THE EFFICACY OF THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE: USING LESSONS FROM NEW ZEALAND

by

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ABSTRACT

The general anti-avoidance rule (GAAR) has been adopted by South Africa as one of its methods to combat tax avoidance schemes into which taxpayers enter. Since 1941 when the South African GAAR was first introduced into the tax legislation, it has been amended various times as a result of the weaknesses that were highlighted by its failures to stand up to the rigours of the courts. However, since the most recent amendment to the South African GAAR in 2006, its efficacy remains unknown due to the fact that it has not been tested by the courts in its entirety. This study aims to address this concern by determining the effectiveness of the South African GAAR when compared to its New Zealand counterpart.

This study employed a 'structured pre-emptive analysis' research methodology, which is a combination of doctrinal and reform-oriented approaches. The doctrinal approach was used in Phase 1 of the research whereby a doctrinal analysis of the South African and New Zealand GAARs were performed. This approach allowed an understanding of the interpretation and application of the two GAARs to be obtained, as well as to allow for the identification of weaknesses in the South African GAAR, while simultaneously making suggestions for improvement. The reform-oriented approach was used in Phase 2 of the study in which the South African GAAR was applied to the facts of a case from New Zealand. Phase 3 of the study contained the triangulation of the findings from both Phases 1 and 2 of the study, thereby validating the findings of the study.

The findings from Phases 1 and 2 highlighted various weaknesses that exist in the South African GAAR which indicate that additional guidance should be provided to address the existing uncertainties currently contained within the interpretation and application, in order to prevent inconsistencies that may limit its efficacy. The findings of this study indicate that for a taxpayer to be considered party to an arrangement, they do not need to be aware of the entire arrangement nor all of its details. Furthermore, it was noted that the sole or main purpose requirement should be amended to rather require that obtaining the tax benefit was one of the purposes, provided it is not merely incidental, as opposed to requiring the tax benefit to be the sole or main purpose of the arrangement. In addition, it is suggested that the sole or main purpose test be amended to being a purely objective test and not considering subjective intent of the taxpayer.

The findings of this research also suggest that the tainted elements be incorporated into the tax benefit requirement similar to that of New Zealand's parliamentary contemplation test, as opposed to being considered a separate fourth requirement by allowing the judiciary greater powers of discretion in applying the GAAR.

Keywords: Taxation, general anti-avoidance rules, tax avoidance, impermissible avoidance arrangement, income tax, South Africa, New Zealand.

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Table 1: Abbreviations and acronyms

GAAR	General Anti-Avoidance Rule
The Act	Income Tax Act, No. 58 of 1962
New Zealand Act	Income Tax Act No. 97 of 2007
SARS	South African Revenue Service
SARS Discussion Paper	Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 2962)

CHAPTER 1: INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Taxpayers have been seeking ways to minimise their tax burdens since the concept of tax was introduced (Olivier, 1996:378). Tax has been described as a main component in every economy and provides the government with the financial support it requires to operate (Bird & Davis-Nozemack, 2018; Ion, 2019:1014). While various legislation governs the responsibility and duty to pay tax, this can be structured in a manner to prevent more tax being paid than is necessary by a taxpayer. This principle was portrayed in the case of *IRC v Duke of Westminster* (1936) 19 TC 490, wherein Lord Tomlin stated that every taxpayer is entitled to structure his affairs in such a way as to pay less tax than they otherwise would. Taxpayers can achieve this structuring using illegal or legal methods, namely tax evasion or tax avoidance between which there is a fine line (Pidduck, 2017:1). Tax avoidance differs from tax evasion, in that tax evasion involves illegal and dishonest activities that a taxpayer deliberately undertakes to escape paying tax liabilities (SARS, 2005:2). In contrast to this, tax avoidance is the arrangement of a taxpayer's affairs in a legal manner resulting in reduced, or no income tax being charged (de Koker & Williams, 2020:par:19; OECD, 2017:1).

Tax avoidance may be classified as that which is permissible and that which is impermissible. The South African Revenue Service (SARS) described impermissible tax avoidance 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). Governments worldwide are struggling to combat tax avoidance in both its forms (Cobham, 2017:1). As a result, countries around the world (including South Africa) have made use of three measures to combat tax avoidance including common law, specific anti-avoidance rules and general anti-avoidance rules (GAAR) (Langenhoven, 2016:16). South Africa makes use of all three measures. Specific anti-avoidance rules and the GAAR differ from one another, in that the specific anti-avoidance rules focus on addressing specifically defined transactions, that in turn could provide taxpayers with the opportunity to identify and exploit loopholes, while the GAAR is based on conceptual principles to address tax avoidance (SARS, 2005:6).

This study will focus on the South African GAAR, and ultimately consider the efficacy thereof against tax avoidance arrangements.

The conceptual principles of the South African GAAR are not charging provisions, but rather principles that are intended to protect the South African tax base established by Parliament and to assist in preventing short term revenue loss (SARS, 2005:6). The South African GAAR was first incorporated into South African tax legislation in 1941 through Section 90 of the Income Tax No. 31 of 1941. The GAAR was subsequently replaced by Section 103(1) of the Income Tax Act No. 58 of 1962 (the Act), which for the purposes of this study will be termed "the previous GAAR". This GAAR was later replaced by Sections 80A to 80L of the Act (the current GAAR), which is the current GAAR of South Africa, and has been in effect since 2006 (Bauer, 2018:37; Kujinga, 2013:63). The most recent amendment was made in response to various weaknesses that were identified by SARS in 2005 in the previous GAAR (Pidduck, 2017:34; SARS, 2005:41).

In understanding the weaknesses of the previous South African GAAR, it is important to briefly understand its four requirements, as summarised by SARS (SARS, 2005:38):

1. The Scheme Requirement – there must be a transaction, operation or scheme;
2. The Tax Effect Requirement – the transaction must result in tax avoidance, reduction or postponement of tax;
3. The Abnormality Requirement – the transaction must have been entered into or carried out in a manner that would not usually be employed for normal business purposes, other than to obtain a tax benefit; and
4. The Purpose Requirement – the sole or main purpose of the transaction must have been to obtain a tax benefit.

The resulting effect of these requirements meant that, in order for the previous GAAR to be applicable to a transaction, all four of the above requirements had to be present (SARS, 2005:38). This resulted in the previous GAAR not being applicable to transactions where 'all but one' requirement had been met. In describing the weaknesses of the previous GAAR, SARS identified and described the weaknesses, which resulted in the need for amendment to the GAAR, in a document titled "Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 2962)" (SARS Discussion Paper). The weaknesses were classified as follows (SARS, 2005:41-44):

- **Not an effective deterrent** –The GAAR had proven to be inconsistent and an ineffective deterrent to 'abusive' avoidance schemes and other impermissible tax avoidance.
- **Abnormality requirement** – This was identified as having two fundamental weaknesses. Firstly, it did not cater for *bona fide* business transactions and impermissible tax avoidance schemes separately, and as such, *bona fide* business techniques were hijacked to disguise transactions as genuine. Secondly, frequent use of transactions by taxpayers led to transactions becoming commercially acceptable which in turn resulted in such transactions ceasing to be abnormal, making it difficult for SARS to prove the abnormality thereof and further exacerbated the problems contained within the purpose requirement (SARS, 2005:43).
- **Purpose requirement** - This requirement could only have been met if the sole or main purpose of the transaction was to obtain a tax benefit. In addition to this, proving the sole or main purpose was circumstantial and subjective, making it more difficult for the Commissioner to prove.
- **Procedural and administrative issues** - Uncertainty surrounding the extent to which the previous GAAR may be applied as well the authority of the Commissioner to apply the previous GAAR "in the alternative".

In order to address the weaknesses identified, the previous GAAR was amended and ultimately replaced. The current GAAR was effective from 2 November 2006 after the Revenue Laws Amendment Act No. 20 of 2006 was enacted, with Sections 80A to 80L of the Act containing the amended requirements that may be summarised as follows (Pidduck, 2017:4-5):

1. There must be an arrangement (ie: a transaction, operation or scheme);
2. The arrangement must result in a tax benefit;
3. The sole or main purpose of the arrangement must be to obtain such tax benefit; and
4. The arrangement must contain at least one 'tainted element', which are as follows: the arrangement is carried out in a manner that is not normally employed (*bona fide*), the transaction lacks commercial substance, the transaction creates rights or obligations that are not at arm's length, or the transaction results in the misuse or abuse of the Act.

The current GAAR, upon initial comparison, appears to have retained a similar structure as well as similar wording to that of its predecessor. However, the current GAAR incorporates additional tainted elements (as part of the fourth requirement) to its predecessor, thus

increasing its scope (Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006:63-64). Consequently, the current GAAR has been described as long and complex, with various complex concepts having been introduced through the amendments and resulted in SARS only issuing its first notices on this new GAAR six years after its enactment (Liptak, 2017:1). Nevertheless, Liptak (2017:1) acknowledges that the new GAAR has failed to overcome the primary weaknesses of its predecessor, which was to be a more effective deterrent to impermissible tax avoidance. While there has been limited judicial consideration of the current GAAR, in *ABSA and Another v Commissioner for South African Revenue Service* (2019/21825) [2021] ZAGPPHC 127 (*ABSA* case), the most recent case, only two of the four requirements were considered. As a result, it is submitted that no cases have been brought before the courts since the amendment to the Act in 2006 where all four requirements of the GAAR have been subjected to judicial consideration and further research is required in order to determine its efficacy (Bauer, 2018:2; Kujinga, 2013:4; Pidduck, 2017:4).

This study aims to identify the weaknesses of the current South African GAAR through the comparison to the New Zealand GAAR, and in doing so, make recommendations to counteract these weaknesses through lessons learnt from application to New Zealand case law.

1.2. RATIONALE FOR THE STUDY

Since the amendment to the South African GAAR in 2006, no cases have been brought before the courts that consider the current GAAR as a whole, and as such the efficacy of the current GAAR in combatting impermissible tax avoidance remains unknown (Bauer, 2018:4; Pidduck, 2020:255; Pidduck, 2017:5). As a result, further research is required in order to determine whether the amendments made to the previous GAAR are effective. The traditional approaches to research are not appropriate in assessing the efficacy of the current GAAR as hindsight, in this case, is not applicable (Pidduck, 2017:255). The efficacy of the amendments to the previous GAAR, and the resulting current GAAR, however, can be assessed through the comparison of the current South African GAAR to other jurisdictions. The efficacy of the South African GAAR has been tested through comparison, but this comparison is limited to only two jurisdictions, namely Australia and Canada, and no other jurisdictions have been considered (Bauer, 2018; Pidduck, 2017). Some studies performed have focused on identifying the weaknesses and making recommendations for

improvement through theoretical analyses and interpretation of the legislation (Bauer, 2018:5; Calvert, 2011:6; Kujinga, 2013:7; Pidduck, 2017:5). The study performed by Calvert (2011) assessed the efficacy of the current GAAR against that of previous South African cases. However, the current South African GAAR could also be applied to the facts of applicable cases from other jurisdictions in order to determine whether the current South African GAAR would have been effective in preventing impermissible tax avoidance. Such a comparison would allow the identification of the weaknesses in the current GAAR and proposed amendments to be made through the lessons learnt from the international counterpart. The study performed by Pidduck (2017) adopted this approach for both Australia and Canada, and thus assessed the efficacy of the current South African GAAR in a more international context. However, the SARS Discussion Paper identified multiple countries facing tax avoidance challenges, including Australia, Canada, New Zealand, Spain, the United Kingdom and the United States (SARS, 2005:27). It is evident that New Zealand was also identified as having a similar GAAR to South Africa in concept but no studies have yet been performed whereby the efficacy of the South African GAAR is tested against New Zealand. This study aims to fill a gap in the research by determining what amendments can be made to the current South African GAAR in order to address its weaknesses. Therefore, this study aims to determine if any lessons can be learnt from the New Zealand GAAR in order to improve the efficacy of the current South African GAAR.

1.3. RESEARCH PROBLEM

Tax avoidance has been highlighted as an area on which SARS intends to focus (National Treasury, 2021), however, the application of the current South African GAAR in its entirety has not been tested in the courts since its amendment in 2006 (Pidduck, 2017:5). To date, there has only been one reported case that considered two of the requirements of the GAAR (*ABSA* case). Therefore, whether or not the current GAAR is effective in combatting tax avoidance by determining whether an impermissible avoidance arrangement is present (ie: all four requirements have been met), remains unknown. While research has been conducted to test the efficacy of the South African GAAR, no research has been conducted on the efficacy of the GAAR when compared to that of the New Zealand GAAR. Therefore, the research problem of this study is to identify what amendments can be made to the South African GAAR to improve its efficacy based on lessons from New Zealand case law.

1.4. RESEARCH QUESTION

- What are the primary weaknesses of the 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 identified weaknesses and improve the efficacy of the South African GAAR?

1.5. RESEARCH OBJECTIVES

In order to address the research questions stated above, the following research objectives were identified and pursued in answering the research questions:

- To identify weaknesses in the current South African GAAR;
- To compare the theoretical principles of the South African GAAR to the principles of the GAAR of New Zealand;
- 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;
- To suggest improvements to the South African GAAR to address identified weaknesses.

1.6. RESEARCH DESIGN AND METHODOLOGY

This study will be conducted using a qualitative approach, namely that of a 'structured pre-emptive analysis' (SPA) methodological approach, which is a combination of doctrinal and reform-oriented approaches (Pidduck, 2019:201; Pidduck, 2020:255). The objective of qualitative research has been described as that of gaining a contextual understanding of data or any given topic using textual data through an interpretive analysis in order to develop an understanding thereof (Hennink, Hutter & Bailey, 2020:10). This differs to quantitative research methodologies in that quantitative methods involve the quantification and extrapolation of data using statistical data (numbers as opposed to words) through a statistical analysis to make generalisations about a broader population (Hennink *et al.*, 2020:16-17). Qualitative research is appropriate for this study as it aims to gain an understanding of the South African GAAR which is interpretative in nature.

The SPA is pre-emptive in nature and has been specifically designed for qualitative research where judicial inquiry for the legislation in question is absent (Pidduck, 2019).

The SPA is appropriate for this study since the application of the current GAAR as a whole (ie: all four requirements) has not been brought before a court of law since the amendments were made in 2006. As such, judicial inquiry into the application of the current GAAR as a whole is absent, making the SPA approach appropriate for the study. Doctrinal and reform-oriented research methods are discussed below.

1.6.1. DOCTRINAL RESEARCH

Doctrinal research, also referred to a "black letter law" is defined as "a research methodology that concentrates on seeking to provide a detailed and highly technical commentary upon, and systematic exposition of, the content of legal doctrine" (Salter & Mason, 2007:113). It follows that doctrinal research is the analysis of literature that involves rigorous analysis and creative syntheses, making connections between seemingly disparate doctrinal strands and the challenge of extracting general principles from an inchoate mass of primary materials (Council of Australian Deans, 2005:3). The 'doctrine' in question includes legal concepts and principles of case law, statutes and rules (Hutchinson & Duncan, 2012a:84). For the purposes of this study, the doctrine in question would be that of the South African GAAR. This methodology enables a critical analysis of documentary data in order to reach conclusions regarding the interpretation and application thereof (Pidduck, 2019:210). Doctrinal research methodology, given the objective of this study, is considered to be appropriate as amendments will be proposed to address the weaknesses of the current GAAR through a critical analysis of the South African legislature. The doctrinal research methodology will be employed in Chapters 2 and 3 (Phase 1) and the phased approach is explained in Paragraph 1.6.3 below.

1.6.2. REFORM-ORIENTED RESEARCH

The second component to the SPA is reform-oriented research, which involves the critical evaluation of existing legislation and laws in order to allow the author to identify potential weakness and thereby make recommendations to address these weaknesses (Coetsee & Buys, 2018:76; Hutchinson & Duncan, 2012b:101). This research method can be used to make connections across international and comparative legal concepts, such as that of South Africa and New Zealand. However, this requires a critical understanding of context across diverse jurisdictions which simultaneously allows a gain of appreciation of the implications of developments in the international fields in order to "take advantage of what is possible" (Alley & Bentley, 2008:129). This research method is therefore appropriate for

this study as recommendations to the current South African GAAR will be made based on the New Zealand counterpart. The reform-oriented research methodology will be employed in Chapter 4 (Phase 2) and the phased approach is explained in Paragraph1.6.3 below.

1.6.3. STRUCTURED PRE-EMPTIVE ANALYSIS

The SPA renders it possible to identify what amendments can be made to the South African GAAR to improve its efficacy based on lessons from New Zealand case law. The SPA allows untested legislation to be applied to factual elements of practical cases through a structured approach, while incorporating measures that support improved replicability, robustness and validity (Pidduck, 2019:206-207). The objective of this study is to determine the efficacy of the current South African GAAR (the untested legislation) rather than to focus on the outcome of the selected case (see Section 1.7.3). This method uses the facts of the case (as heard in New Zealand) and allows the untested legislation (the current South African GAAR as a whole) to be applied to the facts in a structured manner (Pidduck, 2019:206). This multi-method qualitative research will be carried out in three phases:

- **Phase 1 – doctrinal research (Chapters 2 and 3).** The doctrinal research approach will be employed in Chapters 2 and 3 of this study to allow a comprehensive analysis of the existing South African and New Zealand literature to be carried out, which will enable an understanding to be obtained as to how the respective GAARs should be interpreted and applied. The subject matter for this study consists of the South African and New Zealand GAARs. This doctrinal analysis includes the development of a framework to allow for the consistent application of the South African GAAR to the facts of the case selected in Chapter 4 (Phase 2). The framework developed by Pidduck (2017:102-104) will be used as a starting point and amended where necessary for application to the case in Chapter 4 (Phase 2). The use of this framework improves replicability and the credibility of the findings of this study.
- **Phase 2 – reform-oriented research (Chapter 4).** The reform-oriented research approach will be employed in Chapter 4 of this study and the framework developed in Phase 1 will be used to apply the South African GAAR to the facts of the selected case in New Zealand, allowing the researcher to identify which aspects of the South African GAAR are effective and should remain intact and which aspects are ineffective and should be amended (Pidduck, 2017:44-45). Thus, amendments to the current South African GAAR will be proposed.

- **Phase 3 – theoretical comparison and suggestion of improvements (Chapter 5).** The theoretical comparison of the South African and New Zealand GAARs from Phase 1 and the results from the application of the South African GAAR to the facts of the selected case in Phase 2 are used to suggest improvements to the South African GAAR. This allows for triangulation and validation of the findings of the research (Pidduck, 2019:210).

The next section refers to the manner in which the legislation will be interpreted.

1.7. INTERPRETATION OF THE LEGISLATION

A standardised method will be used in order to ensure that bias is prevented when interpreting the South African GAAR, namely the purposive approach (Goldswain, 2008:109). This approach to applying the legislation contains guidance and it interprets the legislation by giving effect to the general underlying purpose of the statutory provision (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); *IncomeTaxCaseNo.1396* (1984) 47 SATC 141; *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA)). The approach used for interpretation is as follows:

1. The ordinary grammatical meaning and literal meaning of words is to be applied, which is referred to as the 'primary rule of interpretation' (Goldswain, 2008:111; *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA)).
2. If the ordinary grammatical meaning gives rise to absurdities, then the primary rule can be departed from in order to give effect to the true intention of the legislature (Goldswain, 2008:111; *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A)).
3. If a word, sentence or section of legislature has already been interpreted by the courts, then such interpretation should be used, provided that the context and intention in both situations was similar (Pidduck, 2017:53).
4. Anti-avoidance legislation should be taken into consideration whereby the interpretation should be widely applied but not beyond what the language itself permits (*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)).

In order to apply the current GAAR to the facts of the case (as selected in Paragraph 1.7.3), a framework (as developed by Pidduck (2017:102)) will be used. The application of this framework is discussed in the section below.

1.7.1. APPLICATION OF THE FRAMEWORK

In addition to the SPA, the framework for applying the South African GAAR will be used as developed by Pidduck (Pidduck, 2017:102). This framework was developed in order to provide a consistent method and a criterion for application of the South African GAAR to the case in Chapter 4. The use of the framework allows for consistent application of the GAAR which increases the external validity of findings due to the consistent application of the GAAR which allows other researchers to reach the same findings (Pidduck, 2019:214). The framework is contained in Section 2.5. One of the benefits of making use of the framework is the increased validity of the findings of the study. The validity and reliability of the study as a whole will be discussed below.

1.7.2. VALIDITY AND RELIABILITY

Due to the nature of qualitative research, the validity and reliability of the findings needs to be addressed. The researcher has taken the following measures to ensure that the validity, reliability and objectivity of the study are not compromised:

- Subjectivity or bias in interpreting the legislation could impact the results when the South African GAAR is applied to the facts of the case (Pidduck, 2017:55). A doctrinal analysis is used to analyse and interpret the South African GAAR using authoritative texts, such as legislation, case law, journal articles and books. The approach followed to ensure the appropriate interpretation of the legislation is detailed in Paragraph 1.6.1.
- A structured framework is used to improve the validity and replicability of the research. The framework allows for the consistent application of the South African GAAR to the facts of the case which increases external validity of findings as it provides a mechanism for the consistent application of the South African GAAR to facts of the case, enabling other researchers to reach the same conclusion and findings (Pidduck, 2019:214). This structured framework will be amended to include updated literature in the field as part of Phase 2 of the study.
- Subjectivity and bias in selecting the case from New Zealand has been addressed by using an appropriate method, purposeful maximal sampling, as discussed in Paragraph 1.7.3.
- The final area of concern arises from the risk that the case is selected from an unreliable source (Pidduck, 2017:56). To address this concern, an independent and reliable source, the Judicial Decisions Online Database, was used to obtain the case, facts and

judgment, thereby ensuring that the full facts and details of the judgment are used in the application of the South African GAAR (Ministry of Justice: New Zealand Government, 2021). Data will be obtained from a substantial body of information, being that of case law, journal articles, legislation and other applicable documentation – contributing to the qualitative nature of this research (Pidduck, 2019:216). Since the data is publicly available, there are no ethical considerations arising from its use.

1.7.3. SELECTION OF THE JURISDICTION FOR COMPARISON

In order to follow the 'structured pre-emptive analysis' approach, the jurisdiction of comparison should be selected in a manner that is supportive of the answering of the research question and objectives (Pidduck, 2019:209). In this study, two jurisdictions will be selected, namely the primary jurisdiction and the jurisdiction for comparison. The primary jurisdiction selected is that of South Africa, given that the goal of this study is to identify weaknesses and propose improvements to the current South African GAAR. Furthermore, the researcher is resident within this jurisdiction and had an in-depth knowledge of the applicable tax legislation.

The jurisdiction selected for comparison was selected through 'purposeful maximal sampling' which involves the selection of a case to meet a certain objective and thus answer the research question (Cresswell & Cresswell, 2018:185). The jurisdiction selected for the purposes of this study is New Zealand. The reason for this is threefold: firstly, both South Africa and New Zealand have their legal foundations in English Common Law thereby providing an appropriate basis for comparison (Berkowitz *et al*., 2003:Table 4; Cox, 1998:11); secondly, New Zealand was one of the jurisdictions referred to by the SARS Discussion Paper released in 2005 that ultimately led to the amendments of the South African GAAR (Pidduck, 2017:7; SARS, 2005:1-76). Thirdly, while studies following the SPA methodological approach have been performed, no studies have been done where New Zealand was used as the comparative jurisdiction and jurisdictions studied in this manner to date are limited to Australia and Canada (Bauer, 2018; Pidduck, 2017). Therefore, a gap is identified which this study aims to fill. New Zealand is thus determined to be an appropriate jurisdiction for the purposes of this study, which improves both the validity and the quality of the research due to a specific basis of selection being applied, thereby avoiding bias and questionable findings (Pidduck, 2019:209).

1.7.4. COURT CASE SELECTION

One of the research objectives of this study is to apply the South African GAAR to the facts of a case selected from New Zealand. The case for purposes of this study was selected in accordance with purposeful maximal sampling methods (Cresswell & Cresswell, 2018) and represented the most critical case. Preference was given to the most recent case in which the New Zealand GAAR was applied in an income tax context in order to obtain the latest interpretation of the New Zealand GAAR as heard by the Court of Appeal. Cases heard in the Court of Appeal of New Zealand have statutory jurisdiction as well as common law jurisdiction and as a result, the decisions are binding on the courts and tribunals below it (Ministry of Justice: New Zealand Government, 2021). Therefore these Court of Appeal cases represent the most critical cases and are appropriate for the purposes of this study.

The case was selected from the Judicial Decisions Online Database on 25 February 2021, which contains all reported judgments and decisions of the New Zealand High Court, Court of Appeal and Supreme Court (Ministry of Justice: New Zealand Government, 2021). The most recent case in which the New Zealand GAAR was applied in the Court of Appeal was *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* (2020) NZCA 383 ("*Frucor* case") and is used for purposes of Phase 2 (Chapter 4) of this study.

1.7.5. SCOPE LIMITATION

When a case is used in a study, it may be difficult to generalise the outcomes (Yin, 2008:38). However, "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 follows then that the objective of this study is not to apply the findings of the application of the case to all other cases that could possibly come before the courts. The case is applied in order to obtain an understanding relating to the application and interpretation of the current South African GAAR. The study is limited to the jurisdictions of South Africa and New Zealand, and limited further to only the legal principles of tax avoidance (GAAR) relating to each jurisdiction's income tax legislation, ensuring a realistic scope. Therefore, the study does not aim to include all possible cases that have come before the respective courts, but rather to provide insight into the practical application of the South African GAAR. It is therefore imperative that the findings must be interpreted within the specific context in which they arose to determine whether such results can be applied to different cases. This study is further limited to only one court case from the New Zealand

jurisdiction, but the findings may be indicative of larger symptomatic problems or weaknesses within the South African GAAR in such contexts.

1.8. STRUCTURE OF THE MINI-DISSERTATION

Chapter 1: Introduction (background, problem statement and research question). The aim of this chapter is to introduce the topic and provide the background and rationale with the related research question and objectives. The research methodology and design are included, along with a description of the method used to select the jurisdiction and case.

Chapter 2: South African GAAR. This chapter includes an analysis of the South African GAAR including an identification of the weaknesses based on the literature examined. The previous GAAR as well as the current GAAR are examined in order to ensure that an appropriate understanding is obtained. This chapter also includes the introduction to the framework that will be used for the purposes of applying the case to the current South African GAAR in Chapter 4.

Chapter 3: New Zealand GAAR. This chapter contains an analysis of the New Zealand GAAR, including an identification of the weaknesses using a doctrinal analysis. The New Zealand GAAR is compared to the South African GAAR and the differences and similarities are identified and explained. This forms the basis for the recommendations to improve the South African GAAR using lessons obtained from New Zealand.

Chapter 4: Application of the South African GAAR to the case selected. This chapter includes a summary of the facts of the selected case as well as the application of the South African GAAR to the case. This chapter includes the identification of weaknesses of the South African GAAR when applied to the case and areas of improvement in addition to those identified in Chapter 3.

Chapter 5: Conclusion. This chapter concludes on the study. The weaknesses, recommendations and lessons learnt from New Zealand are summarised and concluding comments are made.

CHAPTER 2: THE SOUTH AFRICAN GAAR

2.1. INTRODUCTION

The objective of this study is to analyse the South African GAAR in order to identify its weaknesses and to make suggestions for improvement using the lessons learned from New

Zealand. Chapter 1 of this study briefly introduced the South African GAAR, detailed the research question and objectives and provided a description of the research methodology that will be employed in this study. Chapter 2 presents a doctrinal analysis of the South African GAAR allowing for the identification of weaknesses, as discussed in Section 1.6.1.

2.2. PREVIOUS SOUTH AFRICAN GAAR

South African tax legislation has to date contained three GAARs, the third of which is the current GAAR as included in Section 80A-80L of the Act which has been in effect since 2 November 2006. Despite the amendments made in 2006, the current GAAR is seen to have 'borrowed' various terms from its predecessor, and as such, a discussion of its predecessor is required in order to obtain an adequate understanding and interpretation of these terms. The most recent predecessor of the GAAR, the previous GAAR (Section 103(1)) contained four elements that were required to be met 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."

These four requirements are summarised below:

- The Scheme Requirement – there must be a transaction, operation or scheme;
- The Tax Effect Requirement – the transaction must result in tax avoidance, reduction or postponement of tax;
- The Abnormality Requirement – the transaction must have been entered into or carried out in a manner that would not usually be employed for normal business purposes, other than to obtain a tax benefit; and
- The Purpose Requirement – the sole or main purpose of the transaction must have been to obtain a tax benefit.

In summary, in order for the previous GAAR to apply, the Commissioner had to be satisfied that all four elements had been met and the initial onus to prove that these provisions would apply was on the Commissioner (Kujinga, 2013:75). In order for the previous GAAR to have been applicable, both the subjective purpose or intention and the objective abnormality had to be present simultaneously. Due to the difficulty in proving the subjective purpose, the rebuttable presumption as contained in Section 103(4) of the Act meant that unless or until proven otherwise, it was presumed that the transaction had been entered into solely or mainly for the purpose of tax avoidance. The onus of disproving and rebutting this presumption was on the taxpayer (de Koker & Williams, 2020:par19.14). Had all four requirements been met, the Commissioner was then entitled to determine the amount of the tax liability as if the transaction had not been entered into or carried out as per Section 103(1)(c). A discussion of the weaknesses of the previous GAAR is included below.

2.2.1. Weaknesses of the previous GAAR

SARS (2005:41-44) identified the following weaknesses of the previous GAAR in the SARS Discussion Paper:

Not an effective deterrent

SARS (2005:41) described the previous GAAR as an inconsistent and ineffective deterrent to impermissible tax avoidance due to the failure thereof to stand up to the rigours of the courts. The inconsistency and ineffectiveness of the previous GAAR resulted in significant time and resources being required in order to identify and prevent avoidance schemes. This inevitably led to costly and lengthy battles between SARS and the taxpayer(s) which damaged the relationship between the two parties (SARS, 2005:42).

Abnormality requirement

SARS (2005:42) stated that the abnormality requirement contained fundamental weaknesses. Firstly, there was no clear distinction in the tax world to divide '*bona fide*' business transactions and impermissible tax avoidance schemes. Secondly, impermissible tax avoidance schemes would hijack techniques that were initially developed for *bona fide* business purposes, and as a result a transaction could become 'normal' or 'acceptable' if it became widely used. This resulted in the transaction being commercially acceptable and thus not containing an element of abnormality, making it easier for plausible business purposes to be manufactured (SARS, 2005:43; Katz, 1996:par 11.2.2; Margo, 1987:par 27.28).

Purpose requirement

This requirement can only be met if the sole or main purpose of a transaction was to obtain a tax benefit. The term 'main' has generally been construed to mean 'predominant' (SARS, 2005:43). It follows that if a transaction has more than one purpose, the purpose requirement would only have been satisfied if it was proven that obtaining the tax benefit was the predominant one. This was seen to be a subjective test, which placed the Commissioner in the difficult position of having to disprove a taxpayer's supposed intentions by looking at the purpose which a taxpayer claimed to have intended to achieve (SARS, 2005:43&44). Similarly, SARS (2005:43) stated that since most transactions entered into in a business context have "at least a colourable commercial rationale", taxpayers frequently argued that a commerical purpose for a transaction is sufficient to protect the steps within from being challenged (SARS, 2005:44).

This requirement was also described as intensifying the difficulties relating to the abnormality requirement as described above (SARS, 2005:43; *Commissioner for Inland Revenue v Louw,* 1983 (45) SATC 113 (A); *Secretary for Inland Revenue v Gallagher,* 1978 (40) SATC)). To summarise the above, the words of RC Williams are applicable:

> "In essence ... a taxpayer could with impunity enter into a transaction with the (subjective) sole purpose of avoiding tax provided that there was no (objective) abnormality in the means or manner or in the rights and obligations which it created. Conversely, a taxpayer could with impunity enter into a transaction which was objectively 'abnormal' provided that he did not, subjectively, have the sole or main purpose of tax avoidance".

The effect is that a transaction could fall short of the provisions of the previous GAAR if it contained one of the above requirements, but not the other. Both the purpose and abnormality requirements needed to be present in order for the previous GAAR to be applicable to the transaction. Therefore, should a taxpayer have been able to disprove either of these requirements, the GAAR would fail to stand up to the rigours of the courts and would not be applicable to such transactions (SARS, 2005:43). This placed taxpayers in a rather powerful position given the ease at which they could escape either one of these requirements and ultimately, escape the GAAR (Pidduck, 2017:73). The purpose requirement was left up to the courts to determine, as no standards for this were defined in the legislation.

Procedural and administrative issues

Additional uncertainty within the previous GAAR existed, relating firstly to the scope and whether it could be applied to individual steps in a larger transaction, or only to the transaction as a whole (de Koker & Williams, 2020:par 19.4). Secondly uncertainty existed with regard to the authority bestowed upon the Commissioner 'in the alternative' where another provision of the Act was also in dispute (SARS, 2005:44).

The weaknesses identified and discussed above led to the amendment of the GAAR in 2006. This amendment aimed to address these weaknesses to improve the effectiveness of the GAAR, through changes that would be made to existing law (SARS, 2005:48). The resulting amended provisions are discussed in Paragraph 2.3 below.

2.3. CURRENT SOUTH AFRICAN GAAR

The current GAAR is now contained in Sections 80A to 80L of the Act. In order for the current GAAR to be applicable to an arrangement, an 'impermissible avoidance arrangement' must exist which is defined in Section 80A. Section 80A of the 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; 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
>
> b) 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)."

Section 80A of the Act contains four elements that must be present in order for an 'impermissible avoidance arrangement' to exist, and thus for the current GAAR to be applicable, which may be summarised as follows:

- An arrangement (transaction, operation or scheme) must be present;
- The arrangement must result in a "tax benefit" (ie: avoidance arrangement is present)
- The sole or main purpose of the arrangement must be to have obtained the tax benefit; and
- One of the tainted elements must be present, which is determined based on whether the arrangement is "in the context of a business" or "in a context other than a business":
    - "in the context of a business"
        - Arrangement must be abnormal (ie: not *bona fide* business purposes);
        - Arrangement must be lacking in commercial substance;
    - "In any context"

- Arrangement creates rights and obligations that do not normally arise when parties interact at arm's length
- Arrangement results in abuse or misuse, whether directly or indirectly, of the Act.

Each of the four individual requirements of the current South African GAAR will be discussed below, in order to obtain an understanding as to how they may be interpreted and applied by the Commissioner. This will then be compared to the framework developed by Pidduck (2017:102), after which it will be applied to the selected case (*Frucor* case) in order to identify and propose improvements that could improve the efficacy of the current South African GAAR, consistent with the objectives of this study.

2.3.1. ARRANGEMENT

The first requirement of the provisions of the GAAR is that an arrangement must be present. Section 80L of the Act defines the term 'arrangement' as follows:

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

The terms 'transaction, operation and scheme' have not been defined in the Act but were present in the previous GAAR (Bauer, 2018:41). As these terms have not been defined, previous interpretation by the courts and thus the principles previously established by the courts in relation to these terms are still applicable (Bauer, 2018:41). These terms have been widely interpreted by the courts as is evident through the judgement that Beyers JA held (at 300) that "the word 'scheme' is a wide term… and it is sufficiently wide to cover a series of transactions" in the *Meyerowitz v Commissioner for Inland Revenue*,1963 (25) SATC 287 (A) case. This interpretation was validated by the courts in the case of *CIR v Louw,* 1980 (2) SA 721 (A). This wide interpretation of the terms is aligned with the purpose of the GAAR, allowing the GAAR to be applied to any possible transaction, operation or scheme that avoids tax in order to allow the Commissioner to take action (Loof & Emslie, 2013:9; Pidduck, 2017:78).

In fact, until the *ABSA* case was heard in the High Court in 2021, no cases had failed to trigger the provisions of the GAAR on the basis that no arrangement was present. The *ABSA* case introduced an additional consideration for purposes of the arrangement requirement –

that the taxpayer must have been a 'party' to the arrangement. Section 80L of the Act defines 'party' as any person who participates or takes part in an arrangement. However, in the *ABSA* case it was held that ABSA was not a party to the arrangement and that in order for a taxpayer to have been a "party" to an arrangement, the taxpayer was required to 'participate in or take part' in the arrangement and that such conduct requires volition. Therefore, the taxpayer needs to *be participating in* the arrangement and not merely just be present. It was held by Sutherland ADJP (at 39), that ABSA was an "unwitting recipient of a benefit from a share of the revenue derived from an impermissible arrangement cannot constitute taking part in such arrangement". It is submitted that there may be an additional weakness to the GAAR that was not brought to light until judgment on the *ABSA* case was passed. Based on the fact that ABSA was "not a party to" such arrangement, purely because they were an "unwitting recipient" of a tax benefit means that other taxpayers may claim ignorance as a defence to the provisions of the GAAR by virtue of the fact that they were not a party to the arrangement or that they were not aware of the arrangement in its entirety. By merely stating that the taxpayer was unaware of the consequences that a transaction may have, they can exclude themselves from being a party to an arrangement, thereby ensuring that the arrangement requirement is not met, which will inevitably result in the tax benefit requirement also not being met (refer to Paragraph 2.3.2), resulting in the GAAR not being applicable on the basis that not all four steps are met. This will, in turn, require SARS to prove with circumstantial evidence that the taxpayer was in fact not ignorant when assessing whether the arrangement requirement is met, suggesting that this test may be subjective in nature – refer to the discussion of sole or main purpose in Paragraph 2.3.3.

The definition of an arrangement also applies to "all steps therein or parts thereof" which enables the Commissioner to apply the provisions of the GAAR to the arrangement as a whole, but also to individual steps within such an arrangement. This provision is contained in Section 80H of the Act which states "the Commissioner may apply the provisions of this Part to steps or parts of an arrangement". Kujinga (2013:106) states that this provision (Section 80H) is intended to prevent taxpayers from including steps within a larger arrangement that have tax savings effects where the larger arrangement does not. Pidduck (2017:79) states that this could be seen as 'unfair' to taxpayers as it could be considered to be an intrusion to their right to avoid tax, but that this alone is not decisive given that it must still be characterised by one of the tainted elements. Kujinga (2013:107) explains that as a result, the isolation of steps does not violate any rights, given that it is not decisive of the

application of the GAAR. Thus, while a step can be isolated, this in itself does not trigger the application of the GAAR.

The *ABSA* case also considered the application to steps and parts of an arrangement, and it was noted (at 40) that an arrangement "must encompass all the transactions described". It was further noted that an arrangement containing several distinct transactions is considered to be a scheme. However, it was held (at 40) that the mere series of subsequential events does not constitute a chain which is required for a scheme to be present. The legislation does state that the provision can be applied to parts of an arrangement (which includes a scheme), but it does not provide insight into how a scheme is determined. When considering the judgment of the *ABSA* case, it is noted that in order for a scheme to be present, unity is required in order to tie several transactions into a deliberate chain. It is submitted that there may be yet another weakness to the GAAR that was not brought to light until the judgment of the *ABSA* case was passed. In turn, taxpayers may use this as another defence to the GAAR. Therefore using ignorance as a defence, taxpayers can claim that the transactions are not linked to one another in a deliberate chain, and thus do not represent a scheme. Refer to the discussion on sole or main purpose in Paragraph 2.3.3.

For the purposes of applying the framework developed by Pidduck (2017:102), the first step will be to determine whether an arrangement exists, which will be interpreted in accordance with the case law described above, and given the same wide interpretation as the courts. An amendment will be made in light of the research conducted in respect of the arrangement requirement, and a second step will be added to the framework. The second step will be to assess whether the taxpayer was a party to the arrangement by establishing whether the taxpayer acted with volition.

2.3.2. TAX BENEFIT

The second requirement of the current GAAR is that a tax benefit must be obtained as a result of the arrangement before it is considered to be an avoidance arrangement. It is therefore critical to establish the presence of a tax benefit, regardless of the value thereof (Pidduck, 2017:79). The following terms relevant to 'tax benefit' are defined in the Act:

- 'Tax' is defined as "any tax, levy or duty imposed by this Act or any other law administered by the Commissioner" (Section 80L);

- ‘Tax benefit’ is defined in the Act to include “any avoidance, postponement or reduction of any liability for tax” (Section 1).

As a result of the above definition, the term ‘tax’ encompasses all taxes (such as Income Tax and Value Added Tax), levies or duties (such as Estate Duty and Transfer Duty) that SARS administers. The term ‘tax benefit’ has been widely interpreted and due to the placement of the word ‘any’ in front of ‘liability’, should be interpreted as widely as possible. In establishing whether a tax benefit exists, the burden of proof lies with the Commissioner, and not with the taxpayer (de Koker & Williams, 2020:par:19.40).

In order for the Commissioner to prove that such a tax benefit has been obtained, the actual transaction is compared to alternative arrangements that the taxpayer could have entered into that would have yielded the same commercial results and the resulting tax consequences (de Koker & Williams, 2020:par:19.37; Loof & Emslie, 2013:14). The courts have evaluated the concept of a ‘tax benefit’ and as such these views can be used in the interpretation of the current GAAR. Past interpretations of this term are summarised below:

- The *Commissioner for Inland Revenue v King*,1947 (14)SATC 184 (A) case held that a tax benefit emerges when an anticipated tax liability is avoided by entering into a transaction that reduces the taxpayer’s income from what it would have been in future However, it should be noted that this is not the same as avoiding an existing liability for tax in the form of debt owed to SARS, as this would constitute tax evasion rather than avoidance.
- The *Smith v Commissioner for Inland Revenue,* 1964 (26) SATC 1 (A) case held that a tax benefit is created when a taxpayer steps out of the way of, prevents or escapes an anticipated liability.
- The *Income Tax Case No. 1625,* 1996 (59) SATC 383; the *Smith v Commissioner for Inland Revenue,*1964 (26) SATC 1 (A) case and the *Commission for Inland Revenue v Louw,* 1983 (45) SATC 113 (A) case introduced the “but for” test whereby the following question should be asked: Would the taxpayer have suffered tax ‘but for’ the transaction? The but for test was confirmed in the *ABSA* case wherein it was held that the ‘but for’ test is applied to a future anticipated tax liability to determine whether a tax liability was evaded.

In the *ABSA* case, the tax benefit requirement was considered and it was found (at 21) that the issued assessment, which at the discretion of the officials could be revoked, resulted in

an anticipated tax liability being present as opposed to an existing liability. Similarly, the 'but for' test was confirmed (at 42) where it was found that there was no plausible link between ABSA and the transaction. ABSA claimed to have been unaware of the tax benefit and given that ABSA was found to not be a 'party' to the arrangement (i.e. the arrangement requirement was not met), no plausible link between the tax benefit and the transaction was found, and as such no tax benefit existed (i.e. the tax benefit requirement was thus also not met). In order for the second step of the GAAR to be met, there must have been an arrangement that resulted in a tax benefit. Therefore, if there is no arrangement, step two cannot be met, which was the outcome of the *ASBA* case.

As a result, two tests have been incorporated into the framework as developed by Pidduck (2017:102-104):
Test 1: Did the taxpayer step out of the way of, escape or prevent an anticipated tax liability that would have arisen from the transaction? And
Test 2: The application of the "but for" test (Would a tax liability have existed but for this arrangement?).

2.3.3. SOLE OR MAIN PURPOSE

The third requirement of the GAAR is that the sole or main purpose must have been to obtain a tax benefit. When establishing whether the sole or main purpose was to obtain a tax benefit, Section 80A requires that the intention of the transaction, and not the intention of the taxpayer, be considered, constituting an objective test (Pidduck, 2017:83). The terms 'sole' and 'main' are not defined in the Act, but are similar to those terms used in the previous GAAR. As a result, past findings and interpretations by the courts are still applicable (de Koker & Williams, 2020:par:19.38). The interpretation of the word 'main' had generally been construed to mean 'predominant' (SARS, 2005:43) and that where a transaction had more than one purpose, the predominant purpose needed to be that of obtaining a tax benefit as discussed in Paragraph 2.3.2. This is considered to be a weakness of the current GAAR, given the uncertainty surrounding the word 'main' and the need to prove the predemoninant purpose.

The purpose of the transaction is presumed to be solely or mainly to obtain a tax benefit unless the taxpayer is able to prove otherwise, as per Section 80G of the Act. The onus to dispove the presumption therefore lies on the taxpayer. Should a taxpayer merely assert

that their sole or main purpose was not to obtain a tax benefit, this in itself is not sufficient to discharge the onus, and affirmative or conclusive evidence is required to satisfy a court upon a balance of probability and 'reasonably considered in light of the relevant facts and circumstances that the sole or main purpose of the transaction was not to obtain a tax benefit (de Koker & Williams, 2020:par:19.38). However, it should be noted that Section 80G requires that the relevant facts and circumstances should be considered which, as stated by Kujinga (2013:110), suggests that a subjective test may be applicable.

The purpose test in the previous GAAR was considered to be subjective in nature through the consideration of what the taxpayer claimed to have intended to achieve (SARS, 2005:43&44) and was interpreted subjectively as in the cases of *Ovenstone v Secretary for Inland* Revenue, 1980 (42) SATC 5 (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). However, under the current GAAR, the sole or main purpose requirement is seen to be an objective test, as suggested by Section 80A, whereby the taxpayer can discharge the onus based on factual and objective means (de Koker & Williams, 2020:par:19.38; Kujinga, 2013:110). As per the above, it is evident that conflicting views exist as to whether the sole or main purpose requirement is subjective or objective.

The problems experienced with regard to the sole or main purpose requirement are further compounded by the fact that the courts support the view that taxpayers may choose to structure such transactions in such a way as to attract the least amount of tax, as established in the *CIR v Conhage (Formerly Tycon)* (1999) 4 SA 1149 (SCA) (*Conhage* case). Despite structuring their transactions to attract the least amount of tax, the sole or main purpose of such transactions will not necessarily be tax avoidance, nor will it be assumed if the transaction has commercial reason (Pidduck, 2017:84) which was supported in *R Ltd and K Ltd v Commissioner of Taxes* (1983) 45 SATC 148 (ZH) and *Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd* (1999) 62 SATC 65.

The *ABSA* case shed some light with regard to the purpose test, but instead of considering this as part of the sole or main purpose requirement, it was considered as part of the arrangement requirement. Sutherland ADJP (at 41) stated the following:

> "Moreover, there is no basis to construe the factual basis as supporting an inference that the ABSA investment was, in the least, motivated by an intention to obtain relief from an anticipated

tax liability, a necessary attribute of an arrangement. The expectation of receiving dividend income which is free of tax is so banal a transaction that it cannot support a suspicion of pursuing an ulterior motive and thus cannot serve to broaden the compass of the participants in a scheme" [emphasis added].

The implications of this extract of judgment is that motive and intent are now considered when examining the arrangement requirement. It is therefore submitted that a weakness may have been introduced by the judgement in the *ABSA* case through the motive and intent of the taxpayer being considered (indicating a subjective test, not an objective test) which reintroduces the weakness identified in the previous GAAR and discussed in Paragraph 2.2.1.

Due to the conflicting views that exist as to whether this test is subjective or objective in nature, it is not clear which test the courts would apply when assessing the sole or main purpose requirement. As a result of this, the framework incorporates elements of both tests – using a subjective test with supporting facts (Paragraph 2.5).

2.3.4. TAINTED ELEMENTS

The fourth and final requirement of the GAAR that needs to be present for a transaction to be considered an impermissible avoidance arrangement, is the 'tainted elements' requirement. As per the definition of an impermissible avoidance arrangement in Section 80A, at least one of the tainted elements must be present. The onus of proving the presence of one of the tainted elements lies with the Commissioner, who may rely on the guidelines and definitions contained within Sections 80C to 80E of the Act to discharge this onus (Kujinga, 2013:111). There are four possible tainted elements that can be considered, depending on the context in which the transaction takes place.

- If the transaction takes place in the context of a business, the tainted elements that should be considered are abnormality (not for *bona fide* purposes) or lack of commercial substance.
- If the transaction takes place in a context other than business, the applicable tainted element is abnormality.
- If the transaction takes place in any other context, the applicable tainted elements are misuse and abuse of the Act or rights and obligations created are not at arm's length.

The four tainted elements are summarised as follows:

- Abnormality element
- Lack of commercial substance element
- Creation of rights and obligations not at arm's length element
- Misuse or abuse element

Bauer (2018:45) and Pidduck (2017:85) observe that both the 'abnormality' and 'non-arm's length rights and obligations' were retained from the previous GAAR and as a result, any precedent or interpretation by the courts with regard to these two elements may still be applicable for purposes of the current GAAR. However, additional elements had been included in the current GAAR and would require interpretation (de Koker & Williams, 2020:par:19.39; Langenhoven, 2016:38). Each of the tainted elements will be discussed individually below.

2.3.4.1. ABNORMALITY ELEMENT

The first of the four tainted elements is the abnormality element. The abnormality element was retained from the previous GAAR despite the pre-existing uncertainty regarding the interpretation of the meaning of the word 'normal' which remains undefined in the Act. This could possibly result in uncertainty when applying the GAAR and result in the interpretation being left to the courts (Kujinga, 2013:111; Langenhoven, 2016:38). In addition to this uncertainty, the weaknesses identified in relation to the abnormality requirement of the previous GAAR above may still be present in the current GAAR. Kujinga (2013:111) suggests that this interpretation by the courts may result in inconsistent application and may ultimately lead to limited efficacy of the GAAR. Pidduck (2017:85) states that this simply highlighted that the amended and current GAAR failed to rectify the problems of the previous GAAR due to the fact that there is still no guidance on normality, and thus uncertainty remains with regard to the abnormality requirement. However, the words contained in the previous GAAR "having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out" have been removed and as such, indicates that this abnormality test will now be an objective test as opposed to a subjective test (Pidduck, 2017:85; SARS, 2005:56).

The issue of the abnormality requirement is not whether the transaction had commercial purpose, but rather whether the transaction was carried out in a manner that would normally

be carried out for *bona fide* purposes (other than to obtain a tax benefit) (Kujinga, 2013:111). In determining abnormality, it was held in the *Hicklin v Secretary for Inland Revenue (*1980) 1 All SA 301 (A) that if a transaction was carried out at arm's length, then the rights or obligations created, and the means and manner employed in entering into the transaction would be regarded as normal. On the contrary, if the transaction was not carried out at arm's length, this would give rise to an abnormal transaction. In other words, this has been described as a comparison between the actual arrangement and the manner in which a comparable arrangement would be carried out which was confirmed in the *Income Tax Case No. 1712* (2000) 63 SATC 499. Should it be determined that the transaction was not carried out in a manner that would normally be for *bona fide* purposes, the arrangement could be considered to be 'tainted'. The framework incorporates the abnormality requirement by comparing the applicable transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration to determine whether an element of abnormality exists.

2.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second of the four tainted elements is the lack of commercial substance element. This element only applies to arrangements in the context of a business and is located in Section 80C(1) of the Act. Section 80C(1) contains a general rule for when an arrangement would lack commercial substance, and Section 80C(2) contains a non-exhaustive list of indicators that taxpayers can use to determine whether a transaction may lack commercial substance. Section 80C 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."

The general rule of when an arrangement could lack commercial substance, as established within Section 80C(1), states that an arrangement lacks commercial substance when the result of such arrangement is a significant tax benefit that did not have a significant effect on the business risks or net cash flows of the party. The terms 'significant tax benefit', 'significant effect', 'business risks' and 'net cash flows' are not defined in the Act, and as such, uncertainty is created regarding how the courts will interpret the meaning of these terms, and thus creates uncertainty regarding the application of the GAAR on the basis of a lack of commercial substance as a whole (de Koker & Williams, 2020:par 19.39).

Section 80C(2) provides a non-exhaustive list of characters that are indicative of a lack of commercial substance, providing guidance on what "could be" rather than providing limits which could be widely interpreted (Bauer, 2018:46). The framework incorporates the lack of commercial substance tainted element as well as the four indicators. Each indicator is discussed below.

Substance over form indicator

The substance over form indicator is contained in Section 80C(2)(a) and is the first indicator that a transaction may lack commercial substance. Section 80C(2)(a) reads as follows:

> "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".

The presence of the word 'significant' once again gives rise to uncertainty. This test is not defined in the Act and has been developed through common law (de Koker & Williams, 2020:par: 46.22). The principle established through common law is that effect will be given to the substance of the transaction rather than its form when the intention of the parties is disguised (*Relier v Commissioner for Inland Revenue* (199 60 SATC 1 (A); *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) 3 SA 942 (A)). In other words, the deliberate disguise of the true nature of an arrangement (Langenhoven, 2016:42). Olivier (1996:737) concludes that where the intention of the transaction was disguised, the Commissioner need not make use of the GAAR, and that such transactions are regulated under common law (Pidduck, 2017:91).

When considering the GAAR, common law has established that effect should be given to what the transaction 'really is' and not what it 'appears to be' (*Commissioner for South African Revenue Service v NWK Ltd* (2010) ZASCA 168 (SCA)). In order to test for the

presence of the substance over form element, it should be determined whether the risks and rewards of the arrangement are those that would be expected from such an arrangement (Pidduck, 2017:91).

The framework incorporates the substance over form indicator by asking whether the true intention of the parties is reflected, whether the taxpayer has remained insulated from virtually all economic risk and whether the purpose of the transaction was only to achieve tax avoidance.

Round trip financing indicator

Round trip financing is defined in Section 80D of the Act and is a new addition to the current GAAR. As a result, there is no previous court interpretation regarding this indicator. Section 80D of the Act reads as follows:

- 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.
- This section applies to any round tripped amounts without regard to—
  a) whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;
  b) the timing or sequence in which round tripped amounts are transferred or received; or
  c) the means by or manner in which round tripped amounts are transferred or received.
- For the purposes of this section, the term “funds” includes any cash, cash equivalents or any right or obligation to receive or pay the same.”

Kujinga (2013:114) explains that round trip financing typically involves the absence of ‘actual money or funds’ and where no real risk of loss is present. Ultimately, this means that there is no true business transaction due to the fact that money appears to pass between the parties with the end result being the money ending up in the hands of the parties of the arrangement, leaving them in the same financial position as they were prior to the arrangement, the only exception being the tax benefit obtained (de Koker & Williams, 2020:par 46.23).

In order for round trip financing to be present, an arrangement would be required to meet all three requirements as contained in Sections 80D(1)(a) and 80D(1)(b). The first requirement makes use of the words “among” and “between”, neither of which are defined in the Act, and would thus be subject to the interpretation of the courts. This would need to be done in the context of the GAAR, which Pidduck (2017:92) suggests would likely be done in accordance with the ordinary meaning of the words. The ordinary meanings would indicate that the funds would have to be transferred between parties, through some type of reciprocal action (Pidduck, 2017:93) The second requirement is that the above transfer of funds results in a tax benefit, whether directly or indirectly. Pidduck (2017:93) states that in order for Section 80D to be applicable, this benefit arising from the transfer of funds must be present, even if the tax benefit for the arrangement as a whole has been determined already. The third and final requirement requires that the above transfer of funds either significantly reduces, offsets or eliminates any business risk incurred by any of the parties’ to the arrangement. Once again, the word ‘significant’ is found within this requirement and would thus be subject to the interpretation of the courts which could result in added uncertainty being introduced in the application of the GAAR.

The framework incorporates the test for the presence of the round trip financing indicator by considering whether funding was transferred between parties through some type of reciprocal action that results in a tax benefit. However, what the framework does not consider is whether the transfer of funds resulted in the reduction, offsetting or elimination of business risks as contained in Section 80D(1)(b)(ii). The framework will therefore be amended to include this consideration.

Accommodating or tax-indifferent party indicator

The third indicator is an arrangement that includes an accommodating or tax-indifferent party, which is defined in Section 80E(1) of the Act, which reads as follows:

1) “A party to an avoidance arrangement is an accommodating or tax-indifferent party if—
    a) any amount derived by the party in connection with the avoidance arrangement is either—
        i) not subject to normal tax; or
        ii) significantly offset either by any expenditure or loss incurred by the party in connection with that avoidance arrangement or any assessed loss of that party; and
    b) either—

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

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

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

(cc) constituted revenue in the hands of another party would be treated as capital by that other party; or(dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or

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

As can be seen from the above, 'tax-indifferent party' is widely defined. However, Section 80E(1) does not contain the words "are not limited to" unlike Section 80C (lack of commercial substance element), which De Koker and Williams (2020:par19.39) indicate may therefore be an exhaustive list. In addition to the above Section 80E(2) provides that the tax-indifferent or accommodating party need not be a connected person in relation to any part of the arrangement.

SARS (2005:21) describes 'tax-indifferent parties' as "taxpayers that can either generate offsetting deductions to absorb any income they derive from their participation in a scheme or utilise existing assessed losses." Furthermore, it is noted that these taxpayers generally received a fee for the service of absorbing the income or "selling" their tax-advantageous status to other participants within the same scheme (this fee is usually in the form of an above-market return on investment). The result of this is that any parties that sell their tax advantages to other parties are regarded as tax-indifferent parties regardless of their relationship to any of the other parties within the same scheme (Pidduck, 2017:96). The implication of there being a tax-indifferent or accommodating party is that Section 80F allows the Commissioner to treat such parties as one and the same, or to disregard any such parties. Despite the wide interpretation of this indicator, Section 80(E)(3) of the Act specifically excludes certain parties from qualifying as accommodating or tax-indifferent parties. Section 80(E)(3) provides that:

"(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."

The exclusion of a controlled foreign company that is considered to have a foreign business establishment can be problematic, given that the use of such companies in the context of a multi-national enterprise (MNE) is not uncommon. As a result, MNEs may seek to use these controlled foreign companies (complying with Section 9D(1) and thus, be excluded from the definition of a tax-indifferent party) and thereby prevent the application of the GAAR. Pidduck (2020:266) states that this was possibly not considered when drafting the current GAAR, and may undermine the effectiveness of the current GAAR. The framework incorporates the test for an accommodating or tax-indifferent party by considering whether a tax advantage was transferred from one party to another.

Offsetting or cancelling indicator

The fourth and final indicator that an arrangement lacks commercial substance, is the 'offsetting or cancelling indicator' and is contained in Section 80C(2)(b)(iii) of the Act. This indicator considers the presence of elements that have the effect of offsetting or cancelling other elements within an arrangement. This was introduced to counteract the fact that the arrangement (or part thereof) may have no fiscal consequences, but may still result in the GAAR being applicable had the sole or main purpose of the arrangement been to obtain a tax benefit (de Koker & Williams, 2020:par 46.25; Pidduck, 2017:97).

While it may be argued that there is no ambiguity in this section, and the ordinary meanings of the words can be used for the purposes of interpretation, no guidance is provided on the size of the offsetting or cancelling elements. The offsetting or cancelling elements could also

refer to rights and obligations that offset or cancel each other and do not necessarily need to be expressed in monetary terms (de Koker & Williams, 2020:par:19.39; Pidduck 2017:07). There is thus no definitive list of what these offsetting or cancelling elements are or are not, which creates uncertainty with regard to the application and interpretation of this indicator. The uncertainty relating to what the elements are, and the lack of guidance with regard to the size may be a weakness of the current GAAR. The cancelling or offsetting elements have been referred to as a "self-neutralising mechanism" which was inspired by a UK precedent, in the case of *WT Ramsay Ltd v IRC Eilbeck (Inspector of Taxes) v Rawling* (1981) 1 All ER 865. This case established the principle whereby a transaction in which the gains are offset is a "fiscal nullity and this amounts to impermissible tax avoidance".
Considering the above, Pidduck (2017:97) states that this indicator is aligned with the purpose of the GAAR, being that "it has been interpreted to prevent the mischief achieved by tainting a transaction where cancelling or offsetting has occurred, and no change exists other than that of a tax benefit". Kujinga (2013:115) states that this provision is aimed at avoidance arrangements that create a gain and a loss in order to offset the tax implications. However, a taxpayer is entitled to obtain the tax benefit from expenditure or losses actually incurred (in accordance with Section 11(a) of the Act) but the GAAR becomes applicable when transactions create such expenditure or losses with the purpose of offsetting the relative gain (Kujinga, 2013:115).

The framework incorporates this indictor by considering whether elements exist in the transaction which have the effect of offsetting or cancelling one another.

2.3.4.3. RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the creation of rights or obligations that are not at arm's length. This element applies both to the context of a business as well as to any context other than a business. This test focuses on whether the rights or obligations that are created in the avoidance arrangement are similar, or if they differ to rights and obligations that would have arisen from a "normal transaction" (Kujinga, 2013:116).

The term "arm's length" is not defined in the Act and as a result could lead to uncertainty in its interpretation. Counteracting this uncertainty is the fact that this element was retained from the previous GAAR, and thus interpretation by the courts is still seen as relevant in this regard (Bauer, 2018:51). In the current GAAR, the words "the nature of the transaction,

operation or scheme in question" as contained in the previous GAAR have been removed The change in word structure in the current GAAR has been argued to now represent an objective test (de Koker & Williams, 2020:par19.39). In the case of *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A) it was held that arm's length refers to the determination of what unconnected parties would have done in the same situation. Therefore, in contrast, any transactions entered into not at arm's length would be indicative of a lack of commercial substance.

The framework, developed by Pidduck, considers what unconnected persons would have done in the same situation, in order to determine whether this element is present within an arrangement (Pidduck, 2017:99).

2.3.4.4. MISUSE OR ABUSE

The 'misuse or abuse' element is new to the current GAAR and has not been defined in the Act, nor has it been interpreted by the courts. The presence of undefined terms that are both new and not previously interpreted by the courts results in increased uncertainty with regard to the application of this element. As such, one would obtain guidance from the ordinary grammatical meaning of the words, together with the intention of the legislation (Pidduck, 2017:53).

The intention of the legislation was to incorporate the 'misuse or abuse' element with the purpose of aligning the GAAR with international standards and practices, specifically Canadian standards (Pidduck, 2017:100; Louw, 2007:38). Van Schalkwyk and Geldenhuys (2009:172) recommended that it may be helpful to consider how this provision was interpreted in Canadian law, and that this could provide an indication as to how the South African courts may approach and interpret this element. In the Canadian case *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, the Supreme Court of Canada indicated that 'misuse or abuse' "imply frustrating or exploiting the purpose of the legislation relied on by the taxpayer". Therefore, the intention of the provisions must first be understood in order to determine whether the purpose of the arrangement was to frustrate or exploit such provisions to achieve a result not initially intended by the provisions (Pidduck, 2017:101). Van Schalkwyk and Geldenhuys (2009:172) note that the Canadian interpretation is consistent with the intention of the legislation relating to the inclusion of the 'misuse or abuse' element in the current GAAR of South Africa.

The framework incorporates the ‘misuse or abuse’ element by considering whether the arrangement frustrates, exploits or manipulates the provisions, or whether provisions of the Act are used to achieve a result not intended by the legislator.

2.4. WEAKNESSES OF THE CURRENT GAAR

The analysis contained in Paragraph 2.3. above, has allowed for the identification of weaknesses of the current South African GAAR, through which it has been noted that the current GAAR may potentially be an ineffective deterrent to tax avoidance schemes. A summary of these weaknesses is included below.

- The additional consideration introduced by the *ABSA* case in the arrangement requirement (a taxpayer must be a ‘party to’ an arrangement, requiring volition) could result in taxpayers claiming ignorance as a defence to the provisions of the GAAR. It is submitted that this may result in the arrangement requirement becoming a subjective test (Paragraph 2.3.1.).
- While the GAAR is applicable to steps within a transaction, two weaknesses have been found within this requirement:
    - Although Section 80H of the Act allows steps within an arrangement to be considered, Pidduck (2017:159) argues that when a part of an arrangement is considered in isolation, it may lose commercial substance if the context of the wider transaction is not considered (Paragraph 2.3.1.).
    - The definition of an arrangement includes a scheme, the presence of which may be disproven if a taxpayer can prove that there is no deliberate chain linking various transactions together, or by merely claiming that they were an unwitting participant or ignorant thereof (*ABSA* case) (Paragraph 2.3.1.).
- In the current GAAR, the ‘sole or main purpose’ requirement and the ‘tainted elements’ requirement (previously abnormality requirement) are still two separate requirements, which are *both* required to be met, placing the taxpayer in a rather powerful position to escape the GAAR, given the ease at which they could escape either one of these requirements (Paragraph 2.2.1.).
- When considering the sole or main purpose requirement, the following weaknesses were identified:

- If a transaction has more than one purpose, the purpose requirement would only have been satisfied if it was proven that obtaining the tax benefit was the predominant one (Paragraph 2.3.3.).
- Uncertainty exists as to whether the determination of the sole or main purpose requirement will be subjective or objective, which creates uncertainty with regard to its application and interpretation (Paragraph 2.3.3.)
- The consideration of motive and intent as part of the 'party' to the arrangement instead of within the sole or main purpose requirement (as a result of the judgment in the *ABSA* case) may indicate that the intended change to an objective test for purposes of the sole or main purpose requirement may be superfluous and may thereby reintroduce a weakness of the previous GAAR (Paragraph 2.3.3.).

- When considering the tainted elements requirements, the following weaknesses were identified:
  - A transaction could become 'normal' or 'acceptable' if it became widely used, rendering it to be commercially acceptable and thus not containing an element of abnormality (SARS, 2005:43; Katz, 1996:par 11.2.2; Margo, 1987:par 27.28) (Paragraph 2.3.4.1.).
  - No guidance is provided on the size of the offsetting or cancelling elements and such elements could also refer to rights and obligations that offset or cancel each other (ie: no clear list of what is or is not an offsetting or cancelling element) (Paragraph 2.3.4.2.).
  - Various terms and definitions within the current GAAR refer to the word 'significant' (indicators of tainted elements – Paragraph 2.3.4.2.) and thus also make reference to size. As 'significant' is undefined, this creates uncertainty with regard to its application and interpretation which could impact the efficacy of the current GAAR.
  - Uncertainty exists with regard to how the indicators of a lack of commercial substance should be applied and interpreted (Pidduck, 2017:322) (Paragraph 2.3.4.2.). It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to how the misuse or abuse tainted element should be applied.
    - The tax-indifferent or accommodating party indicator to the lack of commercial substance tainted element contains an exclusion of a controlled foreign company with a foreign business establishment from its definition, which can

result in taxpayers escaping the provisions of the GAAR by using controlled foreign companies. This weakness if further compounded by the fact that the use of such companies in the context of MNEs is not uncommon and may use controlled foreign companies to purposefully be excluded from the definition of a tax-indifferent party (Paragraph 2.3.4.2.) .

- Uncertainty exists with regard to how the misuse or abuse tainted element should be applied and further guidance is needed to ensure that it is correctly and consistently applied (Paragraph 2.3.4.4.) (Pidduck, 2017:322).

- The current GAAR contains many terms that are not defined in the Act, which could create uncertainty with regard to the application and interpretation of the terms. These terms include, ‘normal’, ‘significant effect’, ‘business risks’, ‘net cash flows’, ‘among’, ‘between’, ‘arm’s length’, ‘misuse’ and ‘abuse’. It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to the definitions and meanings of the abovementioned terms.
- No guidance has been provided with regard to how special relationships between parties to a transaction may impact the application of the individual requirements of the GAAR (Pidduck, 2017:322). It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to how special relationships between parties to a transaction may impact the application of the requirements of the GAAR.

2.5. FRAMEWORK

Pidduck (2017:102-104) developed a framework that may be used to apply facts of selected court cases to the current South African GAAR. It will be used in Chapter 4 to apply to the facts of the *Frucor* case. The following two amendments have been made to the framework in accordance with the research performed:

1. **Arrangement:** Did the taxpayer participate in the arrangement with volition? (Paragraph 2.3.1.)
2. **Round trip financing:** Did the transfer of funds result in the reduction, offsetting or elimination of business risk? (Paragraph 2.3.4.).

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. • Amendment: Did the taxpayer participate in the arrangement with volition?
2 – Does the transaction, operation or 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 (the but for test)? (*Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case; *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 it 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 stated non-tax benefit intention of the arrangement? (Meyerowitz, 2008:par.19-12; De Koker and Williams, 2015:par.19.38) and ***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 to obtain 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 that did not attract tax or attracted less tax, this does not indicate that obtaining a tax benefit was 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 for normal 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 type of reciprocal action, resulting directly or indirectly in a tax benefit? *Amendment*: Did the transfer of funds result in the reduction, offsetting or elimination of business risk?
- *Tax-indifferent party test*: Is there a party who effectively transferred its tax advantage to others, irrespective 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)
- Unconnected persons would not 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?

Adapted: (Pidduck, 2017:102-104)

2.6. CONCLUSION

This chapter provided a doctrinal analysis of the current South African GAAR through the use of existing literature, case law as well as the applicable legislation. Through the comparison of the current GAAR to its predecessor, it was noted that some elements were retained. As a result, some of the weaknesses of the predecessor have been retained in the current GAAR while. Additional weaknesses of the current South African GAAR were identified that may render the current GAAR an ineffective deterrent against impermissible

avoidance arrangements. Finally this chapter presented the amended framework to be used as a basis for the application to the selected case (the *Frucor* case) in Chapter 4.

The next chapter, Chapter 3, analyses the New Zealand GAAR and provides a comparison of the South African GAAR to that of its New Zealand counterpart. The aim of Chapter 3 is to identify improvements that could be made to the South African GAAR by using lessons obtained from New Zealand.

CHAPTER 3: THE NEW ZEALAND GAAR

3.1. INTRODUCTION

The objective of this study is to analyse the South African GAAR in order to identify its weaknesses and to make suggestions for improvement using the lessons learned from New Zealand. Chapter 2 contained a doctrinal analysis of the current South African GAAR in order to identify its weaknesses. This chapter provides a doctrinal analysis of the New Zealand GAAR through an analysis of each of the requirements to which the current South African GAAR is compared and, using the lessons learned from the New Zealand GAAR, recommendations will be made in order to improve its efficacy. This chapter therefore addresses the second and fourth objectives of this study (refer to Paragraph1.4).

3.2. NEW ZEALAND GAAR

New Zealand first introduced a GAAR to its legislation in 1878 which was contained in Section 62 of the Land Tax Act 1878. In 1879, the GAAR was brought into Section 29 of the New Zealand Property Assessment Act 1879 (Elliffe, 2014:148; Tretola, 2018:3). In 1891 the GAAR was brought into Section 40 of the Land and Income Assessment Act 1891 and thereafter to Section 108 of the Land and Income Tax Act 1954 (Elliffe, 2014:148; Tretola, 2018:3). The amendment to Section 108 of the Land and Income Tax Act in 1976 resulted in the GAAR being moved to Section 99 of the Income Tax Act 1976 (Prebble & McIntosh, 2015:1029). Thereafter it was brought into Section BG 1 and GB 1 (substantively in the same form) of the Income Tax Act 1994, and then ultimately to Section BG 1 and YA 1 of the current Income Tax Act No. 97 of 2007 (New Zealand Act) which represents the current New Zealand GAAR (New Zealand GAAR) (Prebble & McIntosh, 2015:1029). This study only considers the current New Zealand GAAR and the application thereof.

The New Zealand GAAR is applicable to tax avoidance arrangements, whereas the current South African GAAR is applicable to impermissible tax avoidance arrangements. In order for the New Zealand GAAR to be applicable to an arrangement, there must be a tax avoidance arrangement that is defined in Section YA 1 of the New Zealand Act 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."

The New Zealand GAAR involves a three-step approach:

- An arrangement must be present;
- There is a presence of tax avoidance; and
- The arrangement must have tax avoidance as its purpose or effect or as one of its purposes or effects that is not merely incidental.

Should a tax avoidance arrangement exist (as defined in Section YA 1 of the New Zealand Act), the arrangement will be considered to be void as per Section BG (1) of the New Zealand Act. Sections BG 1(2) and GA 1(2) of the New Zealand Act provide for additional consequences. Section BG 1(2) of the New Zealand Act allows the Commissioner to counteract the tax advantage obtained from a tax avoidance arrangement and Section GA 1(2) of the New Zealand Act allows the Commissioner to adjust the taxable income to counteract the tax advantage obtained as a result of the tax avoidance arrangement. This allows the Commissioner to either treat the taxpayer who entered into the tax avoidance arrangement as if they had not done so at all (voiding the transaction), or to impose tax according to a hypothetical arrangement that could have been carried out (Datt & Keating, 2018:467).

The New Zealand GAAR contains 3 requirements in order for the GAAR to be applicable, whereas the current South African GAAR contains four requirements to determine the presence of an 'impermissible avoidance arrangement'. While each requirement of the New Zealand GAAR will be analysed in the forthcoming paragraphs, the New Zealand GAAR can already be seen to be shorter and more concise than that of the current South African GAAR. While it may be shorter, it is noted that Parliament intentionally left the GAAR "deliberately general" and vague, leaving it to the courts to "work out" and to develop judicial constraints due to the fact that the ingenuity of taxpayers can never be predicted, regardless of how well-drafted the provision may be (Cassidy, 2012:10; Keating & Keating, 2011:13).

The highest court in New Zealand, the New Zealand Supreme Court, first heard a GAAR case in 2008 in the case of *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue,* 2008 NZSC 115 (2009) 2 NZLR 289 (*Ben Nevis case)* which is seen to be the leading case on the GAAR (Littlewood, 2013:534; Tretola, 2018:4). As this is the leading case, the principles established in this case will be used amongst others for the analysis of the New Zealand GAAR. Each of the requirements of the New Zealand GAAR are discussed below.

3.2.1. ARRANGEMENT

The first requirement is that an 'arrangement' must be present which is defined in Section YA 1 of the New Zealand Act and reads as follows:

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

The term, as within the current South African GAAR (Paragraph 2.3.1.), has a wide definition which allows for a wide interpretation (Cassidy, 2012:10; Littlewood, 2013:525). The case of *Ashton v Commissioner of Inland Revenue* (1975) 2 NZLR 717 (PC) supported this by stating that an arrangement can be oral or written, thereby giving it a wide scope. The purpose of the wide definition is to ensure that 'arrangement' has a broad meaning, contributing to the broad scope of the GAAR as a whole (Cassidy, 2012:10; Littlewood, 2013:525). The courts have supported this wide interpretation and the judgments of *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548 and *Commissioner of Inland Revenue v BNZ Investments Ltd* (2002) 1 NZLR 450 (CA), where it was held that the term arrangement encompasses all actions that may be undertaken by parties in order to achieve a specific purpose or effect. Hwong and Li (2020:546-547) state that no case in New Zealand seems to turn on the meaning of 'arrangement'.

In addition to the above, the definition of arrangement includes "all steps and transactions by which it is carried into effect" which is similar to the South African GAAR. In the *Ben Nevis* case (at 105) it was stated that tax avoidance may be found in individual steps, or within a combination and that while steps within a transaction may be individually acceptable, the combination of steps may constitute a tax avoidance arrangement. Cassidy (2012:23) notes that when the steps of an arrangement are combined, the arrangement as a whole may no longer comply with the Parliamentary intention and thus constitute tax avoidance. In the current South African GAAR, as contained in Section 80H of the Act, the current South

African GAAR can be applied to steps within, or to the whole arrangement and is therefore similar to that of the New Zealand GAAR.

Nevertheless, one important difference between the New Zealand GAAR and that of South Africa is that the taxpayer does not need to be aware of, nor be a party to, the arrangement in order for the New Zealand GAAR to apply, as confirmed in *Peterson v Commissioner of Inland Revenue* (2005) UKPC 5 (2006) 3 NZLR 433 (at 34) (*Peterson* case) (Elliffe, 2021:4). Therefore a taxpayer is still considered to be a party to an arrangement, even if they did not know all, or some of, the details or mechanisms by which the 'agreement, contract, plan or understanding' would be carried out by another person (Elliffe, 2021:4). When compared to the current South African GAAR (the *ABSA* case) a taxpayer must act with volition to be a 'party to an arrangement', therefore a taxpayer who did not know about the arrangement or who was an unwitting participant, would not be considered to be a party to the arrangement. Therefore, as the New Zealand GAAR does not depend on the taxpayer being a party to the arrangement by participating in the arrangement with volition, it is submitted that South Africa learn from its New Zealand counterpart by not requiring that a taxpayer be a party to an arrangement to ensure that taxpayers cannot use ignorance as a defence to the GAAR.

3.2.2. TAX AVOIDANCE

The next requirement in order for the New Zealand GAAR to be applicable, is that there must be tax avoidance resulting from the arrangement. The current South African GAAR refers to the term 'tax benefit' whereas the New Zealand GAAR refers to 'tax avoidance' but they have similar definitions and interpretations. The term 'tax avoidance' has been defined in Section YA 1 of the New Zealand Act as:

> "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 reworded above directly or indirectly avoids, postpones or reduces any liability to income tax or any potential or prospective liability to future income tax."

Tax avoidance is therefore the alteration, avoidance, postponement or reduction of any income tax, whereas the current South African GAAR is applicable to any type of tax (Paragraph 2.3.2.). When the definition of tax avoidance is compared to the current South African GAAR, it is noted that while the New Zealand GAAR makes reference to a potential

or prospective liability in its definition, South Africa refers to a liability for tax and the avoidance of an anticipated liability was determined by the courts (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) and *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A)). It is recommended that South Africa incorporate the words 'anticipated', 'potential' and 'prospective' into its GAAR to reduce the reliance on court interpretations.

Nevertheless, Littlewood (2011:41-42) identifies two issues with regard to the definition of tax avoidance. The first issue arising from Paragraph (a) was identified in the case of *Elmiger v Commissioner of Inland Revenue* (1966) NZLR 683 (SC) where it was held that almost all transactions have the effect of and ability to alter the potential incidence of tax. Littlewood (2011:269) reiterates this, saying that this could not have been the intention of the provision, as it could then be applicable to virtually every conceivable transaction. The second issue arises from Paragraph (b) where Littlewood (2011:42) explains that once a liability has accrued, the taxpayer can no longer do anything about it and this provision is thus 'empty'. In addition, he explains that potential liabilities could cover every transaction as all transactions affect potential liabilities of tax. It is therefore important to determine how literally the New Zealand GAAR should be interpreted. Lord Donovan, in *Mangin v Commissioner of Inland Revenue* (1970) 70 ATC 6001 (PC) stated that if the GAAR were to be interpreted literally that the results would be absurd.

In light of the problems experienced with the term tax avoidance noted above, the courts have been prompted to develop judicial constraints to the New Zealand GAAR's application (Cassidy, 2012:10) The courts have thus developed the Parliamentary contemplation test (i.e. the "two-step approach") to assess whether tax avoidance has occurred. This was developed accordingly in the *Ben Nevis* case and is described as follows:

Step 1: The first step examines whether the taxpayer has met the requirements of the specific provisions, and thereby considers whether the taxpayer used the provisions within their intended scope (Ebersohn, 2012:265; Elliffe & Cameron, 2010:449).

Step 2: The second step considers the arrangement as a whole and whether the use of the provisions were aligned with the contemplation and purpose of Parliament when the provision was enacted (Ebersohn, 2012:265; Elliffe & Cameron, 2010:449).

In considering how this two-step approach compares to the current South African GAAR, it is noted that there are similarities between the principles incorporated into this two-step test and the misuse or abuse tainted element (Paragraph 2.3.4.4.). The misuse or abuse tainted element seeks to determine whether the purpose of the arrangement was to achieve a result not initially intended by the provision (Pidduck, 2017:101). In the New Zealand GAAR, establishing whether the intention of the provision was complied with is found within the tax avoidance requirement and is thus linked to whether or not tax avoidance occurred. In the South African GAAR, the comparable requirement is found in Step 4 (the misuse or abuse tainted element – Paragraph 2.3.4.4.) after the presence of a tax benefit was determined, and as a result, the intention of the provision and the manner in which the provision was used by the taxpayer is not considered when assesing whether a tax benefit occurred. It is submitted that the current South African GAAR may learn from its New Zealand counterpart in this regard by incorporating the misuse or abuse consideration into the tax benefit requirement. In addition to this, it is submitted that the current South African GAAR considers incorporating a similar approach to that of the two-step Parliamentary contemplation test for purposes of the misuse or abuse tainted element, to consider to arrangement as a whole and whether the use of the provisions was aligned to the contemplation and purpose of Parliament when it was enacted.

The courts have provided guidance as to when an arrangement would be considered not to be within Parliament's contemplation in the *Ben Nevis* case (at 108) as follows:

> "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."

Cassidy (2012:24) notes that it needs to be determined whether the arrangement is artificial or contrived, and of equal importance is determining the commercial reality and economic substance of an arrangement. The manner in which a transaction is carried out and the consistency with the intended purpose of the provisions must be assessed (Elliffe, 2014:156; Tretola, 2018:6). In the *Ben Nevis* case (at 108), the court highlighted a non-exhaustive list of relevant factors to be taken into consideration when determining the commercial reality and economic effects of an arrangement, and thus whether the arrangement may be 'artificial' or 'contrived' (Cassidy, 2012:24; Tretola, 2018:6), which are as follows:

- The manner in which the arrangement is carried out
- The role of relevant parties and their relationship with the taxpayer
- 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 Supreme Court held in the *Ben Nevis* case (at 109) that when these matters are considered, the courts would not be limited to purely legal considerations but should also consider the use of specific provisions in light of the commercial reality and the economic effect. The courts have indicated that the significance of each of the factors will depend on the facts of the relevant arrangement, but a combination of the factors would be particularly significant (Cassidy, 2012:28). As such, the degree of artificiality is important to distinguish between tax avoidance and tax mitigation and there are certain characteristics which may suggest that an arrangement is artificial or contrived, which are as follows: (Tretola, 2018:6):

- arrangements with no commercial purpose
- arrangements with circular flows of money
- arrangements that have offsetting effects
- arrangements where the investor has no risk
- or arrangements between tax asymmetrical parties that are not at arm's length.

Cassidy (2012:28) notes that these are the "badges of tax avoidance" which can be used in the application of the Parliamentary contemplation test and are generic notions of commercial reality, economic substance and artificial and contrived schemes. These "badges of tax avoidance" and the manner in which economic and commercial reality is determined, that are indicative of tax avoidance arrangements as defined by the courts, are comparable to the South African GAAR's legislated tainted elements (Paragraph 2.3.4.) (Cassidy, 2012:8&24). However, in the New Zealand GAAR these "badges of tax avoidance" have been established through judicial precedence, whereas the current South African GAAR has incorporated these into its legislation. However, the judicial based application of the New Zealand GAAR has been described as vague and uncertain, which has resulted in the need for legislative clarification to provide direction as to the GAAR's parameters (Cassidy, 2012:8-9; Elliffe & Cameron, 2010:458-459). It is submitted that the judicial approach followed by New Zealand may be considered more effective than the current South African GAAR's inclusion of the tainted elements in its legislation, and that South

Africa should consider following a similar approach due to the weaknesses identified in the onerous and often ambiguous tainted elements, as well as the success rate of the New Zealand GAAR (see Paragraph 3.3.1.). An analysis of the similarities and differences in this regard is presented below:

- **The manner in which the arrangement is carried out** considers the particular way in which an arrangement has been structured (*BNZ Investments Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC 23,582 (HC)), in order to establish what was commercially and economically achieved. It is relevant to consider whether the way in which the arrangement was structured differs from usual commercial practice, whether the arrangement contains unusual features, whether the arrangement is hard to understand from a commercial point of view and whether the structure results in certain provisions of the New Zealand Act being applicable or not (Inland Revenue, 2013:62). When compared to the current South African GAAR, it is considered to be similar to the 'abnormality' tainted element (Paragraph 2.3.4.1.). It is submitted that requiring the courts to consider the manner in which a transaction is carried out instead of making reference to the words normal or abnormal may assist in addressing the weakness identified in the abnormality element, (Paragraph 2.3.4.1.).
- **The role of relevant parties and their relationship with the taxpayer** considers the roles of relevant parties and their relationships to each other, including relationships with the taxpayer (Inland Revenue, 2013:63). The roles of the parties may become relevant when they have enabled the parties to "put a different appearance on the facts", whether such parties are related or not. For example, a taxpayer may be legally separate to the other parties but remains part of the same group (related party), or where the parties are unrelated but potentially agree to share tax benefits arising from an arrangement in a manner that is outside Parliament's contemplation (unrelated party) ((*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC), (Inland Revenue, 2013:63)). This factor may be compared to the 'accommodating or tax-indifferent party' indicator to the lack of commercial substance tainted element (Paragraph 2.3.4.2.), contained in Section 80C(2)(b)(ii) of the Act. However, the current South African GAAR contains very detailed and specific provisions within Section 80C(2)(b)(ii). The detailed and specific provisions have essentially removed the power of the South African courts to decide as they are confined to the parameters of the definition. This issue, however, is not present in the New Zealand GAAR, as the broad nature thereof allows the courts to exercise their

discretion without being bound by prescriptive legislation. In addition, the analysis contained in Paragraph 3.3.1. (the success of the New Zealand GAAR) indicates that this approach is better. Similarly, the prescriptive definition of 'accommodating or tax-indifferent party' does not consider relationships between parties which this New Zealand factor does. Lastly, the exclusion of controlled foreign companies (Paragraph 2.3.4.2.) and the associated issues is not found in the New Zealand GAAR, as the GAAR is broad and remains at the discretion of the courts. Therefore, rather than having such a prescriptive definition of 'accommodating or tax-indifferent party', it is submitted that South Africa could learn from New Zealand and allow the courts to decide, thereby allowing the consideration of relationships between parties to be considered and less restrictive parameters.

- **Economic and commercial effect of documents and transactions** considers whether the documents and transactions are consistent with the real outcomes of the arrangement (Inland Revenue, 2013:64). When compared to the current South African GAAR, it is considered to be similar to the lack of commercial substance tainted element which contains a list of indicators. It is submitted that the economic and commercial effect of documents and transactions factor should be used as opposed to the substance over form indicator that includes uncertainty (Paragraph 2.3.4.2). By using this test from New Zealand and no longer relying on the word 'significant' and thus removing the associated uncertainty (Paragraph 2.3.4.2.), the efficacy of the current South African GAAR may be improved.
- **The duration of the arrangement** considers the timing aspects within an arrangement, such as the duration and intervals between particular events (Inland Revenue, 2013:65). This factor has been considered by the courts where it was held that a mismatch in timing may result in tax avoidance being achieved through the timing difference between incurring the expenditure and the eventual economic payments (*Ben Nevis* case). When compared to the current South African GAAR, it is noted that there is no element present that considers the timing or duration of the agreement. It is submitted that this factor should be incorporated into the current South African GAAR to consider timing aspects within an arrangement to improve the efficacy of the current South African GAAR.
- **The nature and extent of the financial consequences for the taxpayer** considers whether the nature of the transaction is consistent with what the taxpayer claims it to be, and whether the resulting financial consequences are consistent with the tax outcomes

claimed by the taxpayer (Inland Revenue, 2013:66). Examples include situations where deductions are claimed but no expense was incurred, and where an amount is paid for something other than what was claimed (Inland Revenue, 2013:66). When compared to the current South African GAAR, it is noted that this factor may be similar to the lack of commercial substance tainted element (Paragraph 2.3.4.2.) which considers whether there was a significant effect on the taxpayer's business risks or net cash flows. The undefined terms 'significant tax benefit', 'significant effect', 'business risks' and 'net cash flows' result in uncertainty due to the lack of definition of these terms (Paragraph 2.3.4.2.). It is submitted that rather considering the nature and extent of financial consequences is preferable to considering terms and words that are undefined and so subjective and relative, to reduce the uncertainty.

- **Arrangements with no commercial purpose** considers whether an arrangement has a commercial and other non-tax avoidance purpose as part of understanding the arrangement (Inland Revenue, 2013:78). The existence of commercial and non-tax avoidance purposes is not directly relevant to the Parliamentary contemplation test (which determines the commercial and economic effects of an arrangement), but does assist in obtaining an understanding of the arrangement and thus whether a commercial purpose exists other than the tax benefit (Inland Revenue, 2013:78-79). When compared to the current South African GAAR, this factor may be compared to the substance over form indicator to a lack of commercial substance tainted element (Paragraph 2.3.4.2.) in which effect is given to what the transaction 'really is' and not what it 'appears to be' (*Commissioner for South African Revenue Service v NWK Ltd (*2010) ZASCA 168 (SCA), allowing consideration to be given to whether the risks and rewards of the arrangement are those that would be expected, similar to the consideration of the commercial and economic effects of an arrangement). Once again it is noted that the provision creates uncertainty and refers to the word 'significant', thus not only restricting the courts to the legislation but creating uncertainty with regard to its application and interpretation. It is submitted that the incorporation of this factor instead of the substance over form indicator (Paragraph 2.3.4.2.) may address the weaknesses and uncertainties identified within this element and thus improve the efficacy of the current South African GAAR.
- **Arrangements with circular flows of money** considers the circularity of movements of money, which is often an indicator of tax avoidance (Inland Revenue, 2013:73). This factor considers whether the movement of cash flows in an arrangement neutralises the

outcomes and conceals the real or underlying economic effect ((*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC), *Peterson v Commissioner of Inland Revenue* (2006) 3 NZLR 433)). For example, where the absence of genuine economic outlays is disguised, such as an arrangement where expenditure is claimed as a deduction, but the corresponding receipt is not assessable (Inland Revenue, 2013:73). When compared to the current South African GAAR, this factor may be compared to the round-trip financing indicator to the lack of commercial substance tainted element, which contains undefined terms that may lead to uncertainty in the interpretation and application thereof (Paragraph 2.3.4.2.). In addition to the undefined terms, the round-trip financing indicator also requires that the round-tripped amounts result in a tax benefit, which is not considered in the arrangements with circular flows of money factor. It is submitted that the approach to 'arrangements with circular flows of money' consideration should be followed instead of the prescriptive legislated definition that currently exists, to eliminate the existing uncertainty arising from undefined terms within this requirement, as well as to eliminate the need for a tax benefit to be the result of the round-tripped amounts, in order to improve the efficacy of the current South African GAAR.

- **Arrangements that have offsetting effects** – this factor may be considered similar to the offsetting or cancelling elements indicator to the lack of commercial substance tainted element in the current South African GAAR (Section 80C(2)(b)(iii) of the Act). While this section may contain no ambiguity, and the ordinary meanings of the words can be used for the purposes of interpretation, no guidance is provided as to what may constitute such cancelling or offsetting elements (Paragraph 2.3.4.2.). No guidance relating to the application of this indicator is present within the South African or the New Zealand Income Tax Acts and both leave the consideration to the courts. It is submitted that this test remain as being left to the courts to consider.
- **Arrangements where the investor has no risk** considers the possibility that no or minimal risks may be taken, even though the tax consequences suggest that commercial or financial risks have been taken (Inland Revenue, 2013:75). When compared to the current South African GAAR, this factor may be compared to the lack of commercial substance tainted element (Paragraph 2.3.4.2.) which requires that a significant tax benefit was obtained that did not have a significant effect on the business risks or net cash flows of the party. However, the terms 'significant tax benefit', 'significant effect', 'business risks' and 'net cash flows' are not defined in the Act, and as such uncertainty is

created regarding how the courts will interpret and apply the meaning of these terms (Paragraph 2.3.4.2.) It is submitted that the uncertainty within this element could be reduced if the wording is changed to exclude the undefined terms and a smiliar approach to that of the 'arrangements where the investor incurs no risk' is adopted .

- **Arrangements between tax asymmetrical parties** is considered to be similar to the 'accommodating or tax-indifferent parties' indicator to the lack of commercial substance tainted element (Paragraph 2.3.4.2.) in the current South African GAAR. This indicator contains an exhaustive definition in Section 80E of the Act which also contains exclusions, such as a controlled foreign company. The exclusion of a controlled foreign company has been said to undermine the effectiveness of the current South African GAAR (Paragraph 2.3.4.2.). It is submitted that a less prescriptive definition of 'accommodating or tax-indifferent' parties be incorporated into the current South African GAAR, similar to the 'arrangements between tax asymmetrical parties' factor in the New Zealand GAAR, to avoid certain parties, like controlled foreign companies, from being excluded and to allow the courts room to decide without being bound by the parameters of the legislation.
- **Not at arm's length** is considered to be similar to the 'rights or obligations not at arm's length' tainted element (Paragraph 2.3.4.3.) in the current South African GAAR which considers whether the rights and obligations created are not those that would usually be created between parties that are dealing at arm's length. However, 'arm's length' is not defined in the Act and as a result could lead to uncertainty in its interpretation. 'Arm's length' is also referred to, but not defined, in other sections of the Act (South Africa), such as in the Section 31 transfer pricing provisions. Chapter 2 of the OECD Transfer Pricing Guidelines states that 'arm's length' can be determined in multiple ways, further indicating the difficulty and ambiguity in applying this term. It is submitted that South Africa follow the same approach as its New Zealand counterpart and leave this factor to the courts to interpret.

It is evident that while there are similarities between the tax avoidance requirement and the tax benefit requirement of the two GAARs, it is submitted that the efficacy of the current South African GAAR could be improved if certain factors, similar to those considered for the purposes of the Parliamentary contemplation test, are incorporated into the determination of the tax benefit requirement. The factors discussed above ("badges of tax avoidance") are considered in the New Zealand GAAR as part of the Parliamentary contemplation test within the tax avoidance requirement, whereas the South African GAAR contains an entirely

separate requirement for the tainted elements, and as a result are considered separately and not as part of the tax benefit requirement. It is submitted that this separate requirement may be a weakness of the current South African GAAR as, if it can be proven that a tainted element does not exist, the GAAR cannot be successfully invoked. It is thus submitted that the efficacy of the current South African GAAR could be improved if the tainted elements are considered as part of the tax benefit requirement rather than as a separate requirement, using the lessons learned from its New Zealand counterpart.

3.2.3. PURPOSE OR EFFECT

In order for the New Zealand GAAR to be applicable to an arrangement, tax avoidance must have been the purpose or effect of the arrangement, and where more than one purpose or effect is present in an arrangement, the tax avoidance purpose must be not merely incidental to the other purposes or effects. The terms 'purpose' and 'effect' have not been defined in the New Zealand Act, and the interpretation by the courts is thus applicable in this regard. 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 terms 'purpose' or 'effect' was adopted by the Supreme Court and thus remains relevant (Inland Revenue, 2013: 40). This test has been determined by the courts to be objective in nature and not subjective, with consideration being given to the purpose and outcome of the arrangement and not the motive or intention of the taxpayer (Elliffe & Cameron, 2010:444; Hwong & Li, 2020:550; Littlewood, 2011:279). Elliffe and Cameron (2010:445) note that while the courts intended for this test to be objective, subjective factors are also considered in the assessment process and are likely to be "highly influential", proof of which can be found in the *Ben Nevis* case. Thus, the New Zealand GAAR has a similar issue to that of South Africa – whether assessing the purpose of the transaction is an objective or subjective test. Subsequent to the *Ben Nevis* case, the Supreme Court held in in *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 that this test is objective. As there is still uncertainty regarding the subjective or objective interpretation of the sole or main purpose requirement in the current South African GAAR (refer to Paragraph 2.3.3.) it is submitted that a purely objective test could be implemented

to eliminate the existing uncertainty within the sole or main purpose requirement, resulting from lessons learned from the New Zealand GAAR.

3.2.3.1. MERELY INCIDENTAL

Where an arrangement has multiple purposes or effects, the New Zealand GAAR will only be applicable if the tax avoidance purpose or effect is not merely incidental to the other purposes (Inland Revenue, 2013: 5; Littlewood, 2013: 526). The term 'merely incidental' has not been defined in the New Zealand Act and the interpretation by the courts is thus applicable. The Commissioner considers merely incidental to mean that the tax avoidance purpose must follow as a natural concomitant of the arrangement that was structured to achieve non-tax avoidance purpose(s) (Inland Revenue, 2013: 89). When considering the principles established in the *Ben Nevis* case regarding 'merely incidental '(at 114), the following was determined:

> "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".

Therefore it is evident that if it is determined (through the Parliamentary contemplation test) that the arrangement has tax avoidance as a purpose or effect, then it becomes necessary to examine whether the tax avoidance purpose is merely incidental (Elliffe, 2014:156). Similarly the court highlighted that if an arrangement is outside Parliament's contemplation, it would likely also fail the merely incidental test (Inland Revenue, 2013:92). It follows that an element of artificiality or contrivance in an arrangement indicates that the tax avoidance purpose is not merely incidental (Ebersohn, 2012:264; Inland Revenue, 2013:92). The Commissioner will apply the merely incidental test by considering all non-tax avoidance purposes in order to determine whether the tax avoidance purpose or effect follows from, or is concomitantly linked to, without contrivance, the other commercial purposes or effects (Elliffe, 2014:156).

Another factor to consider when determining whether the tax avoidance purpose is merely incidental is the size of the tax benefit (*Hadlee and Sydney Bridge Nominees Ltd v Commissioner of Inland Revenue* (1989) 11 NZTC 6,155 (High Court)). Furthermore, taxpayers have freedom to use the legislation to structure transactions to their best advantage in New Zealand, which was confirmed in *Ben Nevis* (at 111) where it was provided that taxpayers may utilise available tax incentives in whatever way, provided it is

within the intended scope and provision. In South Africa, the courts similarly support the view that taxpayers may choose to structure such transactions in such a way so as to attract the least amount of tax (*Conhage* case). Thus, in both jurisdictions taxpayers are entitled to structure their affairs in such a manner so as to achieve the most beneficial tax position. In South Africa, where transactions were structured to attract the least amount of tax, this would not necessarily be considered to be for the sole or main purpose of obtaining a tax benefit, provided the transaction has commercial reason (Pidduck, 2017:84). It is submitted that the current South African GAAR could incorporate the merely incidental test into its 'sole or man purpose' requirement to improve the efficacy by considering whether the tax benefit flows from or is concomitantly linked to other purposes in the arrangement. In addition, it is submitted that the current South African GAAR should consider whether the tax benefit obtained is "within the intended scope and provision" when considering how the taxpayer chose to structure the arrangement.

When considering how this relates to that of its South African counterpart, it is noted that the purpose of the arrangement is a crucial requirement in determining the applicability of the GAAR in both jurisdictions. The New Zealand GAAR will be triggered if the tax avoidance purpose or effect is not seen to be merely incidental to other purposes of the arrangement, while the South African GAAR will be triggered if the sole or main purpose of the arrangement is determined to be that of obtaining a tax benefit. South Africa could therefore incorporate New Zealand's approach and contain a "wider net" that catches all arrangements where the purpose was not merely incidental, as opposed to only those where the actual purpose was tax avoidance to improve the efficacy of the current South African GAAR.

3.3. COMPARISON OF NEW ZEALAND AND SOUTH AFRICAN GAAR

The comparison in Paragraph 3.2. above contained a doctrinal analysis of the New Zealand GAAR as compared to the current South African GAAR, in order to identify lessons to be learned by the current South African GAAR to improve its efficacy. Paragraph 3.3.1. contains a high-level summary of the differences and similarities noted between the GAARs. Paragraph 3.3.2. summarises the identified weaknesses and recommendations to the current South African GAAR as contained in Chapter 3. This comparison addressed the first and fourth research objectives in Chapter 1 (Paragraph 1.5.).

3.3.1. HIGH LEVEL COMPARARISON

The South African GAAR and the New Zealand GAAR contained the following similarities:

- Both of the GAARs require the presence of an 'arrangement'. This term is defined in both GAARs and it is noted that the definition in both jurisdictions is similar to that of the other and is widely interpreted in both.
- Both of the GAARs require the presence of a 'tax benefit' (in the South African GAAR) or 'tax avoidance' (in the New Zealand GAAR) to be present, and while these terms are defined in both GAARs, the definitions are similar in both jurisdictions.
- Both of the GAARs require that the purpose of the arrangement was to obtain either the tax benefit (in the case of South Africa) or the tax avoidance (in the case of New Zealand). The South African GAAR requires that obtaining the tax benefit must be the sole or main purpose of the arrangement, and the New Zealand GAAR requires that the tax avoidance purpose must not be merely incidental.

While similarities between the two GAARs exist, there are also differences. The most distinguishable difference when the two GAARs are compared is that the South African GAAR contains four requirements, whereas the New Zealand GAAR contains only three requirements. The presence of an additional requirement (tainted elements requirement) within the South African GAAR may make it more burdensome to apply, which may ultimately be to the taxpayer's benefit. While the New Zealand GAAR does not explicitly incorporate these tainted elements, the courts consider similar factors when determining whether tax avoidance has occurred as part of the Parliamentary contemplation test as part of the tax avoidance requirement (refer to Paragraph 3.2.2). It is recommended that the tainted elements be considered as part of the tax benefit requirement, rather than being considered as a separate requirement to the current South African GAAR.

Length and degree of complexity

The current South African GAAR is considerably longer than the New Zealand GAAR and is also considered to be more complex (Bauer, 2018:37; Satumba, 2012:18) which is as a result of its prescriptive nature and detailed provisions for its elements (Calvert & Dabner, 2012:54). The New Zealand GAAR is considered to be simpler and shorter due to it containing considerably fewer words than that of its South African counterpart, providing the courts with flexibility (Tretola, 2018:20). In order for a GAAR to catch and deter tax avoidance arrangements, it needs to be general and leaving it to the courts has been described as

"better", as judges (who have greater jurisprudential skills) are better suited to determine where the line should be drawn between tax planning and tax avoidance than Parliament (Tretola, 2018:21,25). Elliffe (2014:163,164) describes this as a "significant advantage of judicial flexibility" due to the fact that the courts can continually refine their approach without having to amend the legislation. The simpler and shorter GAAR, that relies on judicial interpretation, has proven to be effective and efficient (Tretola, 2018). Its success is evidenced through "almost an unbroken run of victories in tax avoidance cases" (Littlewood, 2020:1). Since the Supreme Court of New Zealand was established, the cases that successfully applied the GAAR are: *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), the *Ben Nevis* case, *Ian David Penny and Gary John Hooper v Commissioner of Inland Revenue* (2011) NZSC 95,*Vinelight Nominees Limited v Commissioner of Inland Revenue* (2012) NZHC 3306, *Cullen Group Limited v Commissioner of Inland Revenue* (2019) NZHC 3110, and *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* (2020) NZCA 383. The GAAR was however not successfully applied in the *White v Commissioner of Inland Revenue* (2010) 24 NZTC 24,600 (HC) and the *Frucor Suntory New Zealand Limited v Commission of Inland Revenue* (2018) NZHC 2860 case (that was overturned on appeal). As is evident from the cases where the GAAR was successfully applied versus the one case in which it was not, it is submitted that South Africa could learn lessons from its New Zealand counterpart and consider a less prescriptive and less detailed approach.

3.3.2. WEAKNESSES AND RECOMMENDATIONS

While the two GAARs contain similarities and differences at a high level, the weaknesses identified in the individual components alongside any recommendations are presented below.

ARRANGEMENT

- Weakness: While both GAARs require the presence of an ‘arrangement’, it was noted that the South African GAAR requires that the taxpayer was ‘party’ to the arrangement and participated with volition, but the New Zealand GAAR does not (Paragraph 3.2.1.)
    - Recommendation: It is submitted that the efficacy of the current South African GAAR could be improved so that the taxpayer does not need have prior knowledge, or act with volition, for the taxpayer be a ‘party to the arrangement’.

TAX BENEFIT

- Weakness 1: The definition of ‘tax benefit’ in the South African GAAR refers to a liability, and the concept of an ‘anticipated liability’ was determined by the courts. The New Zealand GAAR defines tax avoidance by referring to a ‘potential’ and ‘prospective’ liability (Paragraph 3.2.2.).
    - Recommendation 1: It is submitted that, in order to improve the efficacy of the current South African GAAR, the words ‘anticipated’, ‘potential’ and ‘prospective’ are included in the legislated definition of tax benefit to reduce the reliance on court interpretations.
- Weakness 2: The South African GAAR only considers ‘misuse or abuse’ (tainted element) after the presence of a tax benefit has been determined which results in the intention of the provision, and the manner in which the provision was used by the taxpayer, not being considered as part of the determination of a tax benefit. The New Zealand GAAR considers this as part of the tax avoidance requirement through the Parliamentary contemplation test (Paragraph 3.2.2.).
    - Recommendation 2: It is submitted that, in order to improve the efficacy of the current South African GAAR, that the ‘misuse or abuse’ consideration be incorporated into the determination of ‘tax benefit’ to allow for the purpose and manner of the taxpayers use of the provision(s) to be linked to whether or not a tax benefit is present. It is further submitted that, as part of this consideration, that an approach similar to the Parliamentary contemplation test be incorporated for the purpose of the ‘misuse or abuse’, to consider the arrangement as a whole and whether the use of the provision was aligned to the contemplation and purpose of Parliament, so that South Africa consideres whether the tax benefit obtained is

"within the intended scope and provision" when considering how the taxpayer chose to structure the arrangement.

PURPOSE

- Weakness 1: Both jurisdictions contain uncertainty as to whether the purpose test (New Zealand) or sole or main purpose requirement (South Africa) is objective or subjective (Paragraph 3.2.3.).
    - Recommendation 1: It is submitted that, in order to improve the efficacy of the current South African GAAR, a purely objective test be implemented.
- Weakness 2: The current South African GAAR requires that the sole or main purpose be to obtain the tax benefit, whereas the New Zealand GAAR requires the purpose to be not merely incidental to other purposes (Paragraph 3.2.3.1.).
    - Recommendation 2: It is submitted that, in order to improve the efficacy of the current South African GAAR, the 'merely incidental' consideration be incorporated into the sole or main purpose requirement to consider whether the tax benefit flows from, or is concomitantly linked to, any other purposes of the arrangement.
- Weakness 3: The New Zealand GAAR considers whether a taxpayer has used the provision within its intended scope when determining whether tax avoidance has occurred, whereas South Africa does not (Paragraph 3.2.3.1.).
    - Recommendation 3: It is submitted that, in order to improve the efficacy of the current South African GAAR, consideration be given to whether the usage of the provision was within its intended scope or not.

TAINTED ELEMENTS

One of the main differences identified between the GAARs is that the South African GAAR contains a list of tainted elements to determine whether an arrangement is an impermissible avoidance arrangement. The New Zealand GAAR does not contain any such indicators in its legislation and has ultimately placed the burden of determining the presence of a tax avoidance arrangement onto its courts, who consider factors that may be indicative of tax avoidance arrangements as part of the Parliamentary contemplation test (Paragraph 3.2.1.) It is submitted that the incorporation of these additional factors into the tainted elements may increase the efficacy of the South African GAAR. Weaknesses are identified and

recommendations are made to the relevant tainted elements as per the analysis in Paragraph 3.2.2. and are summarised below:

- It is submitted that considering the **manner in which the arrangement is carried out**, instead of referring to the words normal or abnormal, will increase the efficacy of the abnormality tainted element as well as reducing the current uncertainty surrounding the word 'normal' and may assist in addressing the weakness identified in the abnormality element, (Paragraph 2.3.4.1.).
- It is submitted that considering the **role of relevant parties and their relationship with the taxpayer** will increase the efficacy of the accommodating or tax-indifferent party indicator to the lack of commercial substance tainted element, as it is a less prescriptive approach that would provide the courts with the opportunity to exercise their discretion (Paragraph 2.3.4.2.).
- It is submitted that considering the **economic and commercial effect of documents and transactions** instead of the substance over form indicator by considering whether the documents and transactions are consistent with the real outcomes of the arrangement will improve the efficacy of the South African GAAR. This will eliminate the uncertainties in its application as well as the word 'significant' and thereby give the courts the opportunity to exercise their discretion (Paragraph 2.3.4.2.).
- It is submitted that considering the **duration of the arrangement** will increase the efficacy of the current South African GAAR and should be incorporated into the lack of commercial substance element to allow for timing aspects within the arrangement to be considered.
- It is submitted that considering the **nature and extent of the financial consequences for the taxpayer** will increase the efficacy of the lack of commercial substance element, which considers whether there was a significant effect on the taxpayer's business risks or net cash flows. Rather considering the nature and extent of financial consequences is preferable to considering terms and words that are undefined that may be subjective and relative, in order to reduce uncertainty arising from the lack of definition of these terms (Paragraph 2.3.4.2.).
- It is submitted that considering the **lack of commercial purpose** will increase the efficacy of the substance over form indicator to the lack of commercial substance tainted element that considers what the transaction 'really is' rather than what it 'appears to be'. The substance over form indicator once again contains an uncertainty, as well as the

word ‘significant’ which is not defined and therefore creates uncertainty, as well as limitations with regards to its interpretation. By considering a lack of commercial purpose in a similar manner to that of New Zealand, the word ‘significant’ and its related uncertainty can be eliminated and provide the courts with more room to decide (Paragraph 2.3.4.2.).

- It is submitted that considering **arrangements with circular flows of money** will increase the efficacy of the round-trip financing indicator to the lack of commercial substance tainted element, which contains a prescriptive definition and undefined terms. By considering arrangements with circular flows of money in a similar manner to that of New Zealand, the undefined terms and the resulting uncertainty can be eliminated as well as the need for a tax benefit to be the result of the round-tripped amounts (Paragraph 2.3.4.2.).
- It is submitted that the consideration of **arrangements where the investor has no risk** will increase the efficacy of the lack of commercial substance tainted element which considers whether a significant tax benefit was obtained that did not have a significant effect on the business risks or net cash flows of the party. However, many of these terms are undefined and thus create uncertainty. It is submitted that the uncertainty within this element could be reduced if the wording is changed to exclude ‘significant’ and to rather consider ‘arrangements where the investor has no risk’ (Paragraph 2.3.4.2.).
- It is submitted that the consideration of **arrangements between tax asymmetrical parties** will increase the efficacy of the ‘accommodating or tax-indifferent parties’ indicator to the lack of commercial substance tainted element. ‘Accommodating or tax-indifferent parties’ is exhaustively defined in Section 80E of the Act which contains exclusions, such as controlled foreign companies. It is submitted that a less prescriptive definition of ‘accommodating or tax-indifferent’ parties be incorporated into the current South African GAAR, similar to the ‘arrangements between tax asymmetrical parties’ factor in the New Zealand GAAR, to avoid certain parties like controlled foreign companies from being excluded (Paragraph 2.3.4.2.).
- It is submitted that the consideration of **not at arm’s length** will increase the efficacy of the ‘rights and obligations not at arm’s length’ tainted element which considers whether the rights and obligations created are not consistent with what would usually be created, had the parties been transacting at arm’s length. However, ‘arm’s length’ is not defined and as a result creates uncertainty. It is submitted that South Africa follow the same

approach as its New Zealand counterpart and leave this factor to the courts to interpret (Paragraph 2.3.4.2.).

3.4. CONCLUSION

This chapter provided a critical analysis (using a doctrinal research method) of the New Zealand GAAR, as well as the identification of differences and similarities to the South African GAAR, and ultimately recommendations for improvement to the South African GAAR. This is consistent with the research objectives of this study. The following chapter, Chapter 4, will make use of a reform-oriented approach whereby the South African GAAR will be applied to the facts of the selected New Zealand case. Recommendations made as a result of this comparison will be compared to those of this chapter.

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

4.1. INTRODUCTION

Chapters 2 and 3 provided a doctrinal analysis of the current South African and New Zealand GAARs respectively. In this chapter, the framework in Chapter 2 (Paragraph 2.5.) will be used to apply the requirements of the South African GAAR to the facts of *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* (2020) NZCA 383 (*Frucor* case). The application of the South African GAAR to the facts of the case will be used to identify improvements to the South African GAAR. This addresses the third research objective as stated in Paragraph 1.5. The reform-oriented analysis performed in this chapter will allow a conclusion to be drawn with regard to the efficacy of the South African GAAR when compared to the New Zealand GAAR. This will be summarised in Chapter 5 along with a comparison of the findings from Chapters 2 and 3, allowing for a triangulation of findings.

4.2. FACTS OF THE FRUCOR CASE

The *Frucor* case was first heard by the High Court in 2018, where the court found in favour of Frucor Suntory New Zealand Limited (Frucor). This case was subsequently appealed by the Commissioner of Inland Revenue in 2020 where it was held by the Court of Appeal that the financing agreement entered into by Frucor Suntory New Zealand Limited was a tax avoidance arrangement to obtain a tax advantage through interest deductions.

Frucor entered into a structured finance transaction in March 2003 (the funding agreement). As per the terms of this agreement, an amount of $204 million was advanced to Frucor by Deutsche Bank New Zealand (DBNZ) in exchange for a fee of $1.8 million and a convertible note with a face value of $204,421,565 (the Note) which was redeemable in five years at maturity at the election of DBNZ, by the issue of 1025 non-voting shares in Frucor. The advance of $204 million by DBNZ was mainly funded by a simultaneous payment to DBNZ by Frucor's then Singapore-based parent (Danone Asia Pty Ltd (DAP)) of $149 million upon commencement of the agreement, for the purchase of the shares from DBNZ in five years' time at a pre-agreed price equal to the face value of the Note ($204,421,565) (the forward purchase agreement). The balance of $55 million was advanced by DBNZ, which had been advanced to it by Deutsche Bank Treasury. When Frucor received the $204 million, they immediately returned $60 million to DAP as capital, in a share buy-back transaction, and the

balance of $144 million was used to repay an existing loan from another Danone entity (Danone Finance SA located in France). At maturity of the forward purchase agreement, DBNZ exercised its option to accept repayment by the issue of shares which were immediately transferred to DAP.

The coupon payment (principal and interest) on the Note was payable semi-annually in arrears at 6.5% per annum. Frucor paid a total of $66 million to DBNZ over the five year term which was calculated on an interest only basis on $204 million. The $66 million interest was made up as follows:

- $11 million interest expense in respect of the $55 million advanced to Frucor by DBNZ. The $55 million was advanced to DBNZ by Deutsche Bank Treasury; and
- $55 million interest expense in respect of the $149 million advanced to Frucor by DBNZ. The $149 million was advanced to DBNZ by DAP.

The Commissioner claimed (at 4) that the $66 million coupon payments, as a matter of commercial and economic reality, represented both the principal ($55 million) and interest payments ($11 million) that were required in order to repay the amortising loan received from DBNZ, the value of which was $55 million. Subsequently the Commissioner accepted that the $55 million was advanced by DBNZ from Deutsche Bank Treasury and as a result, the deduction for this was not challenged (at 5). However, the Commissioner stated (at 4) that the $149 million received by DBNZ was effectively received from DAP, Frucor's 100% parent, for the issue of 1025 shares in Frucor and that DBNZ was merely a conduit for the payment and the issue of the shares (DAP owned all shares in Frucor throughout the agreement). As a result, Frucors deduction of interest expense to the value of $55 million in respect of the $149 million advance is challenged by the Commissioner.

The agreement is therefore considered to encompass the following steps:

(1) $204 million is advanced to Frucor by DBNZ in exchange for a fee and a Note;

(2) Frucor pays DBNZ a fee of $1.8 million and the Note with a face value of $204,421,565 which was redeemable in five years at maturity at the election of DBNZ through the issue of 1025 non-voting shares in Frucor;

(3) $149 million is advanced by DAP to DBNZ upon commencement of the agreement, which mainly funded the $204 million advance to Frucor for the purchase of the shares from DBNZ in five years' time at a pre-agreed price equal to the face value of the Note ($204,421,565);

(4) $55 million is advanced by Deutsche Bank Treasury to DBNZ upon commencement of the agreement, constituting the balance of the $204 million that was advanced to Frucor;

(5) Upon receipt of the $204 million, Frucor immediately returned $60 million as capital to DAP in a share buy back transaction;

(6) The remaining balance of the $204 million received by Frucor was used to repay an existing loan from another Danone entity (Danone Finance SA located in France);

(7) Frucor made payments to DBNZ to the value of $66 million over the five year term which was calculated on an interest only basis on $204 million. The note was payable semi-annually in arrears at 6.5% per annum;

(8) At maturity, DBNZ exercised its option to accept repayment by the issue of 1025 shares in Frucor; and

(9) The 1025 shares in Frucor that were obtained in terms of the Note were immediately transferred to DAP in terms of the forward purchase agreement

The Commissioner contended that the funding agreement was a tax avoidance arrangement in terms of Section BG 1 of the New Zealand Act and was therefore void. The relevant deductions amounted to $10,827,606 and $11,665,323 in the 2006 and 2007 years respectively.

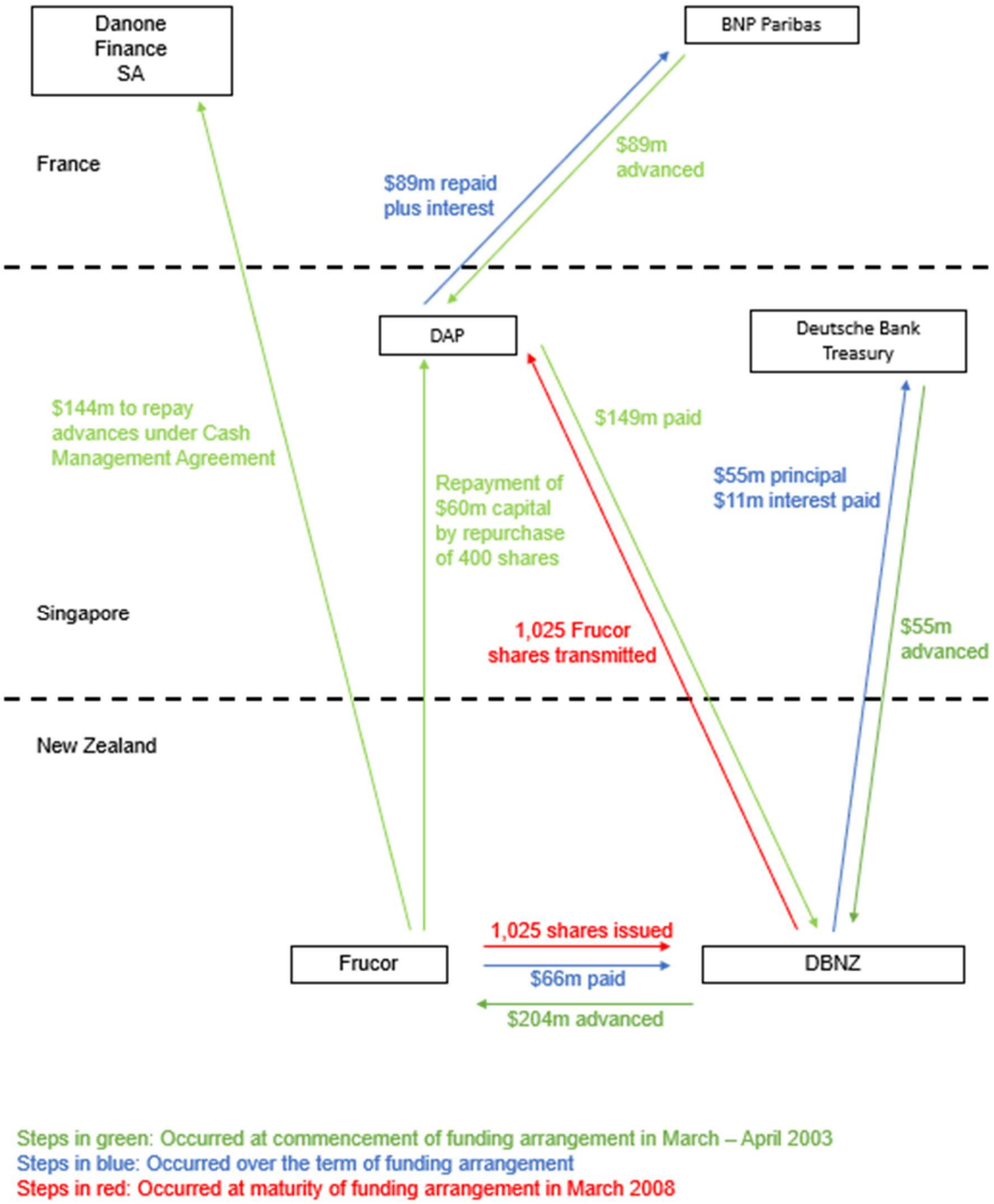
Table 3: Progress of the *Frucor* case

Court	High Court	Court of Appeal
Decision	Held in favour of the taxpayer	Held in favour of the Commissioner

Source: Own design

Figure 1 below diagrammatically depicts the transactions of the *Frucor* case.

Figure 1 Diagramatic representation of the Frucor case



Source: *Frucor* case

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

4.3.1. ARRANGEMENT

The first requirement of the current South African GAAR is the presence of an arrangement. From a review of the facts of the *Frucor* case, it is evident that the entire arrangement was

attacked in both the High Court and the Court of Appeal. This is further corroborated (at 3) whereby the court held that the Commissioner contends “that the funding arrangement was a tax avoidance arrangement”, with ‘funding arrangement’ having been described (at 1) as the structured finance transaction entered into by Frucor in March 2003. The funding agreement was described in the facts, as Steps 1 to 9, above in Paragraph 4.2.

However, in considering whether *Frucor* was a ‘party’ to the arrangement, the principles determined within the *ABSA* case become relevant. Through a review of the facts of the *Frucor* case, there is no indication that Frucor denied knowledge of any of the steps, nor that they claimed ignorance of any part thereof. Therefore, it is submitted that *Frucor* was a party to the arrangement and acted with volition, and Steps 1 to 9 as described in Paragraph 4.2 above constitute a transaction, operation or scheme entered into by the taxpayer (Frucor). These steps as a whole therefore meet the definition of an ‘arrangement’ per Section 80L of the Act

4.3.2. TAX BENEFIT

The second requirement of the South African GAAR is that a tax benefit must arise as a result of the arrangement. Tax benefit is defined in Section 1 of the Act and includes the avoidance, postponement or reduction of any liability for tax. In addition, when determining whether a tax benefit is present, two tests are considered as contained in the framework in Paragraph 2.5. In applying the framework for the South African GAAR to the facts of the *Frucor* case, the tax benefit must have arisen as a result of the taxpayer effectively having stepped out of the way of, escaped or prevented an anticipated liability (Test 1) or the “but for” test must be applied (Test 2).

As a result of entering into the arrangement, Frucor claimed interest deductions to the value of $66 million in terms of Section DB 7(1) and the financial arrangements rules in subpart EW of the New Zealand Act which allows a company to deduct interest incurred. This is consistent with the “but for” test as set out in the *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and the *Louw* case - if it were not for this arrangement there would have been no interest deduction which in turn would not have reduced the taxable income and the tax liability would have existed. Furthermore, Frucor was able to step out of the way of, escape or prevent an anticipated liability for tax as set out in the *Smith* case and the *King* case – through the reduced taxable income as a result of the interest deductions. From the

review of the facts of the *Frucor* case, it is noted that the advance from DBNZ to the value of $55 million was accepted by the Commissioner, and as a result the interest thereon, $11 million, was allowed as a deduction and was not challenged. Nevertheless, the advance of the $149 million from DBNZ was not accepted by the Commissioner, as it was noted that these funds were effectively received from DAP in which DBNZ was merely the conduit for the payment and issue of the shares. Interest thereon, $55 million, and its deductibility was questioned. The Commissioner submitted (at 59) that Frucor achieved an interest deduction to the value of $66 million, without having incurred the corresponding cost for which Parliament had intended that deductions would be available.

Even though the tax benefit requirement in the context of the current South African GAAR is met, the above analysis as well as that contained in Paragraph 3.2.2. highlight the fact that the current South African GAAR does not consider the purpose or intention of the legislation or the factors (ie: 'tainted elements') as part of the tax benefit requirement, whereas the New Zealand GAAR considers this within the two-step Parliamentary contemplation test. Therefore, the current South African GAAR does not consider whether the interest should have been deductible according to the intention of the legislation. Thus even though it may comply with the strict requirements of the relevant provisions to qualify for the deduction, no consideration is given as to whether it 'should have' complied or whether the taxpayer merely made it appear to comply in an artificial manner to get the deduction. It is therefore submitted that the lack of consideration of the purpose or intention of the legislation, or the consideration of the tainted elements within the tax benefit requirement is a weakness to the current South African GAAR. It is recommended that an approach similar to that of New Zealand's be used whereby purpose is considered as part of establishing the tax avoidance requirement.

In applying the framework for the South African GAAR, the transactions entered into by Frucor constituted an arrangement which had the effect of obtaining a tax benefit in the form of interest deductions. As a result, the arrangement constitutes an avoidance arrangement as defined in Section 80L of the Act.

4.3.3. SOLE OR MAIN PURPOSE

The third requirement of the South African GAAR is that the sole or main purpose of an arrangement must have been to obtain the tax benefit. Therefore, the sole or main purpose

of the nine steps identified by the Commissioner in the *Frucor* case must be for the sole or main purpose of the achievement of the tax benefit. The framework (Paragraph 2.5.) for the application of the current South African GAAR, contains two tests in order to determine whether the sole or main purpose requirement has been met, the subjective and the objective test. The subjective test considers the stated intention of the taxpayer, whereas the objective test considers the actual effect of the arrangement and whether or not this supports the stated intention of the taxpayer as determined by the subjective test. When considering the stated, and subjective, intention of the taxpayer, Frucor argued (*Frucor Suntory New Zealand Limited v Commission of Inland Revenue* (2018) NZHC 2860, at 208):

(a) The arrangement was motivated by legitimate commercial objectives: refinancing the New Zealand subsidiary and introducing local currency debt with a fixed rate of interest at a higher level.
(b) These objectives required deductions at (or over) the level achieved by the convertible note.
(c) The deductions achieved would have arisen whether the funding involved bank debt, related-party debt, a combination of the two, a hybrid instrument, or a vanilla loan repayable at the end of the funding term.

Supporting Frucor's stated intention, Stanley Marcello Jr., the Senior Director of Tax for Danone North America, who was the only witness to give evidence for Frucor, suggested (at 80) several reasons why the transaction may have been entered into (apart from achieving the tax benefit). These reasons were cash accumulation/retention benefits, future expanded capital base, Singaporean tax treatment, lower fixed interest rate funding for Frucor, local currency funding and an improved debt/equity ratio for Frucor. While the details of each of these reasons were not provided in any detail in the facts of the case, it is however noted that this may be due to the fact that Stanley Marcello was not involved at the time of the arrangement. It is doubtful how much his evidence may have counted for purposes of applying the South African GAAR for the subjective test. In addition to the subjective facts provided above, the nature and purpose of the scheme was confirmed by Danone, in a document, which was not dated, that included the following:

> "**What was the point of the scheme?**
>
> The scheme allowed [Frucor] to finance the purchase of Frucor in a way that would entitle it to tax credits for the life of the scheme.
>
> Under the arrangement [Frucor] made two coupon payments to [Deutsche Bank] each year. The coupon payments were approximately $7m per payment and were funded by

payment of a fully imputed dividend … to [Frucor]. These coupon payments were treated differently for Management and Statutory purposes.

For **Stat (and Tax)** purposes, the whole payment was treated as an interest expense. The interest payment was 100% deductible. Total payments over the life of the scheme added up to $66m, which equated to $21.8m of tax credits (approx $4.4m for each year of the scheme's life).

For **Management** purposes, part of the payment was treated as an interest expense, and part was treated as repayment of the principal of the convertible note loan."

This document confirms that the subjective purpose of the transaction was to allow Frucor to finance the purchase in a way that would entitle it to tax credits over the life of the scheme and to obtain a tax benefit, in the form of an interest deduction, despite being aware of the fact that part of the payment constituted interest and part of the payment constituted the repayment of principal of the Note.

- Groupe Danone SA (Danone) confirmed that the transaction was to proceed, suggesting a fee should be paid to DBNZ for the role they were to play. This was confirmed in an internal email sent by DBNZ which confirmed the following (at 66):

> "They've now confirmed they want to go ahead with the convertible structure. Next steps they've asked for are (i) New Zealand memorandum/opinion confirming deductibility of coupons; (ii) UK memorandum/opinion relating to forward purchase; and (iii) termsheet.
> …
> Concerning fees they have suggested upfront arrangement fee of $1mio plus credit spread and costs (the idea would be that the credit spread is set by Corporate Bank in Paris who provide risk weighted assets and take the credit risk in return for earning the credit spread. Accordingly SCM [Deutsche Bank Structured Capital Markets] just keeps the upfront fee but has no credit risk etc). Danone's justification for this level of fee is:
>
> 1. Fees for these transactions in Europe are generally 1% of the principal. Here the principal on the notes is only about $80mio;
> 2. We had agreed to execute the Argentinian transaction for this pricing (although this is because it would have been a ground-breaking transaction for Emerging Markets in

Argentina. Also we expected to earn more by selling the notes to a tax sparing investor);

3. They have (apparently) been inundated by other banks willing to execute this structure with them in New Zealand (they have a moral commitment to us arising out of Argentina). Accordingly we should probably accept this but let me know what you think (there is also a lot of glory in this with DCM who have been trying to develop the relationship with Danone)."

This email proves firstly, that the deductibility of the coupons, for which confirmation was requested, was intended; and secondly that the transaction was purposefully structured to achieve tax benefits. Furthermore, the email states that fees for these transactions in Europe are usually 1% of the principal and that the principal amount on the Note in this case was $80 million. Therefore, a 1% fee would have amounted to $800,000 whereas the fee charged was $1.8 million, which is substantially higher than the usual 1% charged. This indicates the transaction was somewhat "unusual" and not consistent with the normal practices.

- An internal Deutsche Bank approval document provided further confirmation of the purpose of the transaction, indicating that "it was designed to provide cheaper, tax efficient funding to [Frucor]" (at 71).
- The purpose of the transaction was contained under a heading "Summary" in a Deutsche Bank document that was distributed, stating that the structure provides funding to Frucor at an after-tax cost that is "significantly below the Group's normal cost of funds" (at 68).

From a review of the facts of the case, Frucor did in fact refinance through the use of local currency debt, however there does not seem to be objective evidence presented by the taxpayer to support the often contradictory subjective evidence that the arrangement was not solely or mainly to achieve the tax benefit. Therefore, it is unlikely that if the above evidence was presented to the South African courts for the purposes of applying the South African GAAR that the objective purpose would have supported a non-tax purpose. Nevertheless, the objective purpose cannot be determined with absolute certainty based on the evidence provided to the courts, as this was not required by the New Zealand courts.

Notwithstanding the above, Section 80G of the Act contains a presumption that the sole or main purpose of the arrangement was to obtain the tax benefit, with the burden of disproving this resting on the taxpayer. As per the analysis of the facts of the case as well as the

discussion above, it is evident that, while the taxpayer (Frucor) attempted to argue a legitimate commercial objective to the transaction, it is unlikely that they would have been able to provide sufficient evidence to discharge the onus and prove that the sole or main purpose of the arrangement was not to obtain the tax benefit.

In terms of objective evidence presented by the Commissioner the following is evident from the *Frucor* case: Mr Smith (for the Commissioner) made a submission based on Professor Choudhry's (a Fellow of the Chartered Institute for Securities and Investment and the London Institute of Banking and Finance, an expert witness called by the Commissioner) evidence (at 81) that the outcomes were readily achievable simply by borrowing the same amount from a bank in New Zealand over the same term at the same interest rate which indicates the rights and obligations may be considered to be at arm's length. The principle of the *Conhage* case thus becomes applicable, in which it was held that merely choosing to structure a transaction in a manner that results in the least amount of tax being payable when the commercial outcome could be achieved in different ways, that this would not necessarily indicate that the sole or main purpose of the arrangement was to obtain the tax benefit. In the case of Frucor, it may be argued that they achieved their stated subjective intention of refinancing through the use of local currency debt. While there were supposedly other ways in which to accomplish this, they may have merely chosen the option that resulted in the least tax being payable. Therefore, based on the *Conhage* case principle, Frucor may have been able to argue that their sole or main purpose was not to obtain a tax benefit. It is submitted that the use of the *Conhage* case for purposes of the sole or main purpose requirement constitutes a weakness to the current South African GAAR, whereby taxpayers could argue that they merely chose to structure the transaction in a manner that resulted in the least amount of tax being payable resulting in the GAAR not being applicable to the arrangement.

Nevertheless, it is submitted that in light of the contradictory evidence that the obtaining of the tax benefit was intended by the parties, and it is therefore submitted that at least one of the purposes of this transaction was that of tax avoidance. As noted through the comparison of the New Zealand GAAR to the current South African GAAR in Paragraph 3.2.3. the New Zealand GAAR requires that the tax avoidance purpose be not merely incidental in order for the purpose requirement to be met, whereas the current South African GAAR requires that the 'sole or main purpose' be that of obtaining the tax benefit. In the context of the current

South African GAAR, it is noted that extensive reliance is placed on the onus of proof to prove that the sole or main purpose was to obtain the tax benefit. Furthermore, it is submitted that a purely objective test be implemented thereby excluding the subjective test. It is submitted that the efficacy of the current South African GAAR may be improved if a 'more than merely incidental' purpose requirement be adopted instead of the 'sole or main purpose'. It is submitted, in accordance with the above arguments, that the only reason that the sole or main purpose succeeded against the facts of the *Frucor* case is due to the fact that, based on the facts, insufficient evidence to discharge the onus created by Section 80G of the Act would have been provided resulting in the sole or main purpose requirement being met. In applying the framework for the South African GAAR, it is submitted that the sole or main purpose of the arrangement was to obtain the tax benefit, and that this requirement is therefore met.

4.3.4. TAINTED ELEMENTS

The fourth and final requirement for the current South African GAAR is that the arrangement must contain at least one of the tainted elements. The tainted element(s) that should be considered depend(s) on the context in which the transaction takes place, as the tainted elements have been categorised according to whether the arrangement occurred in the context of a business, in a context other than a business or in any context. The arrangement in the *Frucor* case occurred in the context of a business and as a result the applicable tainted elements are 'abnormality' and 'lack of commercial substance'. In addition to this, the tainted elements in any context are also discussed, and therefore, the 'rights and obligations not at arm's length' and the 'misuse or abuse' tainted elements are also discussed.

4.3.4.1. ABNORMALITY

The first tainted element is the 'abnormality' tainted element, which considers whether the transaction was carried out in a manner that would normally be carried out for *bona fide* purposes. The framework for the current South African GAAR considers whether there is 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 (Paragraph 2.5.). Professor Moorad Choudhry, a Fellow of the Chartered Institute for Securities and Investment and the London Institute of Banking and Finance, an expert witness called by the Commissioner, stated the following (at 79):

> "there is no doubt that this is not a conventional [convertible bond] but rather a "pretend" construct of a [convertible bond], which has the effect of generating a tax benefit."

Furthermore, a Deutsche Bank document (at 68) states that the structure resulted in funding being provided to Frucor at a cost that is "significantly below the Group's normal cost of funds", indicating that the transaction was unusual and not consistent with normal lending practices of the Group. Mr Smith (for the Commissioner) made a submission based on Professor Choudhry's evidence, that the outcomes were readily achievable simply by borrowing the same amount from a bank in New Zealand over the same term at the same interest rate, which was accepted by the court (at 81). It is therefore submitted that it is likely that there is a difference between the transaction entered into by the taxpayer (Frucor) and a transaction entered into for *bona fide* purposes in the absence of a tax consideration. Furthermore, as discussed in Paragraph 4.3.3. the fee charged (of $1.8 million) was substantially higher than the standard fee of 1% of the principal amount for similar Notes. Had the fee been charged at 1% of the principal (indicated in the email to be $80 million), it would have been $800,000 as opposed to $1.8 million. Therefore, it is likely that the arrangement would be considered to be abnormal.

At this point, the arrangement would constitute an impermissible avoidance arrangement in terms of the current South African GAAR, as all four requirements have been met. It would not be necessary to test the presence of the remaining tainted elements as 'abnormality' (at least one) is already present. However, the remaining tainted elements are discussed for completeness purposes.

4.3.4.2. LACK OF COMMERICAL SUBSTANCE

The second tainted element considers whether a transaction lacks commercial substance by considering whether there was a significant effect on the net cash flows and business risks of the party who obtains the tax benefit. In addition to this, the framework also considers the individual indicators for the lack of commercial substance element, which are each considered separately below.

Section 80C(1) states that an arrangement lacks commercial substance when the result of such arrangement is a significant tax benefit that did not have a significant effect on the business risks or net cash flows of the party. In this regard it is noted that Frucor received an advance of $204 million from DBNZ, which it then used to repay a loan from another group entity, Danone Finance SA (located in France), ($144 million) and the repayment of

capital to DAP ($60 million). Therefore, effectively the full $204 million received by Frucor was paid out. Over the five year term Frucor then paid $66 million to DBNZ in addition to the initial fee of $1.8 million, and ultimately issued 1025 shares to DBNZ who, in terms of the agreement, transferred these shares to DAP. It is submitted that a tax benefit was received (the interest deductions) that did have an effect on the net cash flows of the party (Frucor) in the form of the payments made. Whether this tax benefit was 'significant' or the net cash flows can be considered significant cannot be concluded with absolute certainty. Furthermore, it is submitted that there was an effect on the business risks of Frucor as a result of the issuing of additional shares. However, as DAP remained the 100% parent at all times, and Frucor may have been exposed to risk when issuing the additional shares, in terms of legislative requirements and having to comply therewith, whether this risk was 'significant' once again cannot be concluded with absolute certainty. As stated by Professor Choudhry (at 79) it would appear as if the convertible Note was structured in a manner that facilitated interest deductions for Frucor, without there being any significant risk for the other parties. In addition, the transaction enabled Frucor to make deductions on an advanced sum of money that had effectively been received from its parent, DAP, for the purchase of 1025 shares in five years' time. However, as discussed in Paragraph 2.3.4.2., the term 'significant' is not defined and thus it cannot be said with absolute certainty whether these effects would be 'significant' when considering the tax benefit, effect on cash flows or the effect on business risks.

In applying the current South African GAAR, it is concluded that it is uncertain whether the transaction meets the general test for lack of commercial substance (significant tax benefit with a significant impact on net cash flows and business risks). Given the uncertainty surrounding the interpretation and application of the word 'significant', it is submitted that additional guidance is required in order to eliminate the uncertainty and ultimately improve the efficacy of the current South African GAAR.

Substance over form

The framework for the current South African GAAR, when testing the substance over form indicator considers whether the true intention of the parties was reflected in the agreement, as per Section 80C(2)(a) of the Act. In addition, the risks and rewards arising from the arrangement must be considered, and it must be determined whether such risks and rewards could be expected from such a transaction. It is submitted that the true intention of

the parties was not reflected in the agreement, given that DBNZ essentially acted as a conduit for the advance of funds to Frucor, so that Frucor would be entitled to obtain the tax benefits in the form of interest deductions (at 51). Furthermore, as discussed in Paragraph 4.3.3. it is evident that the statutory purpose differed to the management/other purpose. It is therefore submitted that the arrangement provided an advance to Frucor by DBNZ in form, but not in substance, given that the advance was effectively (in substance) received from its parent DAP for the subscription of an additional 1025 shares. Therefore, it is submitted that the substance over form indicator is met.

Round trip financing

The framework for the current South African GAAR, when testing the round trip financing indicator, considers the transfer of funds through some type of reciprocal action, that results in a tax benefit (directly or indirectly) and whether the transferred funds resulted in the reduction, offsetting or elimination of business risk. Section 80D(3) of the Act states that the term “funds” includes cash, cash equivalents and any right or obligation to receive or pay an amount. It is evident that, in the *Frucor* case, a loan was granted from DBNZ to Frucor which meets the definition of ‘round trip financing’. A loan constitutes ‘funds’ due to it being a right/obligation to receive or pay an amount. A loan involves the transfer of money through reciprocal action (one party pays, the other party receives) which results in a tax benefit through interest deductions. It is submitted that this is a weakness to the current South African GAAR, as it is not what should have been intended by the courts upon the drafting of the provision as legitimate loans, not designed for avoidance purposes, and may fall foul of this aspect of the GAAR. However, as per the discussion in Paragraph 3.2.2., the current South African GAAR’s prescriptive legislation prevents the courts from being allowed to use their discretion and being confined to the parameters of the legislation.

When considering the facts of the *Frucor* case, it is evident that the advance from DBNZ to Frucor constitutes ‘round trip financing’ for the following reasons:

- The loaned amounts constitute ‘funds’, as it is an obligation to Frucor to pay, and the right to receive an amount for DBNZ.
- The loaned amounts constitute the transfer of funds through reciprocal action (DBNZ pays, Frucor receives).
- The loaned amounts result directly in a tax benefit, in the form of interest deductions for Frucor.

It is submitted that this indicator is therefore met and round trip financing is present.

Accommodating or Tax-indifferent parties

The framework for the current South African GAAR, when considering the 'accommodating or tax-indifferent parties' indicator considers whether there is a party who effectively transferred its tax advantage to others, irrespective of its relationship with any of the contracting parties. The arrangement within the *Frucor* case contains offshore parties located in South Africa, New Zealand and Singapore. From a review of the facts of the case, insufficient facts were available to conclude as to whether accommodating or tax-indifferent parties are present, and thus this cannot be said with absolute certainty. However, it is submitted that the entities in the different jurisdictions may be subject to normal tax, even though it may be at different rates and the current South African GAAR does not account for different tax rates. This is largely due to the prescriptive nature of the legislation. The requirements in Section 80E(1) may thus exclude the three entities from being considered tax-indifferent parties if they are all subject to normal tax, albeit at lower tax rates in their respective jurisdictions. It is noted that the corporate tax rate in both South Africa and New Zealand is 28%, but the corporate tax rate in Singapore is 17% (Inland Revenue Authority of Singapore, 2021). It is submitted that not considering different tax rates is a weakness to the current South African GAAR, and it is submitted that parties subject to tax at different rates should be included in what constitutes tax-indifferent parties. Therefore, in applying the framework for the current South African GAAR, it is noted that there are no accommodating or tax-indifferent parties in the *Frucor* case, despite the reduced tax rates by entities subject to tax at significantly lower tax rates in offshore jurisdictions.

Offsetting or cancelling effects

The framework for the current South African GAAR, when considering the 'offsetting or cancelling effects' indicator, considers whether there are elements within the transaction that have the effect of offsetting or cancelling each other. The following elements have the effect of offsetting or cancelling each other in this transaction:

- DBNZ provided an advance (loan) in exchange for the Note. Frucor made payments in respect of the Note which would have been included as income for DBNZ. However, this income inclusion was offset by the deduction claimed by Frucor with regard to the interest payments made to DBNZ in respect of the Note.

- $149 million and $55 million were advanced to DBNZ by DAP and Deutsche Bank Treasury respectively, which DBNZ then advanced to Frucor, resulting in an offset effect being achieved (Steps 3 and 4 – Paragraph 4.2.)
- Upon receiving the advance from DBNZ, Frucor immediately returned $60 million as capital to DAP in a share buy back transaction, resulting in the advanced funds being offset against the share buy back (Step 5 – Paragraph 4.2.)
- Upon receiving the advance from DBNZ, Frucor repaid the loan from Danone Finance SA, resulting in the loan being an offset advance (Step 6 – Paragraph 4.2.)
- Upon maturity date, DBNZ elected to exercise their option and accepted repayment of the advance to Frucor in the form of 1025 shares in Frucor, resulting in the advance being offset (Step 8 – Paragraph 4.2.)
- The 1025 shares in Frucor that were obtained by DBNZ in terms of the Note were immediately transferred to DAP in terms of the forward purchase agreement, offsetting the shares received by DBNZ (Step 9 – Paragraph 4.2.)

Based on the above list of offsetting or cancelling elements within the *Frucor* case transaction, it is submitted that there may be an additional weakness to the current South African GAAR exposed by the *Frucor* case – whether a convertible Note, forward purchase agreements and share buy backs should be considered as items that offset or cancel each other. It is submitted that the GAAR is vague as to what may constitute an 'offsetting or cancelling element' and as a result the scope is widened, which was likely not the intention of the legislator. It is recommended that a similar approach to that of New Zealand be incorporated, where this is left to the discretion of the courts to interpret and apply. As a result, there were elements that had an offsetting or cancelling effect that were present in the arrangement. It is therefore submitted that, in terms of the framework for the current South African GAAR, that 'offsetting or cancelling' elements were present within the arrangement.

The analysis of the indicators of a lack of commercial substance above indicates that the arrangement, in the *Frucor* case, lacked commercial substance due to the substance over form indicator, round trip financing indicator and the offsetting or cancelling elements indicator being present. The only indicator not present was that of the accommodating or tax-indifferent parties due to insufficient evidence in the facts of the case.

4.3.4.3. RIGHTS AND OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the 'rights and obligations not at arm's length' tainted element which considers whether 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 agreed to the same terms in the same situation. The rights and obligations arising from the arrangement considered in the *Frucor* case are as follows:

- Frucor must issue 1025 non-voting shares in itself in exchange for a fee of $1.8 million and a convertible note with a face value of $204,421,565.
- The coupons on the Note are payable by Frucor semi-annually at a rate of 6.5% per annum.

Upon reviewing the evidence presented to the court, Mr Smith (for the Commissioner), based on Professor Choudhry's evidence, stated (at 81) that the outcomes were readily achievable simply by borrowing the same amount from a bank in New Zealand over the same term at the same interest rate which indicates the rights and obligations may be considered to be at arm's length. As discussed in Paragraph 4.3.3., the fee charged (of $1.8 million) was substantially higher than the standard fee of 1% of the principal amount for similar Notes. Had the fee been charged at 1% of the principal (indicated in the email to be $80 million), it would have been $800,000 as opposed to $1.8 million. It is therefore submitted that the fee was not at arm's length and that each party was not striving to get the utmost advantage out of the transaction for themselves. In addition, it is submitted that unconnected persons would not have agreed to the same terms, given the fee of $1.8 million is 125% higher than the standard fee charged at 1% of the principal. From a review of the facts and evidence, it is therefore concluded that the rights and obligations created in this transaction are not at arm's length. Therefore this indicator is met.

4.3.4.4. MISUSE OR ABUSE

The final tainted element is the 'misuse or abuse' tainted element which considers whether the arrangement frustrates, exploits or manipulates the provisions of the Act, or if the arrangement uses provisions of the Act to achieve a result not intended by the legislator. When considering the facts of the *Frucor* case, it appears as if Frucor correctly applied the provisions of Section DB 7 whereby a deduction is allowed for interest incurred, as well as the financial arrangements rules in Subpoint EW of the New Zealand Act, as submitted by Mr Smith (for the Commissioner) (at 51). However, in economic terms, Frucor effectively

received $149 million from its 100% parent in return for 1025 shares which it issued five years later. Mr Smith contended that the issue of these shares came at no cost to Frucor and DBNZ was merely a conduit for both transactions. Frucor claimed deductions as if it had made interest payments of $66 million, whereas in reality this was the amount that was required to repay the principal and interest to discharge the $55 million loan from DBNZ. Thus, the arrangement artificially created the required circumstances to comply with the provisions of the legislation, which may be considered to frustrate, exploit or manipulate the provisions of the Act and the use of provisions to achieve results not intended by the legislator. It is therefore submitted that the arrangement would result in the misuse or abuse of the Act for the purposes of the current South African GAAR.

4.4. CONCLUSION

The outcome of applying the current South African GAAR to the facts of the *Frucor* case indicate that the arrangement is likely to constitute an impermissible avoidance arrangement, as all four requirements of the current South African GAAR were satisfied for the purposes of the framework for the current South African GAAR.

While Frucor stated that the purpose of the transaction was to refinance and introduce local currency debt, it is evident that a tax benefit was achieved through the claiming of interest deductions. Furthermore, Frucor would have been unlikely to be able to provide sufficient objective evidence (based on the facts of the case) to support the contradictory stated subjective purpose of the arrangement. As a result, it was concluded that the sole or main purpose was indeed that of obtaining a tax benefit. Nevertheless, it was noted that the principles established in the *Conhage* case were relevant to Frucor, due to the fact that the same commercial outcome could be achieved in different ways, and that they merely may have chosen the option that resulted in the least amount of tax payable. However, it should be noted that this cannot be concluded with absolute certainty and therefore represents a weakness to the current South African GAAR. It is submitted that the *Frucor* case revealed that extensive reliance is placed on the onus of proof to prove that the sole or main purpose was to obtain the tax benefit. It is submitted that the efficacy of the current South African GAAR may be improved if a ‘more than merely incidental’ purpose requirement was adopted, instead of the ‘sole or main purpose’ needing to be that of obtaining the tax benefit.

The transaction was considered to be tainted, due to the presence of the abnormality, lack of commercial substance, rights and obligations not at arm’s length and misuse or abuse

tainted elements. While it was concluded that the transaction lacked commercial substance, various weaknesses in the current South African GAAR were identified within the application of this tainted element. Firstly, in considering the general lack of commercial substance test, it was found that the tax benefit did have an effect on the net cash flows of Frucor. However, it was concluded that whether this effect was 'significant' could not be concluded with absolute certainty, due to the fact that this term is undefined and therefore contains uncertainty with regard to its interpretation and application. It is submitted that additional guidance is required in order to eliminate the uncertainty and ultimately improve the efficacy of the current South African GAAR.

Secondly, in considering the application of the round trip financing indicator to the lack of commercial substance tainted element, it was noted that a 'loan' (and possibly every loan by default) meets the definition of round trip financing due to it being a right/obligation to receive or pay an amount which involves the transfer of money through reciprocal action that results in a tax benefit through interest deductions. It is submitted that this is a weakness to the current South African GAAR, as it is not what should have been intended by the courts upon the drafting of the provision. This is because legitimate loans that are not designed for avoidance purposes, may fall foul of this aspect of the GAAR and the prescriptive nature of the legislation prevents the courts from being allowed to use their discretion and results in them being confined to the parameters of the legislation.

Thirdly, in considering the accommodating or tax-indifferent parties indicator to the lack of commercial substance tainted element, it was noted that the current South African GAAR does not, in its prescriptive legislation, account for different tax rates. The requirements in Section 80E(1) would thus exclude entities from being considered tax-indifferent parties if they are subject to normal tax at lower rates. It is therefore submitted that not considering different tax rates is a weakness to the current South African GAAR, and it is submitted that parties subject to tax at different rates should be included in what constitutes tax-indifferent parties.

Lastly, in considering the offsetting or cancelling elements indicator to the lack of commercial substance tainted element, it was noted that there may be an additional weakness to the current South African GAAR exposed by the *Frucor* case – whether convertible Notes, forward purchase agreements and share buy backs should be considered as items that offset or cancel each other. It is submitted that the GAAR is vague as to what may constitute

an ‘offsetting or cancelling element’ and as a result the scope is widened, which was likely not the intention of the legislator. It is recommended that a similar approach to that of New Zealand be incorporated, where this is left to the discretion of the courts to interpret and apply.

In conclusion, the application of the current South African GAAR to the facts of the *Frucor* case revealed that the GAAR would likely have been applied successfully, which is therefore consistent with the findings of the New Zealand Court of Appeal wherein it was concluded that the transaction was indeed a tax avoidance arrangement for the purposes of the New Zealand GAAR. Despite the successful application of the current South African GAAR, this chapter revealed additional weaknesses in the current South African GAAR.

CHAPTER 5: CONCLUSION

5.1. INTRODUCTION

Taxpayers continuously seek ways to minimise their tax burdens, and have done so since the concept of tax was first introduced (Olivier, 1996:378). As discussed in Chapter 1, the manner in which taxpayers minimise their tax burdens can be achieved through illegal and legal methods, the latter being tax avoidance. In an attempt to combat tax avoidance, one of the measures implemented by South Africa is the GAAR. The South African GAAR has been amended several times since it was first incorporated into the tax legislation in 1941. The most recent amendment, and the resultant current South African GAAR, has not been tested in its entirety before the courts creating uncertainty with regard to its application and interpretation. It thus remains unknown as to whether the current South African GAAR is effective in combatting impermissible tax avoidance. As a result, further research is required in order to determine whether the amendments made to the previous GAAR, and the resulting current South African GAAR, are effective in this regard.

The aim of this study is to fill a gap in the research by determining what amendments can be made to the current South African GAAR in order to address its weaknesses, through the comparison of the current South African GAAR to the New Zealand GAAR. Therefore, this study aims to determine if any lessons can be learnt from the New Zealand GAAR, in order to improve the efficacy of the current South African GAAR. In order to achieve this goal, the research objectives adopted were as follows (refer to Paragraph 1.5):

- To identify weaknesses in the current South African GAAR;
- To compare the theoretical principles of the South African GAAR to the principles of the GAAR of New Zealand;
- 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
- To suggest improvements to the South African GAAR to address identified weaknesses.

The research methodology employed in this study was that of the SPA, whereby a combination of doctrinal and reform-oriented approaches were used. The doctrinal research

method was adopted in order to analyse the current South African and New Zealand GAARs, whereas the reform-oriented approach was adopted in order to suggest improvements to the current South African GAAR in order to address the identified weaknesses.

5.2. ACHIEVEMENT OF THE RESEARCH OBJECTIVES

Chapter 2 of this study provided a critical analysis of the requirements of the current South African GAAR, which were compared to that of its predecessor. The comparison revealed that various terms and elements that were present in the predecessor, are still present in the current South African GAAR. Therefore, the weaknesses that were identified in the previous GAAR may have been carried over into the current South African GAAR. While additional indicators have been incorporated into the current South African GAAR, both the abnormality and purpose requirements are essentially still present in the current South African GAAR. In Chapter 3, the theoretical principles of the current South African GAAR were compared to that of the New Zealand GAAR. The analysis of the two GAARs highlighted various similarities, such as within the arrangement requirement, the tax benefit requirement and the purpose requirement. Differences were also highlighted and identified, the most distinguishable being that the current South African GAAR contains four requirements whereas the New Zealand GAAR contains only three. In addition, the following differences were identified:

- **Length and degree of complexity:** The New Zealand GAAR is considered to be shorter and simpler than the current South African GAAR, which is considered to be more complex. The current South African GAAR is prescriptive and contains detailed provisions, whereas the New Zealand GAAR relies on the interpretation of the courts and provides the courts with more flexibility when determining whether an arrangement constitutes an avoidance arrangement. The approach followed by New Zealand has been argued to be “better”, and ultimately more efficient and effective, the success of which is evidenced by an almost unbroken run of victories in tax avoidance cases. The current South African GAAR could learn lessons from its New Zealand counterpart in this regard by adopting a less prescriptive approach, thereby allowing the courts more flexibility.
- **Arrangement:** The current South African GAAR requires that the taxpayer was ‘party’ to the arrangement and participated with volition (*ABSA* case), but the New Zealand

GAAR does not, and would thus be applicable even if the taxpayer was not aware of all or some of the details of the arrangement.

- **Tax benefit:** For a tax benefit to exist, the current South African GAAR refers to a liability, or anticipated liability, whereas the New Zealand GAAR refers to a anticipated, potential or prospective liability. Additionally, the current South African GAAR only considers 'misuse or abuse' (tainted element) after the presence of a tax benefit has been determined, which results in the intention of the provision, and the manner in which the provision was used by the taxpayer, not being considered as part of the determination of a tax benefit. However, the New Zealand GAAR considers this as part of the tax avoidance requirement through the Parliamentary contemplation test.
- **Purpose:** The current South African GAAR requires that the sole or main purpose be to obtain the tax benefit, whereas the New Zealand GAAR requires the purpose to be not merely incidental to other purposes, which is arguably better than determining 'sole' or 'main'. It is submitted that, in order to improve the efficacy of the current South African GAAR, the 'merely incidental' consideration be incorporated into the sole or main purpose requirement to consider whether the tax benefit flows from, or is concomitantly linked to any other purposes of the arrangement. In addition, The New Zealand GAAR considers whether a taxpayer has used the provision within its intended scope when determining whether tax avoidance has occurred, whereas South Africa does not. It is submitted that, in order to improve the efficacy of the current South African GAAR, consideration be given to whether the usage of the provision was within its intended scope or not.
- **Tainted elements:** The current South African GAAR contains a list of tainted elements to determine whether an arrangement is an impermissible avoidance arrangement. The New Zealand GAAR does not contain any such indicators in its legislation and has ultimately placed the burden of determining the presence of a tax avoidance arrangement onto its courts who consider factors that may be indicative of tax avoidance arrangements as part of the Parliamentary contemplation test. It is submitted that the incorporation of these additional factors into the tainted elements may increase the efficacy of the South African GAAR.

Furthermore, the requirements of the current South African GAAR were applied to the facts of the *Frucor* case (from New Zealand), to determine which elements may require improvement. The outcome of the case is summarised next in Paragraph 5.2.1.

5.2.1. CASE OUTCOME

The application of the current South African GAAR to the facts of the *Frucor* case, using the framework in Paragraph 2.5., indicated that the arrangement would constitute an impermissible avoidance arrangement and the current South African GAAR would thus be successful in curbing the tax avoidance. The framework was applied as follows where the following findings were noted:

- An 'arrangement', as defined in Section 80G of the Act, was present (Paragraph 4.3.1.).
- The arrangement resulted in a 'tax benefit' as a result of the interest deductions claimed by Frucor (Paragraph 4.3.2.).
- The 'sole or main purpose' requirement was satisfied as it was concluded that the sole or main purpose of the arrangement was to obtain a tax benefit based on the contradictory subjective and objective evidence presented before the court. While insufficient objective evidence was found in the facts of the case to support the often contradictory, subjective evidence, it is submitted that Frucor would likely not have been able to discharge the onus whereby it is presumed that the sole or main purpose is to obtain a tax benefit. Furthermore, the principles established in the *Conhage* case are applicable, as they may have been able to argue their sole or main purpose was not to obtain a tax benefit and that they merely chose, from various possibilities, the outcome that resulted in the least amount of tax being payable. The application of the facts of the case also revealed that a strength existed in the New Zealand GAAR, and that the efficacy of the current South African GAAR may be improved if a 'more than merely incidental' purpose requirement be adopted instead of the 'sole or main purpose'. Overall, the findings of applying this section resulted in it being plausible that the only reason that the sole or main purpose succeeded against the facts of the *Frucor* case is due to the fact that insufficient evidence to discharge the onus created by Section 80G of the Act would have been provided resulting in the sole or main purpose requirement being met (Paragraph 4.3.3.).
- All four 'tainted elements' were present within the arrangement, as it was concluded that the arrangement was abnormal, lacked commercial substance, created rights and obligations not at arm's length and resulted in the misuse or abuse of the provisions of the Act. The application of the facts of the *Frucor* case revealed the following issues and weaknesses to the current South African GAAR (Paragraph 4.3.4.):

- The general lack of commercial substance test (as contained in Section 80C(1) of the Act, while considered to be met, revealed uncertainty regarding the word 'significant', as it is undefined, and thus uncertainty in determining whether there was a significant effect on the net cash flows and business risks (Paragraph 4.3.4.2.).
- The round-trip financing indicator, while considered to be met, revealed a potential weakness to the current South African GAAR in that a 'loan', and all loans by default, meet the definition of round trip financing. Therefore, legitimate loans, not designed for avoidance purposes, may fall foul of this aspect of the GAAR (Paragraph 4.3.4.2.).
- Accommodating or tax indifferent parties were not considered to be present, due to the fact that different normal tax rates in different jurisdictions are not considered as part of the tax indifferent party definition, which may limit the efficacy of the current South African GAAR by excluding certain parties due to the prescriptive nature of the legislation, resulting in this indicator not being met (Paragraph 4.3.4.2.).
- Offsetting or cancelling elements, while considered to be met, revealed a potential weakness to the current South African GAAR, being whether convertible Notes, forward purchase agreements and share buy backs should be considered as items that offset or cancel each other. It is submitted that the GAAR is vague as to what may constitute an 'offsetting or cancelling element' which may limit the efficacy of the current South African GAAR (Paragraph 4.3.4.2.).

The reform-oriented research performed in Chapter 4 and the relevant findings are submitted to provide validation for the recommendations made in Chapter 3 to improve the efficacy of the current South African GAAR, as made in the doctrinal analysis phase. The weaknesses identified in the doctrinal and reform-oriented phases of this research (including the *Frucor* case) are provided below.

5.2.2. WEAKNESSESS OF AND RECOMMENDATIONS TO THE CURRENT SOUTH AFRICAN GAAR

The following weaknesses in the current South African GAAR were identified through the analysis in Chapters 2 and 3 (doctrinal research), and the application of the GAAR in Chapter 4 (reform-oriented research):

ARRANGEMENT

- Weakness 1: While both GAARs require the presence of an 'arrangement', it was noted that the South African GAAR requires that the taxpayer was 'party' to the arrangement and participated with volition, but the New Zealand GAAR does not (Paragraph 2.3.1. and 3.2.1.). Although Section 80H of the Act allows steps within an arrangement to be considered, Pidduck (2017:159) argues that when a part of an arrangement is considered in isolation, it may lose commercial substance if the context of the wider transaction is not considered (Paragraph 2.3.1.). The definition of an arrangement includes a scheme, the presence of which may be disproven if a taxpayer can prove that there is no deliberate chain linking various transactions together, or by merely claiming that they were an unwitting participant or ignorant thereof (*ABSA* case) (Paragraph 2.3.1.).
    - Recommendation 1: It is submitted that the efficacy of the current South African GAAR could be improved so that the taxpayer does not need to have prior knowledge, or act with volition, for the taxpayer be a 'party to the arrangement'.

TAX BENEFIT

- Weakness 1: The definition of 'tax benefit' in the South African GAAR refers to a liability, and the concept of an 'anticipated liability' was determined by the courts. The New Zealand GAAR defines tax avoidance by referring to a 'potential' and 'prospective' liability (Paragraphs 2.3.2. and 3.2.2.).
    - Recommendation 1: It is submitted that, in order to improve the efficacy of the current South African GAAR, the words 'anticipated', 'potential' and 'prospective' are included in the legislated definition of tax benefit to reduce the reliance on court interpretations.
- Weakness 2: The South African GAAR only considers 'misuse or abuse' (tainted element) after the presence of a tax benefit has been determined which results in the

intention of the provision, and the manner in which the provision was used by the taxpayer, not being considered as part of the determination of a tax benefit. The New Zealand GAAR considers this as part of the tax avoidance requirement through the Parliamentary contemplation test (Paragraphs 2.2.1. and 3.2.2.).

- Recommendation 2: It is submitted that, in order to improve the efficacy of the current South African GAAR, that the 'misuse or abuse' consideration be incorporated into the determination of 'tax benefit' to allow for the purpose and manner of the taxpayers' use of the provision(s) to be linked to whether or not a tax benefit is present. It is further submitted that, as part of this consideration, that an approach similar to the Parliamentary contemplation test be incorporated for the purpose of the 'misuse or abuse', to consider the arrangement as a whole and whether the use of the provision was aligned to the contemplation and purpose of Parliament, so that South Africa considers whether the tax benefit obtained is "within the intended scope and provision" when considering how the taxpayer chose to structure the arrangement.

PURPOSE

- Weakness 1: Both jurisdictions contain uncertainty as to whether the purpose test (New Zealand) or sole or main purpose requirement (South Africa) is objective or subjective (Paragraphs 2.3.2. and 3.2.3 and 4.3.3.). Furthermore, the consideration of motive and intent as part of the 'party' to the arrangement instead of within the sole or main purpose requirement (as a result of the judgment in the *ABSA* case) may indicate that the intended change to an objective test for purposes of the sole or main purpose requirement may be superfluous and may thereby reintroduced a weakness of the previous GAAR (Paragraph 2.3.3.).
  - Recommendation 1: It is submitted that, in order to improve the efficacy of the current South African GAAR, a purely objective test be implemented.
- Weakness 2: The current South African GAAR requires that the sole or main purpose be to obtain the tax benefit, whereas the New Zealand GAAR requires the purpose to be not merely incidental to other purposes (Paragraphs 2.3.3. and 3.2.3.1. and 4.3.3.).
  - Recommendation 2: It is submitted that, in order to improve the efficacy of the current South African GAAR, the 'merely incidental' consideration be incorporated

into the sole or main purpose requirement to consider whether the tax benefit flows from, or is concomitantly linked to, any other purposes of the arrangement.

- Weakness 3: The New Zealand GAAR considers whether a taxpayer has used the provision within its intended scope when determining whether tax avoidance has occurred, whereas South Africa does not (Paragraphs 2.3.3. and 3.2.3.1.).
    - Recommendation 3: It is submitted that, in order to improve the efficacy of the current South African GAAR, consideration be given to whether the usage of the provision was within its intended scope or not.
- Weakness 4: The principles of the *Conhage* case may allow taxpayers to argue that their sole or main purpose was not to obtain a tax benefit by proving that they merely chose the option that resulted in the least amount of tax payable. Furthermore, it was noted that extensive reliance is placed on the onus of proof to prove that the sole or main purpose was to obtain a tax benefit (Paragraphs 2.3.3. and 4.3.3.).
    - Recommendation 4: It is submitted that the efficacy of the current South African GAAR may be improved if a 'more than merely incidental' purpose requirement is adopted instead of the 'sole or main purpose' needing to be that of obtaining the tax benefit.

TAINTED ELEMENTS

One of the main differences identified between the GAARs is that the South African GAAR contains a list of tainted elements to determine whether an arrangement is an impermissible avoidance arrangement. The New Zealand GAAR does not contain any such indicators in its legislation and has ultimately placed the burden of determining the presence of a tax avoidance arrangement onto its courts, who consider factors that may be indicative of tax avoidance arrangements as part of the Parliamentary contemplation test (Paragraph 3.2.1.) It is submitted that the incorporation of these additional factors into the tainted elements may increase the efficacy of the South African GAAR. Weaknesses and recommendations are made to the relevant tainted elements as per the analysis in Paragraph 3.2.2. and are summarised below:

- Weakness: No guidance is provided on the size of the **offsetting or cancelling elements,** and such elements could also refer to rights and obligations that offset or cancel each other (ie: no clear list of what is or is not an offsetting or cancelling element) (Paragraph 2.3.4.2.). Furthermore, it is unknown whether convertible notes, forward

purchase agreements, share buy backs and ordinary loans should be considered as items that offset or cancel each other. It is submitted that the GAAR is vague as to what may constitute an 'offsetting or cancelling element' and as a result the scope is widened, which was likely not the intention of the legislator.

    - Recommendation: It is submitted that a similar approach to that of New Zealand be incorporated where this is left to the discretion of the courts to interpret and apply.

- Weakness: Uncertainty exists with regard to how the **misuse or abuse tainted element** should be applied and further guidance is needed to ensure that it is correctly and consistently applied (Paragraph 2.3.4.4.) (Pidduck, 2017:322).
    - Recommendation: It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to how the misuse or abuse tainted element should be applied.

Additional factors

- It is submitted that considering the **manner in which the arrangement is carried out**, instead of referring to the words normal or abnormal, will increase the efficacy of the abnormality tainted element as well as reducing the current uncertainty surrounding the word 'normal' and may assist in addressing the weakness identified in the abnormality element (Paragraphs 2.3.4.1. and 3.2.2.). A transaction could become 'normal' or 'acceptable' if it became widely used, rendering it to be commercially acceptable and thus not containing an element of abnormality (SARS, 2005:43; Katz, 1996:par 11.2.2; Margo, 1987:par 27.28) (Paragraph 2.3.4.1.).
- It is submitted that considering the **role of relevant parties and their relationship with the taxpayer** will increase the efficacy of the accommodating or tax-indifferent party indicator to the lack of commercial substance tainted element, as it is a less prescriptive approach that would provide the courts with the opportunity to exercise their discretion (Paragraphs 2.3.4.2. and 3.2.2.). No guidance has been provided with regard to how **special relationships** between parties to a transaction may impact the application of the individual requirements of the GAAR (Pidduck, 2017:322). It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to how special relationships between parties to a transaction may impact the application of the requirements of the GAAR.

- It is submitted that considering the **economic and commercial effect of documents and transactions** instead of the substance over form indicator, by considering whether the documents and transactions are consistent with the real outcomes of the arrangement will improve the efficacy of the South African GAAR. This will eliminate the uncertainties in its application as well as the word 'significant' and thereby give the courts the opportunity to exercise their discretion (Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.).
- It is submitted that considering the **duration of the arrangement** will increase the efficacy of the current South African GAAR and should be incorporated into the lack of commercial substance element to allow for timing aspects within the arrangement to be considered (Paragraph 3.2.2.).
- It is submitted that considering the **nature and extent of the financial consequences for the taxpayer** will increase the efficacy of the lack of commercial substance element, which considers whether there was a significant effect on the taxpayer's business risks or net cash flows. Rather considering the nature and extent of financial consequences is preferable to considering terms and words that are undefined and so subjective and relative, in order to reduce the uncertainty arising from the lack of definition of these terms (Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.).
- It is submitted that considering the **lack of commercial purpose** will increase the efficacy of the substance over form indicator to the lack of commercial substance tainted element that considers what the transaction 'really is' rather than what it 'appears to be'. The substance over form indicator once again contains uncertainty as well as the word 'significant', which is not defined and therefore creates uncertainty, as well as limitations with regard to its interpretation. By considering a lack of commercial purpose in a similar manner to that of New Zealand, the word 'significant' and its related uncertainty can be eliminated and provide the courts with more room to decide (Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.).
- It is submitted that considering **arrangements with circular flows of money** will increase the efficacy of the round-trip financing indicator to the lack of commercial substance tainted element, which contains a prescriptive definition and undefined terms. By considering arrangements with circular flows of money in a similar manner to that of New Zealand, the undefined terms and the resulting uncertainty can be eliminated as well as the need for a tax benefit to be the result of the round-tripped amounts (Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.).

- It is submitted that the consideration of **arrangements where the investor has no risk** will increase the efficacy of the lack of commercial substance tainted element, which considers whether a significant tax benefit was obtained that did not have a significant effect on the business risks or net cash flows of the party. However, many of these terms are undefined and thus create uncertainty. It is submitted that the uncertainty within this element could be reduced if the wording is changed to exclude 'significant' and to rather consider 'arrangements where the investor has no risk' (Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.).
- It is submitted that the consideration of **arrangements between tax asymmetrical parties** will increase the efficacy of the 'accommodating or tax-indifferent parties' indicator to the lack of commercial substance tainted element. 'Accommodating or tax-indifferent parties' is exhaustively defined in Section 80E of the Act which contains exclusions, such as a controlled foreign companies. It is submitted that a less prescriptive definition of 'accommodating or tax-indifferent' parties be incorporated into the current South African GAAR, similar to the 'arrangements between tax asymmetrical parties' factor in the New Zealand GAAR, to avoid certain parties like controlled foreign companies from being excluded (Paragraphs 2.3.4.2. and 3.2.2.).

  Furthermore, in considering the accommodating or tax indifferent parties indicator to the lack of commercial substance tainted element, it was noted that the current South African GAAR does not, in its prescriptive legislation, account for different tax rates. The requirements in Section 80E(1) would thus exclude entities from being considered tax-indifferent parties if they are subject to normal tax at different rates. It is therefore submitted that not considering different tax rates is a weakness to the current South African GAAR, and it is submitted that parties subject to tax at different rates should be included in what constitutes tax-indifferent parties (Paragraph 4.3.4.).
- It is submitted that the consideration of **not at arm's length** will increase the efficacy of the 'rights and obligations not at arm's length' tainted element which considers whether the rights and obligations created are not consistent with what would usually be created, had the parties been transacting at arm's length. However, 'arm's length' is not defined and as a result creates uncertainty. It is submitted that South Africa follow the same approach as its New Zealand counterpart and leave this factor to the courts to interpret (Paragraphs 2.3.4.2. and 3.2.2.).

General

- Weakness: Various terms and definitions within the current GAAR refer to the word '**significant'** (indicators of tainted elements – Paragraphs 2.3.4.2. and 3.2.2. and 4.3.4.) and thus also make reference to size. As 'significant' is undefined, this creates uncertainty with regard to its application and interpretation which could impact the efficacy of the current GAAR.
    - Recommendation: It is submitted that additional guidance is required in order to eliminate the uncertainty and ultimately improve the efficacy of the current South African GAAR.
- Weakness: The current GAAR contains many **terms that are not defined** in the Act, which could create uncertainty with regard to the application and interpretation of the terms. These terms include, 'normal', 'significant effect', 'business risks', 'net cash flows', 'among', 'between', 'arm's length', 'misuse' and 'abuse'.
    - Recommendation: It is submitted that, in order to improve the efficacy of the current South African GAAR, further guidance be provided as to the definitions and meanings of the abovementioned terms.

5.3. LIMITATIONS OF THIS STUDY

It was highlighted in Chapter 1 (Paragraph 1.7.4.) that there are certain limitations to this study. The use of a case in Phase 2 results in a limitation, as it may be difficult to generalise the outcome of a study that uses a case. However, the findings of the case may be indicative of characteristics included in the population of cases as a whole (Gomm, Hammersley & Foster, 2000:99). Therefore, this study did not address all possible court cases, but the findings from the case used in the study may provide an understanding of the interpretation and application of the current South African GAAR.

5.4. FUTURE AREAS OF RESEARCH

Areas of further research have been identified throughout this study, as follows:

- A study could be performed in which the South African GAAR is compared to GAARs of other jurisdictions in which the GAAR is considered to be effective. This could aid in suggesting improvements to the current South African GAAR by identifying additional areas for improvement.

- A study could be performed whereby the tainted elements are incorporated into the tax benefit requirement (ie: using three requirements and not four) to determine whether the current South African GAAR would be more effective than it currently is, given that the tax benefit and tainted elements are separate requirements.

5.5. CONCLUSION

This study contained an analysis of the current South African GAAR as well as the New Zealand GAAR and provided a comparison of the two GAARS. The analysis showed that the current South African GAAR contains various weaknesses, despite the amendments to the GAAR in 2006 that were intended to address such weaknesses. The weaknesses may result in the current South African GAAR being an ineffective deterrent to impermissible avoidance arrangements. This study identified areas for improvement, which are not limited to amendments to the legislation, but also include guidance on the interpretation of some of the elements of the GAAR. The findings of this study indicate that, in order for a taxpayer to be considered party to an arrangement, they do not need to be aware of the entire arrangement nor all its details. Furthermore, it was noted that the sole or main purpose requirement should be amended to rather require that obtaining the tax benefit was one of the purposes, provided it is not merely incidental, as opposed to requiring the tax benefit to be the sole or main purpose of the arrangement. In addition, it is suggested that the sole or main purpose test be amended to being a purely objective test, and not considering subjective intent of the taxpayer. The findings of this research also suggest that the tainted elements be incorporated into the tax benefit requirement, similar to that of New Zealand's Parliamentary contemplation test, as opposed to being considered a separate fourth requirement by allowing the judiciary greater powers of discretion in applying the GAAR. It is submitted that the above amendments would increase the efficacy of the current South African GAAR.

In conclusion, the findings of this study have shown that while the current South African GAAR has been amended various times, it still contains weaknesses and lessons may be learned from its New Zealand counterpart, in order to improve the efficacy of the current South African GAAR. As a result, it is submitted that the current South African GAAR requires further amendment.

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