An analysis of the South African General Anti-Avoidance Rule: lessons from New Zealand

by

Thembelihle Mzila

16052383

Submitted in partial fulfilment of the requirements for the degree

MCom (Taxation)

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

Supervisor: Dr Teresa Pidduck

Co-supervisor: Prof Riël Franzsen

August 2020

ACKNOWLEDGEMENTS

Firstly, I would like to say a huge thanks to my supervisor, Dr Teresa Pidduck, for her continuous guidance and support. Her insight, knowledge and passion for the research topic have made this research process an inspiring experience for me.

I also wish to thank Prof Riël Franzsen and the NRF for granting me funding and thereby making it possible for me to further my studies.

I would like to especially thank my parents for their unconditional love and support throughout this journey.

I would also like to thank the rest of my family, my colleagues and my friends (special mention goes to my best friend Mvelo Msele) for listening to my complaints and always offering words of encouragement.

Lastly, but certainly not least, I would like to thank my Heavenly Father for providing me with the ability and opportunity to further my studies and giving me wisdom and strength throughout the journey to completion of this mini-dissertation.

ABSTRACT

South Africa has adopted a general anti-avoidance rule (GAAR) as one of the methods to combat the innovative tax avoidance schemes into which taxpayers may enter. Nevertheless, since its introduction it has undergone numerous amendments due to weaknesses highlighted by its failures in court. Yet, since its most recent amendment in 2006, the efficacy of the South African GAAR has not been established as it has not been tested in the courts. This study addresses this concern by employing a 'structured pre-emptive analysis' to identify the weaknesses of the South African GAAR when compared to its New Zealand counterpart.

This approach is essentially qualitative and combines the typical doctrinal or black letter law approach used in law with that of reform-oriented approaches. Firstly, the South African and New Zealand GAARs were analysed and compared using a doctrinal approach to gain an understanding of the interpretation and application of the two GAARs. This allowed for the identification of weaknesses in the South African GAAR, whilst also making suggestions for its improvement. Thereafter, the South African GAAR was applied to the facts of a case from New Zealand by making use of a reform-oriented methodological approach. In applying the South African GAAR to the facts of the case, a framework of the South African GAAR was used to enhance the reliability of the findings by reducing subjectivity and improving replicability.

The findings from the doctrinal and reform-oriented approaches revealed the weaknesses in the current South African GAAR when compared to its New Zealand counterpart. These weaknesses may be addressed in three ways. Firstly, guidance should be provided in order to address uncertainties in the interpretation and application of the South African GAAR so as to prevent inconsistencies that may limit its efficacy. Secondly, the purpose requirement and tainted elements could be consolidated into one requirement, where the presence of one of the tainted elements informs the objective purpose of the arrangement. Thirdly, the purpose requirement should be amended so that it need not be the sole or main purpose, but rather should be one of the purposes, provided it was not merely incidental. It is acknowledged that while the South African and New Zealand GAARs are directed to achieve the same end, the proposals for amendment would arguably go some way towards improving the efficacy of the South African GAAR.

Key words: General anti-avoidance rules, impermissible avoidance arrangement, purpose, tax avoidance, tax benefit.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS AND ACRONYMS

Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
AIL	Approved Issuer Levy
GAAR	General Anti-Avoidance Rule
Income Tax Act	Income Tax Act, No. 58 of 1962
Income Tax Act 2007	Income Tax Act No. 97 of 2007
SARS	South African Revenue Service

CHAPTER 1:
INTRODUCTION

1.1. BACKGROUND

Benjamin Franklin once wrote "in this world nothing can be said to be certain, except death and taxes" (Franklin & Smyth, 1907:410). Given the assumption that taxes are inevitable, taxpayers have always looked for ways to minimise their tax burden (Cassidy, 2006:261). In reducing their tax burdens taxpayers may use both legal and illegal methods to do so. Tax avoidance relates to the use of legal means to minimise a tax burden (degl'Innocenti & Rablen, 2017:816; Tretola, 2018:2). In contrast, tax evasion is described as the use of illegal means to reduce tax burdens (Russell & Brock, 2016:279). Tax avoidance can further be divided into permissible tax avoidance and impermissible tax avoidance. Permissible tax avoidance is tax avoidance that is carried out in accordance with the intention of the legislation (Kujinga, 2014:430). This principle was demonstrated in *IRC v Duke of Westminster* (1936) 19 TC 490 where Lord Tomlin stated that:

> "[e]very 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."

Impermissible tax avoidance on the other hand, is described as:

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

If contrasted to permissible tax avoidance it may be deduced that it is carried out in a manner that is not in accordance with the intention of the legislation. If it is considered that taxes are an important source of revenue for governments, impermissible tax avoidance transactions cause the fiscus to lose the funds needed to operate (Bird & Davis-Nozemack, 2018:1014). Further harmful effects of tax avoidance include economic inefficiency, undermining of legislative provisions, complexities in the drafting of legislation as the government is forced to constantly enact new provisions to close loopholes, and it negatively affects the fairness and integrity of the tax system (Ebersohn, 2012:255-257; SARS, 2005:9). As a result of these problems, revenue authorities worldwide have introduced measures to combat tax avoidance transactions. South Africa is no exception and two legislated methods are used to combat avoidance transactions, namely: specific anti-avoidance rules and general anti-avoidance rules (GAAR) (Pidduck, 2017:1). Specific anti-avoidance rules are included in the legislation and address specific avoidance transactions, whereas GAARs are based on general principles targeting impermissible tax avoidance arrangements (de Koker & Williams, 2020:par 19.5; Kujinga, 2013:2). The focus of this study is on the current South African GAAR and its effectiveness in combating impermissible tax avoidance transactions.

The South African GAAR was introduced for the first time in 1941 and was contained in Section 90 of the Income Tax Act No. 31 of 1941 (Kujinga, 2013:63). After numerous amendments it was found in Section 103(1) (the previous GAAR) of the Income Tax Act No. 58 of 1962 (Income Tax Act) (Kujinga, 2013:74). This GAAR was amended again in 2006 by the Revenue Laws Amendment Act 20 of 2006 (the current GAAR), following various weaknesses that were identified (Pidduck, 2017:4). The requirements of the previous GAAR were summarised by SARS (2005:38) as follows:

- there must be a transaction, operation or scheme;
- which results in the avoidance, reduction or postponement of tax;
- the transaction must have been carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit (abnormality requirement); and
- the transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (purpose requirement).

In light of this summary it was evident that all four elements were required to be present before the previous GAAR was applicable (SARS, 2005:39). In analysing the components of the previous GAAR, it was apparent that if a transaction was carried out in a manner not normally employed for business purposes, but the sole or main purpose was not to obtain a tax benefit, then the GAAR was not applicable (de Koker & Williams, 2020:par 19.4; Williams, 1997:675). Similarly, if the transaction had a sole or main purpose of obtaining a tax benefit but was carried out in a manner normally employed for business purposes, the GAAR was again not applicable (de Koker & Williams, 2020:par 19.4; Williams, 1997:675).

This placed the taxpayers in a strong position as they could escape the abnormality and purpose requirements with relative ease due to the inherent weaknesses of these requirements (SARS, 2005:42-43).

The various weaknesses of the previous GAAR were identified by the South African Revenue Service (SARS) and are briefly summarised as follows:

- Purpose requirement - the taxpayer was able to provide a commercial reason for entering into the transaction with ease, which made it difficult for the Commissioner to prove that obtaining a tax benefit was the main purpose of the transaction (SARS, 2005:43).
- Abnormality requirement - it was difficult to distinguish between transactions employed for *bona fide* business purposes and impermissible tax avoidance transactions, as taxpayers often 'hijacked' transactions that were normally employed for business purposes and as a result were able to manufacture plausible sounding 'normal' business purposes (SARS, 2005:42).
- The GAAR was an inconsistent and ineffective deterrent to impermissible tax avoidance schemes and often failed to stand up to the rigours of court (SARS, 2005:41).
- The GAAR had procedural and administrative issues as there were uncertainties regarding its scope and application (SARS, 2005:44).

As a result of these weaknesses, the need for the amendment of the GAAR was identified by the South African Minister of Finance who stated:

> "what we can't accommodate is a rule which is intended to limit avoidance that is so abused and tatty with wear" (National Treasury, 2005:3).

To address the weaknesses, the previous GAAR was replaced by the current GAAR effective from 2 November 2006 (de Koker & Williams, 2020:par 19.33). The current GAAR was instituted by Section 34(1)(a) of the Revenue Laws Amendment Act No. 20 of 2006 and is set out in Sections 80A to 80L of the Income Tax Act (Kujinga, 2013:103). Pidduck (2017:4-5) summarises the main requirements of the current GAAR as follows:

- There must be arrangement;
- The arrangement must result in a tax benefit;

- The sole or main purpose of the arrangement is to obtain a tax benefit;
- One of the following tainted elements must be present: the arrangement is carried out in a manner which is not considered normal *bona fide* business purposes; the transaction lacks commercial substance; the transaction creates rights and obligations which are not at arm's length or the transaction results in a direct or indirect abuse or misuse of the Income Tax Act.

In comparing the previous GAAR to the current GAAR it is evident that additional tainted elements were added, however the purpose and abnormality requirements were retained. Nevertheless, it has not yet been determined whether the current GAAR effectively addressed the weaknesses identified in the previous GAAR, as no case has to date been presented before the courts where the current GAAR has been tested (Pidduck, 2017:5). In fact, the most recent case that applies the South African GAAR is *Sasol Oil v CSARS* (2018) ZASCA 153 (A). However, this case applies the previous GAAR, as the current GAAR was not yet effective at the time when the transaction took place (Pidduck, 2020:4). Recent studies (Calvert, 2011; Kujinga, 2013; Pidduck, 2017) performed on the current GAAR indicate that significant weaknesses still exist in the current GAAR despite its amendment in 2006. This study aims to expose some of these weaknesses by comparing the current South African GAAR to that of its New Zealand counterpart and identifying areas of improvement from this comparison with the use of a New Zealand case.

1.2. RATIONALE FOR THE STUDY

Since no court cases testing the current South African GAAR have been heard to date, further research is required to establish whether the 2006 amendments were effective in addressing the weaknesses of its predecessor. Various studies (Bauer, 2018; Bodlo, 2016; Calvert, 2011; Kujinga, 2013; Loof, 2013; Pidduck, 2017) have considered the South African GAAR. However, most studies focussed on a theoretical analysis of the GAAR to identify its weaknesses and made recommendations to improve identified weaknesses (Pidduck, 2017:5). Calvert (2011) conducted a study where the current South African GAAR was tested against its predecessor by applying the GAAR to the facts of previous South African cases. This was done by applying the current GAAR to the facts of selected court cases that had hitherto been heard under the previous GAAR. In doing so, Calvert (2011) attempted to determine whether the current GAAR, on the balance of probabilities, would have been more or less effective in combatting avoidance schemes entered into by taxpayers. In 2017, Pidduck (2017) applied a similar methodological approach in a more international context. Pidduck (2017) applied the current GAAR to some cases from some of its international counterparts (Australia and Canada) who have also adopted GAAR in their legislation. In performing this research, Pidduck (2017) compared the jurisdictions to that of South Africa, in order to determine whether aspects of improvement could be identified for the current South African GAAR so as to address its weaknesses. Furthermore, Pidduck (2017) applied the current South African GAAR to the facts of cases from Australia and Canada in order to identify aspects needing improvement. This process aided in making recommendations to improve the efficacy of the South African GAAR, based on the lessons learnt from those two jurisdictions.

Both studies, namely (Calvert (2011); Pidduck (2017)) conclude that weaknesses still exist in the current South African GAAR and indicate that further research is required where the GAAR is compared to other jurisdictions in order to identify additional areas of improvement. As only two jurisdictions have been used to apply this methodological approach to date, this study aims to fill a gap by using New Zealand as a comparative jurisdiction. This study therefore analyses the current South African GAAR in comparison to New Zealand and applies the South African GAAR to the facts of a case in New Zealand using a 'structured pre-emptive analysis' approach (Pidduck, 2019:206). New Zealand has been selected as the comparative country as no previous study has followed this approach to analyse and compare the GAARs of South Africa and New Zealand. This study therefore aids in identifying further areas of improvement to the current South African GAAR.

1.3. RESEARCH QUESTIONS

The key research questions applicable to this study are expressed as:

- What are the primary weaknesses of the current South African GAAR that may render it an ineffective deterrent to impermissible avoidance arrangements?
- What amendments should be implemented, using lessons from New Zealand, to address the identified weaknesses and improve the efficacy of the current South African GAAR?

1.4. RESEARCH OBJECTIVES

The goal of this research is to analyse the current South African GAAR and compare it to the New Zealand GAAR from a case law perspective, so as to identify weaknesses that exist in the South African GAAR. Recommendations will then be made to improve the efficacy of the South African GAAR.

The objectives formulated to answer the research questions and achieve the goal of this study are as follows:

1. to identify weaknesses in the current South African GAAR;
2. to compare the theoretical principles of the South African GAAR to the principles of the GAAR of New Zealand;
3. to apply the South African GAAR to the facts of a case from New Zealand where the GAAR of New Zealand was successful, in order to determine whether the South African GAAR would have been successful and thereby identify elements of the South African GAAR that need improvement; and
4. to suggest improvements to the South African GAAR to address identified weaknesses.

1.5. RESEARCH METHODOLOGY

This study follows a 'structured pre-emptive analysis' methodological approach (Pidduck, 2019). This methodology is an interpretive, qualitative method. Hennink *et al.* (2020:16) describe qualitative research as research that is undertaken to gain a deeper understanding of a particular topic, as opposed to quantitative research methods, which aim to quantify a sample of data and extrapolate the findings to a larger population. The aim of this study is to gain a deeper understanding of the South African GAAR. The data used in qualitative research are words, rather than numbers (Hennink *et al.*, 2020:16). Data is obtained from journal articles, legislation, case law and other relevant documentation.

The 'structured pre-emptive analysis' follows a doctrinal, reform-oriented approach (Pidduck, 2019:208). Doctrinal research is the analysis of laws i.e. cases, statutes and rules (Coetsee & Buys, 2018:75; Hutchinson & Duncan, 2012:84). As part of the doctrinal research of the 'structured pre-emptive analysis' the researcher must extensively examine a broad range of literature to ensure that the interpretation and application of the relevant doctrines is understood (Pidduck, 2019:210). The objective of this study is to analyse the South African GAAR that is included within the legislation of South Africa. Legislation, court law, journals and books are examined, in order to obtain an understanding of the application of the GAAR. The interpretation of some of the words and terms contained in the GAAR is explained from relevant court rulings that set precedent. Doctrinal research is thus appropriate to achieve the goal of this study.

Reform-oriented research critically evaluates existing laws to identify potential existing weaknesses and recommend suggestions for improvement (Coetsee & Buys, 2018:76; Hutchinson & Duncan, 2012:101). This approach is consistent with the objectives of this study, as theoretical weaknesses in the current GAAR are identified from the doctrinal critical analysis. In proposing reform, the GAAR is applied to the facts of the selected New Zealand case, so as to identify weaknesses in its practical application. Reform proposals are then made to address the identified weaknesses using lessons learned from the New Zealand GAAR and case.

1.5.1. VALIDITY AND RELIABILITY

When qualitative research is adopted, the researcher is required to address measures to ensure validity and reliability of the findings (Mangioni & McKerchar, 2013:176). The following measures were taken to improve the validity and reliability of this study:

- Subjectivity in interpreting legislation is a cause for concern, as it could affect the results when the South African GAAR is applied to the facts of the case (Pidduck, 2017:55). It is thus crucial that an appropriate method be used to interpret the legislation (Pidduck, 2019:211). A doctrinal analysis was followed to analyse and interpret the South African GAAR. Authoritative texts were used that include legislation, case law, journal articles and books. When interpreting a word or phrase in the legislation, the literal and ordinary grammatical meaning of the word or phrase is used, provided it is not specifically defined in the Act (de Koker & Williams, 2020:par 25.1A). Should the literal and ordinary interpretation result in absurdities, the courts (like the approach taken in this study) may ignore such interpretation and follow the purposive approach which gives effect to the true intention of the legislation (de Koker & Williams, 2020:par 25.1B). This approach was consistently applied in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) 4 SA 593 SCA. Notwithstanding, should the interpretation of the legislation result in ambiguity, the *contra fiscum* rule will apply, that is, the legislation will be interpreted in such a way that favours the taxpayer (de Koker & Williams, 2020:par 25.1A). Therefore, to reduce bias when interpreting the legislation, where a word or phrase has come before the courts (in a similar context and with a similar intention), the interpretation by the courts is used (Pidduck, 2017:53). On the other hand, if a word or phrase has not been interpreted by the courts, the ordinary grammatical meaning of the word is used together with the intention of the legislation (Pidduck, 2017:53). This method is used in developing the framework that is used in this study to apply the GAAR to the facts of the case in Chapter 4 (Pidduck, 2017:53).

- To improve validity and replicability of the research, care should be given to the interpretation and development of a structured framework that ensures the consistent application of the GAAR (Pidduck, 2019:211). Pidduck (2017) developed a framework that is used in this study to apply the South African GAAR to the facts of the case. This increases the external validity of findings as it allows a consistent application of the GAAR to the facts of the case, enabling other researchers to come to the same findings (Pidduck, 2019:214).
- Subjectivity and bias could be present in the selection of a case from New Zealand. Such subjectivity could negatively impact on the results of applying the South African GAAR to this case (Pidduck, 2019:213). The method employed to ensure an objective selection of a case is explained in Paragraph 1.5.3 below.
- A final concern is that the facts of the case selected could not be derived from a valid and reliable source (Pidduck, 2017:56). To address this, the facts and judgments of the case were obtained from the Judicial Decisions Online database (New Zealand Government, 2020) which is an independent and reliable source.

1.5.2. SELECTION OF JURISDICTION FOR COMPARISON

New Zealand was chosen as a comparative country as both South Africa and New Zealand were colonies of Britain, and consequently the laws of both countries are based on English law and are thus comparable (Berkowitz *et al.*, 2003:Table 4; Cox, 1998:11). Furthermore, the wording of the New Zealand GAAR is simple and the application thereof is considered effective and efficient (Tretola, 2018:26). Lessons could thus be learnt from the New Zealand GAAR to improve the efficacy of the South African GAAR. Similarly, New Zealand was also referred to in the South African Revenue Service (SARS) Discussion Paper released in 2005, which discussed weaknesses in the previous GAAR and proposals for amendment.

1.5.3. SELECTION OF COURT CASE

One of the objectives of this study is to apply the South African GAAR to the facts of a selected case from New Zealand. It was identified that subjectivity could be present in the selection of this case, which could have an impact on the findings of this study. To address this risk, objective criteria were used to select the case.

The case was selected from the Judicial Decisions Online Database (New Zealand Government, 2020). This database includes judgments and decisions from New Zealand courts (New Zealand Government, 2020). Cases that applied the GAAR were identified from the database to obtain cases relevant to this study. Only those cases that considered the avoidance of income tax and not any other tax were considered, and preference was given to the most recent court case to obtain the latest interpretation of the New Zealand GAAR. The most recent case that presented before the High Court of New Zealand was selected, namely, *Cullen Group LTD v Commissioner of Inland Revenue* (2019) NZHC 404. The High Court of New Zealand has both statutory jurisdiction and common law jurisdiction and all its decisions are binding on courts and tribunals below it (Courts of New Zealand, 2020).

1.6. SCOPE LIMITATION

Yin (2009:38) notes that it is difficult to generalise the outcome of a study that uses a case. Nevertheless, “the case investigated is a microcosm of some larger system or of a whole society: that what is found there is some larger symptomatic of what is going on more generally" (Gomm *et al.*, 2000:99). It is thus not the aim of this study to apply its findings to all possible cases that could come before the courts, but it may provide an understanding of the application and interpretation of the South African GAAR more generally. Additionally, in order to maintain a manageable scope, this study is limited to only one court case from New Zealand. The findings must be considered in the context of this case so as to establish whether such findings may be applied to different cases (Pidduck, 2017:54). Moreover, the jurisdictions analysed are limited to only those of South Africa and New Zealand and are limited to the GAAR as it applies to income tax. Therefore, the findings are not intended to be applied in any other jurisdiction or for other taxes.

1.7. STRUCTURE OF THE MINI-DISSERTATION

This study is structured as follows:

Chapter 1: Introduction

The aim of this chapter is to give the background of the research topic as well as the rationale and main objectives of the study. A description of research methodology followed is also included. A description of the method used to select the jurisdiction and case to which the South African GAAR is applied also forms part of this chapter.

Chapter 2: South African GAAR

This chapter includes a doctrinal analysis of the South African GAAR, as well as the identification of its weaknesses from literature. Based on this analysis, a framework is adopted to apply the South African GAAR to the facts of the case in Chapter 4.

Chapter 3: New Zealand GAAR

This chapter provides a doctrinal analysis of the New Zealand GAAR. The theoretical similarities and differences between the South African GAAR and the New Zealand GAAR are identified, analysed and explained. Recommendations to improve the South African GAAR are made using lessons from New Zealand.

Chapter 4: Application of South African GAAR to selected New Zealand case

This chapter provides a summary of the facts of the New Zealand case selected. The South African GAAR is then applied to the facts of the case. A conclusion is made on the similarities and differences between the South African GAAR and the New Zealand GAAR when applied to the facts of the case. Further areas of improvement are identified from this practical application and comparison.

Chapter 5: Conclusion

This chapter provides the conclusion of the study. Future areas of research are also discussed.

CHAPTER 2:

THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE

2.1. INTRODUCTION

The aim of this study is to critically analyse the South African GAAR, to identify its weaknesses and to make suggestions for improvement using lessons from New Zealand. Chapter 1 provided a brief introduction to the South African GAAR, and the rationale, research objectives and research methodology adopted in this study. This chapter serves to identify the weaknesses of the South African GAAR by analysing and interpreting its individual components. In order to achieve this objective, this chapter analyses the South African GAAR using existing literature and relevant court cases.

2.2. THE PREVIOUS GAAR

As stated in Chapter 1, the South African GAAR was introduced in South African legislation for the first time in 1941 and was found in Section 90 of the Income Tax Act 31 of 1941. This GAAR was later amended in 1996 and was found in Section 103(1) of the Income Tax Act. This GAAR was further amended and is now contained in Sections 80A to 80L of the Income Tax Act and came into effect on 2 November 2006. The current GAAR contains some terms that were contained in its predecessors, therefore it is necessary to discuss these terms as they were applied and interpreted for the purposes of the preceding GAAR, so as to gain an understanding of their application and interpretation for the purposes of the current GAAR. The previous GAAR was found in Section 103(1) of the Income Tax Act and read as follows:

> "Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property) –
>
> a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or reducing the amount thereof; and
>
> b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out –
>
> i) was entered into or carried out –

aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and

bb) in the case of a transaction, operation or scheme being a transaction, operation or scheme not falling within the provisions of item (aa) by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or

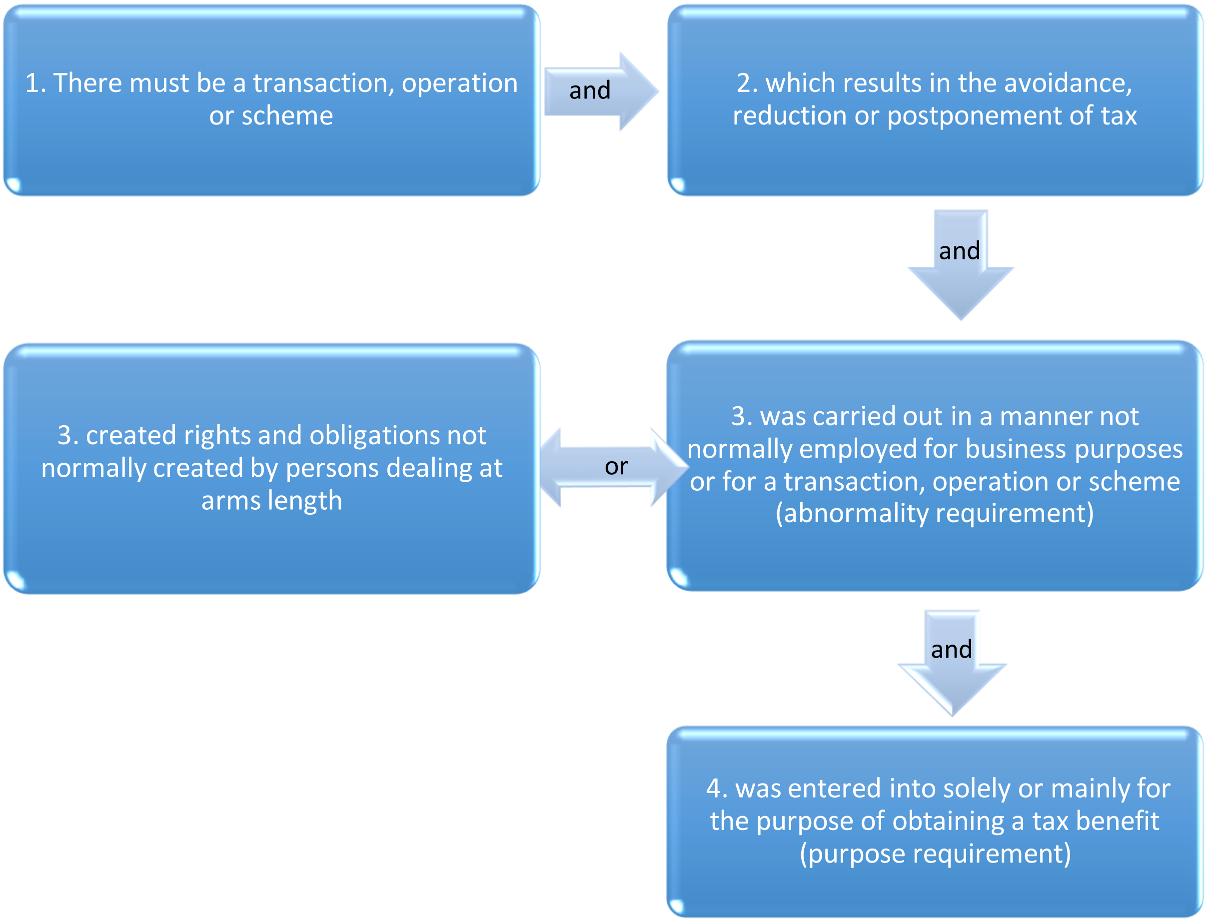
ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and

c) was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit;

the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such a manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction."

From the above section, the four elements that were required to be met before the previous GAAR was applicable are illustrated in Figure 1 below.

Figure 1: The previous South African GAAR



Source: Own design

The Commissioner had to be satisfied that all four requirements of Section 103(1) of the Income Tax Act were met before the previous GAAR was applicable, in which case the Commissioner was entitled to determine the tax liability of the taxpayer as if the transaction had not been entered into (de Koker & Williams, 2020:par 19.4). The abnormality requirement was an objective test while the purpose requirement was a subjective test (de Koker & Williams, 2020:par 19.4), and both had to be met before Section 103(1) of the Income Tax Act was applicable. This had the implication that if the objective abnormality test was met, but the sole or main purpose of the transaction was not to avoid tax, then the GAAR was not applicable. Conversely, if the sole or main purpose was to avoid tax, but the transaction did not meet the abnormality requirement, then the GAAR was again not applicable. In terms of Section 103(4) of the Income Tax Act it was presumed that the transaction was entered into with the sole or main purpose of obtaining a tax benefit, and the burden of proof was on the taxpayer to prove otherwise (de

Koker & Williams, 2020:par 19.4). The previous GAAR however contained various weaknesses that may be summarised as follows:

- **Not an effective deterrent:** The GAAR was inconsistent, and at times, an ineffective deterrent to abusive avoidance schemes and other impermissible tax avoidance (SARS, 2005:41). Taxpayers were also marketing aggressive and increasingly sophisticated schemes to avoid taxes, and processes to detect these schemes were time consuming and expensive (SARS, 2005:42). Additionally, the lengthy battles had a negative impact on the relationship between SARS and the taxpayers (SARS, 2005:42)
- **"Abnormality" Requirement:** Two problems were identified with this requirement. Firstly, there was no clear distinction between transactions employed for normal *bona fide* business purposes and impermissible tax avoidance and schemes were often created by 'hijacking' techniques that were developed for *bona fide* business purposes (SARS, 2005:42). Secondly, because these schemes used methods established for *bona fide* business purposes, it was easy for taxpayers to 'manufacture' plausible sounding business purposes and thus escape the abnormality requirement (SARS, 2005:43). SARS (2005:39-40) noted that the greatest criticisms of the abnormality requirement were derived from the reports issued by the Margo and Katz Commissions. The reports stated that the abnormality requirement presents difficulties, as the wide usage of a tax avoidance transaction could render it commercially acceptable and as a result it would become normal (Katz, 1996:par 11.2.2; Margo, 1987:par 27.28).
- **"Purpose" Requirement:** This requirement had the implication that if a transaction had more than one purpose, the dominant purpose had to be the one of obtaining a tax benefit before falling foul of the provisions of the GAAR (SARS, 2005:43). This was very difficult for the Commissioner to prove, as taxpayers could argue a commercial reason as the main purpose with relative ease (SARS, 2005:43). Similarly, the subjectivity in proving this purpose presented complexities in applying this requirement, as the courts had to consider the intention of the taxpayer when they entered into the transaction (*Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A); *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC).
- **Procedural and Administrative Issues:** There were uncertainties regarding the application of the GAAR to steps within a larger transaction, as well as uncertainties

regarding the use of the GAAR in the alternative if another section in the Income Tax Act was in dispute (SARS, 2005:44).

- **Abnormality and purpose requirement together:** The weaknesses of the purpose and abnormality requirement were compounded by the fact that both had to be met before the GAAR was applicable (Pidduck, 2017:72). This puts taxpayers in a powerful position as they could escape either of these requirements with relative ease (Pidduck, 2017:73).

The weaknesses of the previous GAAR discussed above led to the 2006 amendments and the current GAAR was formulated. The current South African GAAR is discussed below.

2.3. THE CURRENT SOUTH AFRICAN GAAR

The current GAAR as encapsulated in Section 80A of the Income Tax Act reads as follows:

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

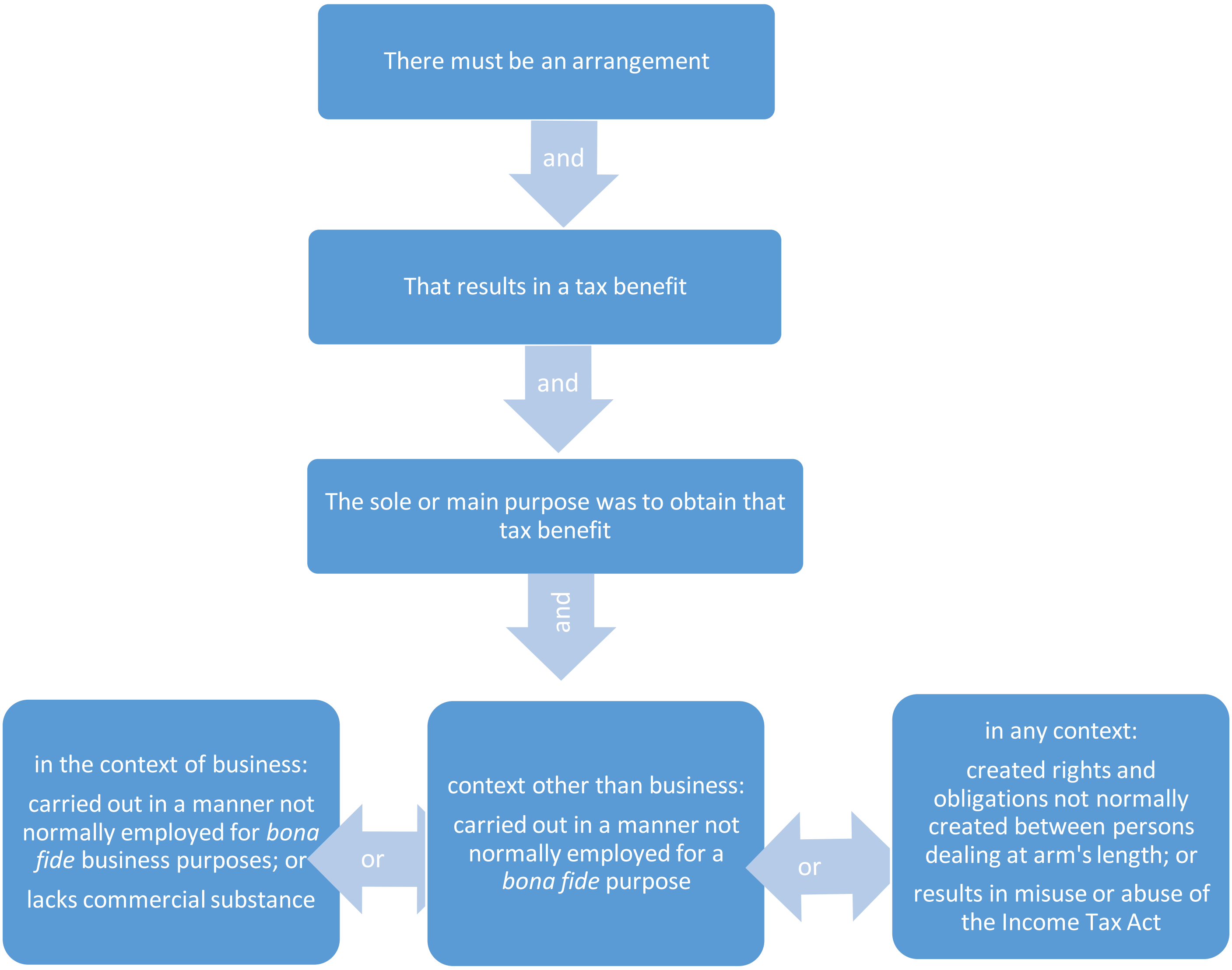
The elements that are required before the current GAAR may be applied can be summarised as follows:

- There must be arrangement;
- The arrangement must result in a tax benefit;
- The sole or main purpose of the arrangement must be to obtain the tax benefit;

- One of the following tainted elements must be present: the arrangement is carried out in a manner that is not considered normal *bona fide* business purposes; the transaction lacks commercial substance; the transaction creates rights and obligations that are not at arm's length; or the transaction results in a direct or indirect abuse or misuse of the provisions of the Income Tax Act.

The requirements of Section 80A of the Income Tax Act are illustrated in Figure 2 below.

Figure 2: The current South African GAAR



Source: Own design

Each of these individual requirements are discussed below, in order to understand how they may be interpreted and applied by the judiciary.

2.3.1. ARRANGEMENT

The first element required for the GAAR is the presence of an arrangement. The definition of the term 'arrangement' is located in Section 80L of the Income Tax Act and states that an arrangement is:

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

The words 'transaction', 'operation', 'scheme', 'agreement' or 'understanding' are not defined in the Income Tax Act and could lead to difficulties in the application of these words. The words 'transaction, operation or scheme' were notably present in the previous GAAR and were interpreted widely by the courts (Pidduck, 2017:78). Since no case has been presented before the courts to apply the current GAAR, the interpretation and precedent by the courts for these terms continues to be applicable (de Koker & Williams, 2020:par 19.4 ; Langenhoven, 2016:31). In *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A), Beyers JA held (at 300) that the word scheme is "a wide term and…it is sufficiently wide to cover a series of transactions...". The wide interpretation of the term provides that the GAAR may be applied to any form of arrangement (Loof, 2013:9; Pidduck, 2017:78). This is evidenced by the fact that there has been no case where the GAAR failed as a result of no arrangement being present (Broomberg, 2007b:1; Pidduck, 2017:78).

Section 80H of the Income Tax Act reads "the Commissioner may apply the provisions of this Part to steps or parts of an arrangement". This section addresses the weakness of the previous GAAR regarding uncertainty over the application of the GAAR to a step within a larger transaction. This is intended to prevent taxpayers from inserting an impermissible tax avoidance step as part of a larger commercial transaction (Kujinga, 2013:106).

For purposes of establishing whether an 'arrangement' exists using the framework in Paragraph 2.5, the word will be interpreted widely as indicated in the case law above.

2.3.2. TAX BENEFIT

Section 80A of the Income Tax Act requires that an impermissible tax arrangement must result in a tax benefit. A 'tax benefit' is defined in Section 1 of the Income Tax Act and includes "any avoidance, postponement or reduction of any liability for tax". The word 'any' in front of the word liability is an indication that liability will be interpreted as widely as possible (De Vos, 2016:47). The word 'tax' is defined in Section 80L of the Income Tax Act and includes "any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner". In addition to income tax, examples of other taxes administered by SARS include value-added tax, estate duty and transfer duty (de Koker & Williams, 2020:par 19.37). The term 'tax benefit' has been interpreted by the courts as follows:

- In *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 it was established that a tax benefit arises when a taxpayer avoids an anticipated tax liability by entering into a transaction that reduces his income from what it will be in future.
- The term 'avoid an anticipated liability' was interpreted in *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) to mean a situation where the taxpayer has stepped out of the way of, escaped or prevented an anticipated liability.
- The courts have established a 'but for' test to determine the existence of a tax benefit (Pidduck, 2017:81). This test asks the question: would the taxpayer have suffered a tax liability but for this transaction? Court cases that confirmed this principle include *Income Tax Case No.* 1625 (1996) 59 SATC 383, *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) and *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113.

The onus of proving that a tax benefit was obtained is on the Commissioner (de Koker & Williams, 2020:par 19.37). To prove that a tax benefit has arisen, the Commissioner must determine what alternative arrangement the taxpayer could have entered into so as to achieve the same commercial outcome and the resulting tax consequences, which is then compared to the actual transaction entered into (de Koker & Williams, 2020:par 19.37; Loof, 2013:14).

In light of the above, the questions that are asked to determine whether a tax benefit exists are whether the taxpayer stepped out of the way of an anticipated liability and whether the taxpayer would have suffered tax but for the transaction. These two tests are included in the framework (Paragraph 2.5).

2.3.3. SOLE OR MAIN PURPOSE

Once it has been established that an arrangement exists and that it resulted in a tax benefit, it must be determined whether the sole or main purpose of the arrangement was to obtain the tax benefit. The words 'sole or main purpose' were contained in the previous GAAR, therefore the precedent interpretations provided by the courts from cases where the previous GAAR was tested are applicable (de Koker & Williams, 2020:par 19.4). Notwithstanding, the purpose requirement for purposes of the current GAAR is presumed to be mainly or solely to obtain a tax benefit, unless the taxpayer can provide evidence that proves otherwise, in accordance with Section 80G of the Income Tax Act. Section 80G of the Income Tax Act reads as follows:

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

Section 80A of the Income Tax Act refers to the purpose of the transaction itself and not the purpose of the taxpayer, therefore it appears as though the current GAAR applies only an objective test in determining the purpose of the arrangement (de Koker & Williams, 2020:par 19.38; Kujinga, 2013:110; Loof, 2013:16). However, Section 80G of the Income Tax Act states that relevant facts and circumstances will be reasonably considered, which implies that a subjective test may be applicable (Kujinga, 2013:110). As the current GAAR has not yet been applied in court, it is unclear whether courts will apply a purely objective test, therefore both the subjective and objective tests will be discussed (Pidduck, 2017:83). Application of this requirement in terms of its predecessor in *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 revealed that the sole or main purpose of a transaction is a subjective test and is determined by considering the intention of the taxpayer. This principle was applied subjectively in *Ovenstone v Secretary for Inland Revenue* (1980) 42

SATC 55 (A), *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A) and *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A). In terms of an objective test, the effect of the transaction is considered rather than the intention of the taxpayer (de Koker & Williams, 2020:par 19.38; Meyerowitz, 2008:par 19.12). As it is unclear whether the objective test (effect of the transaction) or the subjective test (stated intention of the taxpayer) will be applied by courts, both tests have been included in the framework (Paragraph 2.5) (Pidduck, 2017:83). The stated intention of the taxpayer will be measured against the objective effect of the transaction (Pidduck, 2017:83).

However, it was established in *CIR v Conhage (Formerly Tycon)* (1999) (4) SA 1149 (SCA) that if a taxpayer can achieve a commercial result in different ways, the taxpayer may enter into the transaction that attracts less tax. In this case, the sole or main purpose of the transaction will not necessarily be to avoid tax (Pidduck, 2017:84). Consequently, when applying the framework, the sole or main purpose will not be assumed to be one of tax avoidance if the transaction has a commercial reason (Pidduck, 2017:84).

2.3.4. TAINTED ELEMENTS

After establishing that there is an arrangement, a tax benefit and that the sole or main purpose was to obtain the tax benefit, the last step in determining whether the GAAR is applicable is to determine whether one of the tainted elements is present. Section 80A of the Income Tax Act divides impermissible avoidance arrangements into three parts, namely an arrangement that was entered into in the context of business, in a context other than business and in any context. The tainted elements considered in a business context are abnormality or lack of commercial substance, while in a context other than business only abnormality is included. Arrangements in any context include the tainted elements of misuse and abuse of the Income Tax Act or arrangements not at arm's length.

The onus of proving that one of the tainted elements is present is on the Commissioner (de Koker & Williams, 2020:par 19.40). The Commissioner may use the indicators and provisions contained in Sections 80C to 80E to discharge this onus (Kujinga, 2013:111). Some of the words and terms used in the current GAAR in relation to these tainted elements are the same as those used in its predecessor, therefore the precedent and interpretations may still apply to the current GAAR (Calvert, 2011:28; de Koker & Williams, 2020:par 19.4). There are four tainted elements as summarised in Paragraph 2.3 above that are discussed individually below.

2.3.4.1. ABNORMALITY

The first of the four tainted elements considered is the abnormality element. The wording used in the abnormality requirement in the current GAAR is similar to that which was used in the previous GAAR. This has the implication that the weaknesses identified in the abnormality requirement in the previous GAAR (as discussed in Paragraph 2.2 above) may still be present in the current GAAR. Firstly, the word ‘normal’ (like its predecessor) is still not defined in the Income Tax Act and creates uncertainty in applying the GAAR (Kujinga, 2013:111; Langenhoven, 2016:38). However, the omission of the words “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” as contained in the previous GAAR indicates that this test will now be applied objectively in the current GAAR (Pidduck, 2017:85; SARS, 2005:56).

The abnormality test is a test of the method in which the arrangement was carried out and determining whether that method is normally employed for *bona fide* business purposes as opposed to testing whether the arrangement itself was for a commercial or business purpose (Kujinga, 2013:111). This was confirmed in *Income Tax Case No. 1712* (2000) 63 SATC 499 where it was held that the business purpose test is determined by considering how a businessman would have structured the transaction for a *bona fide* business purpose, without taking into account any tax benefit (Louw, 2007:27).

For purposes of testing the abnormality element in the framework in Paragraph 2.5, the arrangement is compared to a normal business transaction entered into for a consideration other than a tax benefit (Pidduck, 2017:86).

2.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element is lack of commercial substance. The element of lack of commercial substance applies to arrangements carried out in the context of business and is found in Section 80C(1) of the Income Tax Act. Section 80C(2) of the Income Tax Act provides a list of indicators for lack of commercial substance, where further guidance on these indicators may be found in Sections 80D and 80E of the Income Tax Act. Section 80C of the Income Tax Act reads as follows:

> "(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
>
> (b) the inclusion or presence of—
>
> (i) round trip financing as described in section 80D; or
>
> (ii) an accommodating or tax indifferent party as described in section 80E; or
>
> (iii) elements that have the effect of offsetting or cancelling each other."

Section 80C(1) states that an arrangement will lack commercial substance if it results in a significant tax benefit but does not have a significant effect on the business risks or net cash flows of the party obtaining the tax benefit. This element is similar to the economic substance doctrine adopted in the United States which means if there is no significant effect on business risk or net cash flows resulting from the arrangement, then there is no commercial reason for the taxpayer to have entered into the transaction other than to obtain a tax benefit (Broomberg, 2007a:9; Kujinga, 2013:212-213; Pidduck, 2017:87). This approach is consistent with the intention of the provision and is included in the framework in Paragraph 2.5 (Pidduck, 2017:87). The word 'significant' is not defined in the Income Tax Act, therefore it is uncertain how courts will determine what constitutes a 'significant tax benefit' and 'significant effect' for purposes of applying of the lack of commercial substance element (de Koker & Williams, 2020:par 19.39). Section 80C(2) of the Income Tax Act provides a non-exhaustive list of indicators that may assist the Commissioner in determining whether an arrangement lacks commercial substance. Each of these indicators is discussed below.

Substance over form

The first indicator for a lack of commercial substance as contained in Section 80C(2)(a) of the Income Tax Act is the principle of the legal substance of the transaction being significantly different from its legal form. Once more, the word ‘significant’ features in this paragraph and brings with it the uncertainty discussed above. The principle of substance over form has been developed in common law (de Koker & Williams, 2020:par 19.13). In terms of common law, where the true intention of the parties has been disguised, effect will be given to the substance of the transaction rather than its form (*Relier v Commissioner for Inland Revenue* (1997) 60 SATC 1 (A); *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A)).

From a GAAR perspective, it was stated in *Commissioner for South African Revenue Service v NWK Limited* (2010) ZASCA 168 (SCA) that effect should be given to what the transaction really is and not in what form it purports to be. According to Pidduck (2017:91), the test for the element of substance over form is to determine whether the risks and rewards created by the arrangement are those than can be expected from such arrangement. This test is included in the framework in Paragraph 2.5.

Round trip financing

The second indicator of an arrangement that lacks commercial substance is one that includes round trip financing. Round trip financing is defined in Section 80D of the Income Tax Act, as follows:

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

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

(b) the transfer of 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.

(3) For the purposes of this section, the term "funds" includes any cash, cash equivalents or any right or obligation to receive or pay the same."

Round trip financing was not contained in the previous GAAR and there are no previous court interpretations regarding this term. de Koker and Williams (2020:par 19.39) describe round trip financing as a situation where:

> "money is made to appear to pass between the participants by way of a commercial consideration, but the funds simply travel in a circle and, when all is said and done, everyone is financially in the same position as they were in the beginning, save for the creation of a tax benefit and the payment of fees to the intermediaries."

An arrangement is said to have round trip financing present if all three requirements of Section 80D(1) are met. The first of these requirements is that funds are transferred between or among the parties. The words 'between' and 'among' are not defined in the Income Tax Act, but it can be concluded that they mean funds are transferred between parties "through some type of reciprocal action" (Pidduck, 2017:93). This interpretation is consistent with the intention of the legislature and will be included in the framework in Paragraph 2.5 (Pidduck, 2017:93). The second requirement is that the transfer of funds results in a tax benefit. This means that the transfer of funds must result in a tax benefit, regardless of the fact that a tax benefit of the arrangement as a whole has been established (Pidduck, 2017:93). The final requirement is that the transfer of funds must significantly reduce, offset or eliminate any business risk incurred by the taxpayer. The word 'significant' is found in this requirement, and as previously discussed, the word has not been defined in the Income Tax Act and thus causes uncertainty in its application.

Tax indifferent party

The third indicator of an arrangement lacking commercial substance is an arrangement that includes accommodating or tax indifferent parties, which are defined in Section 80E(1) of the Income Tax Act 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."

It is clear from the above section that the term 'tax-indifferent' party is widely defined (Pidduck, 2017:96). Section 80E(2) of the Income Tax Act provides that a person may be an accommodating or tax indifferent party whether or not they are a connected person to any party of the arrangement. In an abusive transaction, the tax indifferent party typically receives a fee (often in the form of an above-market return on investment) to absorb income or otherwise sell their tax-advantaged status to the other parties in the transaction (SARS, 2005:21). In applying the tax-indifferent party element in the framework in Paragraph 2.5, it will be considered whether there is a party who sold its tax-advantaged position to others, regardless of their relationship with the other parties in the arrangement (Pidduck, 2017:96). Section 80E(3) provides exclusions where the provisions for tax accommodating or tax-indifferent parties will not apply as follows:

"(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) of the Income Tax Act if it were located outside the Republic and the party in question were a controlled foreign company."

Section 80F of the Income Tax Act states that the Commissioner can either treat connected persons or accommodating and tax-indifferent parties as one and the same person or disregard any tax accommodating and tax indifferent parties.

Elements offsetting or cancelling each other

The fourth and final indicator of an arrangement that lacks commercial substance is one which includes elements that offset or cancel each other, as found in Section 80C(2)(b)(iii) of the Income Tax Act. This part of the section was introduced because it has no fiscal consequences for the taxpayer, and may trigger the application of the GAAR if the sole or main purpose of the arrangement was to obtain a tax benefit (de Koker & Williams, 2020:par 19.39). This provision often involves the use of complex financial derivatives to create a gain in one part and a loss that cancels such gain in another part (de Koker & Williams, 2020:par 19.39). Taxpayers are permitted to genuinely claim expenditure or losses to obtain tax relief, but the GAAR may be applicable where there was an intention by the taxpayer to create losses and gains that neutralise each other to obtain a tax benefit (Kujinga, 2013:115).

The interpretation of this section may be based on the ordinary grammatical meaning of the words as they are not considered ambiguous (Pidduck, 2017:97). Consequently, when applying the framework in Paragraph 2.5, this requirement is tested by considering whether there are any elements that offset or cancel each other with no resulting change other than obtaining a tax benefit (Pidduck, 2017:97).

2.3.4.3. RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the creation of rights or obligations that would not be normally created between persons dealing at arm's length. The term 'arm's length' has not been defined in the Income Tax Act, however these words were present in the previous GAAR so it is possible to use precedent to interpret them (Pidduck, 2017:98). In *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A), Trollip JA (at 16) interpreted it to mean that "it connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself". Consequently, 'arm's length' means what unconnected persons would have done in the same situation.

The words "…the nature of the transaction, operation or scheme in question" from the previous GAAR have been omitted in the current GAAR, and this is an indication that this is now an objective test (de Koker & Williams, 2020:par 19.39). As the term 'normal' is not defined in the Income Tax Act it creates uncertainty and makes it difficult for the Commissioner to succeed in proving this element, as the parties are likely to be able to argue that the transaction is 'normal' and common in the business world (Bauer, 2018:51).

The application of the element of arm's length in the framework (Paragraph 2.5) will consider what unconnected persons would have done in the same situation (Pidduck, 2017:99).

2.3.4.4. MISUSE OR ABUSE

The fourth tainted element is the misuse or abuse of the provisions of the Income Tax Act. This element was not present in the previous GAAR and there have been no court cases that have interpreted it in South Africa to date. The words 'misuse' or 'abuse' are also not defined in the Income Tax Act. All these factors increase the uncertainty when it comes to the application of this provision. This provision was introduced to bring South African legislation in line with the modern international tax approach that considers the intention of the legislation when interpreting its wording (Van Schalkwyk & Geldenhuys, 2009:169).

The misuse or abuse element was inspired by the Canadian GAAR which states that the GAAR would not be applicable if the transaction does not result in the misuse or abuse of the Canadian Federal Income Tax Act RSC 1985 c 1 (5^{th} Supp) (Kujinga, 2012:48). It may thus be helpful to consider the interpretation of the provision in the Canadian laws, as this could provide an indication of how it might be approached by South African courts (Van Schalkwyk & Geldenhuys, 2009:173). The Supreme Court of Canada determined in *Canada Trustco Mortgage Co. v Canada* (2005) SSC 54 that misuse or abuse exists where the transaction defeats or frustrates the purpose of the relevant provision in the legislation. This interpretation is consistent with the intention of the inclusion of this provision in the Income Tax Act (Van Schalkwyk & Geldenhuys, 2009:172).

To establish whether there has been misuse or abuse, the framework in Paragraph 2.5. will consider the intention of the legislator to determine whether the taxpayer has defeated or frustrated this purpose (Pidduck, 2017:101).

2.4. WEAKNESSES IDENTIFIED IN THE CURRENT GAAR

The additional primary weaknesses identified in the South African GAAR from the analysis performed are summarised as follows:

- Although Section 80H of the Income Tax Act provides for the application of the GAAR to a step within a transaction, it has been argued that an arrangement loses its commercial substance when a part thereof is considered in isolation, without considering the context of the wider transaction (Pidduck, 2017:159). There is currently no guidance in this regard clarifying the application of this provision (Pidduck, 2017:322).
- There is uncertainty regarding how the element of misuse or abuse should be applied (Pidduck, 2017:322). Further guidance is required to ensure that the provision is correctly and consistently applied.
- There is a lack of guidance on how the indicators of the lack of commercial substance element should be interpreted and applied (Pidduck, 2017:322).

- The sole or main purpose requirement and tainted elements requirement (previously abnormality requirement) are still two separate tests that must both be met before the GAAR is applicable. This is a weakness that was identified in the previous GAAR, as it puts the taxpayer in a powerful position to escape either of these requirements with relative ease (Pidduck, 2017:73). This weakness could be addressed by consolidating the two tests into one inquiry, where the abnormality of the scheme informs the purpose (Pidduck, 2017:159).
- It is not clear whether the sole or main purpose requirement will be a subjective or objective inquiry. To reduce uncertainty when testing this requirement, guidance should be provided which ensures that weaknesses from the previous GAAR are not carried forward to the current GAAR (Pidduck, 2020:32).
- The GAAR contains many terms that are not defined in the Income Tax Act, which could result in the same weaknesses as were identified in the previous GAAR (Pidduck, 2020:32).
- There is no guidance on how the impact of special relationships between the parties to a transaction affects the application of the GAAR (Pidduck, 2017:322).

2.5. FRAMEWORK

Pidduck (2017:102-104) developed a framework that may be used to apply the current South African GAAR to the facts of selected court cases. The framework will be used in this study to apply the South African GAAR to the facts of the selected case in Chapter 4. The framework is included in Table 2 below.

Table 2: Framework for South African GAAR

Table 2: Framework for applying Sections 80A – 80L to the facts of previous case law
1 - Is there an arrangement? • Is there a transaction, operation or scheme that has been entered into by the taxpayer? This will be widely interpreted in terms of Section 80L of the Act and the *Meyerowitz* case.

2 - Does the transaction, operation, scheme result in a tax benefit?

The definition of tax in Section 80L is applied to the cases.

- Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability? (Smith case; King case)
- Would a tax liability have existed but for this transaction (but for test)? (*Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case and *Louw* case).

3 - Is the sole or main purpose to obtain such tax benefit?

In applying the sole or main purpose requirement of the GAAR to the facts and circumstances of the case studies, the following factors are considered:

- Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (*Gallagher* case)
- Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (Meyerowitz, 2008:19-12; De Koker and Williams, 2015:par19.38) (*Ovenstone* case).

In applying the objective and subjective tests the following principles may be considered:

- If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (*Conhage* case) or
- If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which did not attract tax or attracts less tax, this does not indicate that obtaining a tax benefit was not the sole or main purpose of the arrangement (*Conhage* case) or
- If the dominant subjective purpose of the avoidance arrangement was to achieve some non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (i.e. determine what was in the mind of the taxpayer who entered into the transaction).

4 - Tainted elements requirement

- One of the following with regard to business transactions:

Entered into in a manner not normal for bona fide business purposes?

- Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration? (Louw, 2007:27).

Does the transaction lack commercial substance?

In order to determine whether an arrangement lacks commercial substance the following are applied:

- *General lack of commercial substance test*: Does the arrangement have no significant effect upon the net cash flows or business risks? (Section 80C definition and Broomberg, 2007:9)
- *Substance over form test*: Is the true intention of the parties reflected in the agreement (i.e. are the risks and rewards resulting from the transaction those that can be expected from such a transaction?) Has the taxpayer remained insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary? Or is the purpose of a transaction only to achieve an object that achieves the avoidance of tax? (Then it will be regarded as simulated and the mere fact that parties do perform in terms of the contract does not show that it is not simulated.)
- *Round trip financing test:* Has funding been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit?
- *Tax-indifferent party test*: Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties?
- *Offsetting or cancelling test:* Are there elements within the transaction that have the effect of offsetting or cancelling each other? (This indicates that such parts of the transaction were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance.)

- The following with regard to transactions not in the context of business:

- ***Has the arrangement been entered into in a manner not normal for bona fide purposes?***

  - Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration? (Louw, 2007:27).

- One of the following with regard to transactions in any context:

- ***Has the arrangement created rights and obligations that are not at arm's length?***

The non-arm's length rights or obligations element will not be met if one of the following factors is present:

- Each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves? (*Hicklin* case)
- Would unconnected persons have done the same in this situation? (*Hicklin* case).

Is there misuse or abuse of provisions of the Act?

- Does the arrangement frustrate, exploit or manipulate the purpose of any of the provisions of the Act, or does the arrangement use provisions of the Act to achieve a result not intended by the legislator?

Source: (Pidduck, 2017:102-104)

2.6. CONCLUSION

This chapter provided an analysis of the South African GAAR using case law and existing literature. Both the previous South African GAAR as well as the current GAAR were discussed. The analysis of these two GAARs revealed that some elements were carried from the previous GAAR to the current GAAR. These elements include the purpose requirement, the abnormality requirement and the fact that the purpose and tainted element requirements are still two separate tests. This has the implication that the primary weaknesses identified with regards to such elements in the previous GAAR have been carried over into the current GAAR. Additional weaknesses were also identified from the elements of the current GAAR that were not found in the previous GAAR. All these identified weaknesses may render the current South African GAAR an ineffective deterrent to impermissible avoidance arrangements.

The elements of the South African GAAR are compared to those of its New Zealand counterpart in the next chapter. This comparison is done in order to identify the strengths of the New Zealand GAAR that could be incorporated into the South African GAAR so as to address the identified weaknesses.

CHAPTER 3:
THE NEW ZEALAND GAAR

3.1. INTRODUCTION

The main aim of this study is to critically analyse the South African GAAR in order to identify its weaknesses and thereafter recommend suggestions for improvement using lessons from New Zealand. The previous chapter analysed the South African GAAR and identified the theoretical weaknesses that exist in the South African GAAR. This chapter is an analysis of the New Zealand GAAR. The components of the New Zealand GAAR are described and critically analysed and compared to those of the South African GAAR. This chapter concludes with recommendations to improve the efficacy of the South African GAAR. This chapter thus achieves the second and fourth objectives of this study as stated in Paragraph 1.4. in Chapter 1.

3.2. THE NEW ZEALAND GAAR

New Zealand introduced a statutory GAAR for the first time in its legislation in 1878, even before income tax was introduced (Elliffe, 2014:148). This GAAR was contained in Section 62 of the Land Tax Act 1878 and later in Section 29 of the New Zealand Property Assessment Act 1879 (Elliffe, 2014:148; Tretola, 2018:3). With the introduction of income tax, the GAAR was brought over into Section 40 of the Land and Income Assessment Act 1891 and subsequently Section 108 of the Land and Income Tax Act 1954 (Elliffe, 2014:148; Tretola, 2018:3). In 1976, Section 108 of the Land and Income Tax Act was amended and became Section 99 of Income Tax Act 1976 (Prebble & McIntosh, 2015:1029). It was then carried forward in substantively the same form to Sections BG 1 and GB 1 of the Income Tax Act 1994 and finally to the current Income Tax Act 2007 (Prebble & McIntosh, 2015:1029). The current New Zealand GAAR is found in Sections BG 1, GA 1 and YA 1 of the Income Tax Act No. 97 of 2007 (Income Tax Act 2007). This study only considers the application of the current New Zealand GAAR.

The current New Zealand GAAR is applicable to tax avoidance arrangements. The term ‘tax avoidance arrangement’ is defined in Section YA 1 of the Income Tax Act 2007 as follows:

> “Tax avoidance arrangement means an arrangement, whether entered into by the person affected by the arrangement or any other person, that directly or indirectly:
>
> (a) has tax avoidance as its purpose or effect; or
>
> (b) has tax avoidance as its purpose or effect or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.”

Littlewood (2013:525) notes that the New Zealand GAAR will thus be applicable to arrangements that:

(a) have tax avoidance as their sole purpose or effect; or

(b) have several purposes or effects, one of which is to avoid tax. Provided that the tax avoidance purpose is not merely incidental.

Cassidy (2012a:8) highlights that unlike the South African GAAR, there are no indicators in the New Zealand GAAR as to what might constitute tax avoidance (namely, the tainted elements in South Africa). These indicators have been left to courts to determine (Cassidy, 2012a:8). It was stated in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2008) NZSC 115, (2009) 2 NZLR 289 that this discretion granted to the courts was intended by Parliament. The reason for this is that no matter how well-drafted a provision is, the ingenuity of taxpayers cannot be predicted (Keating & Keating, 2011:13).

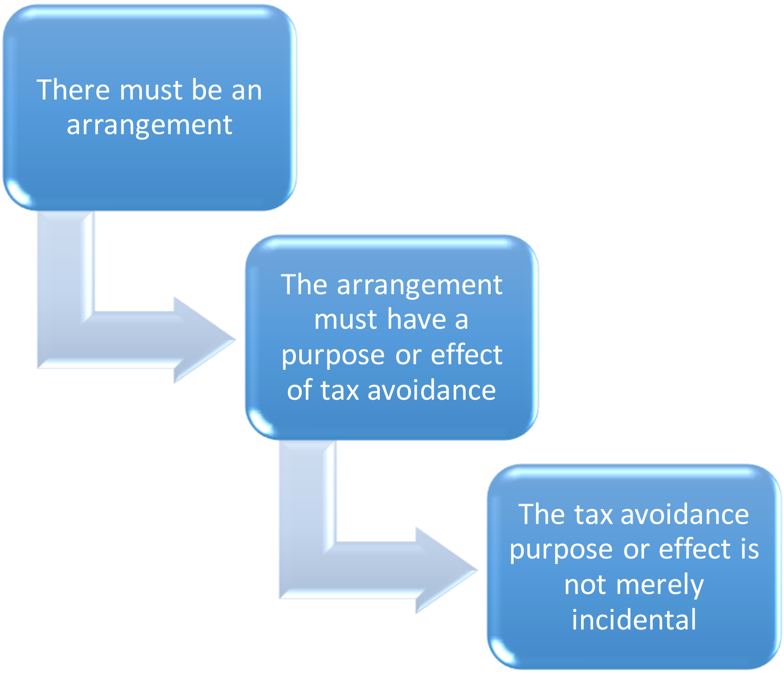
If it has been found that a tax avoidance arrangement exists, the arrangement is considered invalid as contained in Section BG 1(1) of the Income Tax Act 2007 when stating that:

> “a tax avoidance arrangement is void against the Commissioner for income tax purposes”.

However, simply voiding the tax avoidance arrangement is not sufficient to nullify the tax benefit it has produced (Littlewood, 2011:268). Consequently, Section BG 1(2) was added stating that the Commissioner may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement (Littlewood, 2011:268). This is supplemented by Section GA 1(2) of the Income Tax Act 2007, providing that the “Commissioner may adjust the taxable income of a person affected by the arrangement in a way that the Commissioner thinks appropriate, in order to counteract a tax advantage obtained by the person from or under the arrangement”. In doing this, the Commissioner may either treat the taxpayer as if they had never entered into the transaction at all, or tax them according to a hypothetical arrangement that the taxpayer could have carried out (Datt & Keating, 2018:467).

The New Zealand Supreme Court was established in 2004, taking over from the Privy Council as the highest court in New Zealand (Littlewood, 2011:263). The New Zealand Supreme Court considered the application of the GAAR for the first time in 2008 in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2008) NZSC 115, (2009) 2 NZLR 289 (*Ben Nevis* case), which is currently the leading authority in the interpretation of the New Zealand GAAR (Elliffe & Cameron, 2010:440; Littlewood, 2013:530; Tretola, 2018:4). The principles established in this case are used to analyse the elements of the New Zealand GAAR. As established in Section YA 1 of the Income Tax Act 2007, the elements that must be present before the New Zealand GAAR are presented in Figure 3 below.

Figure 3: The New Zealand GAAR



Source: Own design

Each of these elements is discussed below.

3.2.1. ARRANGEMENT

The first requirement for the New Zealand GAAR to be applicable is that there must be an arrangement. The word ‘arrangement’ is defined in Section YA 1 of the Income Tax Act 2007 as:

> “any contract, agreement, plan or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect”.

The term includes varying degrees of enforceability and formality allowing for a wide interpretation, as is the case with the South African GAAR (Inland Revenue, 2013:25; Littlewood, 2013:525). This broad interpretation is supported in *Commissioner of Inland Revenue v BNZ Investments Ltd* (2002) 1 NZLR 450 (CA) where Richardson P (at 46) cited judgment from *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, where it was stated that an arrangement is wide enough to include all actions that parties may undertake in order to achieve a specific purpose or effect.

The definition of arrangement includes all steps and transactions by which it is carried out, and is similar to the South African GAAR. In this regard, the New Zealand Supreme Court stated in the *Ben Nevis* case (at 105) that tax avoidance may be found in individual steps or in a combination of steps. It went on to say that although steps in a transaction may be acceptable on their own, their combination may give rise to a tax avoidance arrangement. In South Africa, Section 80H of the Income Tax Act specifically states that the GAAR may be applied to steps within an arrangement.

3.2.2. TAX AVOIDANCE

For the New Zealand GAAR to be applicable, the tax avoidance arrangement must have tax avoidance as its purpose or effect (Tretola, 2018:5). The definition of ‘tax avoidance’ is found in Section YA 1 of the Income Tax Act 2007 as including any arrangement that:

> “(a) directly or indirectly alters the incidence of any income tax;
> (b) directly or indirectly relieves a person from a liability to pay income tax or from the potential or prospective liability to pay any future income tax;

(c) directly or indirectly avoids, postpones or reduces any liability to income tax or any potential or prospective liability to future income tax."

The definition of tax avoidance refers to the alteration, avoidance, postponement or reduction of income tax. Therefore, the New Zealand GAAR as contained in Sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007 is only applicable to income tax and not any other type of tax, unlike in South Africa where the GAAR is applicable to any type of tax as discussed in Paragraph 2.3.2. in Chapter 2. Paragraph (c) of the definition of tax avoidance is strikingly similar to the definition of 'tax benefit' of the South African GAAR that is defined in Section 1 of the Income Tax Act as including any "avoidance, postponement or reduction of any liability for tax". Similarly, the reference to the potential or prospective liability may also be compared to that of the South African GAAR where the courts in *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 and *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) ruled that a tax benefit arises where the taxpayer avoids an anticipated liability for tax.

Nevertheless, the definition of tax avoidance in the Income Tax Act 2007 is problematic for several reasons. Firstly, tax avoidance refers to any arrangement that alters the incidence of tax. In *Elmiger v Commissioner of Inland Revenue* (1966) NZLR 683 (SC) it was held that almost all transactions alter the potential incidence of tax. This would mean that the GAAR may be applicable to virtually all transactions and cannot have been the intention of the legislature (Littlewood, 2011:269).

Secondly, Paragraph (b) of the definition of tax avoidance in the Income Tax Act 2007 describes a tax avoidance arrangement as one that relieves a person from a liability to pay tax. It is submitted that there is no arrangement to which this provision would apply, as once a liability to pay tax has accrued to the taxpayer, there is nothing that the taxpayer can do about it (Littlewood, 2011:269). Paragraph (b) of the definition of tax avoidance in the Income Tax Act 2007 goes on to say that a tax avoidance arrangement is one that relieves a person from paying any future income tax. This results in virtually all transactions meeting this requirement, as all transactions affect potential liabilities to tax (Littlewood, 2011:269). The New Zealand tax legislation provides that the taxpayer may use the legislation within its scope and purpose to structure their affairs in a manner that results in the best tax position (Elliffe & Cameron, 2010). Applying the GAAR to all arrangements that taxpayers choose from the available alternatives within the scope and purpose of the legislation would be absurd (Littlewood, 2011:270).

In light of the problems identified above with regard to the literal meaning of tax avoidance, it has been left to courts to determine and restrict the broad meaning of tax avoidance (Tretola, 2018:4). To do this, the Parliament contemplation test was developed in the *Ben Nevis* case (Elliffe, 2014:154). This test involves a two-step approach to determine whether there has been tax avoidance:

- The first step involves an inquiry into the application of the specific provisions of the legislation used by the taxpayer and establishing whether the taxpayer used the provision within its intended scope (Ebersohn, 2012:265; Elliffe & Cameron, 2010:449).
- The second step involves considering the use of the provisions in light of the arrangement as a whole, and determining whether it was used within the contemplation and purpose of Parliament when it enacted the provision (Ebersohn, 2012:265; Elliffe & Cameron, 2010:449).

Consequently, in order to determine whether an arrangement is a tax avoidance arrangement, it must be considered whether such arrangement is carried out in a commercially or economically acceptable way and is consistent with the intended purpose of the legislation it applies (Tretola, 2018:6). This approach may be compared to the 'misuse or abuse' element in the South African GAAR that intends to apply the GAAR to arrangements that utilise provisions of the legislation to achieve results not intended by the legislator.

In *Ben Nevis,* the Supreme Court of New Zealand provided guidance on when an arrangement will be considered not to be within Parliament contemplation (Cassidy, 2012a:24). The Court noted (at 108) that:

> "a classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for the specific provisions to be used in that manner."

It thus becomes critical to determine whether an arrangement is artificial or contrived to determine whether it has fallen foul of the GAAR (Cassidy, 2012a:24). Equally important, the Supreme Court of New Zealand also considers the commercial reality and economic substance of the arrangement (Cassidy, 2012a:24). In *Ben Nevis* (at 108), a non-exhaustive list of factors were considered to inform the Court about the commercial reality of the arrangement, as well as whether the arrangement can be considered artificial or contrived (Cassidy, 2012a:28; Tretola, 2018:6). These factors are:

- the manner in which the arrangement was carried out;
- the role of all relevant parties and any relationship they may have with the taxpayer;
- the economic and commercial effect of documents and transactions;
- the duration of the arrangement;
- the nature and extent of the financial consequences for the taxpayer.

The importance of each of these factors will depend on the facts of each arrangement, but of particular significance will be the combination of the factors (Cassidy, 2012a:28). The degree of artificiality is crucial in drawing the line between tax avoidance and tax mitigation (Tretola, 2018:7). Tretola (2018:6) suggests that arrangements that are likely to be 'artificial' or 'contrived' are those:

- with no commercial purpose;
- where money flows in a circle;
- that have offsetting effects;
- where the investor has no risk; or
- between tax asymmetrical parties at prices or terms that are not at arm's length.

The factors considered by the New Zealand courts to determine whether an arrangement is 'artificial' or 'contrived' may be considered to serve a similar purpose to that of the indicators of lack of commercial substance in the South African GAAR. The consideration of the economic and commercial effect of documents and transactions in the New Zealand courts is similar to the indicator that compares the substance of the arrangement to its legal form. Similarly, an analysis of the examples of arrangements likely to be artificial in New Zealand listed above reveal the following:

- arrangements where money flows in a circle are similar to the round trip financing indicator.
- arrangements that have offsetting effects are comparable to the indicator that considers the presence of offsetting or cancelling elements within the transaction.

- the arrangements between tax asymmetrical parties may be compared to the indicator of accommodating or tax-indifferent parties.
- the arrangements that are not at arm's length are similar to the tainted element that considers whether the rights or obligations created in the arrangement are not those that would arise between parties dealing at arm's length.
- reference is made to arrangements where the investor has no risk, whereas in South Africa, Section 80C(1) of the Income Tax Act considers whether there was a significant effect on the business risks of the party obtaining a tax benefit. The word 'significant' is not defined in the Income Tax Act which results in uncertainties in its application, which may limit the efficacy of the South African GAAR. This uncertainty could be eliminated by following the approach of New Zealand and applying the GAAR to arrangements that result in no effect on the risks of the parties involved. This may arguably improve the effectiveness of the South African GAAR.

In addition to the similarities mentioned above, the New Zealand courts also consider the manner in which the arrangement was carried out, the duration of the arrangement and the nature and extent of financial consequences for the taxpayer. It is submitted that South Africa should consider amending the South African GAAR to cater for these additional factors to improve the effectiveness of its GAAR. For example, considering the nature and extent of the financial consequences for the taxpayer, in addition to or as opposed to determining whether the arrangement resulted in a 'significant effect' on the net cash flows of the parties, as a general test of lack of commercial substance. This would reduce the uncertainty that currently exists as to what constitutes a 'significant' effect.

In conclusion, it is clear that similarities exist between the elements of 'tax benefit' in the South African GAAR and 'tax avoidance' in the New Zealand GAAR. However, the New Zealand GAAR considers additional factors that could be incorporated into the South African GAAR in order to improve its efficacy.

3.2.3. PURPOSE OR EFFECT

An arrangement must have tax avoidance as its purpose or effect before the New Zealand GAAR is applicable (Littlewood, 2013:525). The words 'purpose' and 'effect' have not been defined in the Income Tax Act 2007 therefore legal precedent aids in the interpretation of these words. In *Ashton v Commissioner of Inland Revenue* (1975) 2 NZLR 717 (PC) the Privy Council (at 721) stated that:

> "The word 'purpose' means not motive but the effect which it is sought to achieve — the end in view. The word 'effect' means the end accomplished or achieved. The whole set of words denotes concerted action to an end — the end of avoiding tax".

This interpretation of the words 'purpose or effect' are adopted by the Supreme Court of New Zealand (Inland Revenue, 2013:40). In *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 it was stated that the test for purpose is an objective test as opposed to a subjective test. Consequently, the purpose is determined by considering the characteristics and outcome of the arrangement and not the motive or intention of the taxpayer (Elliffe & Cameron, 2010:444; Littlewood, 2011:279).

It was highlighted in the previous chapter that the 'sole or main purpose' in the South African GAAR is also intended to be an objective test (de Koker & Williams, 2020:par 19.38). However, it appears as though a subjective test may still be applicable in the South African GAAR (Kujinga, 2013:110). It should be considered whether a purely objective test, as is the case with the New Zealand GAAR, could improve the efficacy of the South African GAAR.

3.2.4. MERELY INCIDENTAL

For arrangements that have multiple purposes or effects, the GAAR may only be applied if the purpose of tax avoidance is not merely incidental to the other purposes (Littlewood, 2013:526; Ruddell, 2013:500). The Supreme Court of New Zealand was brief in its consideration of the merely incidental test in the *Ben Nevis* case, stating (at 114) that:

> "It will rarely be the case that the use of a specific provision in a manner which is outside parliamentary contemplation could result in the tax avoidance purpose or effect of the arrangement being merely incidental".

For that reason, if a provision of the Income Tax Act 2007 has been used in a manner other than its intended purpose, the tax avoidance purpose will most likely not be merely incidental (Inland Revenue, 2013:92). Accordingly, the introduction of artificiality or contrivance into an arrangement to obtain a tax benefit is an indication that the tax avoidance purpose is not merely incidental (Ebersohn, 2012:264). Previous judicial precedence was established in *Challenge Corporation Ltd v Commissioner of Inland Revenue* (1986) 2 NZLR 513 where Woodhouse P discussed the meaning of 'merely incidental' as:

> "…I am satisfied as well that the issue as to whether or not a tax saving purpose or effect is "merely incidental" to another purpose is something to be decided not subjectively in terms of motive but objectively by reference to the arrangement itself.
>
> As a matter of construction I think the phrase "merely incidental purpose or effect" in the context of s 99 points to something which is necessarily linked and without contrivance to some other purpose or effect so that it can be regarded as a natural concomitant."

The Commissioner will still give regard to this interpretation when applying the merely incidental test (Inland Revenue, 2013:89). The Commissioner will consider all non-tax avoidance purposes and determine whether the tax avoidance purpose or effect flows from, or is concomitantly linked, without contrivance, to those other commercial purposes or effects (Elliffe, 2014:156).

In light of the analysis above it is evident that the GAAR will be applicable in both South Africa and New Zealand if the sole purpose of the arrangement is to obtain a tax benefit or to avoid tax. A difference occurs for arrangements with multiple purposes where the GAAR in South Africa will apply if the main purpose is to obtain a tax benefit, while the GAAR in New Zealand will apply if the tax avoidance purpose is not merely incidental to the other purposes. The effectiveness of the South African GAAR may arguably be improved by following the approach of New Zealand for arrangements with multiple purposes where the GAAR applies if the tax avoidance purpose is not merely incidental.

3.3. COMPARISON OF NEW ZEALAND AND SOUTH AFRICAN GAAR

The South African GAAR is now be compared to the New Zealand GAAR and any theoretical differences and similarities between the two GAARs are identified. This comparison is done in order to identify the strengths of the New Zealand GAAR that could be incorporated into the South African GAAR so as to address its weaknesses. This comparison meets the second and fourth objectives as stated in Paragraph 1.4 in Chapter 1.

3.3.1. HIGH LEVEL COMPARATIVE

The requirements of the GAARs of South Africa and New Zealand show the following similarities:

- Both GAARs require an arrangement. The definition of the word 'arrangement' in both jurisdictions is very similar and is widely interpreted.
- Both GAARs require either a tax benefit or tax avoidance to be present. A tax benefit in the South African GAAR is defined as any avoidance, postponement or reduction of any liability of tax. The definition of tax avoidance in the New Zealand GAAR includes the words "avoids, postpones or reduces any liability to income tax". The statutory definitions of these two terms are thus similar.
- Each GAAR requires the purpose of the arrangement to have been to obtain the tax benefit or tax avoidance. In the South African GAAR the purpose to obtain a tax benefit must have been the main or sole purpose, whereas in the New Zealand GAAR the tax avoidance purpose must not be merely incidental.

The most notable difference between the two GAARs is the fact that the South African GAAR has a four-step approach, whereas the New Zealand GAAR follows a three-step approach. It is submitted that the additional requirement in the South African GAAR may make it more onerous to apply and therefore might unduly favour the taxpayer when compared to its New Zealand counterpart. This fourth requirement in the South African GAAR requires the presence of one or more of the tainted elements. Although the tainted elements are not expressly stated in the New Zealand legislation, the New Zealand courts consider similar factors to the South African courts in this regard as discussed in its tax avoidance requirement (refer to Paragraph 3.2.2).

It is also worth noting that the New Zealand GAAR is considerably shorter and simpler than that of South Africa. The New Zealand GAAR as contained in Sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007 has less than 600 words, while the South Africa GAAR contemplated in Sections 80A to 80L has over 1800 words. The lengthier South African GAAR is due to the fact that it is prescriptive and contains detailed provisions for its elements (Calvert & Dabner, 2012:54). This is in contrast to the New Zealand GAAR that is simple and leaves it up to the courts to determine what constitutes a tax avoidance arrangement (Cassidy, 2012a:31). It is submitted that the experiences of countries with a GAAR indicate that the approach adopted by New Zealand is better (Littlewood, 2019:3; Tretola, 2018:26). This approach allows flexibility, as the interpretation of tax avoidance may be periodically amended by the courts as new schemes come to light (Elliffe, 2014:163).

The use of short and simple wording in the New Zealand GAAR has proven to be effective and efficient (Tretola, 2018:26). Cases that applied the GAAR that were considered after the Supreme Court of New Zealand was established include *Commissioner of Inland Revenue v Penny* (2010) NZCA 231, (2010) 3 NZLR 360, *BNZ Investments Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 23,997 (HC), *Westpac Banking Corporation v Commissioner of Inland Revenue* (2009) 24 NZTC 23,834 (HC), *Education Administration Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,238 (HC), *DT United Kingdom Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,369 (HC), *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 (HC), *Krukziener v Commissioner of Inland Revenue* (2010) 24 NZTC 24,563 (HC) and *White v Commissioner of Inland Revenue* (2010) 24 NZTC 24,600 (HC). The GAAR was successfully applied in all but the *White* case (Littlewood, 2011:264). Given this success, it is submitted that South Africa could learn lessons from New Zealand and consider a less prescriptive and less detailed approach.

3.4. OVERVIEW OF THE DIFFERENCES

Although the two GAARs of South Africa and New Zealand contain similar elements, their application is different. The following differences are found:

3.4.1. TAX BENEFIT

The way in which the tax benefit is determined in South Africa is different from the way in which the tax avoidance is determined in New Zealand. In South Africa, there are two tests to determine whether a tax benefit exists. Firstly, a 'but for' test is done where the question that is asked is: 'would a tax liability have existed but for this arrangement?' Secondly, it is determined whether the taxpayer has effectively stepped out the way of an anticipated liability. In New Zealand, a two-step approach has been developed to test whether there is tax avoidance. The first step is determining whether the specific provision of the Income Tax Act 2007 used in the arrangement has been used in accordance within its intended scope. The second step involves considering the use of the provisions in light of the arrangement as a whole, and determining whether it was used within the contemplation and purpose of Parliament when it enacted the provision. Therefore in New Zealand, a purposive approach has been adopted where the GAAR can only be applicable if a provision of the Income Tax Act 2007 has not been used within its intended scope and purpose.

3.4.2. PURPOSE

In the South African GAAR, obtaining the tax benefit must have been the sole or main purpose. The word 'main' has been interpreted to mean predominant (SARS, 2005:43). In the New Zealand GAAR, there is no such requirement. It is sufficient if the purpose of obtaining the tax benefit is just one of the purposes amongst others, as long as it was more than merely incidental. It is submitted that the South African GAAR requires a stronger purpose to obtain a tax benefit, which may make it slightly more difficult for it to be applicable when compared to its New Zealand counterpart (Tretola, 2018:24).

In South Africa, Section 80G of the Income Tax Act states that it will be presumed that the sole or main purpose of the arrangement was to obtain a tax benefit, unless the taxpayer can prove otherwise. It is not certain whether the test for purpose will be a subjective or objective one (Pidduck, 2017:83). However, the legislation states that "relevant facts and circumstances will be reasonably considered" which implies that a subjective test could be applied (Kujinga, 2013:110). As a result, the taxpayer may potentially argue that there is a main commercial purpose for the arrangement, other than to obtain a tax benefit, and successfully escape the application of the GAAR (SARS, 2005:43-44). In the New Zealand GAAR the purpose is determined objectively by looking at the outcome of the arrangement itself, and even if the taxpayer were to try to argue subjectively that there was no purpose to obtain a tax benefit, they would likely not escape the GAAR because the wording of the New Zealand legislation states there must have been a "purpose or effect" which has the implication that the GAAR will still be applicable because the arrangement will have a tax benefit as its effect (Littlewood, 2011:279). From this it can be seen that a subjective test in the South African 'purpose requirement' may provide the taxpayer with an opportunity to ensure that the GAAR is not applicable by arguing that the commercial reason for the arrangement is the predominant purpose. By contrast, the New Zealand GAAR does not afford taxpayers the same opportunity as it is purely objective. If the effect is tax avoidance, the GAAR may be applicable regardless of the subjective purpose of the taxpayer. It can be concluded that a possible subjective inquiry of purpose in the South African GAAR may reduce its efficacy.

3.4.3. TAINTED ELEMENTS

The South African GAAR contains a defined list of indicators of tax avoidance arrangements, known as the tainted elements (Cassidy, 2012a:8). The New Zealand GAAR does not contain such legislative directive and has left it up to the courts to determine what constitutes tax avoidance (Cassidy, 2012a:8). It is argued that the discretion awarded to New Zealand courts is more desirable due to the fact that an express list of statutory rules provides tax avoiders with an opportunity to find new strategies to escape the GAAR, because no matter how well a provision is drafted, the ingenuity of taxpayers cannot be predicted (Ebersohn, 2012:269; Keating & Keating, 2011:13; Tretola, 2018:25). It is also submitted that this list increases the complexity when it comes to the interpretation and application of the GAAR (Ebersohn, 2012:271; Littlewood, 2011:293). On the other hand, the list of indicators of tax avoidance provides greater certainty and that is preferable in any tax system (Cassidy, 2012a:33; Elliffe, 2014:159). The South African revenue authorities could consider the trade-off between flexibility and certainty in achieving a GAAR that is more effective.

Should the South African legislature continue using the defined list of indicators, it may be more meaningful to add some of those that find relevance from its New Zealand counterpart:

- **the manner in which the arrangement was carried out:** this test includes the consideration of the features of the transaction and the particular way in which they have been structured or carried out (*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC)). It is relevant to establish whether the particular structure adopted differs from usual commercial practice, whether there are unusual features of the arrangement, whether the structure is hard to understand from a commercial point of view and whether the structure has the effect to which provisions of the legislation apply or do not apply (Inland Revenue, 2013:62). The analysis of these aspects may indicate the commercial reality of the transaction which aids in determining whether a tax avoidance arrangement exists. It is submitted that while this may be considered similar to that of “abnormality” as included in the South African GAAR, the manner in which it is included in the New Zealand GAAR may go some way towards combatting the weaknesses noted regarding abnormality as discussed in Chapter 2.
- **the duration of the arrangement:** this test considers the timing aspects of the transaction that include the duration of the arrangement, the time at which the arrangement is entered into and the intervals between particular events in the transaction (*Ben Nevis* case). These timing aspects may provide evidence that a transaction constitutes a tax avoidance arrangement. For example, in the *Ben Nevis* case the tax benefit was based on the timing difference between incurring expenditure and claiming licence premium allowances on one hand and, on the other hand, only making the economic payments in 50 years’ time. The court considered that as a consequence of the length of time that had to pass, it was possible that the taxpayer might never make the licence premium payment for which they would have already claimed allowances. It is submitted that such timing and duration considerations are not currently included for purposes of the South African GAAR and may in fact be useful when considering the innovative schemes employed by taxpayers, including those as demonstrated in the *Ben Nevis* case.
- **the nature and extent of the financial consequences for the taxpayer:** this test includes considering whether the taxpayer actually suffered financial consequences

or whether the nature of the transaction is what is claimed. For example, where an amount is actually paid for something other than what is claimed (Inland Revenue, 2013:66; *Glenharrow Holdings Ltd v CIR* (2008) NZSC 116, (2009) 2 NZLR 359). Currently, Section 80C(1) of the Income Tax Act determines whether the arrangement resulted in a significant effect on the net cash flows of the party obtaining a tax benefit. This causes uncertainty as the word 'significant' is not defined. It is submitted that the consideration of the nature and extent of the financial consequences for the taxpayer, as opposed to considering a 'significant' effect on the net cash flows, could reduce such uncertainty.

It is submitted that these additional factors would strengthen the South African GAAR, as they would allow the courts to consider more characteristics or factors and not restrict them to the defined tainted elements (Pidduck, 2017:156).

3.5. RECOMMENDATIONS TO IMPROVE THE SOUTH AFRICAN GAAR

Based on the analysis of the differences between the two GAARs, the following recommendations are suggested to improve the effectiveness of the South African GAAR:

Sole or main purpose

At this stage, the current South African GAAR has not been applied in court. It is thus not clear whether the purpose test will be an objective or subjective test. A more definitive purpose requirement should be provided, or alternatively guidelines over its objective application should be provided, so as to ensure that the test is an objective one as argued in Paragraph 3.4.2.

As the taxpayer is able to prove, with relative ease, that a commercial purpose is the main purpose of the arrangement for the South African GAAR, it is submitted that the approach taken by New Zealand should be followed where the obtaining of a tax benefit must have been just one of the purposes of the arrangement. However, care must be taken to ensure that the South African GAAR does not apply to transactions that are driven by a genuine purpose where obtaining a tax benefit is merely incidental, as is the case with the New Zealand GAAR. This will arguably improve the efficacy of the South African GAAR.

Purpose requirement and tainted elements

In the South African GAAR the purpose requirement and presence of one of the tainted elements are two separate tests that must be met before the GAAR is applicable. As discussed in the weaknesses of the previous GAAR, the taxpayer may disprove one of these two requirements with relative ease (Pidduck, 2017:73). Consideration should be given to consolidate the purpose requirement and tainted element requirement into one step where the presence of one of the tainted elements is used to determine the purpose (Pidduck, 2017:158). This approach would be similar to the approach used in New Zealand where the artificiality of the arrangement is considered and used to determine the purpose (Tretola, 2018:24). The following factors are amongst those considered by the New Zealand courts to determine artificiality, and might be considered for the purpose of amendment of the South African GAAR:

- **The manner in which the arrangement was carried out** (includes the consideration of the features of the transactions and the particular way in which they were structured or carried out).
- **The duration of the arrangement** (considers the timing aspects of the arrangement including the duration of the arrangement, the time at which the arrangement was entered into and the intervals between particular events in the arrangement).
- **The nature and extent of financial consequences for the taxpayer** (incorporation of this factor could reduce the uncertainty that currently exists in determining a significant effect on net cash flows).
- **Arrangements that have no risk for the investor** (reference to 'no risk' as opposed to 'significant effect on business risks' in testing general lack of commercial substance in terms of Section 80C(1) of the Income Tax Act could arguably reduce the uncertainty that currently exists in interpreting the word 'significant').

It is contended that the incorporation of these additional factors in the South African GAAR would strengthen it, as they will allow more characteristics of the arrangement to be considered, resulting in a more accurate conclusion on the sole or main purpose requirement.

Defining undefined terms

The South African GAAR contains numerous undefined terms, for example the words 'significant' and 'normal'. This leads to uncertainty in their interpretation and application which may limit the efficacy of the GAAR. Consideration should be given to defining undefined terms to increase certainty and ensure consistent application.

3.6. CONCLUSION

This chapter used doctrinal research to analyse and compare the GAARs of New Zealand and South Africa, with the aim of making recommendations to improve the South African GAAR. The comparison of the two GAARs revealed that the primary weakness of the South African GAAR is its sole or main purpose requirement. It is submitted that this weakness may be addressed in two ways. Firstly, guidance should be provided to ensure that the testing of the requirement is an objective enquiry. Secondly, the approach in New Zealand should be followed where obtaining a tax benefit must have been just one of the purposes of the arrangement, provided it is not merely incidental.

The next chapter uses reform-oriented research to apply the South African GAAR to the facts of the selected New Zealand case. The application of the South African GAAR on a practical basis aids in identifying elements of the South African GAAR that require amendment. Recommendations to improve the effectiveness of the South African GAAR made in the next chapter are compared to those suggested in this chapter. The convergence of the findings in these two chapters will provide a strong validation for the suggestions made in this study to improve the efficacy of the South African GAAR.

CHAPTER 4:
APPLICATION OF SOUTH AFRICAN GAAR TO SELECTED NEW ZEALAND CASE

4.1. INTRODUCTION

The previous chapter analysed the New Zealand GAAR and highlighted the similarities and differences between the South African GAAR and the New Zealand GAAR. This chapter uses the framework in Chapter 2 to apply the requirements of the South African GAAR to the facts of the selected tax avoidance case from New Zealand, in order to identify how the South African GAAR may be improved. This addresses the third objective stated in Paragraph 1.4 in Chapter 1. Therefore, in this chapter the South African GAAR is applied to the facts of *Cullen Group LTD v Commissioner of Inland Revenue* (2019) NZHC 404 (*Cullen* case). This allows a comparison between the application of the South African GAAR and the New Zealand GAAR, so as to draw a conclusion on the efficacy of the South African GAAR.

4.2. FACTS OF THE *CULLEN* CASE

Mr Eric Watson emigrated from New Zealand to the United Kingdom in May 2002. He sold all his personal assets and effects and disassociated himself from all clubs and associations in New Zealand, as he wanted to ensure that his tax residency changed from New Zealand to the United Kingdom. Mr Watson restructured his business affairs so that the shares he held in Cullen Investments Limited (CIL), based in New Zealand, were replaced by loans owed by the Cullen Group Limited (Cullen Group) to two conduit companies in the Cayman Islands, Modena Holdings Limited (Modena) and Mayfair Equity Limited (Mayfair).

The restructuring involved the following complex web of entities:

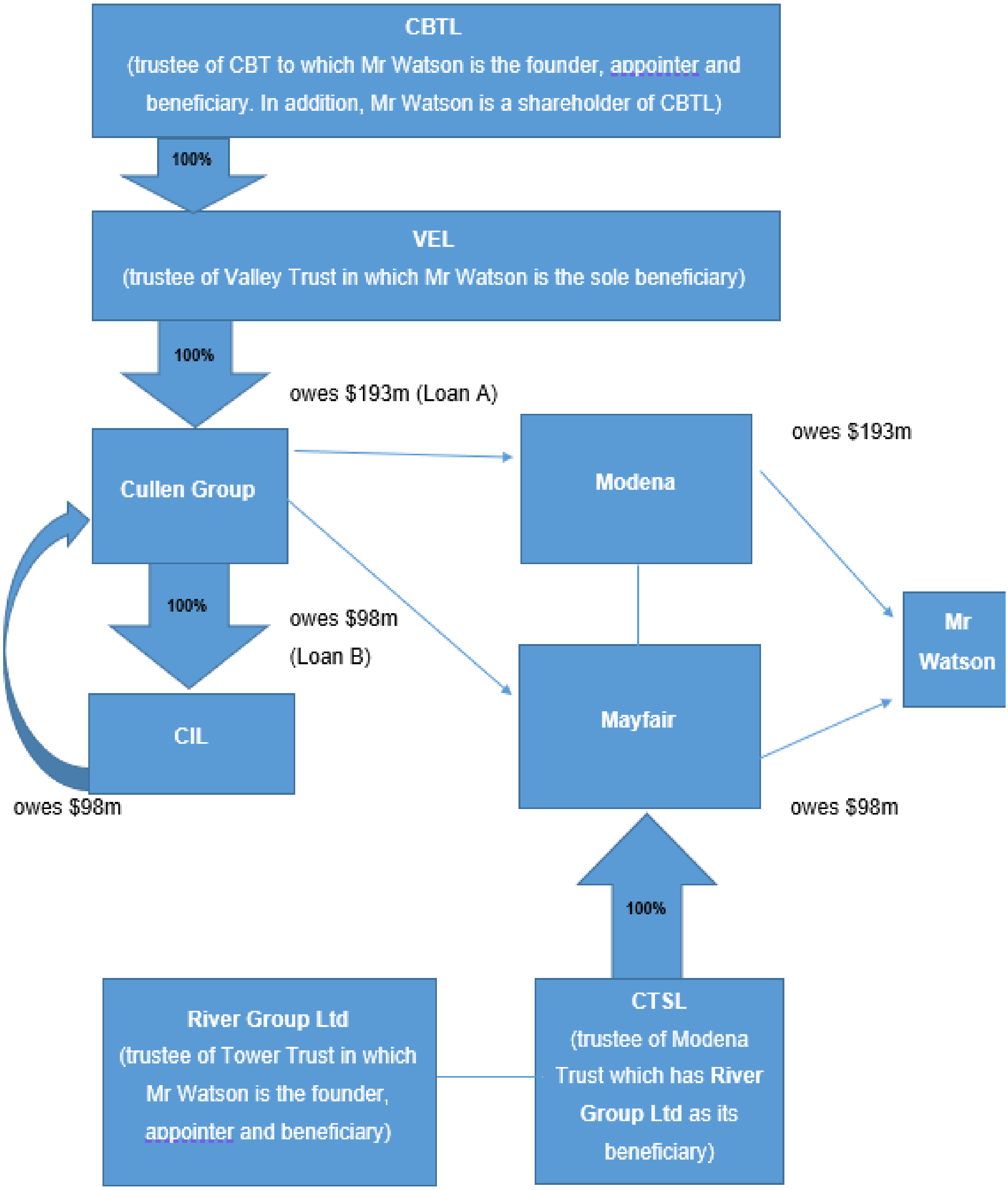
- **CIL** was incorporated in 1995 and its shares were held by Mr Watson. Between 1995 and 2002, Mr Watson lent $98 million to CIL as shareholder advances.
- **Modena and Mayfair** were incorporated in the Caymen Islands on 9 October 2002. The sole shareholder of both Modena and Mayfair was Chartered Trust Services Ltd (CTSL).

- **Modena Trust** was formed on 1 November 2002 by Mr Watson. The trustee of the Modena Trust was CTSL. Mr Watson could appoint and remove beneficiaries other than himself and his relatives. The River Group Limited was its only non-charity discretionary beneficiary.
- **The River Group Limited** was incorporated on 31 October 2002. Its shareholder was Elizabeth Equities Ltd, as trustee of the Tower Trust. Mr Watson created the Tower Trust and was the appointer and discretionary beneficiary of the trust.
- **The Cullen Group** was incorporated on 31 October 2002, with Mr Watson as one of the directors. The shares of the Cullen Group were held by Victoria Equities Ltd (VEL), that in turn was the corporate trustee of the Valley Trust.
- **The Valley Trust** was established by Mr Watson's mother on 31 October 2002 and Mr Watson was the sole final beneficiary of the trust. Mr Watson had the power to appoint and remove trustees and beneficiaries and to veto any amendments.
- **VEL** was incorporated on 25 June 2002 and was initially owned by one of the directors of the Cullen Group, Mr Les Archer. As of 10 October 2003, the sole shareholder of VEL was the Cullen Business Trust Limited (CBTL) as trustee of the Cullen Business Trust (CBT).
- **CBTL** was incorporated in July 2003. Mr Watson was a director and one of the shareholders of CBTL.
- One of the initial trustees of the **CBT** was Mr Watson. On 10 October 2003, CBTL took over as the trustee. Mr Watson was the founder, appointer and discretionary beneficiary of the trust.

Mr Watson restructured his interest in CIL on 13 November 2002. Mr Watson sold his interest in CIL to the Cullen Group for $193 million (Loan A). The purchase of the shares by the Cullen Group was funded by a vendor loan of $193 million from Mr Watson. In addition, Mr Watson lent an amount of $98 million (Loan B) to the Cullen Group, which the Cullen Group on-lent to CIL to enable CIL to repay Mr Watson's shareholder advances. Mr Watson then assigned his rights to Loan A and Loan B to Modena and Mayfair respectively. Mr Watson further provided back-to-back loans of $193 million to Modena and $98 million to Mayfair in order to fund their payment to him as consideration for the assignment in exchange for security over all assets owned by Modena and Mayfair.

The relationships between the different entities and loans provided are illustrated in Figure 4 as follows:

Figure 4: Relationships after restructuring of interest in CIL



Source: Own design

The result of the restructure was that CIL was owned by the Cullen Group, which owed money to Modena and Mayfair which owed money to Mr Watson. Instead of owning shares in CIL, Mr Watson owned loans of the same value in CIL's owner, the Cullen Group, through Modena and Mayfair. Mr Watson had in effect exchanged equity for debt but retained a high degree of control over the Cullen Group through the trust ownership structure involving VEL, the Valley Trust, the Cullen Business Trust and CBTL.

The terms of Loan A and Loan B (assigned to Modena and Mayfair) were as follows:

- Modena or Mayfair could only demand payment from the Cullen Group if Mr Watson demanded payment on the corresponding loan to Modena or Mayfair. The amount demanded by Modena or Mayfair could not exceed the amount demanded by Mr Watson.
- Interest was payable at 16% which reflects an arm's length rate.
- The Cullen Group could not assign its rights and obligations under the loans. Mr Watson, as lender, could assign his rights under the loans. Any other lender, including Modena and Mayfair, could only assign their rights to Mr Watson or with his agreement.
- The Cullen Group was required to register each loan as a registered security for Approved Issuer Levy (AIL) purposes.

The AIL regime was introduced to encourage investment in New Zealand by reducing the cost of finance for New Zealand residents borrowing from non-resident lenders who might otherwise gross up the interest levied so that the New Zealand resident carries the non-resident withholding tax burden (Smith, 1991:77). An approved issuer pays AIL at 2% on registered securities to parties that are not associated persons instead of the non-resident withholding tax of 15% (Elliffe *et al.*, 2008:3). On 14 November 2002, Cullen Group applied as an approved issuer and registered the loans to Modena and Mayfair as registered securities. This application was approved by the Commissioner on 22 November 2002 as Modena and Mayfair were legally not associated persons to the Cullen Group. During the period March 2003 to November 2008 the Cullen Group paid $397 million interest to Modena and Mayfair, on which it paid AIL at a rate of 2% instead of the non-resident withholding tax at 15%. The amount of AIL paid by the Cullen Group during this period amounted to $8 million, whereas non-resident withholding tax would have amounted to $59.5 million.

Outcome of the *Cullen* case in the New Zealand High Court

The High Court of New Zealand ruled in favour of the Commissioner as it decided that the restructuring transaction constituted a tax avoidance arrangement.

4.3. APPLICATION OF SOUTH AFRICAN GAAR TO THE *CULLEN* CASE

4.3.1. ARRANGEMENT

The first requirement for the South African GAAR is the presence of an arrangement. In the *Cullen* case, the Commissioner argued that there is an arrangement for the New Zealand GAAR purposes consisting of the following steps:

a) the Cullen Group being incorporated on 31 October 2002 with VEL as its shareholder;
b) the sale of Mr Watson's shares in CIL to the Cullen Group on 13 November 2002 and the loan provided by Mr Watson to the Cullen Group so as to enable it to purchase the shares;
c) the incorporation of VEL on 25 June 2002 as the corporate trustee of the Valley Trust and the settlement of the Valley Trust on 31 October 2002;
d) the incorporation of CBTL on 8 July 2003 as the trustee of the Cullen Business Trust (shareholder of VEL);
e) the rights to Loan A and Loan B being assigned to Modena and Mayfair;
f) the incorporation of Modena and Mayfair with its shares held by CTSL as trustee of the Modena Trust; and the incorporation of the River Group Limited on 31 October 2002;
g) the application of the Cullen Group as an approved issuer under the AIL regime and paying AIL and filing AIL returns;
h) the Cullen Group paying interest on Loan A and Loan B to Modena and Mayfair.

In applying the framework for the South African GAAR in Paragraph 2.5 to the facts of the *Cullen* case, the steps described above will be a transaction, operation or scheme as contemplated in the definition of 'arrangement' in Section 80H of the Income Tax Act. The transaction would therefore be an arrangement under the South African GAAR.

4.3.2. TAX BENEFIT

The second requirement for the South African GAAR to be applicable is that the arrangement must result in a tax benefit. In applying the framework for the South African GAAR, a tax benefit will exist if the Cullen Group effectively stepped out of the way of, escaped or prevented an anticipated liability, or if a tax liability would have existed but for this transaction.

The payment of interest by the Cullen Group on Loan A and Loan B would have resulted in a tax liability of 15%, being the non-resident withholding tax. It is submitted that the Cullen Group prevented this anticipated tax liability by registering for AIL and was thus exempted from paying the non-resident withholding tax. As a result, the Cullen Group was only liable for AIL at a significantly reduced rate of 2%. The Cullen Group would have been liable for non-resident withholding tax amounting to $56.5 million on the interest paid to Modena and Mayfair, but for this arrangement was only liable for AIL of $8 million.

Therefore, it may be concluded that a tax benefit exists when applying the framework of the South African GAAR to the facts of the *Cullen* case.

4.3.3. SOLE OR MAIN PURPOSE

The third requirement for the South African GAAR is that the sole or main purpose of the arrangement must have been to obtain the tax benefit. The framework of the South African GAAR uses two tests to establish the sole or main purpose. Firstly, the subjective test considers whether the stated intention of the taxpayer was to enter into the arrangement for the sole or main purpose of obtaining a tax benefit. Secondly, the objective test determines whether the actual effect of the arrangement supports the stated intention of the taxpayer.

In considering the stated intention of the taxpayer, Mr Cooper, for the Cullen Group, submitted in the *Cullen* case (at 75) that the "reason for the restructure of CIL's ownership was ensuring that Mr Watson no longer had a permanent place of abode in New Zealand and it was reasonable for him to take all reasonable steps to sever his direct, personal connection with CIL." Furthermore, he contended (at 75) that "aspects of the 13 November 2002 transaction reflected prudent United Kingdom remittance and tax planning."

The effect of the sale of the shares in CIL by Mr Watson to alter his tax residency status is mitigated by the high level of control he retained over the Cullen Group through the complex web of entities, making it questionable whether his stated intention was actually achieved by the arrangement. Nonetheless, if viewed in the most favourable light for Mr Watson, it may be accepted that the arrangement supported the stated intention to change tax residency as the direct, personal interest in CIL was severed. Furthermore, it is submitted that the objective effect of the arrangement may have been that a source of 'clean capital' for United Kingdom remittance purposes is obtained and that would support the contention that certain aspects of the transaction were undertaken for United Kingdom remittance and tax planning purposes.

However, the following actions undertaken by Mr Watson were not required for change in tax residency or United Kingdom remittance planning purposes:

- The complex structure set up in the arrangement;
- The conversion of the shareholder advances to Loan B; and
- The assignment of rights to Loan A and Loan B to Modena and Mayfair.

This indicates that, in viewing the arrangement objectively, the arrangement had more purposes than those stated by the taxpayer. It is submitted that these ownership and debt relationships were included to ensure that Mr Watson, through the Cullen Group, qualified for AIL in order to benefit from the lower rate of tax. The question to be answered is whether obtaining this tax benefit was the sole or main purpose of the arrangement.

In answering this question it is important to remember that South Africa has accepted the principle from *IRC v Duke of Westminster* (1936) 19 TC 490 that a taxpayer is entitled to arrange his affairs in a manner that attracts the least amount of tax (Cassidy, 2012b:320). Therefore, the inclusion of the steps to qualify for a lower rate of tax would not necessarily mean that the GAAR is invoked. In addition, the framework of the South African GAAR considers the principle from the *Conhage* case, stating that where the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, it indicates that the obtaining of the tax benefit was not the sole or main purpose of the arrangement. In this case the same commercial results, being the change in tax residency, could have been achieved without including the complex web of entities and assigning the rights to Loan A and Loan B to Modena and Mayfair. Therefore, it may be argued that in terms of the *Conhage* case, Mr Watson selected to structure the arrangement in a manner that attracted the least amount of tax and is an indication that obtaining the tax benefit was not the sole or main purpose of the arrangement.

The framework of the South African GAAR provides that for arrangements with multiple purposes, the dominant (sole or main) reason for entering into the transaction must be considered. From the facts of the case it seems that the dominant reason for entering into the arrangement appears to have been to ensure that Mr Watson ceased to be a New Zealand tax resident. This was done by restructuring the interest that he had in CIL in a manner that attracted the least amount of tax, and is an indication that obtaining a tax benefit was not the sole or main purpose of the arrangement.

In light of the above, it is likely that Mr Watson would be able to discharge the onus created by Section 80G of the Income Tax Act, providing that the sole or main purpose of the arrangement is presumed to be to obtain the tax benefit. Consequently, it is submitted that the sole or main purpose requirement would not be satisfied in the South African courts.

The New Zealand High Court in the *Cullen* case decided (at 81) that the purpose to obtain the tax benefit was not merely incidental, and as a result the arrangement constituted a tax avoidance arrangement. The differing results support the findings in Chapter 3 that amendments are required for the sole or main purpose requirement of the South African GAAR, in order to improve its efficacy. This supports the recommendation made in Chapter 3 that the South African GAAR could be improved by following the New Zealand approach that requires that obtaining a tax benefit must have been just one of the purposes, provided it is not incidental.

At this point, the arrangement would not constitute an impermissible avoidance arrangement in terms of the South African GAAR, as the sole or main purpose requirement has not been satisfied. It would therefore not be necessary to test the presence of one of the tainted elements. However, the tainted elements are discussed in this study for completeness.

4.3.4. TAINTED ELEMENTS

The final requirement for the South African GAAR is that the arrangement must contain one of the tainted elements. The tainted elements are categorised according to arrangements in the context of business, in a context other than business and in any context. The arrangement in the *Cullen* case was in the context of business, therefore the tainted elements that apply are abnormality and lack of commercial substance. The tainted elements in any context are also discussed, namely arrangements that create rights and obligations that are not arm's length and those that result in misuse or abuse of the Income Tax Act.

4.3.4.1. ABNORMALITY

The first tainted element considers whether the arrangement was entered into in a manner normally employed for *bona fide* business purposes. To test this element, the framework for the South African GAAR considers whether there is a difference between the transaction entered into by the taxpayer and a transaction that would be entered into for *bona fide* purposes in the absence of a tax consideration. It has been established that the complex web of entities set up by Mr Watson, the conversion of the shareholder advance to Loan B and the assignment of Loan A and Loan B to Modena and Mayfair were not required for tax residency change or United Kingdom remittance planning. It appears that there was no commercial reason for these structures, other than to obtain a tax benefit. It is submitted that a transaction entered into for *bona fide* purposes in the absence of a tax consideration would not include the complex structures and loan relationships. Consequently, the arrangement is not considered 'normal' as it may be considered different to a transaction that another taxpayer would have entered into without a tax consideration.

4.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element determines whether the arrangement lacked commercial substance in terms of Section 80C of the Income Tax Act. To test this the framework for the South African GAAR considers whether there is a significant effect on the net cash flows and business risks of the parties. Mr Watson provided loans to the value of $291 million to the Cullen Group for the purchase of his shares in CIL. The Cullen Group then on-lent $98 million to CIL. The value of these loans may be considered to have a significant effect on the net cash flows and business risks of the parties involved. Through the arrangement the Cullen Group acquired 100% ownership of CIL and that investment may have had a significant effect on its business risk. Therefore, in applying the general test, the avoidance arrangement may not have been considered to lack commercial substance.

Substance over form

To test the substance over form indicator contained in Section 80C(2)(a) of the Income Tax Act, the framework of the South African GAAR considers whether the true intentions of the parties are reflected in the agreement. It is submitted that the true intentions of the parties are not reflected in the agreement, as Modena and Mayfair simply acted as conduits for Loan A and Loan B so that a tax benefit was obtained. It is submitted that the ultimate lender was still Mr Watson, as he had control over the funds at all times. Additionally, he remained in control over the relevant entities. Therefore, it may be concluded that the agreement replaced the shares in CIL to loans in the Cullen Group which were assigned to Modena and Mayfair, in form but not substance. Therefore, it may be argued that the substance of the arrangement differed from its form.

Round trip financing

Round trip financing is contained in Section 80D of the Income Tax Act. In terms of the framework of the South African GAAR it refers to the transfer of funds between parties, through some type of reciprocal action, resulting directly or indirectly in a tax benefit. Funds in the form of loans were transferred between Mr Watson, the Cullen Group and Modena and Mayfair. The transfer of the loans by Mr Watson to Modena and Mayfair resulted in a tax benefit, as the two companies were not legally ‘associated persons’ to the

Cullen Group and as a result qualified for AIL. Therefore, the arrangement included an element of round tripping.

Tax-indifferent parties

In terms of Section 80E of the Income Tax Act, Modena and Mayfair could be regarded as accommodating or tax indifferent parties as they were not subject to non-resident withholding tax on the interest received from the Cullen Group due to the application of AIL. Had it not been for Modena and Mayfair being parties to the arrangement, the interest would have accrued to Mr Watson as an associated person who would not have qualified for AIL. In this instance the interest would have been subject to non-resident withholding tax at 15% and not AIL at 2%. In applying the framework of the South African GAAR, it may be concluded that Modena and Mayfair were tax-indifferent parties as they effectively sold their tax advantage to ensure that tax was paid at 2% instead of 15% on the interest paid by the Cullen Group.

Offsetting or cancelling effects

The framework of the South African GAAR considers whether there are elements within the arrangement that have the effect of offsetting or cancelling each other as contemplated in Section 80C(2)(b)(iii) of the Income Tax Act. The Cullen Group provided a loan to CIL in terms of which it included the interest received as income. However, this inclusion was offset by the interest deduction claimed by the Cullen Group on the loan of the same amount payable to Mayfair. Therefore, there were elements that had an offsetting or cancelling effect included in the arrangement. According to the framework of the South African GAAR, this could be an indication that parts of the arrangement were contrived to obtain a tax benefit and indicate a lack of commercial substance.

In light of the discussion the indicators above, it may be concluded that the arrangement in this case lacked commercial substance. Nevertheless, some of the aspects identified may be present in commercial transactions of a similar nature entered into for *bona fide* purposes. The GAAR is not intended to apply to all genuine transactions that have the presence of these indicators (Pidduck, 2017:258). It would be left to the courts to determine where the GAAR would apply. In this case, the manner in which the arrangement was carried out indicates that the arrangement as a whole lacked commercial substance.

4.3.4.3. RIGHT AND OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the creation of rights and obligations that are not at arm's length. The framework of the South African GAAR notes that this requirement will be met if each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves, or if unconnected persons would not have done the same in this situation. The rights and obligations arising from Loan A and Loan B include:

- Modena or Mayfair could only demand payment from the Cullen Group if Mr Watson demanded payment on the corresponding loan to Modena or Mayfair. The amount demanded by Modena or Mayfair could not exceed the amount demanded by Mr Watson.
- Interest was payable at 16% which reflects an arm's length rate.
- The Cullen Group could not assign its rights and obligations under the loans. Mr Watson, as lender, could assign his rights under the loans. Any other lender, including Modena and Mayfair, could only assign their rights to Mr Watson or with his agreement.

The interest rate on Loans A and B at an arm's length rate indicates that Mr Watson was striving to get the utmost possible advantage from the transaction. However, the terms of the loans implied that Modena and Mayfair were not in control of the loans due to them. The assignments of the rights to Loans A and Loan B did not result in any additional benefit for the two entities. Therefore, it may be concluded that Modena and Mayfair were not striving to obtain the utmost possible advantage from the transaction. This arrangement thus created rights and obligations that were not at arm's length, as it is doubtful that unconnected persons would have agreed to these terms in the same situation.

4.3.4.4. MISUSE OR ABUSE

The last tainted element is the misuse or abuse of the Income Tax Act. The framework considers whether the arrangement frustrated or manipulated the provisions of the Income Tax Act it used or whether the provisions were used in a manner not intended by the legislator. In applying this element it seems that the Cullen Group correctly applied the provisions of Section NG 2(1)(b)(i) of the Income Tax Act 2004 No 35 (being the Act applicable during the period of the arrangement) which provides that non-resident withholding tax shall be set at zero per cent on:

> "interest … paid by an approved issuer in respect of a registered security and derived by a person who is not an associated person of the approved issuer".

The Court of Appeal in New Zealand stated (at 34) in *Vinelight Nominees Ltd v Commissioner of Inland Revenue* (2013) NZCA 655 that the objective of the AIL regime was to encourage investment in New Zealand by reducing the financing cost for residents borrowing offshore. In this case there was no genuine overseas investment, as no new funds were introduced into New Zealand. Furthermore, the arrangement artificially created the circumstances necessary to ensure that it complied with the provisions of the legislation. This may be considered to have been done in a manner that frustrated or manipulated the intention of the legislation. In light of this, it is submitted that the arrangement would result in misuse or abuse of the Income Tax Act for purposes of the South African GAAR.

4.4. CONCLUSION

In applying the framework of the South African GAAR to the facts of the *Cullen* case, it is submitted that it is likely that the GAAR would not have been successfully applied as the sole or main purpose requirement was not satisfied. However, the remaining requirements were arguably present for purposes of applying the South African GAAR to the facts of this case.

Interestingly, for purposes of the sole or main purpose requirement, it was identified that the objective effect of the arrangement supported the stated intention, but the inclusion of unnecessary complex steps was not necessary to achieve the stated intentions. This indicated that one of the purposes of the arrangement was to obtain a tax benefit. However, the taxpayer is entitled to structure the arrangement in a manner that attracts less tax in light of the precedent set by the *Conhage* case. In this regard, it is submitted that the precedent from the *Conhage* case may have a negative impact on the effectiveness of the South African GAAR.

In the New Zealand High Court the purpose requirement was satisfied as the purpose to obtain a tax benefit was not considered to be merely incidental. However, the purpose requirement in South Africa would not be satisfied as obtaining the tax benefit was not the dominant (sole or main) purpose for entering into the arrangement. The stronger purpose element required in the South African GAAR resulted in the GAAR not being applicable, making it a less effective deterrent to tax avoidance arrangements when compared to its New Zealand counterpart. This provides support for the recommendation made in Chapter 3 that the effectiveness of the South African GAAR could be improved by amending this requirement, so that obtaining the tax benefit must have been just one of the purposes, provided it was not merely incidental.

In addition to the above, subjective factors were considered in determining the sole or main purpose of the arrangement that might possibly have limited the applicability of the GAAR, as the taxpayer is able to argue with relative ease that some commercial reason was the main purpose for entering into the transaction. It is submitted that guidance should be provided to ensure the determination of this requirement as an objective enquiry. As suggested in Chapter 3, this may be done by consolidating the purpose and tainted elements requirements into one requirement, where the presence of one of the tainted elements informs the objective purpose of the arrangement.

For purposes of the tainted elements requirement, it is submitted that all four tainted elements were found to be present including abnormality, lack of commercial substance, right and obligations that were not at arm's length and misuse or abuse. Furthermore, for purposes of lack of commercial substance it was identified that there was a presence of round-trip financing, tax indifferent parties, offsetting elements and a difference between the substance and the form of the arrangement. Nevertheless, in applying the general test of lack of commercial substance, it cannot be said with absolute certainty that the arrangement resulted in a significant effect on the net cash flows and business risks of the parties, as the term 'significant' is not defined in the Income Tax Act. Therefore, guidance should be provided regarding the meaning of the word 'significant', so as to eliminate uncertainty and thereby improve the effectiveness of the South African GAAR. This is consistent with the findings made in Chapter 3 that consideration should be given to defining undefined terms, in order to increase certainty and ensure consistent application.

In conclusion, the reform-oriented research performed in this chapter highlighted weaknesses of the South African GAAR when applied to the *Cullen case* that impacts upon its effectiveness. The overall findings from the application of the South African GAAR to the facts of the case provide validation for the recommendations made from the doctrinal research performed in Chapter 3.

CHAPTER 5:
CONCLUSION

5.1. INTRODUCTION

Since taxes were introduced, taxpayers have always searched for ways in which to minimise their tax liability (Cassidy, 2006:261). It was established *in IRC v Duke of Westminster* (1936) 19 TC 490 that taxpayers are generally entitled to order their affairs in a way that attracts the least amount of tax. However, sometimes the methods used by taxpayers constitute impermissible tax avoidance and this is described as artificial or contrived arrangements that make use of 'loopholes' in the legislation in a way that was not intended by the legislation (SARS, 2005:4). This has several harmful effects and consequently, South Africa has adopted the GAAR as one of the methods to curb impermissible avoidance arrangements. The South African GAAR was introduced for the first time in 1941 and has since undergone several amendments due to identified weaknesses. The current GAAR came into effect on 2 November 2006 and is found in Sections 80A to 80L of the Income Tax Act.

Research relating to the current GAAR is necessary, as it has not yet been tested in the South African courts and it is contended that it may not have addressed some of the weaknesses of its predecessor. Moreover, there is uncertainty regarding its interpretation and application. This study fills a gap that exists by testing the efficacy of the South African GAAR using lessons from New Zealand and suggesting amendments to address the weaknesses of the current GAAR. The goal of this study was to analyse the current South African GAAR and compare it to the New Zealand GAAR from a case law perspective, in order to identify weaknesses that exist in the South African GAAR. Recommendations were then made to improve the efficacy of the South African GAAR. The research objectives that were adopted to achieve the goal of the study were described as:

1. to identify weaknesses in the current South African GAAR;
2. to compare the theoretical principles of the South African GAAR to the principles of the GAAR of New Zealand;
3. to apply the South African GAAR to the facts of a case from New Zealand where the GAAR of New Zealand was successful, so as to determine whether the South

African GAAR would have been successful and thereby identify elements of the South African GAAR that need improvement; and

4. to suggest improvements to the South African GAAR so as to address identified weaknesses.

The research methodology followed in this study was a 'structured pre-emptive analysis'. This is an interpretive, qualitative method following a doctrinal and reform-oriented approach. Doctrinal research was adopted in order to analyse the South African GAAR and reform-oriented research was followed in order to propose improvements to address identified weaknesses in the South African GAAR.

5.2. ACHIEVEMENT OF THE RESEARCH OBJECTIVES

Chapter 2 of this study critically analysed the requirements of the current South African GAAR. The requirements of the current GAAR were compared to those of its predecessor. This comparison revealed that the current GAAR contains elements and terms that were present in its predecessor. The weaknesses identified in the previous GAAR may have thus been carried over onto the current GAAR. These weaknesses were described by SARS as:

- **Not an effective deterrent:** The GAAR was inconsistent, and at times, an ineffective deterrent to impermissible tax avoidance schemes (SARS, 2005:41). Taxpayers were also marketing aggressive and increasingly sophisticated schemes to avoid taxes, and processes to detect these schemes were time consuming and expensive (SARS, 2005:42). Additionally, the lengthy battles had a negative impact on the relationship between SARS and the taxpayers (SARS, 2005:42).
- **"Abnormality" Requirement:** There was no clear distinction between transactions employed for normal *bona fide* business purposes and impermissible tax avoidance, and schemes were often created by 'hijacking' techniques that were developed for *bona fide* business purposes (SARS, 2005:42). Additionally, because these schemes used methods established for *bona fide* business purposes, it was easy for taxpayers to 'manufacture' plausible sounding business purposes and thus escape the abnormality requirement (SARS, 2005:43). The requirement was further criticised for presenting difficulties as the wide usage of a tax avoidance transaction

could render it commercially acceptable and as a result it would become normal (Katz, 1996:par 11.2.2; Margo, 1987:par 27.28).

- **"Purpose" Requirement:** This requirement had the implication that if a transaction had more than one purpose, the dominant purpose had to be the one of obtaining a tax benefit before falling foul of the provisions of the GAAR (SARS, 2005:43). This was very difficult for the Commissioner to prove, as taxpayers could argue a commercial reason as the main purpose with relative ease (SARS, 2005:43). Similarly, the subjectivity in proving this purpose presented complexities in applying this requirement, as the courts had to consider the intention of the taxpayer when they entered into the transaction (*Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A); *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC).
- **Procedural and Administrative Issues:** There were uncertainties regarding the application of the GAAR to steps within a larger transaction, as well as uncertainties regarding the use of the GAAR in the alternative if another section in the Income Tax Act was in dispute (SARS, 2005:44).
- **Abnormality and purpose requirement together:** The weaknesses of the purpose and abnormality requirement were compounded by the fact that both had to be met before the GAAR was applicable (Pidduck, 2017:72). This put the taxpayer in a powerful position as they could escape either of these requirements with relative ease (Pidduck, 2017:73).

5.2.1. WEAKNESSES OF THE CURRENT GAAR

The analysis of the current South African GAAR in Chapter 2 revealed the following additional weaknesses:

- Although Section 80H of the Income Tax Act provides for the application of the GAAR to a step within a transaction, it has been argued that an arrangement loses its commercial substance when a part thereof is considered in isolation, without considering the context of the wider transaction (Pidduck, 2017:159). There is currently no guidance in this regard clarifying the application of this provision (Pidduck, 2017:322).

- There is uncertainty regarding how the element of misuse or abuse should be applied (Pidduck, 2017:322). Further guidance is required to ensure that the provision is correctly and consistently applied.
- There is a lack of guidance on how the indicators of the lack of commercial substance element should be interpreted and applied (Pidduck, 2017:322).
- The sole or main purpose requirement and tainted elements requirement (previously abnormality requirement) are still two separate tests that must both be met before the GAAR is applicable. This is a weakness that was identified in the previous GAAR as it puts the taxpayer in a powerful position to escape either of these requirements with relative ease (Pidduck, 2017:73). This weakness could be addressed by consolidating the two tests into one inquiry where the abnormality of the scheme informs the purpose (Pidduck, 2017:159).
- It is not clear whether the sole or main purpose requirement will be a subjective or objective inquiry. To reduce uncertainty when testing this requirement, guidance should be provided which ensures that weaknesses from the previous GAAR are not carried forward to the current GAAR (Pidduck, 2020:32).
- The GAAR contains many terms that are not defined in the Income Tax Act, which could result in the same weaknesses as were identified in the previous GAAR (Pidduck, 2020:32).
- There is no guidance on how the impact of special relationships between the parties to a transaction affects the application of the GAAR (Pidduck, 2017:322).

5.2.2. COMPARISON OF THE GAARS OF SOUTH AFRICA AND NEW ZEALAND

Subsequent to the identification of these weaknesses from literature, the theoretical principles of the current South African GAAR were compared to the New Zealand GAAR in Chapter 3. This analysis indicated similarities between the two GAARs, such as those related to arrangement, tax benefit and purpose. Differences between the two GAARs were also identified, where it was evident that the South African GAAR has four requirements while the New Zealand GAAR only has three. The additional requirement makes the South African GAAR more onerous to apply. Additional differences within the requirements were identified as follows:

- The elements of ‘tax benefit’ in the South African GAAR and ‘tax avoidance’ in the New Zealand GAAR have similar statutory definitions, however, they are determined differently in the two jurisdictions. The South African GAAR seeks to answer whether a tax liability would have existed but for this arrangement and whether the taxpayer effectively stepped out the way of an anticipated liability. To test whether there is tax avoidance for purposes of the New Zealand GAAR, the courts consider whether the taxpayer used the provisions of the legislation within its intended scope and whether the use of the provision in light of the arrangement as a whole was used within the contemplation and purpose of Parliament when it enacted the provision.
- The South African GAAR requires that there must have been a sole or main purpose to obtain the tax benefit, while the New Zealand GAAR requires that the purpose to obtain a tax benefit must have been more than merely incidental. The New Zealand purpose is arguably better than the South African purpose requirement, and it is submitted that the South African GAAR could benefit from use of a New Zealand amendment. In addition, in New Zealand the purpose test is purely objective, whereas in South Africa it is not clear whether the test will be applied objectively or subjectively.
- The New Zealand GAAR does not expressly contain the tainted elements in the provisions of the legislation, as is the case with the South African GAAR. It rather relies on the courts to determine what constitutes impermissible tax avoidance. However, precedent set in the *Ben Nevis* case indicates that the New Zealand courts consider similar characteristics of the arrangement to the tainted elements contained in the South African GAAR, with some additional factors that could be considered for inclusion in the South African GAAR.
- The wording of the South African GAAR is lengthier and more complex when compared to its New Zealand counterpart, and the South African GAAR seems to be more prescriptive and contains detailed provisions. The New Zealand GAAR is simpler and relies on the courts to determine tax avoidance arrangements. The approach followed by New Zealand is argued to be more effective and efficient. The South African GAAR could arguably learn lessons from its New Zealand counterpart and consider a less prescriptive and less detailed approach, given the success of the New Zealand GAAR.

5.2.3. RECOMMENDATIONS

The analysis and comparison presented in Chapters 2 and 3 were performed so as to identify elements in the New Zealand GAAR that contribute to its effectiveness and which may be incorporated into the South African GAAR in order to address the identified weaknesses. The suggestions made to improve the efficacy of the South African GAAR after this analysis were:

- Guidance should be provided on whether the sole or main purpose test in the South African GAAR is a subjective or an objective test. Alternatively, guidelines should be provided to ensure that the test is an objective one, as it is submitted that this is more effective.
- As taxpayers are able to prove a commercial reason as the main purpose for entering into an arrangement, it is submitted that the approach of New Zealand should be followed where the purpose to obtain a tax benefit must have just been one of the purposes. Care should however be taken to ensure that the GAAR would not apply to transactions driven by a genuine purpose, where obtaining a tax benefit was merely incidental.
- Consideration should be given to consolidating the purpose and tainted elements into one requirement, where the presence of one of the tainted elements informs the objective purpose of the arrangement.
- Additional factors, such as the manner and duration of the arrangement, should be incorporated into the tainted elements, in order to allow courts to consider more characteristics of the arrangement so as to draw an accurate conclusion on the sole or main purpose requirement.
- Consideration should also be given to defining undefined terms, so as to increase certainty and ensure a consistent application of the South African GAAR.

5.2.4. CASE OUTCOME

The framework of the South African GAAR described in Chapter 2 was used to apply the South African GAAR to the facts of the New Zealand *Cullen* case in Chapter 4. It was concluded that the South African GAAR would on the balance of probabilities not have been successful, due to the sole or main purpose requirement not being satisfied. The framework of the South African GAAR applied as follows:

- An arrangement as defined in Section 80G of the Income tax Act was present. This was expected as the term 'arrangement' is widely defined.
- The arrangement resulted in a tax benefit as AIL was paid at a rate of 2% instead of non-resident withholding tax at 15%.
- The sole or main purpose requirement was not satisfied. This requirement was undermined by the principle from the *Conhage* case, stating that where the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, it indicates that the obtaining of the tax benefit was not the sole or main purpose of the arrangement. Obtaining a tax benefit was found to not be the dominant purpose of the arrangement.
- Each of the four tainted elements were present in the arrangement as follows:
    - The arrangement was found to be abnormal, as it was different from an arrangement that a different taxpayer would have entered into in the absence of tax considerations.
    - The arrangement contained indicators of lack of commercial substance due to the presence of round-trip financing, tax-indifferent parties, offsetting elements and a difference between the substance and form of the arrangement.
    - The arrangement created rights or obligations not at arm's length as the parties did not seek to obtain the utmost advantage from the transaction.
    - The arrangement artificially created the circumstances necessary to satisfy the provisions it relied upon, thereby using the provisions in a manner not intended by the legislator. This results in misuse or abuse of the Income Tax Act.

The recommendations to improve the South African GAAR following the application of the framework of the South African GAAR to the facts of the New Zealand case are described as follows:

- In the New Zealand High Court the GAAR successfully applied. The difference in the results in the two jurisdictions is largely due to the differences in the application of the purpose requirement. In applying the New Zealand GAAR the purpose to obtain a tax benefit was not merely incidental and as a result the GAAR found application. In applying the South African GAAR, obtaining a tax benefit was not the dominant (sole or main) purpose and therefore the GAAR could not apply. The different purpose requirement of the South African GAAR reduces its effectiveness in this case. This supported the suggestion made in the doctrinal research phase in Chapter 3 that the effectiveness of the South African GAAR may be improved by amending this requirement, so that obtaining a tax benefit must have been just one of the purposes, provided it is not merely incidental.
- Subjective factors were considered in determining the sole or main purpose of the arrangement, which may limit the efficacy of the South African GAAR as the taxpayer may argue with relative ease that some commercial reason was the main reason for entering into the arrangement. It is submitted that guidance be provided to ensure that the testing of the sole or main purpose requirement is an objective enquiry.
- In applying the general test of lack of commercial substance, it could not be said with absolute certainty that the arrangement resulted in a significant effect on the net cash flows and business risks of the parties, as the term 'significant' is not defined in the Income Tax Act. Guidance should be provided regarding the meaning of the word 'significant' in order to eliminate uncertainty and thereby improve the effectiveness of the GAAR. This is consistent with the suggestion made in Chapter 3 that consideration should be given to defining undefined terms so as to increase certainty and ensure consistent application.

It is submitted that the findings from the reform-oriented research in Chapter 4 provided validation for the recommendations suggested so as to improve the South African GAAR in the doctrinal research phase in Chapter 3. It is concluded that Chapters 2, 3 and 4 achieved the stated research objectives and in turn addressed the goal of the study.

5.3. LIMITATIONS OF THIS STUDY

It was highlighted in Chapter 1 that it is difficult to generalise the outcome of a study that uses a case. Nevertheless, “the case investigated is a microcosm of some larger system or of a whole society: that what is found there is some larger symptomatic of what is going on more generally” (Gomm *et al.*, 2000:99). Though the findings of this study may not be applicable to all possible cases that may come before the courts, it may provide an understanding of the interpretation and application of the South African GAAR.

5.4. FUTURE AREAS OF RESEARCH

Additional areas that are identified for future research include:

- The South African GAAR could be compared to the GAARs of other jurisdictions using a methodological approach similar to that adopted in this study. This will aid in identifying further areas of improvement in order to address the weaknesses of the South African GAAR.
- A study could be performed to determine whether the expressly stated tainted elements may limit the effectiveness of the South African GAAR. This will aid in determining whether the efficacy of the GAAR could be improved if the GAAR does not expressly state these elements and rather relies on the courts to determine characteristics that indicate impermissible avoidance arrangements.

5.5. CONCLUSION

This study analysed the South African GAAR and compared it to its New Zealand counterpart. It was identified that various weaknesses exist in the current South African GAAR, despite its most recent amendment in 2006. The recommendations made in this study to address the identified weaknesses include legislative amendments, as well as guidance on the interpretation of some of the elements of the GAAR. The findings of this study suggest that the sole or main purpose requirement should be amended, as it reduces the effectiveness of the GAAR. This requirement should be amended so that obtaining a tax benefit must have been just one of the purposes, provided it is not merely incidental. In addition, guidance should be provided in order to ensure that the determination of the sole or main purpose of the arrangement is an objective enquiry. It is suggested that this can be achieved by consolidating the purpose and tainted elements requirements into one requirement, where the presence of one of the tainted elements informs the objective purpose of the arrangement.

In conclusion, the weaknesses that exist in the current South African GAAR may render it an ineffective deterrent to impermissible tax avoidance arrangements. Therefore, the current GAAR which was aimed at addressing the weaknesses of its predecessor is still a cause for concern and requires further amendment.

LIST OF REFERENCES

COURT CASES

New Zealand

Ashton v Commissioner of Inland Revenue (1975) 2 NZLR 717 (PC)

Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue (2008) NZSC 115, (2009) 2 NZLR 289

BNZ Investments Ltd v CIR (2009) 24 NZTC 23,582 (HC)

BNZ Investments Ltd v Commissioner of Inland Revenue (2010) 24 NZTC 23,997 (HC)

Challenge Corporation Ltd v Commissioner of Inland Revenue (1986) 2 NZLR 513

Commissioner of Inland Revenue v BNZ Investments Ltd (2002) 1 NZLR 450 (CA)

Commissioner of Inland Revenue v Penny (2010) NZCA 231, (2010) 3 NZLR 360

Cullen Group LTD v Commissioner of Inland Revenue (2019) NZHC 404

DT United Kingdom Ltd v Commissioner of Inland Revenue (2010) 24 NZTC 24,369 (HC)

Education Administration Ltd v Commissioner of Inland Revenue (2010) 24 NZTC 24,238 (HC)

Elmiger v Commissioner of Inland Revenue (1966) NZLR 683 (SC)

Glenharrow Holdings Ltd v CIR (2008) NZSC 116, (2009) 2 NZLR 359

Glenharrow Holdings Ltd v C of IR (2009) 24 NZTC 23,236

Krukziener v Commissioner of Inland Revenue (2010) 24 NZTC 24,563 (HC)

Russell v Commissioner of Inland Revenue (2010) 24 NZTC 24,463 (HC)

Vinelight Nominees Ltd v Commissioner of Inland Revenue (2013) NZCA 655

Westpac Banking Corporation v Commissioner of Inland Revenue (2009) 24 NZTC 23,834 (HC)

White v Commissioner of Inland Revenue (2010) 24 NZTC 24,600 (HC).

SOUTH AFRICA

CIR v Conhage (Formerly Tycon) (1999) (4) SA 1149 (SCA)

Commissioner for Inland Revenue v King (1947) 14 SATC 184

Commissioner for Inland Revenue v Louw (1983) 45 SATC 113

Commissioner for South African Revenue Service v NWK Limited (2010) ZASCA 168 (SCA)

Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue (1996) (3) SA 942 (A)

Glen Anil Development Corporation Ltd v Secretary for Inland Revenue (1975) (4) SA 715 (A)

Hicklin v Secretary for Inland Revenue (1980) 1 All SA 301 (A)

Income Tax Case No. 1625 (1996) 59 SATC 383

Income Tax Case No. 1712 (2000) 63 SATC 499

Meyerowitz v Commissioner for Inland Revenue (1963) 25 SATC 287 (A)

Natal Joint Municipal Pension Fund v Endumeni Municipality (2012) 4 SA 593 SCA

Ovenstone v Secretary for Inland Revenue (1980) 42 SATC 55 (A)

Relier v Commissioner for Inland Revenue (1997) 60 SATC 1 (A)

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

Secretary for Inland Revenue v Gallagher (1978) 40 SATC 39

Secretary for Inland Revenue v Geustyn, Forsyth and Joubert (1971) 3 All SA 540 (A)

Smith v Commissioner for Inland Revenue (1964) 26 SATC 1 (A)

OTHER JURISDICTIONS

Bell v Federal Commissioner of Taxation (1953) 87 CLR 548

Canada Trustco Mortgage Co. v. Canada (2005) 2 SAR 601; 2005 SSC 54

IRC v Duke of Westminster 1936 19 TC 490

OTHER REFERENCES

Bauer, N. 2018. *An analysis of the South African GAAR: exploring Australian judicial experience.* Unpublished MCom Mini-dissertation Potchefstroom: North-West University.

Berkowitz, D., Pistor, K. & Richard, J.-F. 2003. Economic development, legality, and the transplant effect. *European economic review,* 47(1):165-195.

Bird, R. & Davis-Nozemack, K. 2018. Tax avoidance as a sustainability problem. *Journal of Business Ethics,* 151(4):1009-1025.

Bodlo, P. 2016. *The South African GAAR: Striking a balance between permissible and impermissible tax avoidance.* Unpublished Master's dissertation. Pretoria: University of Pretoria.

Broomberg, E. 2007a. The new General Anti-Avoidance Rule. Cape Town, 6 March 2007.

Broomberg, E. 2007b. Then and Now II. *Tax Planning Corporate and Personal,* 21.

Calvert, T. & Dabner, J. 2012. Gaars in Australia and South Africa: Mutual lessons. *Journal of the Australasian Tax Teachers Association,* 7(1):53-77.

Calvert, T.M. 2011. *An analysis of the 2006 amendments to the General Anti–Avoidance Rules: a case law approach.* Unpublished MCom Mini-dissertation. Potchefstroom: North-West University.

Canada 1985. Canadian Federal Income Tax Act RSC 1985 c 1 (5th Supp).

Cassidy, J. 2006. " To GAAR or not to GAAR-that is the question:" Canadian and Australian attempts to combat tax avoidance. *Ottawa Law Review,* 36(2):259-313.

Cassidy, J. 2012a. The Duke of Westminster should be "very careful when he crosses the road" in New Zealand : the role of the New Zealand Anti-Avoidance Rule. *New Zealand Law Review,* (1):1-33.

Cassidy, J. 2012b. Tainted elements or nugatory directive? The role of the general anti-avoidance provisions ("GAAR") in fiscal interpretation. *Stellenbosch Law Review* 23(2):319-351.

Coetsee, D. & Buys, P. 2018. A doctrinal research perspective of master's degree students in accounting. *South African Journal of Higher Education,* 32(1):71-89.

Courts of New Zealand. 2020. *Structure of the court system*. [Online] Available from: https://www.courtsofnz.govt.nz/about-the-judiciary/structure-of-the-court-system/ [Accessed: 2020-06-18].

Cox, N. 1998. The law of arms in New Zealand. *New Zealand Universities Law Review,* 18(2):225-256.

Datt, K. & Keating, M. 2018. The Commissioner's obligation to make compensating adjustments for income tax and GST in Australia and New Zealand. *Australian Tax Forum,* 33(3):465-495.

de Koker, A. & Williams, R. 2020. *Silke on South African Income Tax.* Cape Town LexisNexis Butterworths.

De Vos, H. 2016. *Analysing the South African General Anti-Avoidance Rule as a Pre-emptive Base Erosion and Profit Shifting (BEPS) Measure.* Unpublished Master's dissertation. Pretoria: University of Pretoria.

degl'Innocenti, D.G. & Rablen, M.D. 2017. Income tax avoidance and evasion a narrow bracketing approach. *Public Finance Review,* 45(6):815-837.

Ebersohn, H. 2012. Tax avoidance and the rule of law. *New Zealand Law Review,* (2):243-272.

Elliffe, C. 2014. Policy forum: New Zealand's General Anti-Avoidance Rule (GAAR)-a triumph of flexibility over certainty. *Canadian Tax Journal,* 62(1):147-164.

Elliffe, C. & Cameron, J.M. 2010. The test for tax avoidance in New Zealand: a judicial sea-change. *New Zealand Business Law Quarterly,* 16:440-460.

Elliffe, C., Marsden, A. & Poskitt, R. 2008. The impact of the Approved Issuer Levy on the New Zealand dollar domestic interest rates. *New Zealand Journal of Taxation Law and Policy,* 14(4):483-499.

Franklin, B. & Smyth, A.H. 1907. *The writings of Benjamin Franklin.* New York Macmillan.

Gomm, R., Hammersley, M. & Foster, P. 2000. *Case study method: Key issues, key texts.* London: Sage.

Hennink, M.M., Hutter, I. & Bailey, A. 2020. *Qualitative research methods.* 2E. ed. Los Angeles: Sage.

Hutchinson, T. & Duncan, N. 2012. Defining and describing what we do: doctrinal legal research. *Deakin Law Review,* 17:83-119.

Inland Revenue. 2013. *Interpretation Statement: Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007.* Wellington: [Online] Available from: https://www.taxtechnical.ird.govt.nz/interpretation-statements/is-1301-tax-avoidance-and-the-interpretation-of-sections-bg-1-and-ga-1-of-the-income-tax-act-2007 [Accessed: 2020-05-23].

Katz, M. 1996. *Third interim report of the commission of inquiry into taxation.* Pretoria: Government Printer.

Keating, M. & Keating, K. 2011. Tax avoidance in New Zealand: The camel's back that refuses to break. *New Zealand Journal of Taxation Law and Policy,* 17(1):115-138.

Kujinga, B.T. 2012. Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada. *Comparative and International Law Journal of Southern Africa,* 45(1):42-63.

Kujinga, B.T. 2013. *A comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible income tax avoidance in South Africa.* Unpublished doctoral thesis. Pretoria: University of Pretoria.

Kujinga, B.T. 2014. Factors that limit the efficacy of General Anti-Avoidance Rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa,* 47(3):429-459.

Langenhoven, A.G. 2016. *Does the South African GAAR criteria of the" misuse or abuse" of a provision included in Section 80A (c)(ii) of the Income Tax Act add any value?* Unpublished MCom dissertation. Cape Town: University of Cape Town.

Littlewood, M. 2011. Tax avoidance, the rule of law and the New Zealand Supreme Court. *New Zealand Law Review,* 1(1):35-68.

Littlewood, M. 2013. The possibility of amending New Zealand's General Anti-Avoidance Rule. *New Zealand Universities Law Review,* 25(3):522-559.

Littlewood, M. 2019. Legislating against tax avoidance. *SSRN Electronic Journal*.

Loof, G. 2013. *A critical analysis of the requirements of the South African General Anti Avoidance Rule Section 80A of the Income Tax Act 58 of 1962.* Unpublished Postgraduate Diploma Mini-dissertation. Cape Town: University of Cape Town.

Louw, I. 2007. *The new general anti-avoidance rule: A comprehensive discourse on this statute.* Unpublished Postgraduate Diploma Mini-dissertation. Cape Town University of Cape Town

Mangioni, V. & McKerchar, M. 2013. Strengthening the validity and reliability of the focus group as a method in tax research. *eJournal of Tax Research,* 11(2):176-190.

Margo, C. 1987. *Report of the commission of inquiry into the tax structure of the Republic of South Africa.* Pretoria: Government Printer.

Meyerowitz, D. 2008. *Meyerowitz on Income Tax* Cape Town: The Taxpayer.

National Treasury. 2005. *The GAAR proposal: A National Treasury Perspective.* Pretoria: Government Printer.

New Zealand 2004. Income Tax Act 2004 No. 35.

New Zealand 2007. Income Tax Act 2007 No. 97.

New Zealand Government. 2020. *Judicial Decisions Online*. [Online] Available from: https://forms.justice.govt.nz/jdo [Accessed: 2020-04-04].

Pidduck, T. 2017. *The South African general anti-tax avoidance rule and lessons from the first world: A case law approach.* Unpublished doctoral thesis. Grahamstown Rhodes University.

Pidduck, T.M. 2019. Tax research methodology for untested legislation: An exemplar for the tax scholar. *South African Journal of Accounting Research,* 33(3):205-219.

Pidduck, T.M. 2020. The Sasol Oil case–Would the present South African GAAR stand up to the rigours of the court? *South African Journal of Accounting Research*:1-19.

Prebble, J. & McIntosh, H. 2015. Predication: The test for tax avoidance in New Zealand from Newton to Ben Nevis. *Victoria University of Wellington Law Review,* 46(3):1011-1034.

Ruddell, J. 2013. Statutory Interpretation, parliamentary Intention and the General Anti-Avoidance Rule. *New Zealand universities law review.,* 25(3):497-521.

Russell, H. & Brock, G. 2016. Abusive Tax Avoidance and Responsibilities of Tax Professionals. *Journal of Human Development and Capabilities,* 17(2):278-294.

SARS. 2005. *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962).* [Online] Available from: https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf [Accessed: 2020-02-19].

Smith, M. 1991. New Zealand's Approved Issuer Levy-A Pragmatic" Concession". *Revenue Law Journal,* 2(2):74-83.

South Africa 1941. Income Tax Act No. 31 of 1941.

South Africa 1962. Income Tax Act No. 58 of 1962.

South Africa 2006. Revenue Laws Amendment Act No. 20 of 2006

Tretola, J. 2018. Comparing the New Zealand and Australian GAAR. *Revenue Law Journal,* 25(1):[1]-29.

Van Schalkwyk, L. & Geldenhuys, B. 2009. Section 80A(c)(ii) of the Income Tax Act and the interpretation of tax statutes in South Africa. *Meditari accountancy research,* 17(2):167-185.

Williams, R. 1997. The 1996 Amendments to the General Anti-Tax-Avoidance Section of the Income Tax Act. *South African Law Journal,* 114:675-683.

Yin, R.K. 2009. *Case study research : design and methods.* Fourth edition. ed. Los Angeles: Sage Publications.