELEMENTS

One of the last requirements to determine if the arrangement is an impermissible tax avoidance, is the abnormality test. As per the SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule*, this is a test of something bad, offensive or harmful which SARS called tainted elements.

As per the Income Tax Act, the abnormality element has three contexts to it, the context of business, non- business context and in any other context. (Professional Tax Handbook. 2022/2023)

In terms of s 80A of the Act, the avoidance arrangement will be impermissible if

a) 'in the **business context** if:
    i. It was entered into pr carried out by means or in a manner which would not normally be employed for bona fide business purpose 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' (Professional Tax Handbook. 2022/2023).

The requirement in s80A(a)(i) is the same as the abnormality requirement contained in s 103(1).

“Abnormality” is to be determined, in terms of ss 80A depending on the context within which the arrangement or transaction in question has been entered into. For example, a transaction entered into in a business context would be regarded as being abnormal if it lacks commercial substance (dealt with in detail in s 80C), whilst in a context outside of business, it has created rights or obligations that would not between persons dealing at arm’s length. This transaction would be considered ‘abnormal’ if it is entered into based on terms not normally employed for *bona fide* purposes.

Impermissible tax avoidance arrangement in a **context other than business**

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 *bona fide* purpose, other than obtaining a tax benefit or

c) In any context –

i. it created rights or obligations which would not normally be created between persons dealing at arm’s; or

ii. it would result directly or indirectly in the misuse or abuse of the provisions of the Act (including the provisions of this Part)’ (Professional Tax Handbook. 2022/2023).

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Business purpose Test

There is no guidance on what constitutes ‘bona fide business purposes’, in terms of s 80A of the Act. ‘In this context’, does not include obtaining a tax benefit (Professional Tax Handbook. 2022/2023).

> ‘By implication, therefore, every bona fide business purpose other than obtaining a tax benefit is included, and if there was also a purpose of obtaining a tax benefit, then the latter purpose must not have been the sole or main (objective) purpose of the transaction’ (de Koker & Williams 2021).

3.4.5 SECTION 80L

Listed below are the definitions of arrangement, avoidance arrangement, party and impermissible avoidance arrangement.

Section 80L of the Act defines arrangement as follows: means 'any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including any or all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property'.

"**Avoidance arrangement"** means any arrangement that, for this Part, results in a tax benefit.

'impermissible avoidance arrangement' 'means any avoidance arrangement described in section 80A;
"party" means any -
(a) person;
(b) permanent establishment in the Republic of a person who is not a resident;
(c) a permanent establishment outside the Republic of a person who is a resident;
(d) partnership; or
(e) joint venture,
who participates in an arrangement;' (Professional Tax Handbook. 2022/2023).

Any tax avoidance arrangement in respect of which the requirements of the GAAR, as revised, are satisfied, according to the September 2006, SARS Tax Avoidance Revised Proposals.

3.5 TAX CONSEQUENCES OF IMPERMISSIBLE TAX AVOIDANCE- SECTION 80B

When an impermissible tax avoidance arrangement has been entered into, the Commissioner may determine if the remedies set out in s **80B** (**Tax consequences of impermissible tax avoidance)** may apply in order to determine the tax consequences to any impermissible avoidance arrangement. (SARS 2005)

In this chapter, there will be a focus on the tax consequences of impermissible tax avoidance, which is the main focus on this research report.

According to the SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule*, the old remedy provisions, while very broad, focus exclusively on the neutralisation of any undue tax benefits that have been obtained. This emphasis on nullifying arrangements had opened the door for taxpayers to argue that section 103 could not be applied to them because they would not have had a tax liability but for the very arrangement under review. On the other hand, the breadth of the old remedy provision had occasionally resulted in excessive or inappropriate adjustments. The current remedy is intended to mitigate these problems.

‘(1) The Commissioner may do the following to determine the consequences under this Act of any impermissible tax avoidance arrangement by-

a) Disregarding, combining or re-characterising any steps in or parts of the impermissible avoidance arrangement.
b) disregarding any accommodating or tax- indifferent party or treating any accommodating or tax indifferent party and any other party as one and the same person
c) deeming persons who are connected persons in relation to one another to be one and the same person;
d) reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
e) re-characterising any gross income, receipt or accrual of a capital nature or expenditure;
f) treating the impermissible avoidance arrangement as if it had not been into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention of diminution of the relevant tax benefit’ (Professional Tax Handbook. 2022/2023).

Below is a summary of consequences when applying s80B. The general remedy provision for impermissible tax avoidance arrangements is provided in s80B(1)(f).

> ‘The Commissioner may in terms of this general remedy determine the liability for tax as if the transaction had not been entered into or carried out, or, alternatively, 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’ (South African Tax Guide (n.d) *General anti-avoidance rule*).

The Commissioner must, in terms of s 80B(2), make the necessary and appropriate adjustments to the applicable tax liabilities to ensure the consistent treatment of all the parties to the arrangement.

> ‘These adjustments are subject to the normal three-year prescription rules. The adjustments are also subject to objection and appeal. It is important to note that the provisions of s80 [A-L] may be applied to any part of an arrangement or to the arrangement as a whole (s 80H)’ (SARS Tax Guide).

Furthermore, reference will be made to *CIR v Conhage (Pty) Ltd* case that had seen to be an impermissible tax avoidance arrangement by the Commissioner.

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).

The 2005 SARS Discussion Paper on Tax Avoidance explicitly recognised a taxpayer's right to mitigate or even eliminate tax liability through legitimate tax-planning. This principle was affirmed in the Supreme Court of Appeal in *CIR v Conhage (Pty) Ltd 1999 (4) SA 1149, 61 SATC 391.*

In the *CIR v Louw* case, the background of the case was

> '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)' (Williams 2001).

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)' (Williams 2001).

In a similar case to *CIR v Louw* case, the *SIR v Geustyn, Forsyth & Joubert* case deals with the transfer of a business from a partnership to an unlimited company.

> '*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)' (William 2001).

'In our experience, SARS favours the objective inquiry. This is so despite the fact that SARS conceded in a published document, entitled Tax Avoidance and Section 103 of the Tax Administration Act, 1962 (Act No. 58 of 1962) – Revised Proposals, that it was never the intention to prevent a taxpayer's explanation of the reasons for an arrangement, but the intention was to ensure that the taxpayer's statement of intent be rigorously tested against the facts and circumstances. In other words, according to the Revised Proposals, the threshold test under the purpose requirement remained unchanged and reinforced existing precedents' (ENSight).

3.6 SECTION 80C - LACK OF COMMERCIAL SUBSTANCE

Section 80C deals with the lack of commercial substance.

The general meaning of 'lack of commercial substance' is set out in s 80C(1) of the Income Tax Act while s 80C(2) provides a non-exhaustive list of factors that indicate a lack of commercial substance.

Section 80C(1),the presumptive test, establishes a general rule for determining whether an avoidance arrangement lacks commercial substance, while s 80C(2) provides a nonexclusive set of characteristics that serve as indicators of a lack of commercial substance (de Koker *at el, 2021).*

The provisions of s 80C of the Income Tax Act are as follows:

> (1). ‘For the purpose of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be derived but for the provisions of this Part.
> (2). For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to
>
> (a) The legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from the legal form of its individual steps; or
> (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.’

The Income Tax Act does not provide a meaning for the concepts of ‘significant tax benefit’ and ‘significant effect upon business risks.’ Consequently, a level of subjectivity may arise in attempting to define these concepts which could lead to lack of clarity about the application of this tainted element (Pidduck, 2018).

The indicators for lack of substance are listed in s 80C(2) and are discussed below.

3.6.1 COMMERCIAL SUBSTANCE OVER FORM INDICATORS

In determining whether the arrangement lacks substance, one needs to apply the indicators as per s 80C(2).

The first indicator is the substance over form. The act does not provide a clear definition of the substance over form indicator; therefore, a reliance is placed on case law.

> ‘Furthermore, the act does not provide any guidance for determining whether the legal substance of an arrangement differs from its legal form. This indicator is further intended to empower the Commissioner to invoke the GAAR against transactions whose legal form

> create the impression that economic risk was incurred while in substance, the taxpayer remains insulated from all economic risk' (SARS 2005).

The 'substance over form' doctrine, can only be invoked where the Commissioner determines that the understanding between the parties is not in line with their true intention (Hofmeyr 2014)

> 'The legal form is what the taxpayer has done (the legal form of his transaction), possibly pointing to the economic or commercial effect thereof' (Stiglingh *et al.* 2022).

In *IRC v Duke of Westminster* it was stated that:

> 'it is said that the substance of the transaction evidenced by the agreement must be looked at, and not its mere words' (Clegg 1991)

The courts will have regard to the substance and not the form of a transaction. As Wessels ACJ said *in Kilburn v Estate Kilburn*:

> 'Courts of law will not be deceived by the form of a transaction; it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance.'

The below cases make reference to substance over form. In *IRC v Duke of Westminster* Lord Tomlin warned that:

> 'This so-called doctrine of "the substance" seems to me to be no more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable' (William 2001).

In *Dadoo Ltd v Krugersdorp Municipal Council* 53 Innes CJ said,

> 'a transaction is in *fraudem legis* when it is designedly disguised so as to escape the provisions of the law but falls in truth within those provisions. Thus stated,
> the rule is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things . . .' (de Koker & Williams 2021)

In the *CSARS v NWK Ltd* (2011) The Tax Court held;

> ‘that NWK had acted in terms of the agreements. It accepted that Barnard, representing NWK, had genuinely intended to act in accordance with the terms of the loan agreement and although aware of the agreements between Slab and FNB, was not a party to them. The Tax Court held that Barnard was a credible and satisfactory witness. I shall deal with his evaluation after considering some of the evidence. It is important to note that the Commissioner’s case in the Tax Court was that the simulation of the transactions was deliberate. There was no contention that the parties had genuinely believed that the transactions were bona fide and would be performed in accordance with their terms. It was argued in that court that NWK and FNB were acting deliberately to conceal the true nature of the transaction.’ (The Supreme Court of Appeal Judgement, par 37)

The Supreme Court of appeal judgement held that;

> ‘The order of the Tax Court is replaced with:
> (a) The objection to the assessments is dismissed and the additional assessments are upheld with costs.
> (b) The objection to the imposition of additional tax of 200 per cent is upheld.
> (c) Additional tax of 100 per cent of the total amount of the additional assessments is imposed in terms of s 76 of the Income Tax Act 58 of 1962’ The Supreme Court of Appeal Judgement, par 98).

The true form of the arrangement needs to be determined and not merely what the taxpayer says the transaction or arrangement represents.

3.6.2 ROUND TRIP FINANCING INDICATOR – S80D

Round-trip financing is the second indicator of a transaction that lacks commercial substance.

Round trip financing is defined in s 80D of the Income Tax Act as follows:

“’(1) Round trip financing includes any avoidance arrangement in which –

(a) funds are transferred between or among the parties (round tripped amounts); and

(b) the transfer of funds would”

(i) Result, directly or indirectly, in a tax benefit but for the provisions of this Part; and

(ii) Significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.

(2). “This section applies to any round tripped amounts without regard to-

(a) Whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;

(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

(3). For the purpose of this section, the term ‘funds’ includes any cash, cash equivalent or any right or obligation to receive or pay the same.’

The issue of tax benefits and business risks is once again addressed in this section albeit with a slight twist. In s 80C(1) discussed above, the avoidance arrangement must have resulted in a significant tax benefit for a party but should not have any significant effect on the business risks of the taxpayer. In s 80D(1)(b)(i) and (ii), the transfer of funds must have resulted in a tax benefit and must significantly reduce the business risks of the taxpayer (Satumba 2011).

As per the provisions of GAAR, round trip financing would encompass any avoidance arrangement in which funds are transferred between or among the parties (“round tripped amounts”) and those round tripped amounts would both (1) result, directly or indirectly, in a tax benefit (but for the provisions of the GAAR), and (2) significantly reduce, offset or eliminate any credit or economic risk incurred by any party in connection with the avoidance arrangement. The provisions are not subject to any “tracing” requirement. (SARS September 2006, Tax Avoidance Revised Proposals).

3.6.3 ACCOMODATING OR TAX - INDIFFERENT PARTIES – S80E

The inclusion of an accommodating or tax indifferent party will indicate a lack of commercial substance as per section 80C (2)(b)(ii).

The characteristics of an accommodating or tax indifferent party can be found in section 80E (1). It reads as follows:

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

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

(i) not subject to normal tax; or

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

(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

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

(3) the provisions of this section do not apply if either

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

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

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

As per the 2005 SARS Discussion Paper on Tax Avoidance, tax indifferent parties are used in avoidance arrangements to defeat the balance between tax deductibility in the hands of one party and taxable income in the hands of another.

3.6.4 TREATMENT OF CONNECTED PERSONS AND ACCOMMODATING OR TAX INDIFFERENT PARTIES – S80F

'For the purposes of applying s 80C or determining whether or not a tax benefit exists for purposes of this Part, the Commissioner may-

(a) Treat parties who are connected persons in relation to each other as one and the same persons; or
(b) Disregard any accommodating or tax-indifferent party or treat any accommodating or tax-indifferent party and any other party as one and the same person' (Professional Tax Handbook. 2021/2022).

'Section 80F allows the Commissioner to combine connected persons and disregard an accommodating or tax-indifferent party or to combine it with another party for the purposes of determining: • whether an avoidance arrangement lacks commercial substance or • whether a tax benefit exists. The Commissioner must give notice, with reasons, of an intention to invoke the GAAR. The taxpayer generally has 60 days to reply to the notice but may request an extension to reply. On receipt of the reply or expiry of the period for a reply the Commissioner has 180 days to raise further queries, withdraw the notice, or invoke the GAAR. If additional information comes to the knowledge of the Commissioner the reasons for invoking the GAAR may be modified or a new notice may be issued if a prior notice has been withdrawn (s 80J)' (South African Tax Guide (n.d) *General anti-avoidance rule*).

3.6.5 PRESUMPTION OF PURPOSE - S 80G

'This section sets forth a revised presumption that would arise in respect of the purpose of an avoidance arrangement and clarifies and confirms that the purpose of a step in or part of an avoidance arrangement may differ from a purpose attributable to the avoidance arrangement as a whole. It would replace the presumption in respect of purpose [previously] found in section 103(4)' (SARS, 2006).

The s 103 remedy provisions, while very broad, focused exclusively on the neutralisation of any undue tax benefits that have been obtained. This emphasis on nullifying arrangements has opened the door for taxpayers to argue that s 103 could not be applied to them because they would not have had a tax liability but for the very arrangement under review. On the other hand, the breadth of s 103 remedy provision occasionally resulted in excessive or inappropriate adjustments. The new proposal is intended to mitigate these problems. (SARS 2005)

The current GAAR provisions gives the Commissioner more power, the Commissioner may determine the tax consequences for any party to an impermissible avoidance arrangement.

The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by-

> ‘(a) Disregarding, combining or re-characterising any steps in or parts of the impermissible avoidance arrangement;
> (b) Disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;
> 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;
> (d) Reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
> (e) Re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
> (f) Treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstance of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit’ (Professional Tax Handbook. 2022/2023).

3.6.6 POWERS OF THE COMMISSIONER - S 80J

In terms of s 103 (1), the Commissioner’s power to determine the taxpayer’s liability as if the transaction had not been entered into or carried out or in such manner as in the circumstances of the case he deems appropriate may be exercised not only in respect of the year of assessment in which the transaction was entered into or carried out but also in respect of all subsequent years of assessment. (SARS 2005) However, this later changed when the new s 80A to s 80L GAAR provisions came into effect in November 2006.

Section 80 J of the Act, which are the current GAAR provisions, states the following:

> ‘(1) The Commissioner must, prior to determining any liability of a party for tax under section 80B, give the party notice that he or she believes that the provisions of this Part may apply in respect of an arrangement and must set out in the notice his or her reasons therefor.
> (2) A party who receives notice in terms of subsection (1) may, within 60 days after the date of that notice or such longer period as the Commissioner may allow, submit reasons to the Commissioner why the provisions of this Part should not be applied.

(3) The Commissioner must within 180 days of receipt of the reasons or the expiry of the period contemplated in subsection (2)-

(a) Request additional information in order to determine whether or not this Part applies in respect of an arrangement;

(b) Give notice to the party that the notice in terms of subsection (1) has been withdrawn; or

(c) Determine the liability of that party for tax in terms of this Part.

(4) If at any stage after giving notice to the party in terms of subsection (1), additional information comes to the knowledge of the Commissioner, he or she may revise or modify his or her reasons for applying this Part or, if the notice has been withdrawn, give notice in terms of subsection (1)' (Professional Tax Handbook. 2022/2023).

A practical example of s 80J can be seen in the *Absa Bank Limited and another v CSARS* case. SARS issued a s 80J notice to Absa, as per s 80J(1) of the Act (83 SATC 401, p 408).

3.6.7 CONCLUSION

It is clear from the s 80B consequences of impermissible tax avoidance are remedies by the Commissioner to ensure there are corrective measures in place for the taxpayer. However, it can also be said that it still contains numerous uncertainties and complexities.

This judgement relates to the *Absa Bank Limited and another v CSARS case,* however SARS appealed the ruling. There are no penalties for the taxpayer in the GAAR provisions but purely corrective measures against the taxpayer who Is involved in an impermissible avoidance arrangement.

4 WHAT ARE THE PENALTIES OF TAX AVOIDANCE

4.1.1 INTRODUCTION

Section 223 provides guidance for penalties in the event that there is an understatement in tax liability, or is of prejudice to SARS or the fiscus as a result of an **impermissible avoidance arrangement**.

4.1.2 WHAT IS AN UNDERSTATEMENT?

Section 223 of the Tax Administration Act outlines the penalties to be levied when a taxpayer has understated their tax liability.

In order to understand what an understatement penalty is, the Act defines understatement in section 221 of the Tax Administration Act.

An **understatement in terms of section 221** of the Tax Administration Act is

> '**understatement** means any prejudice to SARS or fiscus as a result of –
>
> (a) failure to submit a return required under a tax Act or by the Commissioner;
> (b) an omission from a return;
> (c) an incorrect statement in a return;
> (d) if no return is required, the failure to pay the correct amount of "tax"; or
> (e) an impermissible avoidance arrangement'

The SARS Understatement Penalty Guide states the following;

> 'There is nothing in the context of the provisions of the Act relating to understatement penalties to suggest that the word was used in a limited sense in section 221. On the contrary, a comparison of the sense of the words "means ... prejudice to SARS or the fiscus", with and without the insertion of the word "any", suggests that its insertion indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS or the fiscus.'

Furthermore, In *TCIT13725 DBN* the word "any" is given a wide interpretation of

> 'The word "any" is a word of wide and unqualified generality. It may be restricted by the subject-matter or the context, but prima facie it is unlimited.' (*Per Innes CJ in R v Hugo 1926 AD 268 at 271*). There is nothing in the context of the provisions of the Act relating to

understatement penalties to suggest that the word was used in a limited sense in section 221'.

4.1.3 WHAT IS AN UNDERSTATEMENT PENALTY?

Section 222(2) of the Administration Act describes the understatement penalty as follows:

> 'the understatement penalty is the amount resulting from applying highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4) in relation to "understatement"'.

Section 222(3) of the Administration Act, provides that the shortfall is the sum of –

a) 'the difference between the amount of "tax" properly chargeable for the tax period and the amount of "tax" that would have been chargeable for the tax period if the "understatement" were accepted;
b) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the "understatement" were accepted; and
c) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the understatement were accepted, multiplied by the tax rate determined under subsection (5).'

The South African Tax Guide (n.d), states, in terms of s 222(1) of the Tax Administration Act a taxpayer must pay an understatement penalty if that taxpayer has made or caused an 'understatement'. SARS has no discretion in imposing such a penalty. The understatement penalty is a percentage-based penalty determined with reference to the taxpayer's behaviour.

4.1.4 UNDERSTATEMENT PENALTIES FOR IMPERMISSIBLE TAX AVOIDANCE?

The impermissible avoidance arrangement penalties are between 35% to 100% as per s223 of the Administration Act, understatement penalty percentage table.

> 'In the event it is a standard case, a 75% penalty is levied. In the event it is a repeat case or obstruction, there will be 100% penalties levied, in the event of a voluntary disclosure but after audit notification or criminal notification, there will be a 35% penalty levied'. (South African Tax Guide)

Lastly in the event there is a voluntary disclosure before audit notification, no penalties will be levied. (South African Tax Guide)

Below is the understatement penalties percentage table.

In order for taxpayers to have penalties levied on the taxpayer, the arrangement must have deemed to be an impermissible tax avoidance arrangement.

Item	2 Behaviour	3 Standard case	4 If obstructive, or if it is a 'repeat case'	5 Voluntary disclosure after notification of audit	6 Voluntary disclosure before notification of audit
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	Impermissible avoidance arrangement	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

5 CONCLUSION

The GAAR amendment has introduced new provisions to assist the Commissioner to curb impermissible tax avoidance arrangements. These new provisions were discussed in chapter 3 which can be found in s 80A to s80L of the Act.

Section 80B of the Act, gives the Commissioner has vested powers to act on any taxpayer who has been found to be involved in an impermissible tax avoidance transaction.

> 'The taxpayers had entered into a transaction which, in SARS' view, was an impermissible avoidance arrangement as defined in section 80L, and described in section 80A, of the Income Tax Act 58 of 1962 (ITA). Therefore, SARS issued the taxpayers with notices in terms of section 80J of the ITA, inviting the taxpayers to make submissions as to why the GAAR should not be applied' (Tax & Exchange Control Alert November 2023).

> 'The Commissioner may determine the tax consequences of any impermissible tax arrangement. This is done by making compensating adjustments to assessments to ensure consistent treatment of all parties to the arrangement' (*Absa Bank Limited v CSARS,* 2011, par 13).

In the Absa case, the Commissioner exercised powers in respect to an Impermissible avoidance arrangement set out in s 80B of the Act.

The tax consequences provided in s 80B are remedies of tax avoidance that the Commissioner may apply, if the Commissioner finds the arrangement to be an impermissible tax avoidance.

Section 222 and 223 outlines the penalties that could be levied on the taxpayer should the taxpayer be found to have caused prejudice to SARS or to the fiscus as a result of an impermissible avoidance arrangement (s 221 of the Administration Act).

The penalties are levied in the event the taxpayer has understated their tax liability or in the event there is an impermissible avoidance arrangement. The taxpayer will be liable to pay a penalty as well as the tax payable. Section 223 provides a tax percentage penalty table, this tax table percentage would be applicable in the event the taxpayer is found to have an impermissible tax avoidance transaction by the Commissioner.

Section 223 is also applicable in the event the taxpayer has been taken to court by SARS and the judgement is in favour of SARS, the application of s 223 was seen in the *CSARS v NWK Ltd* judgment at the Supreme Court of Appeal, where an additional tax penalty of 200 per cent was levied. The Commissioner issued additional assessments for the period from 1999 to 2003 and levied 200 per cent, and additional interest in terms of s 89quat of the Act.

The order of the Supreme Court of Appeal was as follows.

> 'On appeal from the Tax Court sitting at Johannesburg (per Boruchowitz J and assessors sitting as a court of appeal): 1 The appeal against the order of the Tax Court is upheld with costs including those of two counsel. 2 The order of the Tax Court is replaced with: (a) The objection to the assessments is dismissed and the additional assessments are upheld with costs. (b) The objection to the imposition of additional tax of 200 per cent is upheld. (c) Additional tax of 100 per cent of the total amount of the additional assessments is imposed in terms of s 76 of the Income Tax Act 58 of 1962' (CSARS v NWK (27/10) [2010] ZASCA 168).

This applies when the taxpayer is found guilty of an impermissible avoidance arrangement and in the event the taxpayer intentionally avoided tax. (s 223 of the Tax Administration Act, 2011)

The old GAAR s 103(1) had inconsistencies, however the new GAAR, has tried to curb impermissible tax avoidance and there has been progress. It has not completely been able to achieve this result of curbing impermissible tax avoidance, however, there has been progress from the court rulings that have been presented in the different courts.

From the NWK Ltd case, it can be established that NWK Ltd had entered into an arrangement that resulted in tax evasion. From the Absa Bank Limited case, it can be established that Absa had entered into a impermissible tax avoidance arrangement,. In both cases, the judgement was in favour of SARS.

When a transaction is seen to have characteristics of an impermissible tax avoidance arrangement, s 80B provides for consequences that may re-characterise the transaction and adjust the tax benefit obtained by the taxpayer (Section 80B of Tax Act).

The aim of the tax consequences is to place the taxpayer in a position where the taxpayer would have been in the absence of such a tax benefit, if the remedy is applied (Stiglingh *et al.*

2022). However, it has been noted that SARS had to take some taxpayers to court to prove the transactions are indeed tax avoidance transactions. Taxpayers were of the view that the High Court ruling for the *Absa Bank Limited* case would have provided the key aspects of the GAAR provisions, however the Supreme Court of Appeal ruling left taxpayers in the same position they were before, where taxpayers do not have a clear guideline of what may constitute an impermissible tax avoidance arrangement or a permissible tax arrangement (CDH, Tax and Exchange Control Alert).

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