

**A CRITICAL ANALYSIS OF THE REQUIREMENTS
OF SECTION 80A
OF THE NEW GENERAL ANTI AVOIDANCE RULE**

by

CP (Pamela) Museka

Student number 26010403

Submitted in partial fulfilment of the requirement for the degree of LLM

Faculty of Law

University of Pretoria

Prepared under the supervision of Adv C Louw

November 2011

DECLARATION

I, CP (Pamela) Museka, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously, in its entirety or in part, submitted it at any university for a degree.

Signature:_____

Date:_____

DEDICATION

To my father, Mr Steven Lazarus Museka, and my mother, Mrs Rosinah Museka, thank you very much for being there for me every step of the way, being my moral support and being my source of inspiration. I can never thank you enough for the opportunity that you gave me to stand up and be counted.

To all women, “Empowerment to Women, let us make a difference and a contribution in our society”.

ACKNOWLEDGEMENTS

Firstly I would like to thank the living God Almighty for making all of this possible for me. Thank you Lord.

I would like to thank my supervisor Advocate Louw for the supervision that he gave me throughout my research - the constructive criticism and the support and the fact that he made time to look at my research and guide me regardless of his busy schedule. Thank you very much Adv. Louw.

To all the library staff I would like to say thank you for the necessary support and assistance they gave me when I was in need of material etc. Thank you very much, it is much appreciated.

I would like to thank my parents for being supportive throughout my studies and encouraging me to work hard and never give up regardless of the circumstances. Your moral and emotional support is highly appreciated.

I would like to extend my warm gratitude to Benjamin Kujinga for taking the time to analyse my work. Thank you very much for the constructive criticism, for explaining complex tax law terms I did not understand, and challenging my thoughts and work. I am forever grateful.

Lastly to all my friends (Emily Kinama, Rutendo Satumba, Lindiwe Ndhlovu and Bajabulile Mbatha), thank you very much for the emotional support that you gave me and believing in me. That meant so much to me.

ABSTRACT

The Income Tax Act 58 of 1962 makes provision for the taxation of taxpayers under the new General Anti Avoidance Rule (GAAR) which is encompassed in section 80A-80G. This research basically deals with the analysis of the new general anti avoidance rule. Each provision is critically analysed. An anti avoidance rule has been part of the South African legislation since 1941, in section 90 of the Income Tax Act. Section 103 was later introduced to deal with the provisions of the anti avoidance rule because section 90 had proved to be insufficient to combat tax abuses. However, section 103 was repealed and replaced by the current section 80A (under discussion) because it proved to be an inconsistent and ineffective deterrent to the increasing form of tax arrangements. Furthermore, it was stated that it was not in line with international standards and developments, hence resulting in the introduction of section 80A-80G in 1996.

The aim of this research is to determine whether the new rule is an effective deterrent for abusive tax abuses by the taxpayers. Furthermore, it aims at investigating whether the new general anti avoidance rule has been phrased in clear, unambiguous terms so as to ensure that the taxpayer, the Commissioner and the courts are clear as to what each provision entails. In general each of the provisions of section 80A of the New General Anti Avoidance is analysed. The research deals with the meaning of the terms 'arrangement', thereafter 'tax benefit', 'sole and main purpose', 'commercial substance', and lastly, 'misuse and abuse' of the provisions of the Act.

The analysis of each of the provisions is aimed at determining whether the new general anti avoidance rule is clear and easy to understand. It aims at determining what constitutes an impermissible tax avoidance rule, which in the event that an arrangement or agreement is impermissible tax avoidance, would lead to the provisions of the GAAR being applicable. Furthermore, this research aims to determine whether the Act makes provision for, or rather explains in clear terms, what amounts to permissible tax avoidance.

Lastly, after all the provisions are discussed, the research identifies the major weaknesses of the new GAAR and provides recommendations. It has to be noted that regardless of the fact that the new GAAR might have deficiencies, it is imperative that the legislature makes the provisions the GAAR clear by inserting sections in the Act, or replacing certain provisions in the Act where necessary and applicable, so as to ensure that there is clarity and certainty when dealing with such provisions.

Therefore this research is necessary to ensure that taxpayers are aware of the provisions which qualify as impermissible tax avoidance and when the arrangements they enter into are regarded as permissible. In addition, clarity is required to ensure that the taxpayer, the Commissioner and the courts understand exactly what the new GAAR entails, thus preventing the opening of the floodgates of litigation.

TABLE OF CONTENTS

DECLARATION	ii
DEDICATION.....	iii
ACKNOWLEDGEMENTS.....	iv
ABSTRACT	v
CHAPTER 1. BACKGROUND TO THE RESEARCH	1
1.1. Introduction.....	1
1.2. Historical background	3
1.3. Problem statement.....	6
1.4. Objectives.....	8
1.5. Significance of study	8
1.6. Research methodology	9
1.7. Literature review	9
1.8. Limitations	13
1.9. Chapter overview.....	13
CHAPTER 2. THE MEANING OF ‘ARRANGEMENT’	15
2.1. Introduction.....	15
2.2. Definition of arrangement in terms of section 103(1) of the Income Tax Act.	15
2.2.1 <i>Definition of arrangement in terms of the new anti avoidance rule</i>	17
2.2.2 <i>Definition of transaction, operation or scheme</i>	21
2.3. Step or parts constituting an arrangement	22
2.4. Conclusion.....	24
CHAPTER 3. TAX BENEFIT AND SOLE OR MAIN PURPOSE.....	26
3.1. Introduction.....	26
3.2. Tax benefit.....	26
3.3. Meaning of tax benefit.....	27
3.4. Test to determine a tax benefit.....	27
3.5. Onus of proof.....	28
3.6. Sole or main purpose.....	29
3.6.1 <i>Purpose test.....</i>	30
3.6.2 <i>Presumption for purpose</i>	32
3.6.3 <i>Time of implementation.....</i>	33

3.6.4	<i>Choice principle</i>	34
3.7.	Conclusion	35
CHAPTER 4. ABNORMALITY, COMMERCIAL SUBSTANCE AND MISUSE AND ABUSE PROVISIONS		37
4.1.	Introduction	37
4.2.	Abnormality	37
4.2.1	<i>Context of a business</i>	38
4.2.2	<i>Business Purpose Test</i>	39
4.3.	Commercial substance test	44
4.3.1	<i>Presumptive test</i>	45
4.3.2	<i>Indicative tests</i>	46
4.3.3	<i>Legal substance or effect differs from the legal form of the steps</i>	47
4.4.	Round trip financing	54
4.5.	Presence of accommodating or tax indifferent parties	57
4.5.1	<i>Amounts subject to income tax in other jurisdictions or countries</i>	59
4.6.	Substantive active trading activities	60
4.7.	Elements that offset or cancel each other	61
4.8.	Arrangement in a context other than business	62
4.9.	Arrangement In any other context	63
4.10.	Rights or obligations that would not normally be created between persons dealing at arms length	64
4.11.	Misuse or abuse of the provision of the Act	66
4.12.	Conclusion	72
CHAPTER 5. CONCLUSION AND RECOMMENDATIONS		74
5.1.	Introduction	74
5.2.	Major weaknesses of GAAR	75
5.2.1	<i>The GAAR does not define most of the terms in the Act</i>	75
5.2.2	<i>Unnecessary insertion of certain provisions</i>	76
5.2.3	<i>Repetition of provisions</i>	78
5.2.4	<i>Borrowing concepts from other countries</i>	78
5.3.	Recommendations	80
5.4.	Conclusion	80

CHAPTER 1. BACKGROUND TO THE RESEARCH

1.1. Introduction

Tax avoidance refers to a situation whereby the taxpayer arranges his affairs in such a manner that it would result in his income being reduced, or in some instances the taxpayer will not be liable for taxation.¹ However, this situation is not the same as that of tax evasion. Tax evasion refers to a situation in which the taxpayer engages in illegal activities deliberately so as to evade tax.² Tax evasion is an illegal and fraudulent way to evade tax, whereas tax avoidance is not necessarily so. In some instances it can be acceptable if it does not qualify as impermissible tax avoidance in terms of section 80A of the Income Tax Act.³

A taxpayer cannot be prevented from entering into a bona fide transaction which when carried out has the effect of avoiding or reducing a tax liability.⁴ This fact was supported in the *Duke of Westminster v IRC* case;⁵

'Every man is entitled if he can to order his affairs so that the attaching under the appropriate Act is less than it otherwise would be if he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Revenue or his fellow tax payers may be his ingenuity, he cannot be compelled to pay an increased tax'.

In as much as the above mentioned case is in support of the view that a person may arrange his affairs in a manner that will result in tax avoidance or a reduced tax

¹ De Koker, A.P. (2011). *Silke on South African Income Tax* Chapter 19 par 1.(online version).

² Ibid.

³ Income Tax Act, No. 58 of 1962 (as amended).

⁴ De Koker, A.P. (2011). *Silke on South African Income Tax* Chapter 19 par 1.(online version).

⁵ 51 TLR 467, 19 TC 490 at 520.

liability, if the so mentioned agreement falls within the provisions of GAAR, then the taxpayer will be liable for the payment of tax.

Taxpayers are entitled to arrange their affairs so as to pay the least amount of tax,⁶ however the problem arises when taxpayers enter into schemes so as to avoid tax, hence obtaining an advantage to which they should not be entitled. In the beginning, the provisions dealing with anti avoidance were dealt with in terms of section 90 of the Income Tax Act.⁷

However, restrictive interpretations by the courts necessitated several amendments.⁸ Section 103(1) thereafter was amended so as to curb the problem faced by section 90; however section 103(1) did not necessarily deviate fundamentally from its predecessor as its general structure remained intact.⁹ Prior to 1996, section 103(1) dealt with the provisions of anti avoidance. However, the Legislature amended the Income Tax Act as there were problems when interpreting the provisions and there was no clarity and certainty.¹⁰ It led to impermissible avoidance by taxpayers. In SARS' view,¹¹ it contained certain inherent weaknesses, resulting in the new provisions on impermissible tax avoidance arrangements being incorporated within

⁶ *Bradford Corporation v Pickles* (1895) AC 587. The court stipulated that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Acts.

⁷ Act 31 of 1941.

⁸ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 2. (online version). In CIR v King 1947 (2) SA 196 (AD), 14 SATC 184, the court gave a very restrictive interpretation of section 103(1).

⁹ Clegg, D. & Stretch, R. (2011). *Income tax in South Africa*. Chapter 26 par 3.1 (online version).

¹⁰ The explanatory memorandum on revenue laws amendment bill, 2006 [WP2-06] states that 'the reasons for its repeal and replacement with the General Anti Avoidance Rule was that section 103(1), has proven to be an inconsistent and at times ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance implemented, and it has not kept up with international developments'.

¹¹ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 2. (online version).

the Act in Part 11A, section 80A to 80L, which has been applicable since 2nd of November, 2006.¹²

The Income Tax Act, in addition to the general anti avoidance rule in sections 80A-80L, contains specific anti avoidance provisions designed to prevent or counter schemes or operations aimed at the avoidance of tax.¹³ There are specific anti avoidance provisions that are encountered throughout the Act; for example, paragraph (c) of the definition of gross income in section 1 deals with the receipt or accrual by a person of amounts for services rendered or to be rendered by another person; section 8E deems certain dividends to be interest; and section 9D deals with certain income from foreign sources, just to mention *inter alia* a few sections.¹⁴

This research does not deal with these specific anti avoidance provisions in any further detail. De Koker (2011) states that the provisions set in section 80A -80L pertaining to impermissible tax arrangement provisions act as a safety net in respect of certain transactions not dealt with by the specific anti avoidance provisions.¹⁵

1.2 Historical background

In 1941 the Legislature enacted section 90 of the Income Tax Act 31. This section pertained to the anti avoidance rule. It was enacted so as to hold liable any taxpayer involved in an arrangement to avoid the liability of paying tax.

¹² De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 26 par 1. (online version) It was also stated in the Taxpayer: General Anti Avoidance Rule 56.3 March 2007, that SARS alleged that section 103(1) had a limiting effect. This therefore led to the amendment of section 103(1) of the Income Tax Act.

¹³ SARS, Draft comprehensive guide to the general anti avoidance rule, page 4.

¹⁴ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 26 par 1. (online version).

¹⁵ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 26 par 2 (online version).

Section 90 was found to create confusion and it was regarded as having a very restricted interpretation by the case of CIR v King.¹⁶ The court stipulated that,

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

Taking the above into account it seems as if the application of the section resulted in absurdity; moreover it resulted in a restrictive interpretation of the section. In order to overcome the restrictive interpretation given to section 90, the Legislature replaced the previous section with section 103(1) of the Income Tax Act 58 of 1962.

However, section 103(1) was repealed, because according to SARS,

*“it has proven to be an inconsistent and at the times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance and because it has not kept up with international developments”.*¹⁷

As times change and the economy develops, there are more sophisticated forms of arrangements in which people enter into so as to avoid tax. SARS stipulated that sec 103(1) could not be regarded as an effective deterrent as things were changing and the Act was not being modified so as to cater for the more sophisticated forms of impermissible tax avoidance agreements. Furthermore, SARS stated that section 103(1) could not keep up with international developments hence there was a need to repeal it.¹⁸

¹⁶ CIR v King 1947 (2) ALL SA 155 (A) at pg 168, 14 SATC 184.

¹⁷ Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006 [WP2-06] at 62.

¹⁸ Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006 [WP2-06] at 62.

According to SARS, a major weakness in sec 103(1) lay in the abnormality criteria. It was possible for a taxpayer to argue that it is not 'abnormal' to structure affairs so as to minimise liability for tax because it is ordinary business to do so.¹⁹ According to the abnormality criteria, an arrangement is regarded as abnormal if it does not comply with the normality requirement of carrying on a business. However, a taxpayer is allowed to structure his affairs in a manner that would result in a minimised tax liability. The writer concurs with SARS on this view, in that the major weakness with sec 103(1) lay with the abnormality requirement. It is not abnormal for a taxpayer to minimise his tax liability because he has a right to do so, if it is his ordinary business to do so.

SARS thereafter launched their discussion paper on GAAR on 3 March 2005 which discussed the ramifications of aggressive tax avoidance structures. Thereafter section 103(1) was repealed by section 36(1)(a) of the Revenue Laws Amendment Act 2006, and replaced by a new anti avoidance rule.²⁰ The Legislature enacted sec 80A-80L into the Income Tax Act, effective for arrangements entered into on or after 2nd of November 2006.

¹⁹ Williams, R.C. (2006). *Income Tax in South Africa: Law & Practice*. 4th ed. Durban: Butterworths.

²⁰ Van Schalkwyk, L. (2009). Section 80A(c) (ii) of the Income Tax. *Meditari Accountancy Research*, Vol. 17 No 2 2009:167-185

The GAAR is also available in other jurisdictions, and South Africa adopted some of its provisions from foreign jurisdictions. For example, Canada adopted the GAAR and it is provided for in section 245 of the Canadian Income Tax Act.²¹ Australian GAAR is encompassed in section 177 of the Australian Tax Assessment Act.²²

The new GAAR In terms of the Income Tax Act will be therefore discussed in the subsequent paragraphs and chapters.

1.3. Problem statement

Section 80A²³ defines the term ‘impermissible avoidance arrangement’ by listing the requirements that have to be met. Sections 80C to 80G expand on the requirements listed in section 80A. The issue in this research is to critically analyse the provisions of the new general anti avoidance rule, specifically the requirements stipulated in section 80A of the Income Tax Act. Section 80A has the following requirements that have to be met:

- There must be an arrangement.
- The arrangement must result in a tax benefit and constitute an avoidance arrangement.
- The sole or main purpose of the avoidance arrangement is to obtain a tax benefit.
- If the avoidance arrangement is in the context of business, one of the following requirements must be met:
 - Means or manner not normally employed.
 - Rights or obligations not normally created.

²¹ 1985, c.I (5th Supp).

²² Act of 1997.

²³ Act 58 of 1962.

- Lack of commercial substance or
- Misuse or abuse of provisions of the Act.
- If the avoidance arrangement is in a context other than business, one of the three requirements must be met, namely,
 - Means or manner not normally employed.
 - Rights or obligations not normally created.
 - Misuse or abuse of provisions of the Act.

This research will critically analyse each of these requirements in detail. It has to be determined whether the new rule is meeting its objectives or whether it still leads to uncertainty, as was the case with its predecessors.

De Koker (2011)²⁴ states that there are still some problems with the new general anti avoidance rule. For example, how does one interpret the terms 'tax benefit', and 'sole or main purpose'? How can the sole purpose be determined? Is it acceptable for courts to create assumptions in certain instances?

For example, if it is determined that there was a tax benefit, it is assumed that the sole or main purpose of entering into the arrangement or scheme was to acquire a tax benefit. This might create problems in certain cases. How can the sole or main purpose of the taxpayer be determined? Another problem question is that of normality. Is there a normal way of doing business? Furthermore, how can it be determined that a certain agreement was created or carried on in a normal way?

Is it fair on the taxpayer to decide for him the way he is supposed to carry out his business? The issue of commercial substance and misuse and abuse provision will also be analysed. These are the main issues that have to be critically analysed.

²⁴ De Koker, A.P. (2011). *Silke on South African Income Tax*. Durban: Lexis Nexus.

1.4. Objectives

There are certain provisions of section 80A which are not clear, hence the aim of this research is to provide clarity with regards to the sole or main purpose test, tax benefit, normality, commercial substance and misuse and abuse provisions and the interpretation of these provisions in the courts. It aims at ascertaining whether the new general anti avoidance rule serves as a deterrent for the taxpayer in the event of avoiding taxes, and whether the measures are sufficient, or if they need to be revised so as to ensure that taxpayers pay their taxes. This will ensure that the taxpayer, SARS and courts and anyone else involved can be certain as to what constitutes permissible and impermissible tax avoidance.

1.5. Significance of study

This research is important as it seeks to provide clarity with regards to the interpretation of the new general anti avoidance rule, hence resulting in a situation whereby the taxpayer is not taxed for exercising a tax benefit in the event that it is permissible. Moreover, it will lessen the incidences of the courts making mistakes in their interpretations which might result in the avoidance of tax by the taxpayer in an unacceptable manner. On the other hand, the taxpayer may be prejudiced, as some provisions in the Act place a heavy burden on the taxpayer to prove certain elements.²⁵

This research aims to draw the attention of the reader to the problems of interpretation that may arise due to the new anti avoidance arrangement provisions. Thus it aims at ensuring that an amendment or explanatory note is made so as to ensure certainty and prevent taxpayers avoiding tax.

²⁵ For example when dealing with the issue of sole or main purpose. The taxpayer has to prove that the main or sole purpose of entering into a certain agreement or arrangement was not to obtain a tax benefit. This might be difficult to prove if not almost impossible to prove.

1.6. Research methodology

Due to the fact that the research was wholly conducted in South Africa, the desk method of research was applied. The desk method consists mainly of analysing case law, books, journals and conducting internet-based research. The current GAAR has concepts borrowed from other countries, hence this research makes reference to foreign law, especially Canada and Australia, where necessary and applicable.

1.7. Literature review

This research critically analyses the new provisions of the anti avoidance rule. The purpose is to ascertain whether there is certainty and clarity with regards to the interpretation of certain provisions. This research will take the argument from the beginning, i.e. what constitutes a permissible avoidance arrangement or scheme. This issue was discussed in the case of *CIR v King*,²⁶ the legal question was whether a taxpayer is allowed to structure his affairs in such a manner that will lead to an avoidance or postponement of tax. It was stated that,

‘... 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 the previous years merely because his purpose was to reduce the amount of his income and consequently of his tax’.

Taking the above case into account, it is clear that the Legislature does not intend imposing a penalty on the taxpayer simply because the transaction that he entered into resulted in a reduction of the amount of his income. GAAR will be applicable if the requirements stated in section 80A are complied with, and hence the argument that the Legislature intended to impose a penalty on a taxpayer who acquire a reduced tax liability is absurd.

²⁶ 1947 (2) SA 196 (A).

However, the court stipulated in *CIR v Conhage (Pty) Ltd*,²⁷ that,

‘... a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner however it has to be within the bounds of any anti avoidance provisions in the relevant legislation’.

Although a taxpayer is allowed to minimise his tax, he has to act within the bounds of the specific legislation, failure [to do so] might result in impermissible tax avoidance.²⁸

Section 80A of the Income Tax Act refers to an arrangement or scheme entered into by the taxpayer so as to obtain a tax benefit. The term ‘arrangement’ or ‘scheme’ will be discussed in this research report so as to ascertain what constitutes an arrangement or scheme for the purposes of this discussion. In the case of *Hicklin v SIR*,²⁹ a composite transaction was entered into. The issue was whether a single agreement constituted a scheme. The court stipulated that the single agreement constituted a scheme for purposes of applying the provisions of section 103(1).

²⁷ 61 SATC 391.

²⁸ The Taxpayer, 2007. General Anti Avoidance Rule 56.3, March issue. It was stated that the new general anti avoidance rule is the cumulating attempt to arrive at a concept of tax avoidance which would prevent the taxpayer taking undue advantage of the specific provisions of the Act but not prohibit them from taking advantage of these provisions.

²⁹ 1980 (1) SA 481 (A).

The court, stated that,

‘... a court must have regard to the circumstances under which the transaction, operation or scheme is entered into or carried out’.

The term business was discussed in the case of *Modderfontein Deep Levels Ltd v Feinsten*,³⁰ The court stated in its judgment,

‘ to constitute a business there must be either a definite intention at the first act to carry on similar acts from time to time if opportunity offers, or the acts must be done not once or twice but successively, with the intention of carrying it on, so long as it is desirable’.

The other requirement that will be discussed in this research is the purpose requirement. The purpose of a transaction, operation or scheme under section 103(1) was determined by applying a subjective test.

However, it has to be ascertained whether the subjective test is still being used or a more objective test is used when interpreting the new general anti avoidance arrangement. In the case of *SIR v Gallagher*³¹, it was stipulated that,

‘... if the subjective approach be adopted (as it must) then it is obvious that of prime importance in determining the purpose of the scheme would be the evidence of respondent, the progenitor of the scheme, as to why it was carried out’.

Williams, (1997)³² identified the need for a more objective standard in his article. His views will be discussed during the course of this research. The Taxpayer³³ which dealt with the sole or main purpose requirement stipulated that,

³⁰ 1920 TPD 288.

³¹ 1978 (2) SA 463 (A) at 471.

‘... a subjective approach was to be adopted. However, it further stated that case law stipulates that it is an objective test. That is, a test which has regard rather to the effect of the scheme, objectively viewed as opposed to a subjective test’.

Another requirement that has to be met is that the transaction must have been entered into so as to acquire a tax benefit. In an Australian case of *Federal Commissioner of Taxation v Spotless Services Ltd*,³⁴ the court concluded that,

‘... for there to be a tax benefit, a reasonable person would conclude that the taxpayer and an associate company in entering into and carrying out the particular scheme had, as their most influential and prevailing or ruling purpose and thus their dominant purpose, the obtaining thereby of a tax benefit, in the statutory sense’.

Another problematic issue is that of the meaning of the term ‘solely’ or ‘mainly’ for the purposes of obtaining a tax benefit.

In the case of *SBI v Lourens Erasmus (Eiendoms) Bpk*,³⁵ in relation to a now defunct provision, the conclusion reached was that,

‘... in the context under consideration, the word mainly establishes a purely quantitative measure of more than 50%, and that the associated use of the word solely does not detract from that interpretation’.

The abovementioned case law and journal articles will be discussed as they contribute to ascertaining the meaning of words or phrases in the new general anti avoidance rule.

³² William, R.C. (1997). The 1996 Amendments to the General Anti Avoidance Section of the Income Tax Act. *SALJ*, Vol. 114, p675.

³³ The Taxpayer. (2009). The sole or main purpose test-subjective or objective? Issue 18.1.

³⁴ 96 ATC 5201.

³⁵ 1966 (4) SA 434 (A).

1.8. Limitations

As provisions of section 80A are the pertinent issue, this research will only discuss the four requirements as stated in section 80A.

1.9. Chapter overview

The research is divided into five chapters. Chapter 1 focuses mainly on the introduction, which gives an overview of what the research is about. This Chapter also focuses on the historical background of GAAR.

The discussion begins with section 90 and its shortfalls, thereafter the enactment of section 103, and finally the enactment of the new General Anti Avoidance rule in section 80A.

Furthermore, Chapter 1 addresses the various questions that can be raised with regards to the research focus. This part of the work addresses issues of background, problem statement, objectives, significance of study and the literature review.

Chapter 2 examines the first requirement of section 80A, which states that in order for the new general anti avoidance rule to find application there must be an arrangement or scheme. This chapter will critically analyse the current meaning of the terms and ensure that there is clarity as to what constitutes an arrangement or scheme in the event that the arrangement or scheme is regarded as abnormal.

The term 'tax benefit' as stated in section 80A will be discussed in Chapter 3. This part of the study aims at ascertaining the true meaning of the term 'tax benefit' so as to provide clarity when this issue has to be decided before the courts. The current meaning will be critically analysed to determine the meaning which has to be given to the term. It has to be determined what constitutes a significant tax benefit.

Furthermore, this chapter analyses the meaning of the words 'sole' or 'main' purpose of the taxpayer. The analysis of this term is quite interesting as it has never been considered by the courts.³⁶ The aim is to establish what amounts to a 'sole' or 'main' purpose of the taxpayer. How can one establish whether there is a 'sole' or 'main' purpose? Is there a hard and fast rule in making that determination, or does each case have to be considered based on the surrounding circumstances?

Chapter 4 focuses on the last requirement of the GAAR. The requirement of normality, commercial substance and misuse and abuse provisions will be critically analysed. The question of whether there is a normal way of doing business will be discussed, and whether it is fair on the taxpayer to lay down rules or guidelines on how he is supposed to do business. Secondly, this part of the research will determine whether tax may be levied by interpreting a transaction in relation to its substance, as opposed to its form. It is common cause that it is not easy to establish the true intention of the taxpayer in other instances. Hence, in order to eliminate problems faced in this regard, the best way of dealing with the issue of substance and form has to be established. Lastly, the issue of misuse and abuse of provisions and the problems faced thereof will be critically analysed.

Chapter 5 is the conclusion. This chapter briefly analyses the findings of the research and the problems that have been identified throughout the research. In addition, possible recommendations will be provided when necessary.

³⁶ Clegg, D. & Stretch, R. (2010). *Income Tax in South Africa*. Chapter 26 par 3.4.

CHAPTER 2. THE MEANING OF ‘ARRANGEMENT’

2.1. Introduction

This part of the research discusses the first requirement of GAAR; that of an arrangement. Section 80A of the Income Tax Act³⁷ stipulates that in order for the GAAR to be applied there must be an arrangement.

This chapter discusses the meaning of the word ‘arrangement’ so as to determine or ascertain what constitutes an arrangement in the event that there was avoidance by a tax payer. The analysis of this term is of importance in the event that there is a dispute whether an agreement was entered into with the sole or main purpose of obtaining a tax benefit. This chapter defines the definition of ‘arrangement’ in terms of the old section (section 103)³⁸ and thereafter determines whether the definition has changed in terms of the new section of the Income Tax Act (section 80D).

The meaning of the term ‘arrangement’ in terms of section 103(1) is established and the problems faced thereof discussed. This part of the research also determines whether the new section has provided any relief in the event that the old section was not clear. The chapter also determines what constitutes steps or parts of an arrangement so as to ensure that there is clarity when dealing with the new general anti avoidance provision.

2.2. Definition of arrangement in terms of section 103(1) of the Income Tax Act

Section 103 states the following:

²⁹ Act 58 of 1962.

³⁰ *Ibid.*

(1) *Where 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) has been entered into or carried out which has the effect of avoiding or postponing liability for any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act), or of reducing the amount thereof, and which in the opinion of the Secretary, 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 the Secretary is of the opinion that the avoidance or the postponement of such liability, or the reduction of the amount of such liability was the sole or one of the main purposes of the transaction, operation or scheme, the Secretary shall determine the liability for any tax, duty or levy on income and the amount thereof as if 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'.³⁹

The above-mentioned section described the definition of an arrangement in terms of the old section. The Act stated that an arrangement included a transaction, operation or scheme involving the alienation of property which has been entered into or carried out which has the effect of avoiding or postponing liability.⁴⁰

³⁹ Section 103(1) of the Income Tax Act 58 of 1962.

⁴⁰ Ibid.

Clegg, in his article stated that,

‘.... in applying section 103(1) of the South African Income Tax Act as is the case with section 260 of the Australian Act, a court must look first to whether there are antecedent arrangements or situations which are productive of income and remain in force under the scheme.’⁴¹

These arrangements have to be entered into in order to acquire an unacceptable tax benefit. Clegg⁴² compared South African tax law with Australian law with regards to the anti avoidance provision. Therefore, the issue is whether the arrangement led to the avoidance of the tax. The issue is not necessarily what amounts to an arrangement or scheme. The purpose for which it was entered into is of importance.

In the Taxpayer (2007)⁴³ it was stated that the decision of the Supreme Court of Appeal in *CIR v Conhage*,⁴⁴ was the cause for SARS not making much use of section 103 (1) and to induce SARS to extend the scope of GAAR to overcome the interpretation of the courts. The definition of an arrangement in terms of the new general anti avoidance rule is analysed in order to ascertain whether the two positions differ.

2.2.1 Definition of arrangement in terms of the new anti avoidance rule

Section 80L of the New General Anti avoidance rule defines the arrangement as,

⁴¹ Clegg, D.J.M. (1985-1986).Section 103(1) Freedom of Choice. *South African Tax Journal* Vol.1 pp 224 at 229. This principle was also stated by Krishna in her book. Vern K (1990). Tax Avoidance: The General anti avoidance rule pp 46 par 102. An arrangement or event is an avoidance transaction if it is entered into for the purpose of obtaining a tax benefit or advantage(whether significant or otherwise) unless if it is predicated primarily on a bona fide tax purpose.

⁴² Ibid.

⁴³ The Taxpayer. (2007). *General Anti Avoidance Rule* 56.3. March 2007, pg 41.

⁴⁴ 1999 (4) SA 1149.

*‘... 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’.⁴⁵ (author’s emphasis)*

Taking the above definition in to account it is clear that although the definition of arrangement retains some similar components with that of its predecessor, there are some differences. The main differences pertains to the fact that the new definition states that an arrangement is any transaction, scheme, agreement or understanding whether enforceable or not, and secondly, the new definition makes use of steps or parts (to be discussed in a later section) constituting an arrangement which were not present in the old section 103(1).

Prior to the amendment it was not stated whether the arrangement had to be enforceable or not in order for the Act to find application. However, the new section expressly states that something constitutes an arrangement irrespective of whether it is enforceable or not. It is not required that the transaction or scheme be legally enforceable for GAAR to be invoked.⁴⁶ SARS⁴⁷ gave examples of agreements that are not legally binding which are,

‘agreements between parties to agree in future on reasonable terms and conditions to effect a merger.

-the so-called gentleman’s agreement;

-heads of agreement between parties which sets out the intended result the parties wish to achieve but which is not necessarily legally binding at the time;

-an agreement binding in honour only, binding only in conscience, letter of intent and the like.’

⁴⁵ Act 58 of 1962.

⁴⁶ SARS, Draft comprehensive guide to the general anti avoidance rule, par 3.2.2.

⁴⁷ *Ibid*, at par 3.2.3.

If an agreement like the above mentioned examples are brought before a court in the event of a dispute, it is easier to establish the intention of the parties. Hence the Commissioner will not have problems establishing the existence of an agreement between the parties. The problem arises if there is no legal documentation to show or prove that there was an agreement between the parties.

The SARS Guidelines stipulated that the transaction does not necessarily have to be enforceable, it can be legally reduced in writing or it can be made orally.⁴⁸ Although the issue of whether an agreement was entered or not has not been challenged or addressed in courts, one cannot ignore the fact that this issue might be brought before the courts because of the addition of the words 'whether enforceable or not' in the new section.

In critically analysing this addition by the Legislature, the following question may be asked: How can a party to a legal proceeding prove that there was an agreement or understanding if it was made orally? If the taxpayer wants to avoid tax they can always state there was no agreement as there is no documentation to prove this assertion by the Commissioner. When two or more parties enter into an arrangement, the effect of it is that it should be legally binding on them. However, the writer is aware of the fact that the intention of the Legislature in inserting this provision was to ensure that unenforceable arrangements would not avoid tax.

However, parties should be encouraged to enter into enforceable agreements to prevent the floodgates of litigation. Clegg and Stretch⁴⁹ state that the reference to an 'understanding (whether enforceable or not)' makes it clear that whether an agreement is reduced to writing and is precise in all its elements, or whether it merely constitutes a verbal broad understanding of proposed future conduct which will more than likely take place, it will constitute an arrangement.

⁴⁸ SARS, Draft comprehensive guide to the general anti avoidance rule, par 3.2.3.

⁴⁹ Clegg, D. & Stretch, R. (2010). *Income tax in South Africa*. Chapter 26 par 3.2.

De Koker states that the word '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.'*⁵⁰

In *Newton v FCT*, the court expressed the view that,

*'[T]he word "arrangement" is apt to describe something less than a binding contract or agreement, something in the nature of an understanding **between two or more persons**, a plan arranged between'*⁵¹

In other words, when two or more people have the consensus to be involved in an agreement or transaction, this type of transaction will attract the application of the provisions of GAAR. However, this creates problems, as it may be difficult for the Commissioner to determine whether an arrangement was entered into or not. The other problematic issue that may be brought about by the abovementioned case is that Lord Denning stated in his judgment that it is something less than a binding agreement. It should be reduced to writing and enforceable in terms of the law.

There should be some documentary proof to show that the parties entered into an arrangement. What might amount to an arrangement for one party might not necessarily amount to an arrangement for the other party. One party might dispute it and say that there was no meeting of the minds.

Moreover, it will be difficult to prove the existence of the meeting of the minds unless there is documentation to prove the contrary.

⁵⁰ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 4.

⁵¹ [1958] 2 All ER 759 (PC).

2.2.2 Definition of transaction, operation or scheme

The courts have interpreted the meaning of the words ‘transactions’, ‘operations’ and ‘scheme’ in the past and the same meaning will find application in terms of GAAR since the definition has not drastically changed. In *Meyerowitz v CIR*,⁵² decided under s90⁵³ of the Income Tax Act in relation to the transactions concerning the taxpayer, the Appellate Division of the Supreme Court agreed with the following finding of the court *a quo*:

‘The word “scheme” is a wide term and I think that there can be little doubt that it is sufficiently wide to cover a series of transactions’

The court stipulated that the word ‘scheme’ is a wide term. With that said, it might result in problems when the issue of the meaning of a scheme comes before a court of law because a taxpayer might be unjustly made to pay taxes in a case whereby the arrangement he entered in to would be regarded as a scheme. The law should provide clarity as to what constitutes a scheme. Because if one merely states that the term ‘scheme’ is wide, this might open floodgates of litigation.

In *CIR v Louw*,⁵⁴ the court approved and applied the interpretation that,

‘... the term scheme is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset’.

In *Ovenstone v CIR*⁵⁵ the court analysed the term ‘entered into’ and stated that;

⁵² 1963 (3) SA 863 (A), 25 SATC 287 at pg 299-300.

⁵³ Income Tax Act 31 of 1941.

⁵⁴ 1983 (3) SA 551 (A) SATC 113. See also ITC 1518 (1989) SATC 113.

⁵⁵ 1980 (2) A 721(A), 42 SATC 55 at 68.

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

The above cases have all formulated their own interpretations as to what constitutes a 'scheme' or 'arrangement' entered into means. This reflects that the term is of importance in order for GAAR to find application, and hence the Legislature must formulate clear definitions of the terms.

2.3. Step or parts constituting an arrangement

The terms 'step' and 'part' are not defined, and it is suggested that each connotes a distinct transactional element of the whole.⁵⁶ It is difficult to determine whether there was a step or part of an arrangement, as the terms are not expressly defined in the Income Tax Act. Section 80H of the Income tax Act states that,

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

In the SARS⁵⁷ Guideline, the requirement of the step or part was discussed. It was stated that the purpose of enabling the Commissioner to apply the GAAR provisions to any step or part of an arrangement, which in itself then constitutes the avoidance arrangement, is to overcome the established case law that section 103(1) did not apply, i.e. where the taxpayer could show that the overriding reason for entering into a composite arrangement was a non-tax reason.

⁵⁶ Clegg, D. & Stretch, R. (2010). *Income tax in South Africa*. Chapter 26 par 3.2.

⁵⁷ SARS, Draft comprehensive guide to the general anti avoidance rule, par 3.2.5.

In *Hicklin*,⁵⁸ where a composite transaction was entered into, it was held that a single agreement (the RN agreement) constituted the scheme for purposes of applying the provisions of section 103(1). As long as a step or part of an agreement will result in an impermissible avoidance arrangement, then GAAR will be applicable. A test was formulated in *Meyerowitz v CIR*⁵⁹ which stated that,

'from beginning to end, the transactions constituted a scheme even though they were not all contemplated at the outset. The test is whether the different steps, upon examination in retrospect, appear to be so connected with one another that they could ultimately lead to the avoidance of taxation'.

In *Silke* it is submitted that,

*'an arrangement involving steps or parts carried out or brought into effect wholly or partly outside the Republic, which has a more than incidental purpose of avoiding tax, is caught by the GAAR'.*⁶⁰

In *CIR v Louw*,⁶¹ the court found that,

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

Talking the above into account, it is clear that the different steps will have to be analysed to ascertain whether they were connected to one another so that they lead to the avoidance of tax. If the answer is in the affirmative, then GAAR will find application.

⁵⁸ 1980 (1) SA 481 (A); 41 SATC 179

⁵⁹ 1963 (3) SA 863 (A), 25 SATC 287.

⁶⁰ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 4.

⁶¹ 1983 (3) SA 551 (A).

A question that needs to be addressed is, what happens in the event that the steps are not so connected to lead to the avoidance of tax? If only one step leads to the avoidance of tax and the rest do not, what happens in such a situation? The Income Tax Act does not provide clarity in this regard. It is my submission that the insertion of the 'steps' requirement is unnecessary. Not only will it be time consuming to go through all the steps of an arrangement to prove that some steps were aimed avoidance of tax, it is also not practical to look at steps of an arrangement to prove that there was an intention of avoiding tax. Rather it is preferable to look at the whole arrangement or agreement so as to determine whether the taxpayer intended to avoid tax.

2.4. Conclusion

This chapter dealt with the history of the general anti avoidance rule and the first requirement of the GAAR, which is an arrangement, transaction or scheme. In South Africa, the GAAR was introduced in 1941 and encompassed in section 90, thereafter this section was repealed because of the restrictive interpretation associated by that section. Section 103(1) was enacted to overcome the restrictive interpretation of section 90. However, section 103(1) was also repealed as SARS regarded it as insufficient to address issues and it did not meet international standards. Therefore new provisions were enacted and are encompassed in sections 80A-80L.

The aim of this chapter was to firstly determine the exact meaning of the term arrangement or scheme, so as to create clarity when presented with the problem or issue of whether something amounts to an arrangement or not. The old position (section 103(1)) was determined and compared with the current section (80A) of the Income Tax Act. It has been established that the new anti avoidance arrangement makes provision for the fact that it is applicable regardless of whether the arrangement is enforceable or not enforceable.

Furthermore, the terms scheme, part, or step do not have a precise meaning. This however creates problems. It is safe to conclude that the new section dealing with the meaning of arrangement does not differ substantially from the old section.

Therefore, the same problems that were faced when interpreting the term arrangement or scheme in the old section will be encountered in the new section. The Legislature has failed in its endeavours to create clarity in this regard. Recommendations in this regard will be discussed in Chapter 5.

CHAPTER 3. TAX BENEFIT AND SOLE OR MAIN PURPOSE

3.1. Introduction

After it has been ascertained that there was an arrangement or transaction or scheme entered into by the parties, the next step is to determine whether it was entered into for the sole or main purpose of acquiring a tax benefit. If the answer is in the affirmative, i.e. that the arrangement was entered into to acquire a tax benefit, then there is a presumption that the sole or main purpose was that of a tax benefit. This arrangement may then be regarded as an impermissible avoidance arrangement if all other requirements have been met.

This part of the research will critically analyse the tax benefit and sole or main purpose requirements as stated in section 80(A) of the Income Tax Act.

3.2. Tax benefit

In order for the provisions of section 80A of the Income Tax Act to be applicable, there must be a tax benefit, and the sole or main purpose of entering in to such a scheme or arrangement must have been to acquire a tax benefit.⁶² Section 1 of the Income Tax Act defines tax benefit as follows;

'it includes any avoidance, postponement or reduction of any liability for tax'.

Thereafter the term 'tax', is defined in section 80L of the Income Tax Act;

'Tax includes any tax, levy or duty imposed by the Income Tax Act or any other Act administered by the Commissioner'.

⁶² De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 5.

3.3. Meaning of tax benefit

As stated above, a tax benefit means the avoidance, postponement or reduction of any liability for tax. In *Smith v CIR*,⁶³ 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 in to an arrangement which has the effect of avoiding liability or an anticipated liability which will result in a tax benefit'.

*CIR V King*⁶⁴ states that,

'a tax benefit occurs when there are transactions and operations which if a tax payer carries them out would have the effect of reducing the amount of his income to something less than it was in the past or freeing himself from taxation from some part of his future income'.

Taking the *King* case into account, it is clear that when it has been established that there is a tax benefit, and if all other requirements are met, then GAAR will find application.

3.4. Test to determine a tax benefit

There is no section in the Income Tax Act which expressly provides for the issue of a test for a tax benefit. In *ITC 1625*,⁶⁵ the judgment held that a possible test to apply in

⁶³ 1964 (1) SA 324 (A), 26 SATC 1 at 12.

⁶⁴ 14 SATC 184 at page 191.

⁶⁵ 59 SATC 383.

determining such an existence was whether the taxpayer would have suffered tax but for the transaction.⁶⁶ In other words,

*‘if the transaction had not been entered into, the appellant would not have acquired the property, it would not have earned the income and it would not have incurred the interest expenditure’.*⁶⁷

The court furthermore made reference to the case *CIR v Louw*,⁶⁸

‘another way the question has been posed by the court is 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 to tax thereon’.

Taking the above cases into account, it is clear that although there is no test expressly provided by the legislation in determining a tax benefit, the courts have formulated their own test and enunciated that a ‘but for test is used’.

3.5. Onus of proof

It was stated in the *ITC 1625* case that the onus of proving that there was a tax benefit rests with the Commissioner.⁶⁹

⁶⁶ 59 SATC 383 at pg 396.

⁶⁷ Ibid.

⁶⁸ 1983 (3) SA 551, 45 SATC 113 pg 142-143 and 144.

⁶⁹ 59 SATC 383 at 387. This issue was also discussed in SARS Draft Comprehensive Guide to the General Anti avoidance rule which stated that, ‘The Commissioner bears the onus to prove, on a balance of probabilities, that a tax benefit was derived as a result of an arrangement being entered into or carried out.’

3.6. Sole or main purpose

Section 80A of the Income Tax Act states that GAAR will be invoked if the sole or main purpose, amongst other requirements, was to acquire a tax benefit. The Income Tax Act does not expressly define the terms 'sole' or 'main purpose'. However, our courts have come up with definitions for these terms. In *CIR v Bobat*,⁷⁰ 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'.

In *SBI v Lourens Erasmus (Edms) Bpk*,⁷¹ the meaning of the words 'solely' or 'mainly' were extensively reviewed. The conclusion reached was 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'.*⁷²

The court in this case stated that the word 'solely' might not necessarily have the same meaning as 'mainly'. Solely means the only purpose of the taxpayer, whereas mainly means a quantitative measure of more than 50%.

⁷⁰ 67 SATC 47.

⁷¹ 1996 (4) SA 344 (A), 28 SATC 233.

⁷² *Ibid* at pg 242.

Haffejee stated in his dissertation that,⁷³

'This provision creates confusion in the event of the taxpayer having multiple purposes and it is difficult using the more than 50% approach discussed in this case'.

3.6.1 Purpose test

In *SIR v Gallagher*,⁷⁴ Corbett JA stated that a subjective test is used in order to determine the sole or main purpose. The court stated 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 the scheme in fact were'.*⁷⁵

The question to be asked is, what was in the mind of the taxpayer who entered into the transaction? This question may result in problems as it might be difficult to determine the intention of the taxpayer with regards to the transactions. It might be recommendable to use the objective test. However, it has been decided in case law⁷⁶ that an objective test is used when determining the issue of 'purpose'.

In *Newton v FCT*,⁷⁷ 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'.

⁷³ Haffejee, A. (2009). Critical Analysis of South Africa's Anti Avoidance provisions in Income Tax Legislation. (LLM dissertation, 2009 NMMU) 16.

⁷⁴ 1978 (2) SA 463 (A), 40 SATC 39 at 48-49.

⁷⁵ Ibid.

⁷⁶ *Newton v FCT* [1958] 2 All ER 759 (PC).

⁷⁷ Ibid.

Hence it is common cause that the intention of the taxpayer is irrelevant in this case. SARS prefers a more objective test being used, as stated in its revised proposals.⁷⁸ However some commentator's expressed concern that the proposed "objective" purpose requirement might preclude the court from considering a taxpayer's *ipse dixit*.⁷⁹ In my view, in as much as the intention of a taxpayer might be of importance, in this case it would be fair to make use of the objective purpose requirement; the reason being that it is difficult for the courts to determine the intention of the taxpayer or rather impossible to determine. If the subjective test is used, this might result in the taxpayer escaping liability for the payment of tax.

Moreover, section 80A of the Income Tax Act refers to the purpose of the avoidance arrangement itself, as opposed to the purpose of the parties in entering into or carrying on the avoidance arrangement, which indicates the shift from the subjective test to an objective test.⁸⁰ However section 80G(1) expressly states that an avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining the tax benefit proves that, reasonably considered in the light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

The inclusion of the words, 'reasonably considered in light of the relevant facts and circumstances' by the Legislature in GAAR means that the taxpayer's intention must be considered, taking into account the facts and the circumstances of the case.

Taking the above into account, it creates confusion as it is not certain which test is to be used. The Legislature must expressly state whether the subjective or the objective test is to be used.

⁷⁸ SARS. (2006). Tax Avoidance and Section 103 of the Income Tax Act, 1962 - Revised Proposals. September 2006, p. 21.

⁷⁹ Ibid.

⁸⁰ SARS Draft Comprehensive Guide to the General Anti Avoidance Rule pg 20.

3.6.2 Presumption for purpose

Section 80G creates a presumption for purpose. It reads as follows;

'80G. Presumption of purpose.—

(1) An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

(2) The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole."

This section creates a presumption that if it has been proved that there was an avoidance arrangement, it is presumed that it was entered into for the sole or main purpose of obtaining a tax benefit. The question that begs an answer is, how practical is this situation? Is this position fair on the taxpayer?

This presumption may be problematic in my view, because this places a heavy burden on the taxpayer to prove that the arrangement was not entered into solely or mainly for the purpose of acquiring a tax benefit. It is quite challenging, if not practically impossible, for the taxpayer to prove that the arrangement was not entered into mainly for the purposes of acquiring a tax benefit.

Furthermore the court in *Ovenstone v SIR*,⁸¹ stated that,

⁸¹ 1980 (2) SA 721, 42 SATC 55.

'the presumption established by section 80G places a heavy burden of proof on the taxpayer since the mere assertion that his sole or main purpose was not the avoidance of tax will not discharge the onus resting on upon him'.

De Koker⁸² states that what is required from the taxpayer is affirmative evidence that satisfies a court, upon a preponderance of probability, that reasonably considered in light of the relevant facts and circumstances, the obtaining of a tax benefit was not the sole or main purpose.

Another problematic issue is that the taxpayer might have multiple reasons for entering into the agreement and it is difficult to determine the main purpose. The Legislature must intervene in this regard in order to create clarity as to what constitutes a main purpose.

3.6.3 Time of implementation

The time of implementation is of importance as it has to be determined whether the sole or main purpose of acquiring a tax benefit is present when an agreement is entered into, or it can be any time during the course of the agreement. In *Ovenstone v SIR*,⁸³ the court stated that,

'when determining the sole or main purpose of an arrangement the time when the scheme is implemented and not when it is first conceived, must be looked to. The purpose of a scheme when it is first formulated may not be to avoid tax but this may have become the purpose at the time of implementation'.

Taking the above case in to account, it seems that as long as there is a sole or main purpose of acquiring a tax benefit the provisions of GAAR will be applicable,

⁸² De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 6 (online version).

⁸³ 1980 (2) SA 721, 42 SATC 55.

regardless of the fact that such purpose was not present during the formulation of the agreement.

3.6.4 Choice principle

What happens in an event whereby the taxpayer had to make a choice between entering into a transaction that would result in a tax benefit and one that did not result in such a benefit? Clegg and Stretch⁸⁴ address this issue and state that,

'Where a taxpayer is presented with a choice between two single transactions as alternative methods of achieving the same commercial result, which have a different tax consequences. The main purpose of that transaction cannot be said to be obtaining of a tax benefit, irrespective of which transaction type is selected.'

In the event that a person had a choice between two or more transactions, the fact that he chose a transaction that would result in a reduction does not necessarily mean that his main purpose was that of obtaining a tax benefit. Furthermore, a taxpayer is entitled to enter into transactions that are beneficial to him and might result in a reduced tax liability. This view was supported in the case of *R Ltd and K Ltd v COT* (High Court of Zimbabwe, March 1983) in that,

'When a genuine commercial transaction is considered and that there are two ways of carrying it out, one that involves paying more tax than the other, it is quite wrong to draw the inference, as a necessary consequence, that in adopting the course which involves paying less tax, one of the main object is to avoid tax.'

⁸⁴ Clegg, D. & Stretch, R. (2010). *Income tax in South Africa*. Chapter 26 par 3.4 (online version).

It was held in *ITC 1625* that,

‘... where it was held that a taxpayer is entitled to adopt the most tax effective method of entering into a transaction provided that the sole or main purpose of the transaction is not the avoidance of tax’.

In the *CIR v Conhage*⁸⁵ case, the Supreme Court of Appeal authoritatively confirmed the choice principle, holding that,

‘... where two alternative methods of achieving largely the same commercial results are available, the choice of that alternative which carries the more advantageous tax consequences, does not elevate the main purpose of the transaction to one of the avoidance of tax. The main purpose remains that of achieving the commercial result’.

An analysis of the abovementioned cases presupposes that it could not have been the intention of the Legislature that when a taxpayer has a choice between two alternatives arrangement and he chooses the one with the least tax liability that it should be assumed that his main purpose was to acquire a tax benefit.

3.7. Conclusion

This chapter has brought to the surface the problematic issues that may be faced when applying the first requirements of the GAAR on an agreement entered into by the taxpayer. For example, when one makes an analysis of the term ‘tax benefit’, the Income Tax Act states that when there is a tax benefit, then if all requirements of GAAR are met, the taxpayer may be liable for tax. However, case law⁸⁶ states that a person is free to arrange his affairs in a manner that will result in the least amount of tax being payable.

⁸⁵ 1999 (4) SA 1149 SCA, 61 SATC 391.

⁸⁶ *Duke of Westminster v IRC* 51 TLR 467, 19 TC 490. *Bradford Corporation v Pickles* (1895) AC 587.

When one analyses the decision of this court, it is apparent that the arranging of affairs in such a manner amounts to a tax benefit. Hence this creates confusion.

Secondly, the other problematic issue is one of determining the sole or main purpose of acquiring a tax benefit. How can a sole or main purpose of a transaction be determined? The two tests that could be applicable in this case were analysed. It seems as if there are inconsistencies with the Income Tax Act with regards to the test to be used. The wording of section 80A suggests a move towards the objective test, however section 80G (1) read in context implies that a subjective test is used.

Recommendations in this regard will be discussed in Chapter 5. The following chapter critically analyses the three last requirements of the New General Anti Avoidance Rule, viz. normality, commercial substance and misuse and abuse provisions.

CHAPTER 4. ABNORMALITY, COMMERCIAL SUBSTANCE AND MISUSE AND ABUSE PROVISIONS

4.1. Introduction

This part of the research critically analyses the last requirements of the new anti avoidance rule; viz. the requirement of normality in the context of a business, non business context and any other context, commercial substance and misuse or abuse of provisions of the Income Tax Act. These elements or requirements have been referred to as the 'tainted elements'.⁸⁷ The abovementioned provisions are discussed in section 80A(a)-(c). This chapter will critically discuss each requirement so as ascertain whether the provisions are necessary, and to establish whether there is certainty when one interprets these provisions.

4.2. Abnormality

Section 80A(a) states that

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

(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....

⁸⁷ SARS Comprehensive Guide on the General Anti Avoidance Rule, pg 23.

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).

The abnormality of a transaction may be ascertained in three ways, as provided for by the Act; namely:

- In the context of a business.
- Non business context and
- Any other context.

The following sections deal with each of the abovementioned elements.

4.2.1 Context of a business

When one looks at the context of a business, there are two main issues that need to be analysed in this regard, namely the business purpose test, and the lack of commercial substance test.

4.2.2 Business Purpose Test:

The business purpose test is not a new concept in the GAAR as it was also present in the now repealed sec 103(1) of the Income Tax Act. According to De Koker,⁸⁸ there is a presumption that the avoidance of tax was the sole or main purpose of a transaction if in the context of a business an avoidance arrangement was entered into or carried out in a manner not normally employed for *bona fide* business purposes.

The issue that needs to be addressed is the meaning of the terms '*bona fide*' and 'business context'. The Act does not expressly define these terms, however, Clegg⁸⁹ states that *bona fide* basically means that, 'a transaction must be real and not imaginary'. However, this definition does not provide clarity when dealing with whether a transaction was employed for a *bona fide* business purpose.

The term *bona fide* was discussed in Silke⁹⁰ 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.'

Hence the method and manner have to be abnormal in order for the provisions of GAAR to find application. Williams⁹¹, states that,

⁸⁸ De Koker, A.P. (2011). *Silke on South African Income Tax* Chapter 19 par 7.1 (online version).

⁸⁹ Clegg, D. (2002). Business Purpose Test. *Tax Planning Corporate and Personal*, 16.

⁹⁰ De Koker, A.P. (2011). *Silke on South African Income Tax*. Chapter 19 par 7.1 (online version).

⁹¹ Williams, R.C. (1997). The 1996 Amendment to the General Anti Avoidance Section of the Income Tax Act, *SALJ*, vol 114 p 675.

'the question is not whether the transaction was entered into or not for business purposes but whether the manner in which the transaction was entered into would not normally be employed for bona fide business purposes'.

Noting the principle stated by Williams,⁹² it is clear that he states that the manner in which the transaction was entered into would be analysed, and not whether the transaction was entered into.

In contrast, Canadian law in this regard represents a *bona fide* business purpose method test.⁹³ In a South African context, the word *bona fide* is not defined in the Act; hence this creates uncertainty for the taxpayer.

The second term that is not defined is that of 'business context'. In the now repealed section 103(1), the Legislature did not make reference to a business context. Was there a need for the Legislature to have made such a distinction in the GAAR? It is my submission that the insertion of the terms 'business context', 'on business context' and 'in any context' are not necessary and should be removed as they create confusion for the taxpayer, tax advisers and the Commissioner.

De Koker⁹⁴ states that the business purpose test emanates from a foreign case *Gregory v Helvering*.⁹⁵ In this case the court stated that,

⁹² Williams, R.C. (1997). The 1996 Amendment to the General Anti Avoidance Section of the Income Tax Act, *SALJ*, vol. 114 p 675.

⁹³ Sec 245(3) of the Canadian Income Tax Act states that an avoidance transaction means any transaction:

(b) that is part of a series of transactions, which series, but for this section would result directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide business purposes other than to obtain a tax benefit.

⁹⁴ De Koker, A.P. (2011). *Silke on South African Income Tax Act*. Chapter 19 par 7.1 (online version).

⁹⁵ 293 US 465 (1935).

‘whatever the terms of the statute, a transaction which has no business purpose cannot have any effect on liability for tax’.

Taking this case into account, it is clear that in order for a taxpayer to be liable for the payment of tax, the transaction that he enters in to must have a business purpose. However Clegg and Stretch⁹⁶ state that,

‘the test does not require that the arrangement under examination should have a primary or substantial business purpose per se, but merely that the method employed should be normal in a business context. The test can be passed without there being any actual business purpose whatever’.

When one analyses the statement made by Clegg and Stretch that the ‘method employed should be normal’, this creates problems as it is not clear what amounts to ‘normal’. The question that needs to be addressed in this situation, is whether there is a normal way of doing business? There is clearly no hard and fast rule with regards to the manner of doing business.

It would be absurd to expect taxpayers to do business in a specific way. A taxpayer is free to arrange his business affairs as he pleases and conduct business in a way that he finds suitable. Expecting people to do business in a certain way would result in a limitation of a person’s right to conduct business as he pleases. This is could not have been the intention of the Legislature.

In *SIR v Geustyn, Forsyth & Joubert*⁹⁷ the court looked at the issue of abnormality and stated that;

⁹⁶ Clegg, D. & Stretch, R. (2010). *Income Tax in South Africa*, Chapter 23 3.5. In the SARS Draft Comprehensive Guidelines pg 24, this principle was discussed as well. It was stated that the business purpose test in terms of GAAR is not whether the scheme itself has a commercial purpose but whether the manner in which the transaction is entered into or carried out is a manner which would normally be used for bona fide business purposes other than to obtain a tax benefit.

'There was nothing abnormal in the conversion of the partnership into an unlimited company or in relation to the company's undertaking to pay R240 000 for the goodwill of the business and that the reduction or postponement of tax was not a factor that had been taken into consideration by the partners in deciding to practice as an unlimited company'.

Furthermore, the court⁹⁸ stated that,

'Generally speaking there is nothing abnormal in transferring an existing partnership business to a company; indeed such a transaction may, I think fairly be regarded as relatively commonplace in the commercial world'.

It is clear from the abovementioned principles that it is difficult to establish a 'normal' way of doing business. The case of *SIR v Geusteyn*⁹⁹ dealt with the conversion of a partnership into an unlimited company, and stated that it is common for a partnership to be converted to an unlimited company. This is common in the commercial or business world.

It is my submission that this requirement is not necessary; hence the Legislature may consider removing the normality requirements as there is no normal way of doing business. What may be normal to one person may be abnormal to another person. The Act does not provide for a test for normality.

Furthermore, according to an article in the Taxpayer,¹⁰⁰

'...it was stated that in 1986, the Margo Commission recognised the deficiency of the existing system by stating that the test for abnormality presents difficulties. If a

⁹⁷ 33 SATC 113 at 114.

⁹⁸ *Ibid* at pg 119.

⁹⁹ *Ibid*.

¹⁰⁰ Meyerowitz, D. (ed.). (2006). *The Taxpayer*, Vol. 55, pg 50.

particular form of transaction is widely used for tax avoidance purposes, it may gain a commercial acceptability to the extent that its utilisation becomes normal.'

Taking the above into account, the writer agrees with this notion. It is clear that when a certain transaction is entered into by taxpayer it might end up being normal because it would amount as their normal way of doing business. Hence what might be abnormal in the eyes of the Commissioner might be normal in the eyes of the courts and the taxpayer. This creates uncertainty and confusion. Moreover, the Taxpayer made reference to the discussion paper on the anti avoidance rule and it was noted that the weaknesses of the abnormality requirement are the following:

1. *'The tax world is not divided into two types of transactions namely bona fide business transactions and the other for impermissible tax avoidance schemes.'*
2. *'The manner in which aggressive tax planners sought to manufacture plausible sounding business purpose.'*¹⁰¹

The provision pertaining to abnormality is complex and difficult to apply in practice, and hence an amendment is proposed to the abnormality requirement.

However, the court in *Hicklin v SIR*¹⁰² dealt with the test for normality as follows:

'Hence in an arm's length agreement the rights and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by [s103(1)(b)(ii)]. And the means and manner employed in entering into it or carrying it out are more likely to be normal than abnormal in the sense envisaged by [s103(i)(b)(i)].'

¹⁰¹ Meyerowitz, D. (ed.). (2006). *The Taxpayer*, Vol. 55, pg 50.

¹⁰² 1980 (1) SA 481 (A), 41 SATC 179 at 195.

The *Hicklin*¹⁰³ case stated that the rights and obligations created, and the means and the manner employed in entering into the transaction, are regarded as a normal transaction if conducted at an arm's length. If the transaction is not at arm's length, this would amount to an abnormal transaction and the provisions of section 103 will find application and the taxpayer will be liable for tax. The issue of arm's length will be discussed later in this chapter.

4.3. Commercial substance test

The Act expressly makes provision for the issue of a lack of commercial substance in terms of section 80C of the Income Tax Act. In the context of the business, a lack of commercial substance may result in the application of GAAR if all other requirements are met. Section 80C states as follows;

80C. Lack of commercial substance.—(1) *For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.*

(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*

[Para. (a) substituted by s.40 (1) of Act No. 8 of 2007 deemed to have come into operation on 2 November, 2006 and applicable in respect of any arrangement (or any step therein or parts thereof) entered into on or after that date.]

¹⁰³ 1980 (1) SA 481 (A), 41 SATC 179 at 195.

(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.

Clegg and Stretch ¹⁰⁴ state that the discussion of lack of commercial substance may be divided into two sub-headings, namely the Presumptive test and the Indicative tests.

4.3.1 Presumptive test

‘There is a presumption that an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit but the arrangement does not have a significant effect upon either business risks or net cash flows of that party.’¹⁰⁵

The question that needs to be addressed is, what amounts to a significant tax benefit? The Act does not define this term and Clegg and Stretch ¹⁰⁶ submit 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.’

Taking into account the above argument of Clegg and Stretch, it is my submission that the fact that the terms ‘significant tax benefit’ and ‘significant effect’ are not

¹⁰⁴ Clegg, D. & Stretch, R. (2011). *Income Tax In South Africa* Chapter 26 par 3.5 (online version).

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

defined by the Legislature; this results in to 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 Income Tax 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.

4.3.2 Indicative tests

Section 80C(2) makes provision for the indicative tests that may be used to establish the lack of commercial substance, however the Act states that it is not an exhaustive list. The Act states that the indicators include, but are not limited to, the following:

- legal substance differs from its legal form,
- the inclusion or presence of round trip financing, or
- accommodating or tax indifferent party, or
- elements that have the effect of offsetting or cancelling each other.

Broomberg¹⁰⁷ states that,

'[t]he opening part of section 80C(2), ;'for the purpose of' has the effect that section 80C(2) is not a deeming provision. Secondly the wording of the opening paragraph

¹⁰⁷ Broomberg, E.B. (2008). Then and Now. V. *Tax Planning Corporate & Personal*, 22.

creates the impression that this section needs to be interpreted independently of section 80C(2).'

This section expressly states that for the purposes of this section, presupposing that the indicators are only applicable with regards to that part of the Act and secondly it might have the meaning that if any of the indicators are met, then there was a lack of commercial substance. This situation might result in interpretation problems. Hence the Legislature should have been clear with regards to the drafting of this part of the Act.

The other criticism noted by Broomberg¹⁰⁸ is the fact that section 80C(2) expressly states that the list of the indicators is not an exhaustive list. This is a failure on the part of the Legislature to create certainty as the taxpayer might be prejudiced in such a case. This will create uncertainty for the taxpayer as the Commissioner may allege that a certain provision is an indication that there was lack of commercial substance. The Legislature should insert all indicators that they think might be reasonable to determine the lack of commercial substance for a transaction thus creating clarity.

4.3.3 Legal substance or effect differs from the legal form of the steps

De Koker¹⁰⁹ states that this part of the section means that 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. It has been argued by SARS that this indicator draws upon precedent in both the United Kingdom and the United States of America, and adopts what the House of Lords has referred to as an 'unblinkered' approach to complex multi step composite transaction.¹¹⁰ The term 'legal substance', as postulated in sec 80A(a)(ii), it is submitted could probably be taken to mean the actual legal rights and obligations flowing from the avoidance

¹⁰⁸ Ibid.

¹⁰⁹ De Koker, A.P. (2011). *Silke on South African Income Tax Act*. Chapter 19 par 7.1.

¹¹⁰ Ibid.

arrangement as a whole legal substance reflects the true substance or reality of the arrangement.

Taking the above into account one might conclude that 'legal substance' basically refers to the real agreement of the taxpayer or the effect of such a real agreement. However, when one looks at the legal form, it refers to what the taxpayer actually did; for example, the rights and obligations flowing from an agreement such as the sale of shares.¹¹¹

The question that begs an answer is whether there is a need for legal substance provision in the GAAR. It has been stated in the Taxpayer¹¹² that there is nothing wrong with arrangements that are tax effective, but there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion or the avoidance of a peremptory rule of law.¹¹³

It is imperative to have the legal substance over form rule because taxpayers have resorted to entering into arrangements that do not convey the true agreement, and therefore this leads to tax avoidance.

Hence this provision is of greater importance as it will look at the real agreement so as to ensure that taxpayers are made accountable for the arrangements they enter into.

¹¹¹ *Ibid.* See Clegg, D. & Stretch, R. (2011). *Income Tax in South Africa*, par 26.3 stated that there is a comparison required between the legal reality or the commercial effect of the whole on the one hand and the legal form of the individual steps on the other.

¹¹² The Taxpayer.DM Davis(eds) *The Taxpayer Case Income Tax Deductibility of Interest test for Simulated Transactions Former sec 103(1) of the Income Tax Act*, pg 203 vol 59 No 11&12.

¹¹³ *Ibid* at pg 212.

In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*,¹¹⁴ the court stated that,

'one must distinguish the principle that one may arrange his affairs so as to remain outside the provisions of a particular statute, and the principle that a court will not be deceived by the form of a transaction, it will set aside the veil in which the transaction is wrapped and examine its true nature and substance.'

These two concepts should not be confused. A person is allowed to arrange his affairs in such a manner that he minimises his tax liability; however, when a person enters into agreements which do not convey the true agreements then the court will invoke the principle of substance over form so as to establish the true nature of the agreement entered into by the taxpayer.

Another question which needs to be addressed is that of the distinction between legal substance and economic substance. Clegg and Stretch¹¹⁵ state that a distinction needs to be drawn between economic substance and legal substance as there is confusion with regard to the terms 'substance' and 'form'. They go on to say that economic substance is important for the ascertainment of whether a particular expense is of a revenue or capital nature.

In *New State Areas Ltd v Commissioner for Inland Revenue*¹¹⁶ the court stated that,

'the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure.'

However, the doctrine of substance and form has been under scrutiny by the court in *Duke of Westminster v IRC*.¹¹⁷

¹¹⁴ 1996 (3) SA 942 (A) at 950H-951D.

¹¹⁵ Clegg, D. & Stretch, R. (2011). *Income Tax in South Africa*. Chapter 26 par 7.1 (online version).

¹¹⁶ 1946 AD 610 at 627.

The court 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. This so called doctrine of ‘the substance’ seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.’

In support of the principle stated in the above case it is my submission that the addition of this provision in the Act is not necessary because not only does it cause confusion amongst taxpayers, it is difficult for the courts to interpret this provision. Furthermore, if the Legislature intended to make this provision applicable, the principle enunciated in the Duke of Westminster case, i.e. that a man is allowed to manage his affairs in a manner that might result in the payment of a lower tax amount, must not be applied in our law. This will provide clarity.

Clegg and Stretch¹¹⁷ equate the actual facts of a transaction to the legal reality of an agreement entered into. Therefore the legal substance of an agreement is of relevance when its form does not give clear guidance as to the relationship between the parties, and this lack of clarity will usually be because the agreement between the parties is poorly or confusingly drafted. De Koker notes the following,¹¹⁹

‘... stated that the term legal substance could probably be taken to mean the actual legal rights and obligations flowing from the avoidance arrangement as a whole – legal substance reflects the true substance or reality of the arrangement.’

However, this must be distinguished from a sham transaction, which was discussed in the Ladysmith case. The sham transaction test is more usually applied in

¹¹⁷ 51 TLR 467, 19 TC 490.

¹¹⁸ *Ibid* n106 par 26.7.4.

¹¹⁹ De Koker, A.P. (2011). *Silke on Income Tax on South Africa Income Tax*. Chapter 19 par 7 (online version).

situations where the parties have purposefully disguised the true nature of the transaction between them through the adoption of a form which is at variance with their actual intentions.¹²⁰ In the *Erf 3183/1 Ladysmith (Pty) Ltd v CIR*¹²¹ case, the court stated that,

‘... the written agreements did not correctly reflect the actual agreements of the parties or, put another way, the agreements had to be read together and not independently of one another.’

In the Ladysmith case the legal substance was not consistent with its form. Hence the provisions of GAAR would find application.

In the recent judgement of *CSAR v NWK Ltd*,¹²² the court laid down principles that might be helpful when one has to ascertain the issue of substance and form. The case dealt with an issue whereby a maize trader had a loan from a bank and he had to pay interest. The trader was claiming for deductions for the expenses incurred when paying the interest. The Commissioner disallowed the claim for the deductions and stated that there was a simulated transaction entered into by the trader. 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 evasion of tax, or of a peremptory law, then it will be regarded as simulated.’¹²³

¹²⁰ *Ibid* 106.

¹²¹ 1996 (3) SA 942 (A), 58 SATC 229.

¹²² 2011 (2) All 347(SCA).

¹²³ *Ibid* at pg 348.

The real substance and purpose of the agreement must be ascertained so as to determine whether the agreement was simulated. The true purpose of the agreement will have to be ascertained. The court in the abovementioned case decided that the transaction was simulated, and the hence GAAR found application.

However Gerr¹²⁴ has criticized the decision of the supreme court of appeal. Firstly,

'It appears to be premised on the understanding that as a result of this case, all structured finance facilities in general, or compulsorily convertible loan structures in particular, constitute simulated transactions.'

This could not have been the intention of the Legislature when it drafted this provision.

Secondly, the court in its judgment stated that if the purpose is for the evasion of tax then the agreement is regarded as simulated. Gerr¹²⁵ states that SARS had not raised the issue of tax evasion. It is my submission that this position is correct. There is a difference between tax avoidance and tax evasion. The former being the avoidance of tax by a taxpayer which is governed by the provisions of section 80A-G of the Income Tax Act, whereas the latter refers to the evasion of tax by a taxpayer which amounts to a criminal offence.

It is my submission that this statement made by the court will result in confusion. This reflects that the courts have problems in interpreting this provision. Gerr¹²⁶ furthermore states that by now requiring courts to consider in every instance what the commercial sense of a transaction is before concluding whether a transaction is a

¹²⁴ Gerr, B. Supreme Court of Appeal – a 'maize'-s tax planners with watershed judgment. [http://butterworths.up.ac.za/nxt/gateway.dll/zkfaa/bsxha/b2aac/cvidc/kvidc/nvidc/lwidc?f=document\\$q=general%20anti%20avoidance%20rule\\$x=Advanced#LPHit1](http://butterworths.up.ac.za/nxt/gateway.dll/zkfaa/bsxha/b2aac/cvidc/kvidc/nvidc/lwidc?f=document$q=general%20anti%20avoidance%20rule$x=Advanced#LPHit1).

¹²⁵ Ibid.

¹²⁶ Ibid.

sham, the SCA has effectively conflated the tests within the tax-specific GAAR with the more general 'substance over form' doctrine.

In ascertaining whether the transaction was simulated or not, the courts have to look at the intention of the taxpayers by taking into account, amongst other things, any written agreements entered into by the taxpayer. Does this mean that if an agreement that does not have a commercial purpose it will be regarded as a sham transaction? The insertion of the commercial purpose requirement might open the floodgates of litigation in future cases.

Another criticism that can be made against this new provision of the Act is the fact that the term 'legal substance' of the whole agreement is compared with the legal form of the steps of the arrangement. Broomberg¹²⁷ states that,

'The normal judicial parlance denotes that the term legal is usually used in order to draw a contrast between, on the one hand, the legal effects of an arrangement and on the other hand, its commercial or effect.'

The Legislature in this case should not have complicated the principle of substance over form. The fact that the whole agreement is compared with the steps of an agreement leads to confusion.

This might lead to interpretation problems by the courts and hence the Legislature has failed in its endeavour to create clarity in this regard. It has been submitted by Williams¹²⁸ that,

'Since the principles of the new GAAR are complex, before invoking these principles the Commissioner should first attempt to fight any arrangement where the substance differs from the form of a transaction using common law principals and the GAAR'

¹²⁷ Broomberg, E.B. (2008). Then and Now-VI. Tax Planning Corporate and Personal, 22.

¹²⁸ Williams, R.C. (2009). *Smoke and mirrors or genuine commercial venture?* PriceWaterHouseCoopers Synopsis at 2-4.

should only be considered if the common law principals are unable to reconcile the matter.'

The Commissioner must first apply the principle of substance over form when faced with a situation whereby the substance differs from the form. In the event that the matter cannot be reconciled then the principles stated in GAAR may be used.

4.4. Round trip financing

Section 80 D(1) states that,

1) Round trip financing includes any avoidance arrangement in which—

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

(b) the transfer of the funds would—

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

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

(2) This section applies to any round tripped amounts without regard to—

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

(b) the timing or sequence in which round tripped amounts are transferred or received; or

(c) the means by or manner in which round tripped amounts are transferred or received.

For the purposes of this section, the term “funds” includes any cash, cash equivalents or any right or obligation to receive or pay the same.

Taking the above section into account, it is clear that in order for this section to find application the funds must be transferred between or among parties, and it must result in a tax benefit whether directly or indirectly, and it must significantly reduce, offset or eliminate any business risk incurred by any party in connection with an avoidance arrangement.

Section 80D defines funds as including any cash, cash equivalent or any rights or obligation to receive or pay the same. Furthermore SARS,¹²⁹ states that the term includes promissory notes and amounts paid in foreign currency. Therefore if there has been any transfer of any funds whatsoever between parties which has the effect as envisaged by section 80D(1)(b), then this would amount to round trip financing.¹³⁰ The case of *Ramsay v Inland Revenue Commissioner*¹³¹ dealt with this issue of round trip financing. The court enunciated that,

‘Although sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hand in his pocket.’¹³²

As long as there has been a transfer of funds between parties that has the effect of acquiring a tax benefit, the provisions of GAAR will find application. SARS moreover discussed the concept of round trip financing in relation to foreign principles. It was stated that,

¹²⁹ SARS Draft Comprehensive Guide to the General Anti avoidance rule par 6.4.3(b).

¹³⁰ De Koker, A.P. (2011). *Silke on South African Income Tax Act* Chapter 19 par 7.1 (online version). It was stated that the Legislature presumably envisaged is a number of transfers of the same monetary amount between parties, whether in circular or linear form, which has the end result that one party(or more than one)has transferred to it a sum equal to that transferred by it at another point in the arrangement.

¹³¹ 1982 A.C. 300.

¹³² *Ibid* at pg 322.

*'Round trip financing is wider in scope and can be equated to the concept round robin financing in Australia and circular cash flows in USA.'*¹³³

Therefore, the principle of round trip financing is not limited to the provisions of section 80D; as long as it can be proved that there was a transfer of funds that would result in a tax benefit, then the transaction might be susceptible to attack by the Commissioner provided that all other requirements of GAAR are met. However, if the principle of round trip financing is critically analysed, it is inevitable to notice that this principle resembles that of 'tax benefit' stated in Section 80C(1).¹³⁴ Section 80C(1) pertains to tax benefits and business risks. Section 80D stipulates that if transactions are transferred which will result in a tax benefit, amongst other requirements, then the agreement might be regarded as an impermissible avoidance arrangement.

The insertion of round trip finance results in the duplication of the requirement of tax benefit and business risks.¹³⁵ It is my submission that this was an unnecessary insertion by the Legislature because the issues have already been addressed in section 80C(1).

Moreover, Broomberg,¹³⁶ states that almost every single commercial arrangement between two or more parties will involve the transfer of funds. Does it mean that all transfers of funds between parties might be regarded as constituting round trip financing? This is an issue that still has to be decided by the courts. However, this does not seem to be the intention of the Legislature because most agreements will involve the transfer of funds.

¹³³ Ibid.

¹³⁴ Haffejee, Y. (2009). *A Critical Analysis of South African General Anti Avoidance Provisions in Income Tax Legislation*, pg 27. in his dissertation criticised this provision by stating that this would create confusion for the taxpayer as it appears that exactly the same issues are now being re-addressed in another section.

¹³⁵ Ibid.

¹³⁶ Broomberg, E.B. (2008). *Then and now –VI. Tax planning corporate and personal*, 22.

4.5. Presence of accommodating or tax indifferent parties

Section 80E defines Accommodating and tax indifferent parties as follows:

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

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

(i) not subject to normal tax; or

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

(b) either—

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

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

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

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

(dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or

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

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

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

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

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

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

The implications of this section are that if there is a presence of an accommodating or tax indifferent party, provided that all the other requirements are met, then this would be indicative of a lack of commercial substance. Section 80E deals with what constitutes an accommodating or tax indifferent party. Moreover, it is stated that the parties to the arrangement need not be connected to each other.

Furthermore, the section addresses the various instances where an accommodating and tax indifferent party indicator may be ignored, which qualifies as an exception.

SARS refers to these exclusions as the 'safe harbour provisions' and states that the mere presence of an accommodating or tax indifferent party does not mean that the arrangement will be regarded as lacking commercial substance.¹³⁷ However, one must take into account that if any one of the tainted elements is met in addition to the requirements in section 80C(1), then the arrangement may be regarded as an impermissible avoidance arrangement.

The exceptions will be discussed in the following paragraph.

4.5.1 Amounts subject to income tax in other jurisdictions or countries

This pertains to a situation whereby the amounts derived by a party are also subject to income tax in another foreign jurisdiction of at least two thirds of the normal tax that would have been payable in terms of the South African Income Tax Act. The reasoning behind this exclusion is justifiable in order to alleviate the issue of double taxation. However, this situation might be burdensome for the taxpayer as he would have to familiarise himself with the tax laws of spheres of government that he has dealings with.

Furthermore, Haffejee¹³⁸ states that this situation might be difficult to give effect to because some countries have more than one sphere of government; for example the United States of America, therefore each state has different tax systems. The Commissioner may find it difficult to come up with a comprehensive calculation of all taxes he has paid. In agreement with the statement made by Haafijie,¹³⁹ this requirement is too burdensome for the taxpayer and the Commissioner, and hence it

¹³⁷ SARS Draft Comprehensive Guide to General Anti Avoidance rule pg 33.

¹³⁸ Haffejee, Y. (2009). A Critical Analysis of South African General Anti Avoidance Provisions. In Income Tax Legislation, pg 29.

¹³⁹ Ibid.

is an unnecessary insertion by the Legislature which may be done away with if it proves to be difficult to apply in practice.

4.6. Substantive active trading activities

The accommodating or tax indifferent party may be ignored in the event that such a party participated directly in substantive active trading activities in connection with the avoidance arrangement for at least 18 months. Furthermore, these activities must be attributable to a place of business, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment as per section 9D(1) if it was located outside the Republic and the party concerned were a controlled foreign company.

This section may be problematic as the definition of the term 'substantive active trading' is not defined in the Act, hence this may result in confusion as to what the term means. As a result of the confusion this might lead to an improper ruling by the courts, or the Commissioner attacking the agreement stipulating that there was no substantive active trading. What might amount to substantive active trading to one party might not necessarily amount to the same for the other party. Hence the Legislature needs to define this term, or alternatively a guide or note could be drafted by SARS to address this issue.

The other issue that may be problematic in practice is that of the fact that the other party must be a foreign business establishment, as defined in section 9D. The issue of a foreign business establishment may be difficult to apply. Broomberg¹⁴⁰ states that the foreign business establishment raises some of the most difficult factual issues in the Act, and the fact that the tax indifferent party may be a stranger to the taxpayer makes the requirement absurd.

¹⁴⁰ Broomberg, E.B. (2008). Then and Now –VII. *Tax Planning Corporate and Personal*, 22.

In order for a business to constitute a foreign business establishment, there must be a level of permanency in terms of the definition in section 9D(1). However, this might be problematic in the case whereby a foreign business does not meet the requirement of permanency but nevertheless conducts business through other means.

4.7. Elements that offset or cancel each other

Section 80C(b)(iii) postulates that the presence of elements that offset or cancel each other are indicative of the lack of commercial substance.

The Act does not expressly list or name the elements that offset or cancel each other. Hence this has the effect of creating uncertainty. However, De Koker¹⁴¹ states that,

'The self-neutralising mechanism draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called fiscal nullity doctrine. It is targeted primarily at complex schemes, typically involving complex financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another effectively neutralises the first leg for non-tax purposes.'

This provision is targeted at complex schemes that might have been entered into by the taxpayer so as to avoid tax. However, it is my submission that the Legislature should have made provision or explained in great detail, or at the least given a guideline, as to the instances that might have the effect of offsetting or cancelling each other. Failure to do so might result in interpretation problems and uncertainty among the taxpayer, Commissioner and the courts. It should be noted that this issue of offsetting or cancelling of elements has been repeated, or rather the concepts have been discussed again in section 80D, when dealing with the issue of round trip

¹⁴¹ De Koker, A.P. (2011). *Silke on South African Income Tax Act*, Chapter 19 par 7 (online version).

financing. Hence, as submitted before, the Legislature should deal with this issue under one section and remove the other one so as to create clarity.

4.8. Arrangement in a context other than 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,

‘(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.’

Clegg¹⁴² states that the test used in such a case is objective, as it is determined whether the arrangement was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose. The requirement of normality and the principles applicable to normality, as discussed under section 80A(a), are applicable in this regard.¹⁴³ The difference lies in the fact that section (b) deals with a non-business purpose whereas section (a) is with regards to a business context.

De Koker¹⁴⁴ states that,

‘...it is not a requirement that the means and manner used should be normal but merely that that it be entered into or carried out by means or in a manner normally used by persons, outside of a business context, to achieve, presumably, family, personal or charitable objectives.’

¹⁴² Clegg, D. (2011). *Income Tax In South Africa*. Chapter 26 par 7 (online version).

¹⁴³ This was also stated by De Koker, A.P. (2011). *Silke on South African Income Tax Act*, Chapter 19 par 7(online version) when he stated that the same principle applies in the context of any other transaction, that is, a non-business transaction. As long as the taxpayer complies with the requirement of normality laid down in s80A(b), he may carry out any transaction for the purpose of avoiding or reducing the amount of tax payable

¹⁴⁴ *Ibid* at 19.7.

It has been submitted by various writers¹⁴⁵ that the word *bona fide* is obscure. It is not clear as to what exactly amounts to a *bona fide* purpose for the purposes of applying the GAAR. Clegg and Stretch¹⁴⁶ state that the words relates to the methodology; as in whether the methodology being used could be used to achieve a substantive personal, familial or, for example, charitable end result.¹⁴⁷ De Koker agrees with this, and states that a *bona fide* purpose basically refers to the methodology used in respect of the arrangement.¹⁴⁸

4.9. Arrangement In any other context

Section 80A stipulates an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit, and section (c) furthermore stipulates that,

‘(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).’

This section has been described by Cilliers as the heart of section 80A, as a result of it applying in any context.¹⁴⁹ Since the section stipulates that it applies in any context, this means that this section is wide and is applicable in any other situation

¹⁴⁵ Clegg, D. & Stretch, R. (2011). *Income Tax in South Africa*, Chapter 26 & De Koker, A.P. (2011). *Silke on South African Income Tax Act*, Chapter 19 par 7 (online version).

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

¹⁴⁸ Ibid.

¹⁴⁹ Cilliers, C. (2006). The Proposed sec 80A(c)(ii) of the Income Tax Act: should it be enacted? *The Taxpayer*, October: 182-187.

not covered in the context of a business and in a non-business context. This part of the research will deal with the each of these two requirements in detail.

4.10. Rights or obligations that would not normally be created between persons dealing at arms length

This requirement was present in the now repealed section 103(1) of the Income Tax Act. The previous section stated, amongst other requirements, that the nature of the transaction, operation or scheme in question in relation to a transaction, operation or scheme must be taken into account. De Koker¹⁵⁰ states that the question whether the rights created would normally be created between parties dealing at arm's length is a factual objective inquiry simply because the Legislature omitted the requirement of the considering the circumstances of the agreement.

The meaning of the first requirement at arm's length was discussed in the case of *Hicklin v SIR*.¹⁵¹ The court stipulated that,

'the expression at arm's length connotes that each party is independent of the other and in so doing will strive to get the outmost possible advantages out of the transaction for himself.'

The parties are not supposed to be dependent of each other, and moreover if the rights created are not normally created between parties dealing at arm's length, then this might be an indication of an impermissible avoidance arrangement.

¹⁵⁰ De Koker, A.P. (2011). *Silke on South African Income Tax Act*. Chapter 19 par 7.3. (online version). Furthermore, Clegg, D. (2011). *Income Tax in South Africa*, Chapter 26 par 3.5 (online version) supported this view and stipulated that the test is clearly objective. The absence of any requirement to consider the circumstances of the arrangement effectively neutralises the argument used under the equivalent test in s 103(1), that one has to consider the fact that the parties in certain arrangements are manifestly not at arm's length.

¹⁵¹ 1980 (1) SA 481 (A), 41 SATC 179 at 195.

The court in *Hicklin* furthermore explained that in an arm's length agreement, the rights and obligations it created were most likely to be regarded as normal than abnormal.

In *SIR v Geustyn*¹⁵² the court dealt with the issue of the arm's length requirement. The parties converted a partnership into a company. SARS contended that the formation of the company constituted a scheme for the reduction of the tax liability of the partners in the firm, and applied the provisions of section 103(1) of the Income Tax Act, 58 of 1962.

The court stipulated that there is nothing wrong in transferring a partnership into a company. Such a transaction may be regarded as commonplace in the commercial world.¹⁵³ The writer agrees with the statement made in the abovementioned case. It would be absurd to assume that a conversion of a partnership into a company is abnormal. It could not be the intention of the Legislature as this is common in the commercial world. If the contention by the Commissioner is given effect, this would mean that most of the transactions carried on in the Republic which deal with the conversion of any company or partnership would result in the transaction being regarded as abnormal.

When one looks at this arm's length requirement, it is evident that this requirement is quite difficult to apply in practice as the Commissioner has a limited, or rather slim, chance of succeeding. The Commissioner has the onus of proof on a balance of probabilities that the required degree of abnormality exists.¹⁵⁴ Broomberg¹⁵⁵ supports this view by stating that,

'Taking into account the Geustyn and Hicklin case, the effect of these two cases is that if regard is indeed had to the circumstances under which the transaction,

¹⁵² 33 SATC 133.

¹⁵³ *Ibid* at pg 199.

¹⁵⁴ De Koker, A.P. (2011). *Silke on South African Income Tax Act*. Chapter 19 par 7.3.

¹⁵⁵ Broomberg, E.B. (2008). *Then & Now. Tax Planning*, 22, 9.

*operation or scheme was entered into or carried out, it makes no difference whether the parties are or are not acting at arm's length, the Commissioner is likely to lose either way.*¹⁵⁶

The requirement of arm's length is an unnecessary insertion by the Legislature as it does not provide any relief to the Commissioner; it actually places a heavy burden on the Commissioner as he is likely to lose in any case. Hence this requirement may be done away with. Furthermore, the term 'arm's length' is not defined in the Act, hence this might result to uncertainties amongst the taxpayer, its advisors and the Commissioner.

4.11. Misuse or abuse of the provision of the Act

Any avoidance arrangement which will result in the direct or indirect misuse or abuse of the provisions of the Income Tax Act constitutes an impermissible avoidance arrangement in terms of section 80A(c) (ii). SARS¹⁵⁷ states that this is a new concept, as this provision was not available in the predecessor of GAAR. Hence there is no case law as yet in this regard. However, SARS furthermore stipulates that guidance in this regard may be sought from other jurisdictions.

The explanatory memorandum to the Revenue Laws Amendment Bill of 2006 states that the Legislature has relied on, amongst other things, Canadian precedent in introducing the misuse or abuse concept. In Canadian law the misuse or abuse concept appears in section 245(4). Section 245 (4) states that,

'For greater certainty, subsection 245(2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.'

¹⁵⁶ *Ibid* pg 9.

¹⁵⁷ SARS Draft Comprehensive Guide to General Anti Avoidance Rule pg 39.

Sec 245(4) may not be applied when a transaction does not directly or indirectly result in a misuse or abuse. Therefore it is cast in negative language.¹⁵⁸ If the transaction doesn't result in a misuse or abuse, then the provisions of section 245(5) are not applicable. However, when one looks at the wording of the South African misuse or abuse provision, it states that,

'an avoidance arrangement is an impermissible arrangement of its sole or main purpose was to obtain a tax benefit and amongst other requirements it would result directly or indirectly in the misuse or abuse of the provisions of this Act.'

It is clear that the provisions of section 80A(c)(ii) are couched in positive language, hence it expands the application of the section. It provides a basis for distinguishing between legitimate tax planning and abusive tax avoidance¹⁵⁹

The Canadian Explanatory Note states that the Canadian Act applies the misuse or abuse concept as a limitation on the scope of section 245. This prevents section 245 from being too broad and hitting transactions that the Legislature could not have intended to attack.¹⁶⁰ Therefore, taking the above into account, it is clear that the insertion of section 245 (4) was to ensure that section 245 would be not too broad as this would lead to interpretation problems of the section.

The first case to analyse section 245(4) of the Canadian Act was *OSFC Holdings Ltd v The Queen*.¹⁶¹

Determining whether a particular provision of the Act has been misused, or whether the Act read as a whole has been abused, requires an examination of the purpose

¹⁵⁸ Cilliers, C. (2006). The Proposed sec 80A(c)(ii) of the Income Tax Act: should it be enacted? *The Taxpayer*, October: 182-187.

¹⁵⁹ Van Schalkwyk, L. & Geldenhuys, B. (2010). Reinforce Tainted Elements. *Tax Planning*, 24, 15.

¹⁶⁰ *Ibid* at fn 135.

¹⁶¹ 2001 DTC 5471 (FCA) par 65.

(‘object and spirit’) of the particular provision or scheme of provisions. It is not sufficient merely to rely on the technical language of the particular provision or scheme of provisions to determine whether there has been a misuse of the Act or an abuse of the Act read as a whole.

The court in this case applied the modern approach of interpretation. The purpose of the particular provision must be ascertained. In *Canada Trustco Mortgage Company v Canada*¹⁶² the court dealt with the issue of misuse and abuse provisions. The court stated that in considering misuse, the focus is on the specific legislative provisions relied on, and that the court should not search for an overriding policy of the Canadian Income Tax Act. The court will have to look at the specific legislative provisions; in other words, the court has to give effect to the provisions of the provisions and not look at some overriding policy of the Canadian Income Tax.

In order to explain how the misuse and abuse provisions are to be interpreted, SARS¹⁶³ stipulated that in Canada the misuse or abuse test involves a two part inquiry. SARS made reference to the *Canada Trustco Mortgage Company v Canada* case. The court stated the test involves a two part inquiry namely:

1. Is to interpret the provision giving rise to the tax benefit to determine their object, spirit and purpose.
2. The second is to examine the factual context of a case in order to determine whether the avoidance arrangement defeated the object, spirit or purpose of the provisions in issue.¹⁶⁴

Basically, the court when faced with a case whereby it has to determine whether there was an misuse or abuse of provisions, will firstly have to interpret the provision

¹⁶² 2005 SCC 54.

¹⁶³ SARS Guideline pg 39.

¹⁶⁴ 2005 SCC 54 par 44.

in the Act first which deals with the misuse or abuse of provisions. Secondly, the provision would have to be examined or interpreted in context, taking into account all provisions of the Act. South Africa also adopted the same approach. The Revised Proposal on Tax Avoidance & Section 103 of the Income Tax Act 58 of 1962 stipulated that the rationale behind section 80A(c)(ii) was to reinforce the modern approach to the interpretation of statutes in order to find the meaning that harmonises the wording, object, spirit and purpose of the provisions.

Schalkwyk & Geldenhuys¹⁶⁵ analysed this provision and stated that the word 'reinforce' in essence implies strengthening or supporting an existing concept. The writers furthermore analysed the term 'modern approach' and asked the question, what exactly does a modern approach to the interpretation of tax statutes mean? They¹⁶⁶ stated that in common law there are two approaches; namely literalism and intentionalism for the traditional approach. This approach basically looks at the literal meaning of the words of the statute and intentionalism is when the intention of the Legislature is ascertained.

Secondly, there is the purposive and contextualism for the modern approach.¹⁶⁷ The purpose of the particular provision is taken into account¹⁶⁸ and contextualism refers to the fact that the provision has to be interpreted in context so as to arrive at a proper meaning of certain provisions.¹⁶⁹

The writers moreover state that if the purpose of s80A(c)(ii) was to 'reinforce' the modern approach, this presupposes that a modern approach is already authoritative

¹⁶⁵ Van Schalkwyk, L. & Geldenhuys, B. (2010). Reinforce Tainted Elements. *Tax Planning*, 24, 15.

¹⁶⁶ *Ibid*.

¹⁶⁷ Du Plessis, L. (2002). *Reinterpretation of Statutes*. Durban: Butterworths at 93-8.

¹⁶⁸ See Joubert, W.A. & Faris, J.A. (2001) *The Law of South Africa*. Vol 1 Part 1, Durban: Butterworths. At 285, the writer stated that purposive attributes meaning to a statutory provision in light of the purpose it seeks to achieve.

¹⁶⁹ *Ibid* at 297, the writers defined the term contextualism and state that the meaning of a provision is often said to be determinable by reading its words in context or reaching the language in context or reaching the provision itself in context.

in South Africa, and secondly, section 80A(c)(ii) is capable of reinforcing the modern approach.¹⁷⁰

Taking the above into account, it is clear that when interpreting the misuse or abuse provisions in the Income Tax Act, the courts will use the modern approach of interpretation. This approach enunciates that the provision of the Act is interpreted in light of the purpose it seeks to achieve, and furthermore, the meaning of the provision is read in context.

Although the interpretation of the misuse or abuse provisions of the Income Tax Act may seem easy to understand, one has to look closely at how practical it is to apply the purposive or contextual methods of interpretation to an arrangement. When one analyses the purposive requirement it states that the purpose of the provision must be interpreted in the light of the purpose it seeks to achieve.

It must be noted that it might be difficult to ascertain the purpose of the legislation. What factors are taken into account when arriving at such a conclusion? How would the courts determine the underlying purpose of the Legislature when drafting a particular provision? This might result in inconsistencies within the courts as there is a likelihood of the courts interpreting this provision differently.

Clegg¹⁷¹ states that the great difficulty with discerning abuse or divining the intention of the Legislature is that the underlying spirit and purpose of tax legislation is frequently extremely difficult to discern.¹⁷²

¹⁷⁰ *Ibid* ftn 165 at ftn 37 pg 16.

¹⁷¹ Clegg, D. (2007). Use it or abuse it. *Tax Planning*, 21, 36.

¹⁷² *Ibid* at pg 38.

In *Summit Industrial Corporation v Jade Transporters*,¹⁷³ the court stipulated that,

'It is dangerous to speculate on the intention of the Legislature, and the court should be cautious about departing from the literal meaning of the words of a statute...Moreover it is not the function of the court to supplement a statutory provision in order to provide for a casus omission.'

Clegg defines a '*casus omissus*' as a situation which typically arises when a set of circumstances analogous to that dealt with in a provision is not in fact dealt with, i.e. that is there is a so called loophole.¹⁷⁴ The court has to give effect to the meaning of the provision so as to prevent confusion. In support of the *Summit Industrial Corporation* case,¹⁷⁵ when the court departs from the ordinary meaning of a provision of a Legislature, this would result in the courts creating their own law. This will result in the usurpation of powers of the judiciary, which is not acceptable whatsoever.

Another criticism that may be levied against the misuse or abuse of the provisions of the Act is the fact that it is clear that, in South Africa, the purposive and contextual method of interpretation is the one used when interpreting a provision. On proper analysis of the misuse or abuse of provisions requirement, it seems as if this requirement basically addresses the issue of interpretation. Hence this was an unnecessary insertion by the legislation which may be removed as it is irrelevant. Furthermore, it is difficult to apply.

Haffejee¹⁷⁶ also states that If the provisions of the statute are applied contextually and purposively, as in the case of South Africa, the obvious implication is that there appears to be no relevance to having misuse and abuse provision in the Income Tax

¹⁷³ 1987 (2) SA 583 (A) at 596J-597B.

¹⁷⁴ *Ibid* at ftn 171 at ftn 46 pg 36 ftn 4.

¹⁷⁵ 1987 (2) SA 583 (A) at 596J-597B.

¹⁷⁶ Haffejee, Y. (2009). A critical analysis of South Africa's general anti avoidance provisions in Income Tax Legislation, pg 38.

Act. Cilliers¹⁷⁷ criticizes this section by stating that the proposed GAAR does not need a provision like section 80A(c)(ii). He states that the rest of the GAAR is robust enough to survive without it. The application of this provision only causes problems and complete uncertainty, and erosion of the law. Furthermore, common law principles already make provision for the interpretation of statutes purposively and contextually.¹⁷⁸ It is clear that this provision is a reiteration of the common law principles of interpretation and it was not necessary to insert it.

4.12 Conclusion

In summary, this chapter basically dealt with the last requirement of the new GAAR. Each provision or section was critically analysed so as to create clarity for the taxpayers when entering into certain arrangements. Furthermore, the provisions were analysed so as to ensure that the courts are not confused when being confronted by any of the provisions present in the GAAR.

This part of the research has brought to the surface many issues that may be problematic in the future, or that have proved to be problematic as of now. It is clear that the new GAAR makes provision for an arrangement entered into in a business context, non-business context and in any other contexts.

Hence the new GAAR makes provision for the normality requirement, commercial substance and misuse and abuse provisions of the Act which are encompassed in section 80A(a) - (c). It has been established that there is uncertainty with regards to certain provisions of the GAAR, especially the new provisions which were not present in the now repealed section 103 of the Income Tax Act. Furthermore, the Legislature inserted unnecessary provisions in the Act. Recommendations on how to deal with these problems will be discussed in the following chapter.

¹⁷⁷ Cilliers, C. (2006). The Proposed sec80A(c)(ii) of the Income Tax Act: should it be enacted? *The Taxpayer*, vol. 55 no 10 pg 182.

¹⁷⁸ *Ibid* at pg 187.

The following chapter deals with the conclusion and recommendations for the application of the New General Anti Avoidance Rule. The conclusion also gives a brief summary of the research and problems noted.

CHAPTER 5. CONCLUSION AND RECOMMENDATIONS

5.1. Introduction

This research critically analysed the provisions of the new general anti avoidance rule as enunciated in section 80A. 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 abovementioned provisions of the GAAR have been critically discussed in this research. This chapter will discuss the findings of the research by stating the major weaknesses that have been discovered when critically analysing the new GAAR. Furthermore, the writer will discuss possible recommendation so as to alleviate the problems that are faced when applying the new GAAR.

5.2 Major weaknesses of GAAR

The following problems have been ascertained with regards to the new GAAR:

5.2.1 The GAAR does not define most of the terms in the Act

It has been determined that the Legislature, when drafting the new GAAR, did not define most of the terms that are necessary to create clarity for the taxpayer, the Commissioner and the courts. For example, the Legislature, when defining an arrangement, included the word 'scheme'. However this term is not defined in the Act and hence it is open to different interpretations by the courts. For example, In the case of *Meyerowitz v CIR*¹⁷⁹ it stated that the word 'scheme' is wide enough to cover a series of transactions. This definition alone creates confusion as it states that the word is wide enough to include any series of transaction.

The terms 'sole' or 'main purpose', 'business purpose test', 'bona fide', 'commercial substance', 'substantive activities' when dealing with accommodating or tax indifferent parties was not defined in the Act. Therefore, for business purposes and commercial substance, the courts have resorted to seeking clarity from foreign jurisdictions. These are some of the main terms not defined in the Legislature and hence may lead to uncertainty as it is not clear what the terms might mean.

The effect of this omission by the Legislature is that the failure to define terms may lead to various interpretations by the courts as it is not clear what the terms mean. Furthermore, some provisions leave room for various interpretations. For example, in the case of 'commercial substance', the Act states that the indicative tests mentioned are not an exhaustive list. This means that the Commissioner may attack any agreement and state that it falls under any one of the indicative tests, hence lacking commercial substance.

¹⁷⁹ 1980 (1) SA 481 (A), 41 SATC 179.

Secondly, the Act does not make provision for a list of the elements that offset or cancel each other, and this might lead to uncertainty amongst taxpayers, the Commissioner and the courts.

5.2.2 Unnecessary insertion of certain provisions

It has been determined that the Legislature has inserted many provisions in the new GAAR. However, as discussed in this research, some of the provisions were not necessary as they cause confusion and are difficult to apply in practice. For example, when dealing with what constitutes an arrangement, the Legislature has inserted the words 'whether enforceable or not'.

The writer submits that this insertion was not necessary as it is implied that the Legislature encourages taxpayers to enter into unenforceable agreements. Furthermore, the definition states that the agreement may be made orally or in writing. This is difficult to apply in practice because how does one prove the existence of an oral agreement? This agreement is easily disputable.

Secondly, the other insertion by the Legislature is that there must be a business purpose test. Clegg¹⁸⁰ states that the arrangement should not have a primary or substantial business purpose *per se*, but that the method employed should be normal in a business context. Taking this provision into account, it is clear that it might be difficult to apply in practice because there is no normal way of doing business. A person is free to conduct his business in a way that he deems fit. Hence this was an unnecessary insertion.

¹⁸⁰ Clegg, D. & Stretch, R. (2010). *Income Tax in South Africa*. Chapter 26 par 3.5. (online version)

In any other context there is a provision which states that rights or obligations must arise between parties dealing at arms length. In such a case the Commissioner has the onus of proving that abnormality exists.¹⁸¹

It has been stated by Broomberg¹⁸² that the Commissioner always loses in such a case. Therefore what is the point of inserting such a provision in the Act which has an adverse impact on a claim by the Commissioner? It is unnecessary to have such a provision.

Lastly, the misuse and abuse provision is an unnecessary insertion by the Legislature. This provision basically stipulates that there must be a purposive and intentionalism method of interpretation of the tax statutes or other Act. It is clear that this method of interpretation is already provided for by common law. Therefore there was no need for the Legislature to insert this provision in the new GAAR.

Another issue which raises concern is the fact that the Legislature included the abnormality requirement in the new GAAR, regardless of the fact that it has proven to cause problems in the past. The Revised Proposals,¹⁸³ state that most or many commentators have acknowledged the continuing weakness in the current Abnormality Requirement. The discussion paper dealt with two major weaknesses with this requirement. Firstly, the tax world is not divided into two types of arrangements, namely *bona fide* business transactions and the other for impermissible avoidance arrangements.¹⁸⁴ It is difficult to determine or establish whether a business is a *bona fide* or impermissible avoidance arrangement if the Act is not clear as to what pertains to these transactions. The provisions in the Act are not clear and most provisions create confusion.

¹⁸¹ De Koker, A.P. (2011). *Silke on South African Income Tax* Chapter 19 par 17.3.(online version).

¹⁸² Broomberg, E.B. (2008). Then and Now. *Tax Planning*, 22, 9.

¹⁸³ Revised Proposals on Tax Avoidance pg 6.

¹⁸⁴ *Ibid*.

The second problem noted by the Revised Proposals is that because business transactions are not divided into permissible and impermissible arrangements, this often gives impermissible avoidance arrangements an undeserved patina for normality.¹⁸⁵

5.2.3 Repetition of provisions

When one looks closely at the provisions of section 80C (1) and 80D, it is clear that the legislation made reference to the same principles in two different sections. The principle of round trip financing resembles that of tax benefit and business risks in section 80C (1). Furthermore, the provision of elements which cancel or offset each other may be encompassed in section 80D, which stipulates that the funds must be transferred between or among parties and must result in a tax benefit whether directly or indirectly, and it must significantly reduce, offset or eliminate any business risk incurred by any party in connection with an avoidance arrangement. The repetition of these provisions is a clear indication that the Legislature did not clearly apply its mind when drafting the new GAAR, and this leads to confusion and uncertainty.

5.2.4 Borrowing concepts from other countries

Most of the new concepts or provisions encompassed in the new GAAR have been borrowed from other jurisdictions. For example, the business purpose test has been borrowed from America,¹⁸⁶ commercial substance has been borrowed from United Kingdom, and lastly misuse and abuse provisions have been borrowed from Canada. There is nothing wrong with borrowing concepts from other jurisdictions but the problem arises when the borrowed concepts become difficult to apply in practice.

¹⁸⁵ Ibid.

¹⁸⁶ Gregory v Helvering 293 US 465 (1935).

This results in a very complex GAAR which is difficult to apply and hence the question that has to be addressed is whether it is necessary to borrow foreign concepts which first of all cannot be understood by the taxpayers, the Commissioner and the courts; and secondly, which complicate the new GAAR. The reason why the new GAAR was enacted was, amongst other reasons, to provide clarity; however, some of the borrowed concepts provide uncertainty as their true meaning cannot be established.

When dealing with the issue of the anti avoidance rule in foreign jurisdictions, Broomberg¹⁸⁷ states that reactions faced by the courts in England, America, Canada, Australia and South Africa to tax avoidance cases over the past 70 years or so have displayed a similar pattern. He notes that in some countries there is a general avoidance rule, whereas in others there is none.¹⁸⁸

Broomberg¹⁸⁹ states that there is inconsistency in these countries judgments. Taking into account this factor, it is absurd to think that the Legislature, when drafting the new anti avoidance rule, incorporated some provisions from other countries which have proved to be inconsistent. Furthermore, Broomberg notes that the new GAAR may have added bells and whistles, but they are all playing the same tune.¹⁹⁰ On analysis it is clear that the new GAAR doesn't deviate much from its predecessor, regardless of the fact that new concepts have been added to the general avoidance rule. Moreover, he stipulates that the conclusion that may be reached is that the taxpayers' prospects of success have not altered significantly as a result of the introduction of the new GAAR provision in sec 80A to 80E.¹⁹¹

¹⁸⁷ Broomberg, E.B. (2008). Then & Now VIII. Some Conclusions. *Tax Planning*, 22, 135.

¹⁸⁸ Ibid.

¹⁸⁹ Ibid.

¹⁹⁰ Ibid.

¹⁹¹ Ibid.

5.3. Recommendations

It is clear that GAAR is difficult to apply in practise, hence the Legislature should make a provision for the definition of all the terms which are not defined. This will create clarity and eradicate any potential confusion amongst the taxpayer, the Commissioner and the courts.

Secondly, SARS should make provision for interpretation notes which define and explain specific provisions not defined in the Act, and those provisions which have been borrowed from foreign jurisdictions which are difficult to apply in practice. Alternatively, the Legislature could make provision for an explanatory note explaining the complex provisions and/or insert a section defining some of the terms not defined in the Act.

Thirdly, the Legislature should ensure that they remove some provisions which have been repeated. This ensures that a certain provision is discussed or provided for once, and in clear terms, and hence prevents the problems of taxpayers or the Commissioner using different sections which are beneficial to their case.

Lastly, the Legislature should remove all the unnecessary insertions to ensure that the new GAAR is clear, easy to understand, and apply in practice. Furthermore, the Legislature should clarify and list certain provisions in the Act, for example in the case of elements that offset or cancel each other and the indicative lists of the lack of commercial substance rule. The Legislature should in such a case make provision for a comprehensive list of provisions it regards as elements which cancel or offset each other and the indicative lists of a lack of commercial substance.

5.4. Conclusion

The Legislature intended to have a wide GAAR which would be able to cover all forms of arrangements that may be entered into by taxpayers when trying to avoid

tax. However, one must take caution in enacting a wide GAAR. Cilliers¹⁹² states that it is dangerous to formulate a general anti avoidance rule too widely as it creates uncertainty with regards to the amount of tax payable by the taxpayers and the area within which they will be regarded as trespassers.

These writers¹⁹³ conform to this notion of ensuring that all arrangements entered into to avoid tax which comply with the requirements stated in the new GAAR, should be scrutinised, and if justifiable, the taxpayer should be liable for taxation. Moreover, the GAAR should be wide enough to ensure that all arrangement entered into by the taxpayer will be scrutinised by the Commissioner in the event that they meet the requirements enunciated in sec 80A. However, the provisions should not be too wide so as to prevent a situation whereby there is uncertainty.

After taking the above discussions on the enactment of the new GAAR and the analysis of the new provisions into account, it goes without saying that the new GAAR is complex and difficult to apply in practice. Most of the concepts or provisions inserted into the new GAAR have been borrowed from other countries; hence most of them are difficult to apply in practice. Therefore these borrowed concepts have to be applied with caution. It should be noted that this results in a wide GAAR which is very complex and difficult to apply in practice.

Moreover, the Legislature failed to define most of the new terms in the GAAR, hence creating uncertainty amongst taxpayers, the Commissioner and the courts. Furthermore, since these provisions are not defined, it results in a situation whereby courts will come up with their own interpretation, leading to different judicial rulings.

The new GAAR makes reference to impermissible tax avoidance, but it does not make reference to what exactly amounts to a permissible avoidance; hence it is my submission that the Legislature failed in its endeavour to provide clarity and certainty

¹⁹² Cilliers, C. (2006). The Proposed sec 80A(c)(ii) of the Income Tax Act: should it be enacted? *The Taxpayer*, October: 182-187.

¹⁹³ Ibid.

on the new GAAR. It is recommended that the Legislature expressly inserts a provision which lists or defines what constitutes a permissible avoidance arrangement. Furthermore, SARS should make provision for interpretation notes which specifically deal with all the issues not expressly dealt with in the Act to provide certainty to the taxpayer, the Commissioner and the courts.

In the South African context, the Legislature makes and enacts laws; it is not the duty of the judiciary to make laws in court – they are concerned only with enforcing laws. Anything more than that amounts to the usurping of powers by the judiciary. Hence it is recommended that the Legislature should make proper laws which are practical and easy to understand, and they must ensure that there are no loopholes which will open the flood gates of litigation. In the event that the Legislature borrows provisions from other jurisdictions, it is submitted that they must apply their minds and incorporate those provisions which are practical and which do not impose any heavy burden on either the taxpayer or the Commissioner.

However, regardless of the fact that the Legislature does not provide clarity when dealing with the GAAR, it is not the end of the road for GAAR as it is necessary in any economy to prevent avoidance abuses by taxpayers. South Africa is not the only country that has had problems with the interpretation of GAAR. Difficulties have been encountered with the GAARs in Australia, Canada, South Africa and New Zealand.

There have been many false starts, however it has to be noted that none of the jurisdictions that have introduced a GAAR have shown any sign of wanting to dispense with it; rather they have introduced new and stronger versions where their original attempts have been thwarted, as in Australia and South Africa.¹⁹⁴

¹⁹⁴ Freedom, J. (ed.) (2008). *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management*. Oxford: Oxford University Centre for Business Taxation.

Taking the above research into account, it has been acknowledged that the new GAAR is complex and difficult to apply. Therefore the Legislature must not dispense with it, but rather create clarity to ensure that there are no tax abuses by the taxpayers.

Word count 23 185.

REFERENCES

- Broomberg, E.B. (2008). Then & Now VIII Some Conclusions. *Tax Planning*, 22, 135.
- Cilliers, C. (2006). The Proposed sec 80A(c)(ii) of the Income Tax Act: should it be enacted? *The Taxpayer*, October: 182-187.
- Clegg, D. (1985-1986), Section 103(1) Freedom of Choice. *South African Tax Journal*, Vol. 1 pp 224.
- Clegg, D. (2002). Business Purpose Test. *Tax Planning Corporate and Personal*, 16.
- Clegg, D. (2007). Use it or abuse it. *Tax Planning*, 21, 37.
- Clegg, D. & Stretch, R. (2010). *Income Tax in South Africa*. Durban: Butterworths.
- De Koker, A.P. (2011). *Silke on South African Income Tax*. Durban: Lexis Nexis.
- Haffejee, Y. (2009). *A Critical Analysis of South African General Anti Avoidance Provisions in Income Tax Legislation*. Unpublished LLM dissertation, Nelson Mandela Metropolitan University (NMMU).
- Du Plessis, L. (2002). *Reinterpretation of Statutes*. Durban: Butterworths at 93-8.
- Freedom, J. (ed). (2008). *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management*. Oxford: Oxford University Centre for Business Taxation.
- Gerr, B. (2011). Supreme Court of Appeal – a ‘maize’-s tax planners with watershed judgment.
<http://butterworths.up.ac.za/nxt/gateway.dll/zkfaa/bsxha/b2aac/cvidc/kvidc/nvidc/lwidc?f=document&q=general%20anti%20avoidance%20rule&x=Advanced#LPHit1>.

Joubert, W.A. & Faris, J.A. (2001). *The Law of South Africa*. Vol 1 Part 1, Durban: Butterworths.

Meyerowitz, D. (2006). *The Taxpayer*, vol. 55.

The Taxpayer. (2007). General anti avoidance rule 56.3. *The Taxpayer*, March, 41.

The Taxpayer. (2010). Income Tax-Deductibility of Interest-Test for simulated transactions - Former Section 103(1) of the Income Tax Act. *The Taxpayer*, Nov-Dec 2010, Vol. 59, No. 11&12.

The Taxpayer (2009). The “sole or main purpose” test – subjective or objective? *The Taxpayer*, 18.1.

Van Schalkwyk, L. (2009). Section 80A(c) (ii) of the Income Tax & the Interpretation of Tax Statutes in South Africa. *Meditari Accountancy Research*, Vol. 17 No 2.

Van Schalkwyk, L. & Geldenhuys, B. (2010). Reinforce Tainted Elements. *Tax Planning*, 24, 15.

William, R.C. (1997). The 1996 Amendments to the General Anti-Avoidance section of the Income Tax Act. *SALJ*, Vol. 114, part IV.

Williams, R.C. (2006). *Income Tax in South Africa: Law & Practice*. 4th ed. Durban: Butterworths.

Williams, R.C. (2009). *Smoke and mirrors or genuine commercial venture?* [Online] Available at www.agbiz.co.za/Portals/0/.../pwc-synopsis-september2009.pdf. Retrieved 12 October, 2011.

ACTS

Income Tax Act 31 of 1941

Income Tax Act 58 of 1962

Revenue Laws Amendment Bill, 2006

Revised Proposals on Tax Avoidance

Australian Tax Assessment Act Act of 1997

Canadian Income Tax Act 1985, c.I (5th Supp).

CASE LAW

Bradford Corporation v Pickles (1895) AC 587

Canada Trustco Mortgage Company v Canada 2005 SCC 54.

CIR v Bobat 67 SATC 47.

CIR v Conhage (Pty) Ltd 61 SATC 391.

CIR v King 1947 (2) SA 196 (A), 14 SATC 184.

CIR v Louw 1983 (3) SA 551, 45 SATC 113 pg 142-143 and 144.

CSAR v NWK Ltd 2011 (2) All 347(SCA).

Duke of Westminster v IRC 51 TLR 467, 19 TC 490.

Erf 3183/1 Ladysmith (Pty) Ltd v CIR 1996 (3) SA 942 (A), 58 SATC 229.

Gregory v Helvering 293 US 465 (1935).

Hicklin 1980 (1) SA 481 (A).

Modderfontein Deep Levels Ltd v Feinsten 1920 TPD 288.

Meyerowitz v CIR 1980 (1) SA 481 (A), 41 SATC 179.

New State Areas Ltd v Commissioner for Inland Revenue 1946 AD 610.

Newton v FCT [1958] 2 All ER 759 (PC).

Ramsay v Inland Revenue Commissioner 1982 A.C. 300.

R Ltd & K Ltd v COT 45 SATC 148.

OSFC Holdings Ltd v The Queen 2001 DTC 5471 (FCA) .

SBI v Lourens Erasmus (Edams) Bpk 1966 (4) SA 434 (A).

SIR v Gallagher 1978 (2) SA 463 (A).

SIR v Geustyn 33 SATC 133.

Smith v CIR 1964 (1) SA 324 (A), 26 SATC 1.

Spotless v COT 96 ATC 5201.

Summit Industrial Corporation v Jade Transporters 1987 (2) SA 583 (A).