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Tax avoidance in South Africa: an investigation of how the introduction of S 80A-80L closed the loopholes in the now-repealed S 103(1)

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TAX AVOIDANCE IN SOUTH AFRICA: AN INVESTIGATION OF HOW THE INTRODUCTION OF S 80A-80L CLOSED THE LOOPHOLES IN THE NOW-REPEALED S 103(1)

BY

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A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in fulfilment of the requirements for the degree of Master of Commerce (Specialising in Taxation)

Johannesburg, 2020

Keywords

Tax avoidance, Tax evasion, Tax planning, General Anti-Avoidance Rules (GAAR), Scheme requirement, Transaction, operation or scheme, Tax benefit, Onus of proof, Tainted elements, Abnormality, Context of business, Business Purpose Test, The lack of commercial substance test, Substance over form.

Abstract

Tax avoidance in South Africa has evolved over the years, which results in tax planning and structuring being skewed. On the one hand, taxpayers try and arrange their affairs to pay the least amount of tax, while on the other hand the revenue authorities try and close all the loopholes.

This research report will investigate how the introduction of General Anti-Avoidance Rules in s 80A- 80L closed the loopholes in the now-repealed s 103(1) General Anti-Avoidance Rules. The research will first make a distinction between tax avoidance, tax evasion and tax planning. It will further examine the requirements under the now repealed General Anti-Avoidance Rules (GAAR) in s 103(1) and the ones in the new s 80A-80L of the Act to identify these loopholes.

Declaration

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

Sfiso Dube
20 April 2020

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List of Abbreviations and Glossary

BEPS	Base Erosion and Profit Shifting
CIR	Commission of Inland Revenue
Commissioner	Commissioner for South African Revenue Services
Constitution	Constitution of the Republic of South Africa, Act No. 108 of 1996
GAAR	General Anti-Avoidance Rules (used for old and new GAAR)
ITC	Income Tax Case
New GAAR	Refers to sections 80A to 80L of Part IIA of Chapter III of the Income Tax Act
OCED	The Organisation for Economic Co-operation and Development
Old GAAR	Now-repealed s 103(1)
Ramsay principle	Principle created in *WT Ramsay Ltd v Inland Revenue*
South Africa	Republic of South Africa
s 103(1)	Section 103(1) of The Income Tax Act 58 of 1962
s 80A-80L	new GAAR sections 80A to 80L of Part IIA of Chapter III of the Income Tax Act
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
Tax Administration Act	Tax Administration Act of 2011
the Act	Income Tax Act of 1962 as amended

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1 INTRODUCTION

1.1 Introduction

The basis of any well-functioning economy depends on the effectiveness of the taxation collection system in place. One of the biggest threats to this is those taxpayers who seek to cheat the system and pay lower taxes than that actually due by them.

The old GAAR was effective until 1 November 2006, as of 2 November 2006, a new GAAR regime came into effect. This saw s103(1) which previously bore the GAAR provisions being replaced by 12 new provisions found in s 80A-80L. In my research report, I will use the terms old GAAR and new GAAR to distinguish between the two.

The new General Anti Avoidance rules (GAAR) has been put in place in South Africa as means to combat impermissible avoidance arrangements as described in s 80A. The crux of new GAAR thus rests on the fact that the taxpayer has engaged in an avoidance arrangement, where the sole or the main purpose was to obtain a tax benefit thus rendering the arrangement an impermissible avoidance arrangement. [1]

Section 80B gives the Commissioner the authority to set aside the tax benefit obtained in avoidance arrangements which are proven to be impermissible as defined by s 80A and treat the arrangement as if it had not been entered into other than in the manner the Commissioner would deem to be appropriate. [2]

This research report seeks to analyse the provisions of the new GAAR and assess whether they closed the loopholes in the now repealed s 103(1).

Although the Act has specific and general avoidance provisions, Lord Tomlin in his judgement stated that "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax".[3] The Commissioner attacks only those avoidable arrangements if

[1] S80A
[2] S80B
[3] *IRC v Duke of Westminster* 1936 A.C. 1 (HL)

the sole or main purpose was to obtain a tax benefit.[4] It is thus of great importance to understand the difference between tax evasion and tax avoidance which is achieved through legitimate tax planning.

1.2 The Research problem

The statement of the problem

The objective of this research report is to perform a comprehensive investigation in order to answer a question of how the introduction of General Anti-Avoidance Rules in s 80A-80L closed the loopholes in the now-repealed s 103(1) General Anti-Avoidance Rules?

The Sub-problems

To address the research objective, the research sub-problems below have been identified and will be used in the research in order to address the research question.

- The first sub-problem will deal with what is the difference between tax avoidance, tax evasion and tax planning? It will clearly set out the differences between these from a South African perspective.
- The second sub-problem looks in detail at what the requirements of the now-repealed General Anti-Avoidance Rules in s 103(1)?
- The third sub-problem, will look at what were the loopholes s 103(1)?
- The fourth sub-problem looks in detail at what are the requirements in the new GAAR? Who bears the onus of proof and what are powers does the Commissioner have when dealing with anti-avoidance?
- The fifth subproblem looks at how has new GAAR closed these loopholes?

1.3 Research methodology

The research method adopted is of a qualitative, descriptive nature based on a detailed analysis and review of tax avoidance literature. The research can be classified as being pragmatic as it seeks to perform an investigation on the new GAAR.

The research will be conducted using a qualitative research approach following legal doctrinal methodology. A doctrinal methodology is a research methodology that provides a

[4] S80A

methodical discussion of the rules governing a specific legal category, analyses the correlation between rules, explains areas of difficulty and predicts future developments. A comparative approach falls within this research methodology. The reason for the chosen research methodology is that this research will analyse the now-repealed s 103(1) General Anti-Avoidance Rules and then compare it to the new GAAR requirements and then apply the requirements to selected case laws in order to identify the loopholes and answer the research question .

The data collection method for this research study will be secondary data, in other words, journal articles, theses, court cases and published reports that will be used, analysed and compared. The main sources of information will include publications (journal articles, articles, or published studies including dissertations) on matters that fall within the scope of the research question. The Act will also be used as a source for the analysis of the South African general anti-avoidance rules in this study. Internet-based searches will be performed on key words like 'general anti-avoidance rules' and will be used as a source of information for this study, if relevant. The SARS website will also be used as sources of information.

The research objectives will be achieved by performing a literature review through selection of relevant legislation and case law and to analyse the old GAAR against the new GAAR to be able to draw a conclusion on whether it was effective in closing the loopholes. The selection of the case law is not merely to describe the facts but to analyse the South African General Anti-Avoidance Rules against the facts.

It is also necessary to determine whether any limitation and bias exist for this research study. The aim of this research study is not to address all possible cases that may have come before the courts, but it will only focus on landmark case laws relevant in responding to the research question. Further, this study is only an analysis of s 103(1) and then compare it to the new GAAR requirements with the application of the selected case law to understand how the new GAAR closed loopholes. Therefore, there are limitations regarding principles and lessons from other jurisdictions which will not be considered. Decisions in court are derived from the views of judges through application of the legislation.

2 DIFFERENCE BETWEEN TAX AVOIDANCE, TAX EVASION AND TAX PLANNING

2.1 Introduction

What distinguished tax avoidance from tax evasion, is that tax evasion is a criminal offence and therefore illegal in South Africa.[5] In s 80A, one of the criteria of an impermissible avoidance arrangement is whether an avoidance arrangement lacks, in whole or in part, commercial substance. Before an analysis of the anti-avoidance rules can be done, it is important to define and give meaning to these broad concepts that are sometime very loosely and interchangeably used, see the decision of *CSARS v NWK Limited* 2011 (2) SA 67 (SCA).

2.2 Tax avoidance

Tax avoidance is legal methods of arranging one's affairs to pay less tax. It is *prima facie* lawful, and it amounts to an attempt by a taxpayer to minimize his tax liability legally. It involves the use of legal means to reduce tax liability i.e. seek to pay minimum tax as in accordance with the provisions of the Act.[6] In other words, this involves the use of legitimate means to structure one's tax affairs in such a manner to end up paying less tax.

Many taxpayers seek ways of arranging their affairs so as to escape tax, or reduce or postpone their liability. In the cases that follow below, the courts have said taxpayers are free to structure their affairs in order to minimise income tax and no legal obligation rests upon a taxpayer to pay higher taxes than he is legally bound to under the Act.

- In *IRC v Duke of Westminster*,[7] Lord Tomlin said that "every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."
- Furthermore, in *CIR v Sunnyside Centre (Pty) Ltd*,[8] the court held that "a taxpayer is entitled to order his affairs so as to pay the minimum of tax."
- This was further supported by Hefer JA in *CIR v Conhage (Pty) (Ltd)*,[9] the Supreme Court of Appeals (SCA) said that "within the bounds of any anti-avoidance

[5]https://www.thesait.org.za/news/412400/Tax-attorney-explains-SARS-new-strategy-to-tackle-tax-evasion-.htm (Accessed 29 February 2020).
[6] Huxham, K. Haupt P (2012) Notes on Income tax South Africa 30th edition. Cape Town: Hedron
[7] [1936] AC 1 (HL) 19.
[8] (1996) 58 SATC 319 (A) 327.
[9] 1999 4 SA 1149 (SCA) 1155G-H.

provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner."

- In *Ayrshire Pullman Motors Services and D M Ritchie v IRC,* it was also held that, the taxpayer is entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue. [10]
- And finally, in *Levene v IRC*, it was held that, the taxpayer is free to make their own arrangements so that their cases may fall outside the scope of the taxing Act.[11]

The term 'tax avoidance' in itself can be very problematic in the sense that where a taxpayer's activities fall within the charging provisions, he will be liable for tax. The courts have also expressed their disagreement with regard to tax avoidance. In *Lord Vestey's Executors and Another v IRC*, Lord Normand said that "tax avoidance is an evil, but it would be the beginning of much greater evil if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved." [12]

In the case of *Smith v CIR*[13] 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'.

In the case of *C of IR v Challenge Corp Ltd*, [14] Lord Templeman held that tax avoidance relates to more than merely getting out of the way of an anticipated liability and said that:

"Income tax is avoided, and a tax advantage is derived for an arrangement when the taxpayer reduces his liability to tax without involving him [sic] in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a deduction in his liability as if he had."

[10] (1929) 14 TC 754.
[11] [1928] AC 21
[12] [1949] 1 All ER 1108 (HL) 1120.
[13] 1964 (1) SA 324 (A); 26 SATC 1.
[14] [1986] 2 NZLR 513 (PC) at 561–562.

There are quite a few instances where in determining taxpayers' tax liability where courts have frowned on tax avoidance schemes.

- In *Re Weston's Settlements* it was said the avoidance of tax may be lawful, but it is not yet a virtue. [15]
- In *Elmiger and Another v Commissioner of Inland Revenue* it was held, tax avoidance creates social consequences which are contrary to the general public interest. [16]

As noted from the court cases above, there seems to be a very fine or thin line between tax avoidance and tax evasion.

2.3 Tax evasion

Tax evasion involves the use of illegal or dishonest means in order to reduce the tax liability due or as recognised by SARS. It may also refer either to those transactions, operations or schemes that clearly run afoul of a specific or general anti-avoidance provision. [17]

In the 2020 Budget Speech delivered by the Finance Minister, Tito Mboweni, said

"*SARS is an integral part of the capable state. We are focused on re-establishing institutional integrity and fighting criminal activity. Just this past week two individuals were convicted for up to 168 years' imprisonment for tax fraud*". [18]

Tax evasion usually involves the use of fraud or deceit to reduce a tax liability through the non-disclosure of income and the exaggeration of expenditure claimed as deductions. It normally refers to unlawful methods that result in a taxpayer paying less tax, or no tax at all, to the Revenue Authorities. Tax evasion has also been referred to as 'illegal arrangements through or by means of which liability to tax is hidden or ignored.' [19]

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[15] [1968] 3 All E.R. 338 , [1969] 1 CH 223 (C.A.)
[16] (1966) NZLR 683 (SC) [Elmiger]
[17] https://www.gov.za/sites/default/files/gcis_document/201409/lapd-lprep-resp-2006-01-interim-response-tax-avoidance-and-s103-itact.pdf (Accessed 18 April 2020)
[18] http://www.treasury.gov.za/documents/national%20budget/2020/speech/speech.pdf (Accessed 18 April 2020)
[19] OECD, International Tax Terms for the participants in the OECD Programme of Co-operation with Non-OECD Economies.

Examples as provided by the SARS Draft Comprehensive guide to anti avoidance provisions include the falsifying of financial statements; not disclosing or misrepresenting relevant information in a tax return; or[The] deliberate failure by a cash business to report the full amount of revenue received. [20]

Section 235(1) of the Tax Administration Act, provides that any person who with intent to evade or to assist any other person to evade tax and obtaining undue refunds by fraud or theft.:

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 account or other records;
d) makes 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.

Tax evasion thus amounts to fraud, as by s 235(1) of the Tax Administration Act above which is a criminal offence, and the Act prescribes clear penalties for taxpayers found guilty of tax evasion.[21] Fine or imprisonment are consequences of tax evasion. [22]

The OECD, has defined tax evasion as encompassing:

[20] Tax avoidance and s103 of the Income Tax Act of 1962 Interim response SARS(2005). Tax Evasion, Impermissible Avoidance and Legitimate Tax Planning.pg5
[21] s 235(1) of the Tax Administration Act.
[22] s 235(1) of the Tax Administration Act.

"illegal arrangements through or by means of which liability to tax is hidden or ignored, i.e., arrangements in which the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities." [23]

Section 235(2) of the Tax Administration Act states that any person who makes a statement as per subsection (1) must, unless the person proves that there is a reasonable possibility that he or she was ignorant of the falsity of the statement and that the ignorance was not due to negligence on his or her part, be regarded as being aware of the falsity of the statement.

2.4 Tax planning

Tax planning and tax avoidance are very similar concepts in that a taxpayer can organize his affairs in such a way that he pays a minimum tax liability within the law.

In an article by E. Brinker it was explained as "Legitimate tax planning entails a transaction where a taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and generally suffers the economic consequences that the legislature intended to be suffered by those taking advantage of the option." [24]

Tax planning is similar to tax mitigation. In *CIR v Challenge Corporation Ltd* [1987] AC 155, the court said in tax planning the taxpayer ensures circumstances regarding his assessable income entitle him to reduction in his tax liability.

In *CIR* v *Willoughby,* Lord Nolan described the hall mark of tax planning as one where, the taxpayer takes advantage of a fiscally attractive option afforded by the legislation and genuinely suffers the economic consequences that Parliament intended those taking advantage of the option to suffer. [25]

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

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[23] Organisation for Economic Co-operation and Development, 'Glossary of Tax Terms',[http://www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html] (Accessed 29 February 2020).
[24] Brinker,E. The new General anti avoidance provisions for South Africa? .Business law (online)
[25] (1997) 4 ALL ER 65 at p.73.

The government is faced with the need to balance legitimate commercial transactions against the need to combat tax avoidance arrangements. This balancing act filters through to the South African courts where they strive to decide tax matters in a manner that is equitable to both the taxpayer and the government.

This concept was observed in the case of *CIR V Nemojim*[26] where judge Corbett J A stated the following words:

"…. there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus".

In the case of *IRC v Duke of Westminster*[27], Lord Tomlin stated the following:

"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax"
In the case of *CIR v King,*[28] Watermeyer CJ confirmed the taxpayer's freedom to structure his or her affairs so that they give rise to the minimum tax liability by holding the following: "In a wide sense also the amount of a man's income tax can be reduced from what it was in previous years if he earns less income than in previous years, but here again it is absurd to suppose that the Legislature intended to impose a penalty upon a man who enters into a transaction which reduces the amount of his income from what it was in previous years merely because his purpose was to reduce the amount of his income and consequently of his tax. These two types of cases may be uncommon but there are many other 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 freeing himself from taxation of some part of his future income."

[26] 1983 (4) SA 935 (A).
[27] 1936 A.C. 1 (HL)
[28] 1947 (2) SA 196 (A).

2.5 Conclusion

It is thus clear from the above quoted passages that taxpayers may minimize their tax liabilities by structuring their affairs in a suitable manner using legitimate means. It is therefore always an important principle that taxpayers must bear in mind when structuring their tax affairs. It is also important to note that even where tax avoidance is regarded as legitimate and falling within the law, the conduct itself may sometimes also be seen as unacceptable behaviour if the sole or main purpose is to obtain tax benefit.

It is thus clear that there is a difference between the consequences of tax evasion, tax avoidance and legitimate tax planning. The Commissioner will use the provisions contained in the General Anti-Avoidance Rules to distinguish between these three concepts and to determine the consequences of each.

3 REQUIREMENTS UNDER THE NOW-REPEALED GENERAL ANTI-AVOIDANCE RULES IN S 103(1)

3.1 Introduction

This chapter discusses the requirements in the now repealed s 103(1) anti-avoidance provisions and analyse certain case law to establish the clear requirements with the intention of identifying loopholes or weakness in order to look at how these are closed by the new GAAR in the later chapters that follows.

It should be noted that the General Anti-Avoidance Rules in the now-repealed s 103(1) does not apply to a transaction, operation or scheme entered into on or after 2 November 2006, being the date that the 'new' General Anti-Avoidance Rules came into force. It is nonetheless important to discuss and analyse this section so as to identify the loopholes in the section and see how they have been closed by the new GAAR.

3.2 Requirements in s 103(1) (a), (b)(i), (b)(ii) and (c)

Whilst it was still contained in the Act, s 103(1) read as follows:

"103. 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."

The old GAAR consisted of four key elements that can be summarized as follows:

1) There must be have been a transaction, operation or scheme entered into or carried out (the Scheme Requirement),
2) With the effect of avoiding or postponing or reducing the liability for the payment of any tax (the Tax Effect Requirement),
3) 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 or Arm's Length Test), and
4) The transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the Purpose Requirement).

All of elements as listed above, which are discussed in detail below had to be simultaneously present in order for the Commissioner to rely on the s 103(1).[29]

It should be noted that at the heart of s 103(1) were two inter-locking criteria:

1) The subjective sole or main purpose of the taxpayer to avoid or reduce liability for tax; and,
2) The objective normality or otherwise of the means or manner in which the transaction was entered into or carried out or of the rights and obligations thereby created.

[29] *SIR v Geustyn, Forsyth and Joubert* 1971 3 SA 567 (A) at 571-572.

For s 103(1) to apply to a 'transaction, operation or scheme' both the subjective intention and the objective abnormality had to be concurrently present.

3.2.1 Transaction, operation or scheme

In *Smith v CIR*, it was held that from the wording of s 103(1), the alienation of property can be a "transaction, operation or scheme."[30] However it was also said that such a situation does not arise unless other elements are also fulfilled, such as an "objective abnormality" factor and a subjective sole or main purpose of tax avoidance.[31]

The Commissioner had to be satisfied that a transaction, operation or scheme had been entered into or carried out by the taxpayer.

- In the case of *Meyerowitz v CIR* [32] the question arose whether various transactions amounted to "schemes" within the meaning of s 90 under the first general anti-avoidance provision introduced in South Africa in terms of the Income Tax Act of 1941. Counsel was of the view that "a scheme may consist of several transactions, but they must be connected in the sense of being parts of a preconceived plan, whatever the object of such plan may be."
  The court held that a transaction which did not form part of the scheme when it was entered into can become part of the scheme if it is later '*pressed into the service of the scheme'*.[33]

- In *CIR v Louw* [34] Corbett JA approved and applied the interpretation that the term "scheme" is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset.

- In *Ovenstone v SIR,* [35] Trollip JA stated that "*entered into"* does not mean "*formulated"* but has a connotation of implementation that is similar to *"carried out*." The court held that "it is only when a transaction, operation or scheme is

[30] 1964 1 SA 324 (A) 333 E – F.
[31] *Smith v CIR* 1964 1 SA 324 (A) 333 E – F.
[32] 1963 3 SA 863 (A).
[33] *Meyerowitz v CIR* 1963 3 SA 863 (A).
[34] 1983 (3) SA 551 (A).
[35] 1980 (2) SA 721 (A).

implemented or carried out, and not at the time it was formulated (i.e. conceived, decided or agreed upon) that it becomes a practical reality concerning the fiscus."

Therefore, even if a transaction does not have as its purpose that avoidance of tax at the time when entering into the transaction, it may have the effect when it is carried out and therefore fall within the scope of s 103(1).

In summary, a transaction, operation or scheme must therefore have been entered into or carried out for this requirement to be met.

3.2.2 Tax effects requirement

After establishing the existence of a transaction, operation or scheme, the Commissioner had to determine whether, the transaction, operation or scheme had the effect of avoiding or postponing or reducing the liability for the payment of any tax, duty or levy imposed by the Act or any previous Income Tax Act.

The terms "avoiding", "postponing" and "reducing the liability for payment of tax" are considered in the case laws below in terms of first general anti-avoidance provision introduced in South Africa in terms of the Income Tax Act of 1941 and they still applied under old GAAR.

In *CIR v King*[36], it was held that the tax liability addressed by s 90, is not an existing liability for tax, but an anticipated liability. Watermeyer CJ looked at the meaning of the words "*which has the effect of avoiding or postponing liability for any tax, duty or levy on income"* of s 90(1). [37] He held that the section refers to anticipated liabilities for tax either in respect of a current tax year or in respect of future years.

This interpretation held in the *King* case was confirmed in the case of *Smith v CIR*[38] where the court held that the ordinary meaning of avoiding liability for tax on income was 'to get out of the way of, escape or prevent an anticipated liability.' Steyn CJ held that:

[36] 1947 (2) SA 196 (A).
[37] 1947 (2) SA 196 (A).
[38] 1964 (1) SA 324 (A); 26 SATC 1.

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

From the interpretation of the *CIR v King*[39] and *Smith v CIR*[40] cases it is clear that the Commissioner can easily prove the presence of this requirement.

3.2.3 Abnormality requirement

Under s 103(1)(b) the transaction, operation or scheme had to be entered into "by means or in a manner which would not normally be employed" or it had to "create rights or obligations which would not normally be created between persons dealing at arm's length"[41], in order to satisfy the abnormality requirement.

The test was objective in respect of the abnormality of two aspects:

i. The means and manner in which transaction, operation or scheme was entered into or carried out; and
ii. The rights and obligations not normally created between persons dealing at arm's length under such a transaction, operation or scheme. [42]

In *Hicklin v SIR*[43] the court dealt with "dealing at arm's length". The court held that in an arm's length agreement, each party was independent of each other and would strive to get the uttermost possible advantage out of the transaction for themselves. The rights and obligations that are created are most likely to be regarded as normal as would the manner and means employed also be regarded as normal. The courts would need to use evidence and a factual enquiry to establish whether the parties dealt at arm's length or not.

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[39] 1947 (2) SA 196 (A).
[40] 1964 (1) SA 324 (A); 26 SATC 1.
[41] S 103(1) (3).
[42] S 103(1) (3)(a) and (b).
[43] 1980 1 SA 481 (A).

In respect of the valuation of property in a claim for compensation for expropriated land, King J defined arm's length transactions as follows in *Opera House (Grand Parade) Restaurant (Pty) Ltd v Cape Town Municipality*[44] :
'...sales in the open market by a willing seller to a willing buyer ...'

In a tax appeal relating to the taxation a forsaken interest on the unpaid price of the shares sold to trusts, Froneman AJA held in *C:SARS v* Woulidge[45] that: 'A notional commercial arms' length transaction on interest would assume a lender who would insist on payment of the interest he charges and a borrower able to pay that interest'.

3.2.4 Purpose requirement

In order to satisfy the purpose requirement of s 103(1)(c), the sole or main purpose of the transaction, operation or scheme, had to have been for the purpose of avoiding, postponing or reducing the liability for tax.
This was a subjective requirement that needed to be satisfied in order to meet all the other requirements as was set out in s 103(1). It appeared from the section, that where the taxpayer had more than one purpose of equal weight or significance, where one is the avoidance of tax, the requirement would not have been satisfied.

In this regard, s 103(4) provided that if a transaction, operation or scheme would result in the avoidance or postponement of tax, it was rebuttably presumed that it had been entered into with the requisite sole or main purpose of avoiding or reducing tax. The onus of rebutting this presumption (on a balance of probabilities) was on the taxpayer.

In *SIR v Guestyn, Forsyth and Joubert*[46] the taxpayer was held to have discharged the onus of proving that he had not entered into the transaction in question (the incorporation of a previously unincorporated partnership of professional engineers) for the sole or main reason of avoiding or deferring tax.

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[44] 1989(2) SA 670 (C) at 681
[45] 2002(1) SA 68 (SCA) at para 12.
[46] 1971 (3) SA 567 (A), 33 SATC 113.

A similar conclusion was reached in *CIR v Louw*,[47] namely, that the incorporation of the professional practice had not been implemented for the sole or main purpose of tax avoidance; however, the court held that the subsequent advancing of interest-free loans to the principals had indeed been done for that sole or main purpose and was moreover abnormal in the manner envisaged in s 103(1). Consequently, the advancing of those loans was held to fall foul of s 103(1), but the incorporation of the practice was held to be a severable transaction, which did not fall foul of the provision.

In the case of *CIR v Bobat and Others*[48], the court held that 'a main purpose is obviously one which is dominant over any other'.

An interpretation of *CIR v Bobat and Others*[49] above would the mean that where a taxpayer had two or more purposes of equal importance or significance, s 103(1) could not be applied. In ITC 1625[50] it was stated that the Commissioner bears the onus of proving a tax benefit. The Commissioner needs to prove on a balance of probabilities that that a tax benefit was derived as a result of an arrangement being entered into or carried out.

3.3 Conclusion

For s 103(1) to apply, all of elements as listed above, had to be simultaneously present in order for the Commissioner to rely on the s 103(1).[51] In a 'transaction, operation or scheme' both the subjective intention and the objective abnormality had to be concurrently present. According to s103(1), a taxpayer could, with impunity, enter into any transaction, no matter how (objectively) abnormal, so long as he did not have a (subjective) sole or main purpose of tax avoidance; conversely, he could with impunity enter into any transaction with the (subjective) sole or main purpose of tax avoidance, provided that the transaction was not (objectively) abnormal in the requisite sense. [52]

[47] 1983 (3) SA 551 (A), 45 SATC 113.
[48] 2005 67 SATC 47 (N).
[49] 2005 67 SATC 47 (N).
[50] 1996 59 SATC 383.
[51] *SIR v Geustyn, Forsyth and Joubert* 1971 3 SA 567 (A) at 571-572.
[52] RC Williams, 'The 1996 Amendments to the General Anti-Avoidance Section of the Income Tax Act' 114 South African Law Journal at 675.

4 LOOPHOLES IN S 103(1)

4.1 Introduction

Whilst s 103(1) was on the statute book, it had certain inherent weaknesses hindering the Commissioner from performing his duties. [53] This caused problems in its interpretation and application. [54] A perceived weakness of s 103(1), from the point of view of SARS, was that the requisite sole or main purpose of tax avoidance had to be determined subjectively. [55]

At the heart of s 103(1) were two inter-locking criteria:

1. The subjective sole or main purpose of the taxpayer to avoid or reduce liability for tax; and,
2. The objective normality or otherwise of the means or manner in which the transaction was entered into or carried out or of the rights and obligations thereby created.

The loopholes in s 103(1) are discussed in detail below.

4.2 Loopholes in s 103(1)

1) Subjectivity of the purpose requirement

The subjective nature of the 'purpose requirement' or 'main purpose test,' was one of the weaknesses in the eyes of the Commissioner. [56] The court was required to look into the mind of the taxpayer to determine whether the purpose requirement was present at the time the taxpayer entered into the transaction, operation or scheme.

This proved very difficult to do and it was thus presumed that the transaction was entered for the sole or main purpose of avoiding or postponing tax liability, unless the taxpayer

[53] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[54] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[55] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[56] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.

proved otherwise. [57] It meant that even if there was a tax purpose for entering into a transaction, it would not be in conflict with s 103(1), if this tax purpose was not the sole or main purpose of the transaction.

Furthermore, in s 103(1), if a transaction or, operation or scheme had a commercial or business purpose as its main purpose, it would have been sanctioned by the courts as parties are allowed to structure transactions in the most beneficial manner. [58]

The *ipse dixit* of a taxpayer who stated on oath at the hearing that he did not have such an intention was of course not conclusive, but neither was it irrelevant. [59] It was entirely possible that a scheme which did, in fact, avoid or postpone a tax liability, was not entered into for that sole or main purpose, but for some other purpose, such as to achieve a commercial objective or to put in place a family arrangement for the maintenance of the taxpayer's dependants. [60]

The judgement of *CIR v Conhage*[61] showed that where it was held that a transaction was entered into with a dual purpose, would not satisfy the 'purpose requirement' if the main reason for the transaction was a commercial or business purpose. This has rendered the GAAR as ineffective and toothless as it became very easy for taxpayers to justify a commercial purpose of a transaction or arrangement. SARS found it very difficult to prove that the dominant purpose of the transaction was to obtain a tax benefit. [62]

2) **Abnormality requirement of a transaction, operation or scheme**

The objective nature of the "abnormality test" was also perceived to be a weakness in s 103(1). If a particular kind of transaction, operation or scheme, that was once viewed as 'abnormal', became acceptable in the eyes of public it would then stop being an 'abnormal' transaction, operation or scheme under s 103(1). [63] Despite the ongoing doubts and uncertainties about what 'normal' means in this context, the criterion of normality has been

[57] S 103(4)*(a)*.
[58] *IRC v Duke of Westminster* 1936 19 TC 490.
[59] *Malan v Kommissaris van Binnelandse Inkomste* 1983 (3) SA 1 (A) at 18E.
[60] De Koker & Williams, 2012:19-4.
[61] 61 SATC 391.
[62] Werksmans Tax. 2006:1
[63] Report of the Katz Commission into Tax Reform, Chapter 11 at 11.2.2.

included in s 80A of the new GAAR, but with the addition of a new, alternative criterion of a 'lack of commercial substance'.
A taxpayer could thus enter into a transaction, operation or scheme with the subjective purpose of avoiding tax, provided that the transaction is not objectively abnormal. This was possible as all the requirements had to be simultaneously present. [64]

3) **Uncertainty as to the extent of the powers of the Commissioner**

The powers of the Commissioner were also one of the inherent weaknesses of s 103(1), as uncertainty existed as to whether the Commissioner had the authority to apply GAAR in the alternative where another provision was also in dispute. [65] Section 103(1) gave the Commissioner powers determine tax liability 'as though the transaction, operation or scheme had not been entered into or carried out or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction of tax'.

The Commissioner decided to eliminate this uncertainty by introduction of s 80A-80L of the Act.[66] Although it was felt that, for greater clarity, the Commissioner's powers should be spelled in specific as well as general terms. One of the features of the new GAAR is the detailed setting out in s 80B of the powers of the Commissioner in this regard.

4.3 Conclusion

The courts had held that the Commissioner could not invoke s 103(1) if the sole or main purpose of entering into a transaction, operation or scheme was not to avoid or postpone payment of income tax or any other tax or duty imposed by the Act administered by the Commissioner. Or the objective abnormality requirement was not met.

The cases in which the courts have held tax avoidance was not the sole or main purpose were the *CIR v Conhage (Pty) Ltd*[67] case and the *CIR v Louw*[68] case.

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[64] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[65] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[66] De Koker & Williams, 2012:19-4.
[67] 61 SATC 391.
[68] 1983 (3) SA 551 (A), 45 SATC 113.

The cases which the courts have held the objective abnormality requirement was not met were the *CIR v Louw*[69] case and the *CIR v Geustyn, Forsyth and Joubert*[70] case.

It can thus be concluded that the provisions of s 103(1) were very weak which made it difficult for the Commissioner to successfully apply s 103(1) to certain transactions, and which made it easy for taxpayers to escape liability.

Although s 103(1) was perceived as weak, it was a good starting point for the Legislature to draft s 80A-80L and to eliminate weaknesses in s 103(1).

[69] 1983 (3) SA 551 (A), 45 SATC 113.
[70] 1971 (3) SA 567 (A), 33 SATC 113.

5 REQUIREMENTS UNDER NEW GENERAL ANTI-AVOIDANCE RULES IN S 80A-80L

5.1 Introduction

The General Anti-Avoidance Rules as amended in 2006 are all encompassed in s 80A-80L of the Act. This serves the purpose of replacing s 103(1) and s 103(4). As compared to s 103(1), s 80A-80L are more detailed and comprehensive and consist of twelve provisions as opposed to four which were encompassed in the prior GAAR.

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

For a number of years s 103(1) contained the general anti-avoidance rules in the Income Tax Act. Section 103(1) did however contain certain inherent weaknesses, as described Chapter 4 above that resulted in the incorporation of the new provisions into the Act.

The Income Tax Act was amended to enable SARS to combat tax avoidance more effectively. [71] These new provisions can be found in Part IIA of Chapter III of the Income Tax Act, s 80A-80L and applies to any arrangement entered into on or after 2 November 2006.

These new sections have incorporated most of the requirements set out in s 103(1). Certain of the new provisions, however find their origin in other parts of the world. [72] Although the new sections contain many of the same concepts as s 103(1), it does not mean that these concepts apply in the same context or in the same manner or have same meaning. [73]

This chapter provides a critical analysis of provisions of the new General Anti-Avoidance Rules as they are contained in s 80A-80L.

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[71] South African Revenue Service Law Administration. November 2005. Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962.
[72] Haffejee Y, A critical analysis of South Africa's general anti avoidance provisions in income tax legislation 2009.
[73] the African Revenue Service (SARS).2010. Draft Comprehensive Guide to General Anti-Avoidance Rule (GAAR) p.5.

It has been established that in order for the new GAAR to find application, the following requirements have to be complied with:

1) There must be an avoidance arrangement entered into or carried out.; [74]
2) The avoidance arrangement must result in a tax benefit.. [75]
3) One of the three tainted elements must be present. [76]
4) The sole or main purpose of entering into the agreement or transaction must have been to obtain a tax benefit.. [77]

The three tainted elements are:

1) Normality regarding means, manner, rights or obligations.
2) Lack of commercial substance in whole or in part.
3) Misuse or abuse of the provisions of this Act (including part IIA).

All the above-mentioned provisions of the new GAAR have been critically discussed in this research.

5.2 Elements of General Anti-Avoidance Rules in s 80A-80L

5.2.1 Avoidance arrangement

An arrangement is defined in wide terms as 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.[78] An 'avoidance arrangement' is defined broadly as any transaction that results in a 'tax benefit' referred to in s 80A of the Act.

The provisions of the new General Anti-Avoidance Rules will apply where there is an impermissible avoidance arrangement as defined in the Act in s 80A. Avoidance tax arrangements as defined by the Act are arrangements entered into in order to obtain a tax benefit. [79]

[74] S 80A (preamble).
[75] S 80A (preamble).
[76] S 80A (preamble).
[77] S 80A (a)-(c).
[78] S 80A
[79] S 80A

The amended GAAR is still subject to the four requirements that were previously accounted for in s103 with a new addition namely the misuse or the abuse of the provisions of the Act. The effectiveness of the new addition is yet to be tested in South African courts. [80]

The focus of the following parts will be to determine what constitutes an arrangement in the event that there was avoidance by the taxpayer. It will also look at what constitutes steps or parts of an arrangement.

The first requirement of s 80A states that there must be an arrangement, both the old and new anti-avoidance provisos provided a definition for this term. The courts have also sought to provide a definition for this term.

The Act defines an arrangement as 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.[81]

By looking at the definition it is very clear that although the definition contains similar components as its predecessor in s 103(1), but there are some differences.
The term arrangement is often described and interpreted according to the case of *FCT v Newton* where the court held that:
'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'[82]
This interpretation of the court leads one to believe that consensus between all parties must exist with regards to the terms and conditions of the arrangement, before a valid arrangement exists.

The determination of an 'arrangement' is but the first step to determine whether the outcome of the engagement constitutes impermissible tax avoidance.

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[80] SARS (2006). Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised Proposals. Available: www.sars.gov.za
[81] S 80L.
[82] 1958 2 All ER 759.

The definition of "arrangement" has however gone a step further in the clarification, by including the words "enforceable or not." This effectively means that it is not required for a transaction, operation or scheme to be legally enforceable for the new GAAR to apply.

In the event that agreements like these mentioned above end up in court, it will be easy enough to establish the intention of the parties, but it will be difficult to prove that there was an agreement if there is no documentation.

5.2.2 Section 80A: Impermissible tax avoidance arrangements

Section 80A provides that 'An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and

(a) in the context of business—
    i. it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or
    ii. it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;
(b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or
(c) in any context—
    i. It has created rights or obligations that would not normally be created between persons dealing at arm's length; or
    ii. it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).'

It should be noted that avoidance arrangements are 'permissible' and are unaffected by the provisions of s 80A-80L as these represent bona fide transactions which when carried out have the effect of avoiding or reducing the tax liability. [83] This was further confirmed in the *Duke of Westminster v IRC* case, Lord Tomlin said that:

'*that everyman is entitled if he can to so order his affairs that the attaching tax under the appropriate act is less than it would have otherwise be if he succeeds in ordering them so as*

[83] De korker,A.P (2011).Silke on south Africa income Tax.Chapter 19(online version)

to securer this result, then, however unappreciative the commissioner of Revenue or his fellow tax payers may be to his ingenuity, he cannot be compelled to pay an increased tax'. [84]

Although as stated in the case of *Duke of Westminster v IRC* that a taxpayer is permitted to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be, it should be noted that there is a very thin line exists between a permissible and impermissible avoidable arrangements. Should this line be crossed, it would seem the taxpayer is part of an impermissible avoidance arrangement as defined by the Act and the transaction is deemed to be within the reach of GAAR and the Commissioner is empowered to invoke s 80B.

5.2.3 Tax benefit

The term 'tax benefit' is found in both the preamble to s 80A and the definition of an 'avoidance arrangement'. For the Commissioner to be empowered to invoke the GAAR, it must be shown that the arrangement in question would result in a tax benefit, in other words that it was an 'avoidance arrangement' as defined in s 80L and that the sole or main purpose of the arrangement was to obtain such a benefit and that at least one of the elements of s 80A(a) to (c) was present, in other words, that it was an 'impermissible avoidance arrangement', as defined in s 80L.

Tax benefit is broadly defined in s 1 of the Act to include any avoidance, postponement or reduction of any liability for tax. The amount of the tax benefit is irrelevant.

Tax is defined in s 1 and s 80L as including any tax, levy or duty imposed by the Income Tax Act or any other Act administered by the Commissioner. These Acts include the:
'Value-Added Tax Act, the Customs and Excise Act, the Skills Development Levies Act, the Unemployment Insurance Contribution Act, the Securities Transfer Tax (STT) Act, the Transfer Duty Act and the Estate Duty Act'[85]

It can thus be noted that the definition of 'tax benefit' can be interpreted very widely and can potentially include any transaction by the taxpayer that has the effect of reducing his tax

[84] 51 TLR 467, 19 TC 490 at 520.
[85] Haupt, 2013:498

liability. It can also indicate that a tax benefit in respect of the avoidance of tax could relate to a current, accrued or a past liability. This can create uncertainty and it can be said with respect that such a wide interpretation could not have been the intention of the Legislature. This notion is confirmed in *CIR v King*[86] where the court stated,

"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 s 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"

In the case of *Smith v CIR,*[87] it was stated that,

'to avoid liability in this sense is to get out of the way of, escape or prevent an anticipated liability. GAAR will find application when a taxpayer enters into an arrangement which has the effect of avoiding liability which will result in a tax benefit.'

The test to determine a 'tax benefit'

Determining the existence of a 'tax benefit', therefore, typically requires an identification of the income that might otherwise have accrued to the taxpayer, which is the problem that has faced the courts in most of the reported cases.

[86] 1947 (2) SA 196 (A). 14 SATC 184 at 191.
[87] 1964 (1) SA 324 (A), 26 SATC 1 at 2.

It should be submitted that there is no formal test to determine the existence of a tax benefit, neither is there any section in the Income Tax Act that expressly provides for a test to be applied in determining a tax benefit.

In *ITC 1625*,[88] the court held that a possible test to determine the existence of a tax benefit was whether the taxpayer would have suffered tax but for the transaction. The Commissioner would then need to determine or predict another transaction or scheme that the taxpayer would have entered into.

The court also made reference to *CIR v Louw*, [89] where it was held that, another way the question has been posed by the courts as follows; had it not been for the transactions…..detailed above, the dividend by the IMC to the SA company and the letter to the Rhodesian company, would have come into the appellants hands and he would have been liable for tax thereon. In this case there was no income that accrued. The directors of the company caused the entity to make loans to them instead of issuing them with dividends that would have been subject to tax. The court held that taxable salaries would have been paid if the loans had not been paid. The Commissioner then raised tax payable in respect of those salaries that would have been paid.

Clegg and Stretch[90] held that this approach was incorrect as the court created notional income on which tax would have been paid.
It is thus clear that although there is no clear test for the determination of a tax benefit to be found in the legislation, the courts have adopted their own test and enunciated that a "but for" test is used.

5.2.4 Sole or main purpose

In terms of s 80A, 'an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit'.

[88] 1996 59 SATC 383.
[89] 1983 3 SA 551 (A), 45 SATC 113.
[90] 2013 D Clegg, R Stretch Income Tax South Africa (Online version) at p 26.3.3.

In *SBI v Lourens Erasmus (Edms) Bpk*[91], the court looked at the meanings of the words 'solely' and 'mainly'. The court held that,

'… in the context under consideration, the word 'mainly' establishes a purely quantitative measure of more than 50% and the associated use of the word 'solely' or mainly is inserted, ex abundante cautela, to circumvent the possibility that what may be described as being 'solely' of a particular character would not qualify as being 'mainly' of that character'. [92]

The court held that 'solely' refers to the only purpose of the taxpayer, whereas 'mainly' will refer to a quantitative measure of more than 50%. From a quantitative perspective solely would mean 100%.

In *CIR V Bobat*[93] the court held that,

'… a main purpose is obviously one which must be dominant over any other, because in ordinary language "mainly" means for the most part, principally or chiefly'.

Under s 103(1) the purpose of a transaction, operation or scheme, was determined by applying a subjective test. Section 103(1)(*c*) referred to the purpose for which a transaction, operation or scheme was carried out, as opposed to the purpose of an arrangement.

This subjective approach was confirmed in *SIR v Gallagher*, [94] where Corbett JA held that, '… the criterion to be applied was, not objective, but subjective; that where a taxpayer wishes to negate tax avoidance as one of the purposes of a scheme, it is generally incumbent upon him to establish positively what the purpose, or scheme in fact were'.

The implication in *SIR v Gallagher* [95] above meant that one had to take into account the purpose of the taxpayer when determining whether a transaction, operation or scheme was entered into for the purpose of obtaining a tax benefit.

It was required to look into the mind of the taxpayer who entered into the transaction, under the subjective test. This may result in problems as it is very difficult to determine the intention of the taxpayer with regards to certain transactions.

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[91] 1996 (4) SA 344 (A).
[92] 1996 (4) SA 344 (A) at pg. 242.
[93] 67 SATC 47.
[94] 1978 (2) SA 463 (A), 40 SATC 39 at 48-49.
[95] 1978 (2) SA 463 (A), 40 SATC 39 at 48-49.

In the case of *Newton v FCT*[96] it was decided that an objective test should be used to determine the purpose for which a transaction was entered into. The court stipulated that, '… the word purpose used in the context of an arrangement; regard must be had to the objective effect of the arrangement. Purpose in this sense means not intention, but the effect with which it sought to achieve the end accomplished or achieved'.

An objective test would thus require the court to look at whether the terms of the arrangement have the effect of creating a tax benefit.

In s 80A it is stated that an avoidance arrangement is impermissible if 'its sole or main purpose' was to obtain a tax benefit. In a very strict interpretation of this section the word "its" would force one to look at the purpose of the arrangement and not to the purpose of the taxpayer. This can then be viewed as the move towards an objective test for purpose, as one cannot determine the state of mind of an 'arrangement'.

In s 80G however lies a rebuttable presumption, in that an avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of a tax benefit, unless and until the party obtaining the tax benefit proves that, reasonably considered in the light of the relevant facts and circumstances, that obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

Once the Commissioner has thus proved that an avoidance arrangement exists, it will automatically be presumed that the sole or main purpose of the arrangement was to obtain a tax benefit. The onus will then be shifted to the taxpayer to prove otherwise.

It can thus be seen that more explicit direction from the Legislature is needed, in terms of what test should be used, as it is still unclear if one should use the subjective or objective test to determine 'purpose'.

[96] 1958 2 All ER 759 (PC).

5.2.5 Abnormality, commercial substance and abuse tests

The last requirement that must be met in order to hold that an avoidance arrangement is an impermissible avoidance arrangement is that the arrangement must include an abnormality element.

Section 80A sets out a statement of what constitutes an 'impermissible avoidance arrangement' which is divided into three parts, namely an avoidance arrangement that was entered into in the context of business, in a context other than business and in any context. Certain of the criteria appear in more than one of the three parts. Significantly, the three parts are not expressed as being indicia of a 'sole or main purpose' of obtaining a tax benefit, but are expressed as being necessary elements which, if present in addition to the requisite sole or main purpose, have the result that the avoidance arrangement in question is then characterised as an 'impermissible avoidance arrangement' which is consequently vulnerable to the invocation of the Commissioner's powers under s 80B. It follows that, if the requisite sole or main purpose is absent, the necessity to consider the three-part test falls away.

In this section I will review the requirement in the context of business[97], non-business context[98] and in any other context[99]. SARS in their *Draft Comprehensive Guide to the General Anti-Avoidance Rule*, refers to these requirements as 'tainted elements'.
The previous abnormality test contained similar wording to that of the abnormality test in the new GAAR and all the contextual components of the previous GAAR has been retained in the new abnormality requirement. It is however important to note that the new GAAR has excluded the term "*having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out"* [100] from its preamble when determining the abnormality of an avoidance arrangement.

This omission thus implies that the new abnormality requirement must be considered to be an objective test.

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[97] S 80A (a).
[98] S 80A (b).
[99] S 80A (c).
[100] Repealed S 103(1)(b).

It is thus clear that there are three ways to determine the abnormality of a transaction in terms of the Act, namely:

- In the context of business.
- In a non-business context and
- In any other context.

Avoidance arrangements in the context of business

Section 80A states that an 'avoidance arrangement' is an 'impermissible avoidance arrangement' if its sole or main purpose was to obtain a tax benefit and in the context of business,

(i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or

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

The business context approach can be divided into two further tests, namely:

- The Business purpose test, and
- The Lack of commercial substance test.

The Business Purpose Test

The business purpose test was also included in the now repealed s 103(1) and is not a new concept in the new GAAR.

This test requires that an arrangement must, in a business context, have been entered into and carried out by means or manner that would not normally be employed for bona fide business purposes other than obtaining a tax benefit. The test is thus whether the manner in which the transaction was entered into or carried out is a manner that would normally be used for business purposes other than to obtain a tax benefit. If it is thus established that, in the context of business, an avoidance arrangement was entered into or carried out in a manner

not normally employed for bona fide business purposes, a presumption will exist that the avoidance of tax was the sole or main purpose for the transaction.

A distinction should be drawn between this test and the business purpose test used in the United States of America (USA). The USA's test was set out in the case of *Gregory v Helvering*[101] in 1935, and in terms of this test the courts need to determine if the transaction the taxpayer entered into, was driven by commercial consideration or purely to obtain tax benefits. The business purpose test in s 80A entails a comparison between the transaction that the taxpayer entered into and the way in which that type of transaction would normally be entered into. The test in the USA correlates more closely to the 'sole or main purpose test' that applies in South Africa.

A problem that we find in the business purpose test is that the term *'bona fide business purpose'* is not defined in the Act. Clegg[102] is of the view that the term means that the transaction must be real and not imaginary, but it is also submitted that the term bears the judicial interpretation of '*good faith'*. [103]

The term '*bona fide*' was discussed by in Silke[104] and it was stated that,

'The term relates to the business purpose so that, even if the arrangement is entered into or carried out in a bona fide manner the method employed may nevertheless be found to be abnormal in a business context.'

De Koker[105] in Silke holds the view that the reference in s 80A (a) to '*bona fide business purpose'* is the result of poor draftsmanship and will invite confusion. He states the term 'purpose' has already been dealt with in the opening words of s 80A and to use the word again in a different sense is creating confusion. He also states,
'What s 80A(a) is really talking about, it is submitted, is not purpose (either subjective or objective) but method, that is to say, the overt means or manner by which the taxpayer has entered into or carried out the arrangement in question. If that means or manner was such as

[101] 293 US 465 (1935).
[102] Clegg.D. (2002) Business Purpose Test. Tax Planning Corporate and Personal, vol.16.
[103] Jarvis J (1996). Things are Seldom What They Scheme. Juta's Business Law, vol.4.
[104] De Koker, A.P., Williams R.C. (2013). Silke on South African Income Tax Chapter 19 (online version).
[105] De Koker, A.P., Williams R.C. (2013). Silke on South African Income Tax Chapter 19.39 (online version).

would not normally be employed in the context of business, then s 80A(a) component of an impermissible avoidance arrangement is present.'

It is thus clear that without proper guidance on this term, the doors for arbitrary and discretionary application of GAAR will be open to SARS.

The Lack of commercial substance test

Section 80A(a)(ii) deals with an avoidance arrangement that 'lacks commercial substance'. This is a commercial criterion as distinct from criteria which turn on the existence of legal rights and obligations.

If an avoidance arrangement lacks commercial substance 'in whole or in part' and if, in addition, it had the requisite objective sole or main purpose of obtaining a tax benefit, it will be an 'impermissible avoidance arrangement'.

The commercial substance test applies to transactions in the context of business only. This test is considered to be an extension of the business purpose test and it is divided into two parts as follows:

- A general test[106]
- A list of indicators that indicates a lack of commercial substance. [107]

General test

Section 80C states as follow:

(1) For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash

[106] S 80C (1).
[107] S 80C (2).

flows of that party apart from any effect attributable to the tax benefit that would be obtained 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.

Section 80C(1) contains the general commercial substance test, also known as the 'presumptive' commercial substance test.

This section lays out the test for the lack of commercial substance which the Commissioner will rely on to determine if an arrangement lacks commercial substance. It is clear from the definition that the arrangement must result in a tax benefit and that it must have a significant effect on the business risks or net cash flows.

This part of the new GAAR addresses the fact where tax avoidance schemes often create a façade of substantial investments which serve largely as an illusion and insulate the taxpayer. A significant tax benefit must exist, and the existence of a mere tax benefit will not be enough.

It will thus need to be determined what constitutes a *'significant tax benefit'* as it is not defined in the Act. Clegg and Stretch[108] submits that,

'application of this term is problematic since there is no indication of what would constitute a significant tax benefit. Furthermore, the same difficulty applies in determining whether there is a significant effect on business risk or net cash flow.'

[108] 2013 D Clegg, R Stretch Income Tax South Africa (Online version) at p 26 3.5.

A possible definition for this term could be that it connotes an arrangement to be *material* and *relevant* to a particular taxpayer[109].

SARS[110] states that commercial substance will be lacking where there is-

- a disproportionate relationship between the actual economic expenditure or loss incurred by a party and the value of the tax benefit that would have been obtained by that party but for the provisions of the GAAR; or

- a loss claimed for tax purposes that significantly exceeds any measurable reduction in that party's net worth.

From the arguments of Clegg and Stretch above, it is my submission that the fact that the terms 'significant tax benefit' and 'significant effect' are not defined by the Legislature; this results into uncertainty for the taxpayer. Hence courts will come up with their own interpretations of the words, therefore not creating certainty. What the Commissioner might regard as material to the taxpayer might not necessarily be material or relevant to the taxpayer.

Furthermore, in terms of sec 82 of the Act, the taxpayer has the burden of proving that the arrangement does not lack commercial substance. This places a heavy burden on the taxpayer as it is difficult to prove a lack of commercial substance in this case as the meaning of the terms 'significant tax benefit' and 'effect' are not defined. The Legislature should insert a provision in the Act dealing specifically with the issue of what amounts to a significant tax benefit and effect so as to alleviate the uncertainties surrounding these issues.

Commercial substance indicators

In determining if an arrangement lacks commercial substance, as per s 80C(1), the Commissioner will be assisted by the indicators as contained in s 80C(2).

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[109] L Olivier, DM Davis, G Uruquhart. Juta Income Tax (2009) at 80C-2.
[110] South African Revenue Service (SARS).2006. Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised Proposals p.6.

The Act states that the list of indicators or indicative test is not an exhaustive list and none of them are more important in relation to any other indicator. If the Commissioner establish that one of the indicators are present, it may be sufficient to hold an avoidance arrangement as impermissible, subject that the general test in s 80C(1) is satisfied.

The Act states that the indicators include, but are not limited to, the following:

- The legal substance or effect differs from the legal form of the steps (substance v form);
- The inclusion or presence of round-trip financing;
- Accommodating or tax indifferent parties; or
- Elements that offset or cancel each other.

I will now go on to briefly discuss these indicators.

Substance v Form: The legal substance or effect differs from the legal form of the steps

Section 80C(2)*(a)* provides that an arrangement will lack commercial substance, if either 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.

This test was introduced into the Act, as it is a common practice for taxpayers who want to avoid tax, to insert unnecessary and artificial steps into an arrangement in order to disguise the true substance of the overall arrangement.[111]

'Legal substance' can be taken to mean the actual legal rights and obligations flowing from the avoidance arrangement as a whole and reflects the true reality or substance of the arrangement. It refers to the real agreement of the taxpayer or the effect of the agreement.

The 'legal form' of an arrangement will refer to what the taxpayer actually did.

[111] SARS (2006). Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised Proposals. Available: www.sars.gov.za

In the case of *NWK v C SARS*[112] the court laid down a few important principles relating to substance over form. In this case NWK entered into a series of complicated transactions with First National Bank. NWK had a loan from FNB and had to pay interest. NWK was claiming for deduction for the expenses incurred when paying this interest. The Commissioner disallowed the claim for deductions and raised further assessment on the basis that the agreements concluded between NWK, FNB and its subsidiary did not reflect the true substance of the agreement. The court stated that,

'… the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. The test should go further and require an examination of the commercial sense of the transaction i.e. its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the avoidance of tax, or of a peremptory law, then it will be regarded as simulated.'

It was thus clear from NWK above that the real purpose of the agreement must be established to see whether the agreement was simulated.

When faced with an arrangement where the substance of the arrangement differs from its form, the Commissioner must first apply the principle of substance over form.

Sham test

The courts will disregard a sham, disguised, or simulated transaction and give effect to the real transaction between the parties with its attendant tax consequences. The Sham test is whether Closely related to (if not a subpart of) the determination of the legal substance of the agreement (Clegg & Stretch: Income Tax in South Africa Vol 1 March 2014).
In *WT Ramsay Ltd v IRC*[113] and *Furniss v Dawson*, [114] Lord Wilberforce said that:

"to say that a document or transaction is a "sham" means that while professing to be one thing, it is in fact something different."
Lord Wilberforce also went on to point out that:

[112] *CSARS v NWK Limited* 2011 (2) SA 67 (SCA).
[113] [1982] AC 300.
[114] [1984] AC 474 (HL), 2 WLR 226.

"it is wrong, and an unnecessary self-limitation, [for the commissioners] to regard themselves as precluded by their own finding that documents or transactions are not "shams", from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is. They are not, under the *Westminster* doctrine or any other authority, bound to consider individually each separate step in a composite transaction intended to be carried through as a whole."

Where parties enter into a 'disguised' or 'simulated' transaction, the courts will strip the transaction of its disguise and give effect to the true nature or substance of the contract[115] in accordance with the principle expressed in the maxim plus valet quod agitur quam quod simulate concipitur. [116]

In the often-quoted case of *Zandberg v Van Zyl* [117] the court held that a transaction will be considered as a 'sham' or 'simulation' only if 'there is a real intention, definitely ascertainable, which differs from the simulated intention'. Likewise, in *ERF 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue*, [118] Hefer JA noted that the real question is whether the parties 'actually intended that each agreement would *inter partes* have effect according to its tenor. Simulation will be established if it be shown that the parties do not intend to be bound by all the terms of their contract.'

Round trip financing

The existence of round-trip financing will indicate that there is a lack of commercial substance as stated in s 80C(2).

Section 80D defines round trip financing and states that round trip financing includes any avoidance arrangement in which funds are transferred between parties and the transfer of the funds would –

- Result, directly or indirectly, in a tax benefit but for the provisions of GAAR; and
- Significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.

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[115] *CIR v Saner* 1927 TPD 162, 2 SATC 199; *Bailey v CIR* 1933 AD 204, 6 SATC 69.
[116] 'Greater weight is attached to what is done than to what is purportedly done'; *Be Bop A Lula Manufacturing and Printing CC v King Tex Marketing* (*Pty*) *Ltd* [2006] ZAWCHC 72.
[117] 1910 AD 302 at 309.
[118] 1996 (3) SA 942 (A).

For purposes of s 80D, 'funds' are defined as including any cash, cash equivalents or any right or obligation to receive or pay the same.

This section has the potential to create a lot of absurdities, as the Commissioner will be able to apply it whenever funds, as defined, are transferred between parties, which are almost the case in every transaction or arrangement.

Also, the inclusion of the terms 'tax benefit' and the reduction of 'business risk' in the test for round trip financing, creates a duplication of the test laid out in s 80C(1) for the determination of a tax benefit. This also has the potential to create confusion. [119]

Reportable arrangements and arrangements

Tax avoidance in currently dealt with in s 80A-80L of The Act, which is generally referred to as new GAAR. New GAAR should be read together with reportable arrangements in s 34 to 39 of the TAA.

In s 34 of the TAA a reportable arrangement is defined as an arrangement as referred to in s 35(1) or 35(2) that is not an excluded 'arrangement referred to in s 36.

In (Haupt, 2017:988) a reportable arrangement is an arrangement in terms of which a tax benefit is or will or is assumed to be derived by any party and certain aspects are present such as interest dependant on tax treatment.

An 'arrangement' means any transaction, operation, scheme, agreement or understanding whether enforceable or not.

An arrangement is reportable if it contains certain features stipulated in the legislation or if it is listed in a public notice issued by the Commissioner. Certain arrangements are, however, not reportable despite meeting the criteria if they constitute an excluded arrangement as set

[119] Haffejee Y. (2009). A critical Analysis of South African General Anti Avoidance Provisions in Income Tax Legislation p.27.

out in the TA Act or it they are listed as an excluded arrangement in a public notice by the Commissioner.

The Commissioner for the South African Revenue Service (SARS) issued a public notice in the Government Gazette on 16 March 2015, listing reportable arrangements and excluded arrangements for purposes of the reportable arrangement provisions of the Tax Administration Act. The public notice is effective from the 16 March 2015.

The notice includes as reportable transactions relating to:

- Hybrid equity and hybrid debt instruments
- Company share buy-back coupled with new issues of shares
- SA residents making contributions to foreign trusts in which they are beneficiaries
- The acquisition of companies with assessed losses in excess of R50 million;
- Participants in foreign cell captive insurers[120]

It is important to note that in the latest notice the excluded arrangement where the tax benefit was the main or one of the main benefits of the arrangements has been removed. This exclusion provided relief from the obligation to report where the tax benefit associated with the arrangement was ancillary to any other benefits with the result that many transactions undertaken for purely commercial purposes were not reportable. The removal of this exclusion resulted in many transactions that are of no concern from a tax perspective that may be considered reportable.

In terms of section 212 of the TA Act, a person who fails to disclose the information in respect of a reportable arrangement is liable to a penalty for each month that the failure

[120] Cell captive insurer - Cell Captives are entities consisting of a core and an indefinite number of cell entities which are kept legally separate from each other. Each cell has dedicated assets and liabilities ascribed to it, and the assets of an individual cell cannot be used to meet the liabilities of any other cell. A core cell company may also have noncore assets, which may be made available to meet liabilities that cannot be attributed to another single cell. Depending on the specific structure and operation of the core cell company, it can create and issue cell shares with respect to any of the cells. There may be a common board of directors for all cells or cells may have their own unique board.

continues limited to 12 months. The amount of the penalty may be doubled or even tripled, depending on the amount of the anticipated tax benefit realised by the participant[121].

We can draw the inferences that the term arm's length transaction means a transaction in which the parties involved act independently of each other. Also, in such a case, the mechanics of the transaction are handled as if the transaction takes place between strangers. Sometimes the transaction is conducted by a mutually agreed upon third party, to ensure that one of the principal parties does not influence the other. A transaction, operation or scheme will be characterised as a 'sham' if some of the following elements are present:

- Something that is intended to be mistaken for something else or that is not really what it purports to be viz., spurious imitations, a counterfeit, a disguise or a false front;
- All the parties to the agreement must have a common intention that the acts or documents are not there to create legal rights and obligations other than what is implied.
- The real intentions of the parties are sometimes obscured by the insertion of a sub-agreement within the main agreement.
- The courts must test the intention of the parties as expressed in the documents against their own testimony to show what that intention really was.

5.2.6 Onus of proof

Section 80G(1) provides for a rebuttable presumption as to the purpose of the arrangement in question, and casts onto the taxpayer the onus of proving that the arrangement in question did not have the requisite sole or main purpose of obtaining a tax benefit.

The 'sole or main purpose' requirement under s 80A, read together with the 'presumption' of purpose s 80G(1), may now require the courts to adopt an objective evaluation of the taxpayers sole or main purpose, in entering into the transaction. It should be noted though

[121] 'participant', in relation to an 'arrangement', means (a) a promoter; or (b) a person who is directly or indirectly will derived or assumes that the person will derive a 'tax benefit' or 'financial benefit' by virtue of the arrangement; [section 34 of the TA Act].

that this presumption is not triggered unless and until the Commissioner proves that the arrangement in question was an 'avoidance arrangement', as defined in s 80L. this means that the Commissioner has to prove that it was an 'arrangement' that, would have resulted in a tax benefit.

Section 80G(2) is explicit that the purpose of a step in or part of any avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole and that the Commissioner 'may apply the provisions of GAAR to steps or in parts of an arrangement.

5.2.7 Commissioner's anti-avoidance powers

The definition of "arrangement" includes 'all steps therein or parts thereof' and makes it clear that all steps or part of an arrangement would also constitute as an arrangement.
The term 'step' or 'part' is however not defined in the Act, and it is suggested by Clegg and Stretch that each relates to a distinct transactional element of the whole. [122]

Section 80H also now gives the Commissioner the power to apply the provisions of GAAR in its entirety to 'steps in or parts of an arrangement'. The aim was to enable the Commissioner to apply GAAR to steps or parts of an arrangement if they result in a tax benefit, as legislated by s 80H.This amendment has had the effect of giving the Commissioner greater powers as all that is required is that part of the arrangement must be deemed to have been entered into in order to obtain the tax benefit in order for s 80A–80L to apply.

In terms of s 80H of the Act it is stated that,

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

[122] 2013 D Clegg, R Stretch Income Tax South Africa (Online version) at p 26 3.2.

This means now all steps or parts of an arrangement will now be deemed to be an avoidance arrangement if they result in providing a tax benefit. The insertion of s 80H goes against the principle laid down in *CIR v Conhage*[123] where the court ruled that,

'the courts would look at the whole of the transaction as opposed to reviewing individual steps to ascertain if tax avoidance has taken place'.

The insertion of s 80H widens the scope of what can be considered as tax avoidance. It appears that s 80H was inserted to rectify to the scenario that existed where the taxpayer only had to prove that the overriding reason for entering into a composite transaction was not a tax reason. Under s 103(1) the taxpayer would have escaped liability even if parts of the transaction were to avoid tax.

It is thus clear that every step in a transaction will have to be analysed and examined to ascertain whether they were so connected to one another that they lead to the avoidance of tax. Clarity is however still needed to cater for the scenario where one step in a composite transaction will lead to the avoidance of tax, and the rest does not lead to the avoidance of tax. SARS will have to define what it considers to be a 'step' or 'part' of a composite transaction to which it wishes to apply GAAR.

Broomberg holds the view that s 80H will now force the Commissioner to formally disclose to the taxpayer exactly which aspects of the arrangement he is questioning, which in turn can be used by the taxpayer to his advantage.[124]

[123] 1999 (4) SA 1149 (SCA).
[124] EB Broomberg SC 'Then and Now –II' (2007) 21 Tax Planning Corporate and Personal.

6 HOW HAS S 80A-80L CLOSED THE LOOPHOLES

6.1 Introduction

This chapter examines how the new GAAR closed the loopholes that were prevalent in the repealed s 103(1). The new GAAR was intended to address a number of loopholes in its predecessor, the former section 103(1) of the Act. These loopholes included in summary the following:

1) Subjectivity of the purpose requirement.

2) Abnormality requirement of a transaction, operation or scheme.

3) Uncertainty as to the extent of the powers of the Commissioner.

All the above-mentioned loopholes of s 103(1) have been critically discussed in chapter 4 of this research report. This chapter will discuss the findings of the research on how each one of the loopholes in s 103(1) was closed by new GAAR.

6.2 How loopholes were closed

Tax avoidance is legal while tax evasion is illegal. There is a fine line between tax avoidance and tax planning. Tax planning as discussed in chapter 2.4 is concerned with the organisation of a taxpayer's affairs or the structuring of transactions, so that they give rise to the minimum tax liability within the law without resort to impermissible tax avoidance. [125]

To combat sophisticated forms of tax avoidance the new General Anti-Avoidance Rules were drafted in the Act. The Commissioner had viewed s 103(1) as ineffective and inefficient in combating tax avoidance arrangements, as judgements in certain tax cases were held in favour of the taxpayers. Please see judgements below on the cases discussed in chapter 3:

- *SIR v Guestyn, Forsyth and Joubert*[126]
- *CIR v Louw*[127]

[125] *IRC v Duke of Westminster* 1936 A.C. 1 (HL)
[126] 1971 (3) SA 567 (A), 33 SATC 113.
[127] 1983 (3) SA 551 (A), 45 SATC 113.

- *CIR v Bobat and Others*[128]

As a result, the s 103(1) was repealed in the year 2006 and replaced with s 80A-80L in the Act.

It has been established that in order for the GAAR to find application, the following requirements have to be complied with:

1) There must be an avoidance arrangement entered into or carried out.
2) The avoidance arrangement must result in a tax benefit.
3) One of the three tainted elements must be present.
4) The sole or main purpose of entering into the agreement or transaction must have been to obtain a tax benefit.

The three tainted elements are:

1) Normality regarding means, manner, rights or obligations.
2) Lack of commercial substance in whole or in part.
3) Misuse or abuse of the provisions of this Act (including part IIA).

All the above-mentioned provisions of the GAAR have been critically discussed in this Research report in chapter 5.

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

The purpose requirement in s 80A is based on the sole or main purpose of the avoidance arrangement and not on whether the sole or main purpose of the transaction, operation and scheme is tax avoidance in the opinion of the Commissioner.
The repealed s 103(4) and s 80G both have the presumption that an avoidance arrangement was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit unless or until the party that obtains the tax benefit proves that the tax benefit was not the

[128] 2005 67 SATC 47 (N).

sole or main purpose. Section 80G is more objective as compared to s 103(4) as it requires the arrangement to be 'reasonably considered in light of the relevant facts and circumstance'.

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

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

in s 80A-80L.

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

Selected cases were discussed and analysed in chapter 5. Having analysed these cases, it was found that it is unlikely that certain judgments will be different if s 80A-80L were applied instead of s 103(1) in certain cases, due to the facts of the cases and the evidences that were presented to the courts. This was shown in the *CIR v Conhage* case and the *CIR v Louw* case. In these cases, the purpose and the abnormality requirements were not met by the scheme or the parts of or steps in the scheme, there was no lack of commercial substance and there was no misuse or abuse of the provisions of the Act. Therefore, s 80A cannot be invoked in these cases.

As a result of the introduction of s 80A-80L, two additional tests may be applied to the tax avoidance arrangements. These tests include the lack of commercial substance test and the misuse or abuse test. Further, the Commissioner may apply s 80A-80L to steps in or parts of an arrangement in terms of s 80H. Therefore, the scope and extent of s 80A-80L are significantly broader than s 103(1). In terms of s 80G, the purpose of a step in or part of an

avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole. So, it may be more difficult for the taxpayer to discharge the onus of proving that the sole or main purpose of the arrangement or the step in or part of an avoidance arrangement is not tax avoidance.

7 CONCLUSION

The objective of this research report was to examine how the requirements of the new GAAR s 80A-80L of the Act closed loopholes in the now repealed s 103(1) of the Act. It was found that s 103(1) of the Act contained certain inherent weakness or loopholes that rendered the general anti-avoidance provisions ineffective by the Commissioner when invoked against certain avoidance transactions by taxpayers.

1) The first finding is that the courts have historically determined whether tax avoidance has taken place based on a review of the total circumstances surrounding an arrangement. The new GAAR requires that the Commissioner reviews individual steps of an arrangement in isolation to ascertain whether tax avoidance has taken place.
2) The purpose requirement in section 80A is based on the sole or main purpose of the avoidance arrangement and not on whether the sole or main purpose of the transaction, operation and scheme is tax avoidance in the opinion of the Commissioner.
3) The repealed section 103(4) and section 80G both have the presumption that an avoidance arrangement was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit unless or until the party that obtains the tax benefit proves that the tax benefit was not the sole or main purpose. Section 80G is more objective as compared to section 103(4) as it requires the arrangement to be 'reasonably considered in light of the relevant facts and circumstance'. This would have the effect of almost all arrangements resulting in a tax benefit being scrutinized for tax avoidance by the Commissioner.
4) The difference between the abnormality requirement in section 80A and that in section 103(1) is that the requirement is now intended to be applied more objectively on the features of an arrangement, as it is evident from the deletion of the words 'having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out' in sections 80A to 80L. The wording of the new GAAR now requires an objective application of the arrangement without taking into account the surrounding circumstances.
5) Sections 80A to 80L are also more detailed and comprehensive as it provides definitions of the terms used in 80L, descriptions of the concepts such as round trip

financing and accommodating or tax-indifferent parties in sections 80D and 80E; characteristics which indicate a lack of commercial substance in section 80C, tax consequences of impermissible tax avoidance in section 80B and treatment of connected persons and accommodating or tax-indifferent parties in section 80F. Therefore, sections 80A to 80L may be more effective in combating tax avoidance arrangements as compared to section 103(1).

6) A review of various cases did not provide any conclusive definition for this term. This could result in the Commissioner incorrectly applying s 80A. Section 80A is written in positive language and as such maybe open to a wide application. The conclusion reached was that if a statute is interpreted purposively and contextually, there is no need for the insertion of this provision.
7) Section 80B allows the Commissioner to remedy an avoidance arrangement using any method he deems appropriate. This could result in the Commissioner levying higher taxes on a taxpayer than are warranted, resulting in lengthy and costly legal battles. It was submitted that the Commissioner should issue an Interpretation Note detailing all the methods he deems fit in this regard.

Based on the above the provisions of new GAAR in s 80A-80L seem more comprehensive than the one's in the old GAAR. The effectiveness of the new GAAR in the closing the loopholes in s 103(1) is yet to be tested in South African courts. This will represent the real test for the new legislation as the courts try to govern the implementation of the new harsher provisions while still trying to protect the rights of the taxpayer.

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