General Anti-Avoidance Rule: Lessons for South Africa and New Zealand

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ABSTRACT

South Africa adopted a general anti-avoidance rule (GAAR) as one of its methods to combat innovative tax avoidance schemes into which taxpayers may enter. Since the South African GAAR was introduced for the first time in 1941 it has undergone numerous amendments due to weaknesses highlighted by its failures in court. However, since its most recent amendment in 2006, the efficacy of the South African GAAR is in doubt, as not all of its requirements have been subjected to judicial interpretation and application. This study aims to determine the effectiveness of the South African GAAR when compared to that of its New Zealand counterpart by employing a 'Structured Pre-emptive Analysis' (SPA) to identify the weaknesses in the South African GAAR.

A SPA is a multimethod qualitative approach that combines doctrinal and reform-oriented approaches. The study was carried out in three phases. Doctrinal research was used in Phase 1 to obtain an understanding of the South African and New Zealand GAARs, in order to understand how they should be interpreted and applied, as well as to identify weaknesses and make suggestions for improvement in both. Reform-oriented research was conducted in Phase 2 where the South African GAAR was applied to a case from New Zealand, in order to propose amendments to the South African GAAR. In Phase 3, triangulation was used in order to compare the findings gained in Phases 1 and 2 and thus validate the findings of the research.

The comparison performed between South Africa and New Zealand revealed that guidance should be provided in order to address the uncertainties in the interpretation and application of the South African GAAR, so as to prevent inconsistencies that may limit its efficacy. In addition to this, the South African GAAR should be consolidated into a three-part enquiry instead of the current four-part enquiry, which may be achieved by considering the tainted elements as part of the tax benefit requirement, instead of a separate fourth requirement that would make the South African GAAR more onerous to apply. Lastly, the sole or main purpose requirement should be amended so that it need not be the sole or main purpose to avoid tax, but rather one of the purposes, provided that it was not merely incidental.

Keywords: General anti-avoidance rule, impermissible avoidance arrangement, tax avoidance, tax benefit.

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LIST OF ABBREVIATIONS AND ACRONYMS

Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
GAAR	General anti-avoidance rule
Income Tax Act	Income Tax Act No. 58 of 1962
Income Tax Act 2007	Income Tax Act No. 97 of 2007
SARS	South African Revenue Service
Tax Administration Act	Tax Administration Act No. 28 of 2011

CHAPTER 1:
INTRODUCTION

1.1. INTRODUCTION

From as early as the late 1600's, since the so called 'Window Tax' was introduced by King William III, governments have been struggling to curb tax avoidance. The 'Window Tax' was a tax levied on the number of windows per house (Glantz, 2008:19; Oates & Schwab, 2015:2). Shortly after the window tax was imposed, people started to avoid paying tax by bricking up their windows to reduce their tax burden (Glantz, 2008:18; London Curiosities, 2007). It is thus evident that since the concept of tax was introduced, taxpayers have been seeking innovative ways to avoid paying taxes (Lastiati, Siregar & Diyanty, 2020:1; Olivier, 1996:378).

Due to the innovative ways in which taxpayers seek to avoid paying taxes, the United Nations World Institute for Development Economics Research estimated that US$500 billion is lost annually due to tax avoidance (United Nations World Institute for Development Economics Research, 2017:21). It is estimated that South Africa is losing R7 billion annually due to tax avoidance by companies alone (Donnelly, 2019:1). There is thus clear evidence that the global economy is struggling to combat tax avoidance (Pidduck, 2020:2).

The words 'tax avoidance' and 'tax evasion' have been defined by various authors before. Denis Healy said that: "the difference between tax avoidance and tax evasion is the thickness of a prison wall" (Elliffe, 2011:3). Tax avoidance and tax evasion are commonly distinguished with reference to the legality of the transaction (OECD, 2021). Tax avoidance can be referred to as an arrangement to reduce a taxpayer's liability in a legal manner, whereas tax evasion will be defined as an illegal arrangement (De Koker & Williams, 2020; Van Zyl, 2016). The Organisation for Economic Co-operation and Development (OECD) defines avoidance in their glossary of tax as "an arrangement by a taxpayer's affairs to reduce its tax liability, this arrangement might be in contradiction with the intent of the act but could still be strictly legal" (OECD, 2021). This is also evident in *IRC v Duke of Westminster* (1936) 19 TC 490, where Lord Tomlin stated that:

> *"[e]very man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."*

To curb tax avoidance, governments impose three main anti-avoidance measures, namely general anti-avoidance rules (GAARs), common law and specific anti-avoidance rules (Langenhoven, 2016; Oguttu, 2015). Some governments use only non-legislative measures such as common law, but South Africa uses all three methods to curb impermissible tax avoidance (Pidduck, 2020). It is considered impossible to only rely on specific anti-avoidance rules to combat impermissible tax avoidance. Even if the legislation is well drafted, it is thus of importance to have an effective GAAR (National Treasury: Rebublic of South Africa, 2007). This study will focus on the current South African GAAR to determine its effectiveness in curbing impermissible tax avoidance.

The South African GAAR was included in tax legislation since 1941 but was most recently amended in 2006 by the Revenue Laws Amendment Act 20 of 2006, to address the weaknesses of its predecessor. The current South African GAAR is set out in Sections 80A to 80L of the Income Tax Act No. 58 of 1962 (Income Tax Act) and can be summarised as follows:

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

Since the latest amendments, the South African GAAR has not been challenged in court to its full extent. The only case that was brought before the court was the *Absa Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825) (2021) ZAGPPHC 127 (*Absa Bank case*), where only the 'arrangement' and 'tax benefit' requirements were considered. In this case the South African Revenue Service (SARS) issued a Section 80J notice to the taxpayer indicating that SARS believed that the taxpayers had entered into an impermissible avoidance arrangement. Section 80J of the Income Tax Act requires SARS to issue a notice to the taxpayer if they believe that an

impermissible avoidance arrangement has been entered into by the taxpayer. The taxpayer's only point of dispute was the interpretation of Section 80L as to the interpretation of the terms 'party' and 'arrangement' as set out in this Section 80L. The court held that the taxpayer was not a party to any arrangement and thus the GAAR was not adequately tested, as the 'purpose' and 'tainted elements' requirements were not tested.

Considering the lack of full judicial consideration, it is evident that further research is required to determine whether the South African GAAR is an effective deterrent to impermissible tax avoidance. In doing so this study uses a Structured Pre-emptive Analysis to test the efficacy of the South African GAAR to determine whether the weaknesses of its predecessor have been addressed. While other studies have used this approach before (Bauer, 2018; Calvert, 2011; Pidduck, 2017; Pidduck, 2020), these studies have been limited to comparisons with that of its predecessor, Australia or Canada, and the use of other jurisdictions for research is necessary.

1.2. RATIONALE FOR THE STUDY

Since all of the requirements of the current GAAR have not yet been tested in court, it is not possible to conclude whether the South African GAAR is an effective deterrent to impermissible tax avoidance. Thus, further research is required to determine whether the amendments in 2006 addressed the weaknesses identified in its predecessor. These weaknesses were identified in the Discussion Document released by SARS in 2005 on Tax Avoidance and Section 103 of the Income Tax Act (Discussion Document) (SARS, 2005). This document made proposals for amendment, based on comparisons between South Africa's GAAR and other jurisdictions. Since the amendments, various studies were performed on the efficacy of the South African GAAR with the focus on the theoretical aspects of the GAAR to suggest improvements and to identify the weaknesses (Bauer, 2018; Kujinga, 2013; Loof, 2013). In other studies a more practical approach was followed by comparing the current South African GAAR to the predecessor by applying it to selected court cases heard under the predecessor GAAR to determine whether the current GAAR is a more effective deterrent to impermissible tax avoidance (Calvert, 2011). Further studies applied a similar methodological approach by applying the South African GAAR to cases from other jurisdictions where those countries also adopted GAAR in their legislation, however this was limited to Australia and Canada (Pidduck, 2017).

In the findings from studies performed by Calvert (2011) and Pidduck (2017) it was evident that the South African GAAR still contains weaknesses that required improvement, and both studies indicated that further research should be performed to identify additional areas where the current GAAR could be improved. Since this methodological approach to test the efficacy of the GAAR was limited to Australia and Canada, this study will use New Zealand as a comparison and thereby fill a gap in the research in the field.

1.3. RESEARCH PROBLEM

Several studies indicated that the GAAR is an ineffective deterrent to impermissible tax avoidance (Calvert, 2011; Liptak, 2016; Pidduck, 2017). Therefore, an analysis needs to be performed based on a comparison between South Africa and another jurisdiction's GAAR, to identify the weaknesses and to make suggestions on how to overcome these shortcomings. 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 which amendments can be made to the South African GAAR to improve its efficacy based on lessons from New Zealand and its 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? In this case, what amendments should be implemented using lessons from New Zealand, to address the identified weaknesses and improve the efficacy of the South African GAAR?

1.5. RESEARCH OBJECTIVES

The research objectives that this study will achieve are:

- To identify the primary weaknesses of the South African GAAR;
- To analyse the New Zealand GAAR for the purpose of describing and comparing its elements with the South African GAAR;
- To apply the South African GAAR to the facts of a case from New Zealand in order to determine elements that require improvement in either jurisdiction; and

- To suggest improvements to the South African GAAR to address the identified weaknesses.

1.6. RESEARCH DESIGN AND METHODOLOGY

A multi-method qualitative research design and methodology is undertaken for purposes of this study in the form of a "Structured Pre-emptive Analysis" (Pidduck, 2019:205). Qualitative research is described as an approach to obtain a more detailed understanding of a specific topic, whereas quantitative research aims to quantify a sample of data (Hennink, Hutter & Bailey, 2020:16). The data used for qualitative research will contain words rather than numbers and is described as 'interpretive' in nature (Hennink *et al.*, 2020). The data used in this study consists of words, sentences and paragraphs and a qualitative research methodology is thus consistent with the purpose of this study as it aims to gain an understanding of the South African and New Zealand GAAR, which are interpretative in nature.

A Structured Pre-emptive Analysis methodology approach is a combination of qualitative methodological approaches used in a sequential manner (Pidduck, 2019:217). This methodology approach is appropriate when legislation has not yet been subject to judicial inquiry (Pidduck, 2019:205). Therefore, this methodology approach is appropriate as the South African GAAR has never been subject to judicial enquiry to its full extent. Furthermore, the approach employed includes a combination of a doctrinal and reform-oriented approach (Pidduck, 2019:5).

Doctrinal research

Doctrinal research (also referred to as ''black-letter law'') includes the analysis of cases, statutes and rules (Hutchinson & Duncan, 2012:84). It also includes the extensive examination of a broad range of literature to ensure that the interpretation and application of the relevant doctrines is understood (Coetsee & Buys, 2018:75; Hutchinson & Duncan, 2012:84). This methodology is used to analyse documentary data to reach conclusions and to propose amendments to the existing legislation, if and where appropriate (Pidduck, 2017:9). The objective of this study is to analyse, interpret and to understand the South African GAAR by examining the South African legislation, case law, journals and books. Therefore, the use of doctrinal research is thus appropriate for this study.

Reform-oriented research

Reform-oriented research critically evaluates existing laws to identify the potential weaknesses and recommends suggestions for improvement (Coetsee & Buys, 2018:76; Hutchinson & Duncan, 2012:101). This research approach is described as research that ‘’intensively evaluates the adequacy of existing rules and that recommends changes to any rules found wanting” (Hutchinson & Duncan, 2012:101). This approach is thus consistent with the objectives of this study, as this study will identify the weaknesses of the current South African GAAR based on the application of the South African GAAR to the facts of selected case law from New Zealand.

Structured Pre-emptive Analysis

In applying this methodology approach, the study is carried out in three phases. Doctrinal research is used in Phase 1 (Chapters 2 and 3) to obtain an understanding of the South African and New Zealand GAAR, in order to understand how it should be interpreted and applied. Reform-oriented research is used in Phase 2 (Chapters 4 and 5) as the South African GAAR will be applied to the selected case law from New Zealand to propose amendments for the South African GAAR. Subsequently in Phase 3, the understanding obtained in Phase 1 will be used to compare the knowledge gained in Phase 2 in order to triangulate and thus to validate the findings of this research (Pidduck, 2019:216). Since the results of the two phases converged, there is strong validation of the findings on the GAAR in Phase 3 of the study.

Furthermore, to prevent bias and to ensure a high level of objectivity, a standardised method is applied when interpreting the South African GAAR, when applied to the selected case law. The method used for the interpretation is discussed below:

1.6.1. INTERPRETING THE SOUTH AFRICAN GAAR

To ensure consistency in the application of the GAAR, the framework developed by Pidduck (2017) will be used in this study and amended where appropriate. The use of this structured framework will allow other researchers to reach comparable findings and thus improves the external validity and comparability of this study. Moreover, to prevent bias in the application of the GAAR, a standardised method (the purposive approach) for interpreting the rule is used (Goldswain, 2008:109). The purposive approach interprets the legislation by taking the intention of the legislature by promoting the general purpose of the statutory provision into account (*Natal Joint Municipal Pension Fund v Endumeni*

Municipality (2012) (4) SA 593 (SCA)). The steps taken for the interpretation may be described as follows:

- Firstly, this is done by using the ordinary meaning of the words (unless they are specifically defined) in conjunction with the purpose of the legislation, thereby attempting to determine how the courts will interpretate and apply the words used.
- Secondly, if this meaning of the words will lead to absurdities or anomalies that could not have been the intention of the legislator, the legislator's intention will be used in order to remain within the bounds of the Constitution (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); (Goldswain, 2008:109)
- Thirdly, if a word, sentence or piece of legislation has been interpreted by court (in a similar context) the interpretation of the courts will be used (Pidduck, 2017:53).
- Lastly, the interpretation of the anti-avoidance rule should be interpreted widely to ''suppress the mischief'' but should not be stretched beyond what the language permits (*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)).

Furthermore, as described in the research objectives of this study, the scope is limited to one jurisdiction. The justification for the selected jurisdiction for comparison is discussed below.

1.6.2. SELECTION OF JURISDICTION FOR COMPARISION

In selecting the jurisdiction for comparison for this research, reference was made to the Discussion Document where the South African GAAR was compared to Canada, Australia, Spain, the United Kingdom, the United States as well as New Zealand, that provided the first draft of the current GAAR before its amendment in 2006 (SARS, 2005). These comparatives therefore influenced the amendments made to the South African GAAR in 2006. While some research has been conducted using a Structured Pre-emptive Analysis before, these have been limited to Canada and Australia and no such studies have been performed for New Zealand. Therefore, South Africa will be considered the primary jurisdiction while the jurisdiction selected for comparison is New Zealand. Selecting New Zealand as a comparison is justified by the fact that New Zealand and South Africa have similar legal systems and legislation, as their origins are both found in English law (Rishworth, 2016:2; Van Wyk, 2012:1).

After the selection of the jurisdiction for comparison, predefined objective selection criteria are used to select the case for Phase 2 of the study. The approach applied is discussed below.

1.6.3. SELECTION OF CASE LAW

The selection of case law is an area where bias and objectivity may influence the research negatively (Pidduck, 2017). To reduce this risk, predefined objective criteria are used to diminish the possibility of bias in the selection of the case. For the identification and selection of information rich cases, purposeful maximal sampling is used in order to meet the requirements needed to answer the research problem (Creswell & Creswell, 2018). The selection of the case should represent a critical case in the study (Yin, 2014). When applying the purposeful maximal sampling for purposes of this study, only cases appearing before the Supreme Court of Appeal in New Zealand were considered, as this court is the highest court of judicial precedence in which GAAR matters are heard. The New Zealand Supreme Court was established in 2004, taking over from the Privy Council as the highest court in New Zealand (Littlewood, 2011:263). The Supreme Court is New Zealand's highest and the final appeal court. This court has both statutory jurisdiction and common law jurisdiction and all its decisions are binding on the courts and tribunals below it (Ministry of Justice, 2021).

The cases identified by using the qualitative elimination criteria are the *Ben Nevis Forestry Ventures Ltd v. Commissioner of Inland Revenue*, (2008) and *Penny v. Commissioner of Inland Revenue*, (2011). The *Penny v Commissioner of Inland Revenue*, (2011) case was selected as it is the most recent case presented before the Supreme Court of Appeal.

In addition, measures were taken to ensure validity and reliability of data used in this study. The measures that were used are explained below.

1.6.4. VALIDITY AND RELIABILITY OF DATA

As this study is based on qualitative information, measures should be addressed to ensure validity and reliability of information (Mangioni & McKerchar, 2013:176). The following measures were taken to ensure the validity and reliability of the data used:

- When interpreting the GAAR, it was identified that bias may influence its interpretation and application and consequently affect the results when the South African GAAR is applied to the facts of the case (Pidduck, 2017:55). It was thus of critical importance that an appropriate method was used when interpreting the GAAR (Pidduck, 2019:211). The method for interpretation of the GAAR was addressed in Paragraph 1.6.1. and is consistent with that applied by the judiciary.
- To improve validity and replicability, focus was placed on the framework developed by Pidduck (2017) to ensure that the GAAR was consistently applied (Pidduck, 2019:211). This increased the external validity of the study as the GAAR was applied consistently to the facts of the selected case (Pidduck, 2019:214).
- In Chapter 2 and 3 a doctrinal approach is applied to obtain an understanding of the South African and New Zealand GAARs, whereas Chapter 4 applies a reform-oriented approach. Subsequently, triangulation is used to validate and strengthen the research findings.
- Selection of the jurisdiction might be influenced by subjectivity and bias that could negatively impact the study (Pidduck, 2019:213). However, this was addressed in Paragraph 1.6.2 where objective purposeful maximal sampling was employed to select the case.
- A concern exists that the facts of the case selected could not be derived from a valid and reliable source (Pidduck, 2017:56). To ensure validity and reliability the case was obtained from Judicial Decisions Online database (New Zealand Government, 2020), which is a reliable and independent source.

The data for this research is publicly available and thus there are no ethical concerns relating to the use of the information.

1.7. SCOPE LIMITATIONS

It is recognised that it may be difficult to generalise the outcome of a study that uses a case (Yin, 2009:38). Nevertheless, "the case investigated is a microcosm of some larger system or of a whole society: that what is found there is symptomatic of what is going on more generally" (Gomm, Hammersley & Foster, 2000:99). This study does not address all possible cases that may come before court, but an insight into the practical workings of the South African GAAR is provided. As this study follows a Structured Pre-emptive Analysis by applying the South African GAAR to the facts of a case from New Zealand, the findings

must be interpreted in the context of the specific facts applied (Pidduck, 2017:54). The following additional limitations of this study have been identified:

- The study focusses on the interpretation and efficacy of the South African GAAR and thus provides limited use to other jurisdictions.
- Specific anti-avoidance rules will not be considered as only the current South African GAAR will be tested.
- The interpretation of legislation in the context of this study may inherently include subjectivity. Measures taken to limit the subjectivity are described in Paragraph 1.6.4. Furthermore, as subjectivity is inherent in the interpretation of the GAAR, many decisions in court are derived from the views of judges (Calvert, 2011:8).
- The aim of this study is not to apply all GAAR cases, but a detailed understanding of the application and interpretation of the South African GAAR. In order to maintain a manageable scope, the application of the South African GAAR is limited to one case from one jurisdiction (New Zealand).

The following measures are taken to limit bias and subjectivity in the interpretation:

- The subjectivity in the interpretation of the GAAR is addressed by using a detailed literature review in the form of doctrinal research to understand the working of the GAAR by applying the framework in Paragraph 2.5.
- A multi-method methodology approach is applied in the form of doctrinal and reform-oriented research. The use of these two approaches had the advantage of allowing findings from the doctrinal research to be compared with the findings gained from the reform-oriented research. Since the methodologies used converged, there is a strong validation of the findings on the South African GAAR.
- The study will be conducted in three phases allowing the results from the two methodology approaches to be compared via triangulation.
- An objective approach was used in selecting the case for the purpose of Phase 2.
- The case law documentation obtained from objective sources contained the full facts and details, and a purposive approach was used when interpreting the legislation and applying it to the facts of the cases.

1.8. STRUCTURE OF THE MINI-DISSERTATION

This study is structured as follows:

Chapter 1: Introduction

The aim of this chapter is to give the background of the research topic as well as the rationale and main objectives of the study. The research methodology used in this study is also included as well as the methods used in selecting the jurisdiction for comparison and the case law.

Chapter 2: The South African GAAR

This chapter includes the doctrinal analysis of the South African GAAR and the identified weaknesses from the literature. Based on the analysis a framework is adopted to apply to the facts of the selected case in Chapter 4.

Chapter 3: The New Zealand GAAR

This chapter includes the doctrinal analysis of the New Zealand GAAR. The chapter analyses the similarities and differences between the South African and New Zealand GAARs and makes recommendations for both using this doctrinal analysis.

Chapter 4: Discussion of the South African GAAR based on the facts of the case law

The South African GAAR will be applied to the facts of the selected New Zealand case law to identify whether the South African GAAR will be an effective deterrent to impermissible tax avoidance and to identify further weaknesses for which amendments are required.

Chapter 5: Summary, conclusion and recommendations

The research findings will be summarised based on the outcome of the doctrinal and reform-oriented findings. A summary of the weaknesses and recommendations for the South African GAAR will be made and a conclusion will be drawn as to whether the South African GAAR is an effective deterrent to tax avoidance.

CHAPTER 2:
THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE

2.1. INTRODUCTION

Chapter 1 provided an introduction to the South African GAAR, the research question and objectives, as well as the methodological approach of the study. This chapter serves to identify the weaknesses of the South African GAAR by analysing and interpreting its individual components. This analysis and interpretation of the South African GAAR is in the form of a critical analysis and provides an opportunity to analyse the components of the previous and current GAARs of South Africa.

2.2. THE PREVIOUS SOUTH AFRICAN GAAR

To date the tax law of South Africa has imposed three versions of the GAAR to curb impermissible tax avoidance. The first GAAR was included in Section 90 of the Income Tax Act No. 31 of 1941 and since the amendments made in 1996 to this GAAR, Section 103(1) was introduced and is referred to as the predecessor. The predecessor was further amended in 2006 and as a result the current GAAR is now contained in Sections 80A to 80L of the Income Tax Act. The current GAAR contains some of the same terms that were contained in the predecessor, and it is important to discuss these terms as they were interpreted for the purposes of understanding and interpreting the current GAAR. The previous GAAR was found in Section 103(1) of the Income Tax Act and read as follows:

> "Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property) –
>
> a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or reducing the amount thereof; and
>
> b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out –
>
>   i) was entered into or carried out –
>
>   aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit; and
>
>   bb) in the case of a transaction, operation or scheme being a transaction, operation or scheme not falling within the provisions of item (aa) by means or

in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or

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

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

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

The previous GAAR may be summarised as follows (SARS, 2005:38):

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

The Commissioner had to prove that all four requirements were met before the GAAR was applicable to a transaction entered into by the taxpayer, whereafter the Commissioner was entitled to determine the tax liability as if the taxpayer did not enter into the transaction (De Koker & Williams, 2020:par 19.14). The predecessor applied the sole or main purpose and abnormality requirement and both these requirements needed to be present for the predecessor to be applicable (De Koker & Williams, 2020:par 19.14). The subjective test was applied to the 'sole or main purpose' requirement of the taxpayer, whereas the objective test is applied to the 'abnormality' requirement (De Koker & Williams, 2020:par 19.14). The implication of these requirements was that if the objective abnormality test was met, but the sole or main purpose of the transaction was not to avoid tax, the GAAR could not be applied to the transaction and vice versa. In the Discussion Document released by SARS, before the amendments were made to the current GAAR in 2006, it was noted that

the predecessor was not an effective deterrent to impermissible tax avoidance (SARS, 2005). The weaknesses identified in the Discussion Document may be summarised as follows:

- **Not an effective deterrent:** The predesessor was inconsistent, and at times, an ineffective deterrent to abusive avoidance schemes and other impermissible tax avoidance arrangements (SARS, 2005:41). SARS improved its ability to detect and combat these schemes, however that entailed significant commitments of time and resources for both SARS and the taxpayers (SARS, 2005:41). The relationship between SARS and taxpayers was also negatively impacted due to the lengthy battles between the parties (SARS, 2005:42).
- **"Abnormality" requirement**: Two fundamental weaknesses were identified with this requirement. Firstly, there was no distinction between *bona fide* business transactions and impermissable tax avoidance and thus schemes were often created by "hijacking" techniques that were developed for *boda fide* business purposes (SARS, 2005:42). Secondly, taxpayers structured their transactions in a *bona fide* business purpose by using techniques from geniune business transactions to disguise their arrangements and thus it was easy for taxpayers to escape the abnormality requirement (SARS, 2005:43). In the Discussion Document SARS stated that the ''Achilles heel'' of the abnormality requirement was derived from the reports issued by the Margo and Katz Commissions (SARS, 2005:39-40). These reports stated that the wide usage of tax avoidance arrangments could render it commercially acceptable and as a result it would become normal (Katz, 1996:par 11.2.2; Margo, 1987:par 27.28). The word ''normal'' was however not defined and thus placed significant reliance on judicial interpretation. As a result of the reliance placed on the judicial interpretation uncertainty was created as there is a possibility that it might be interpreted inconsistently as to what will be seen as normal.
- **"Purpose" requirement:** The GAAR was only applicable if the sole or main purpose was to obtain a tax benefit and the word 'main' has generally been constructed to mean ''predominant'' (SARS, 2005:43). Thus, if the transaction had both a tax and commercial purpose, this requirement was only applicable if it could be proven that the tax purpose was the predominant one. The Commissioner had to prove that the taxpayer's intention was to obtain a tax benefit, but as most

transactions had a commercial purpose the Commissioner was placed in a difficult position to disprove a taxpayer's allegations (SARS, 2005:43). In the *Commissioner for Inland Revenue v Conhage* (Pty) Ltd 1999 (4) SA 1149 (SCA), 61 SATC 391 case, taxpayers argued that a transaction had a commercial purpose when capital was raised for an overall transaction and that it is sufficient to ''inoculate'' each and every step in it from challenge (SARS, 2005:43).

- **Procedural and administrative issues:** Uncertainty was created as to when the GAAR would be applied to steps within a larger transaction as well as the use of the GAAR when another section in the Income Tax Act was in dispute (SARS, 2005:44).
- **Abnormality and purpose requirement together:** The abnormality requirement and the purpose requirement had to be present for the GAAR to be applicable (Pidduck, 2017:73). This resulted in a favourable position for the taxapayer as it was relitively easy for the taxpayer to prove that one of the requirements was not applicable (Pidduck, 2017:73).

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

2.3. THE CURRENT SOUTH AFRICAN GAAR

As a result of the 2006 amendments, the current South African GAAR is contained in Part IIA in Sections 80A to 80L of the Income Tax Act and is applicable to all transactions entered into on and after the 2 November 2006. Section 80A contains the basic requirements for the GAAR to be applicable and reads as follows:

> "An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and—
>
> (a) in the context of business—
>
> i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
>
> ii) it lacks commercial substance, in whole or in part, taking into account the provisions of Section 80C;
>
> (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit; or

(c) in any context—

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

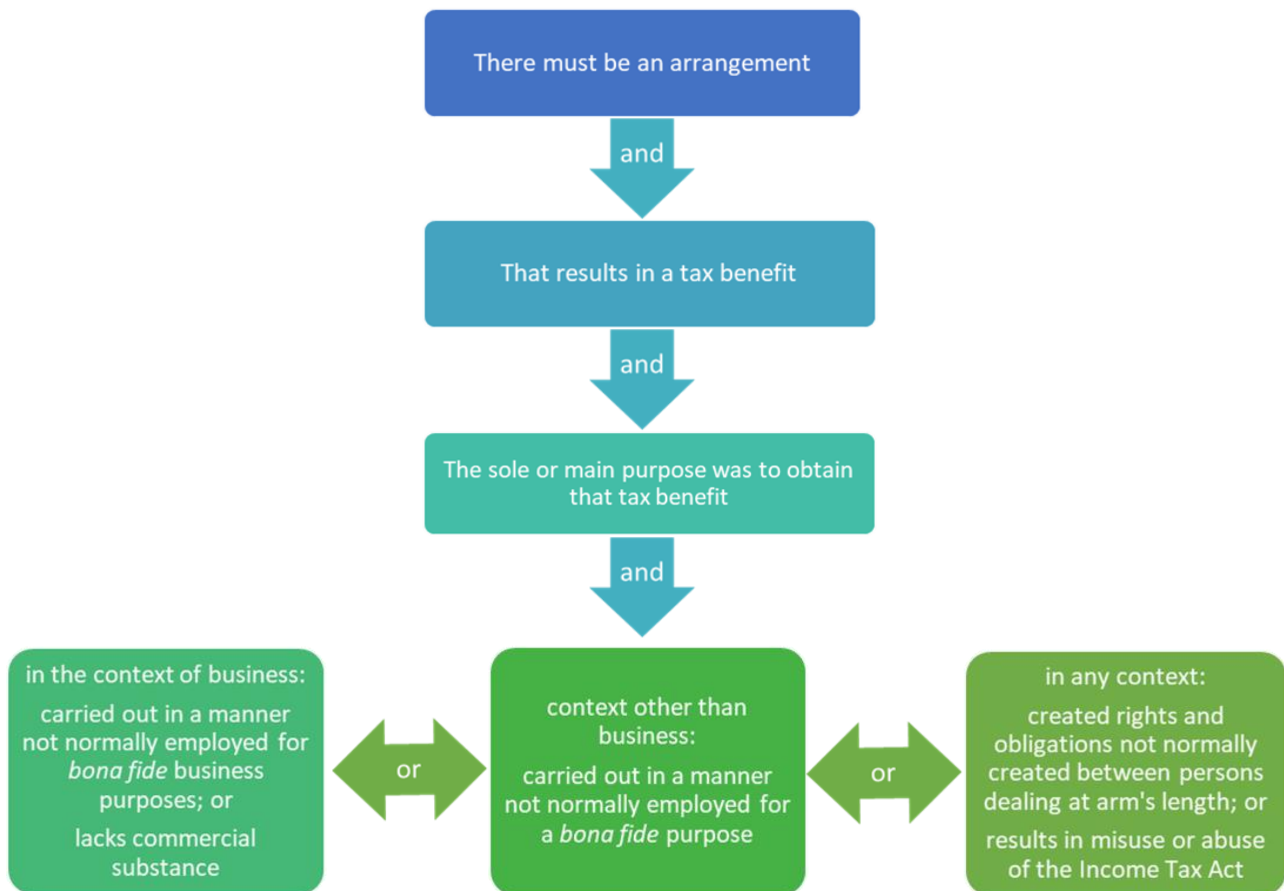
ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).”

Thus, the current GAAR contains four elements that must be present for the GAAR to be applicable. The requirements are summarised as follows:

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

The requirements of Section 80A of the Income Tax Act are illustrated in Figure 1 as follows:

Figure 1: The current South African GAAR



Source: (Own design)

A comparison between the predecessor and the current GAAR reveals that both the abnormality and purpose requirement are still present in the current GAAR, even though the abnormality requirement has been expanded and may now be referred to as the 'tainted elements' requirement (De Koker & Williams, 2020:par19.33). Similarly, the purpose and tainted elements requirements must both be satisfied before a transaction, operation or scheme is determined to fall foul of the GAAR (Pidduck, 2017:76). In addition, in many instances similar wording was used for purposes of both the current and preceding GAAR's. Each of the individual requirements of the current South African GAAR are discussed below, in order to understand how they may be interpreted and applied by the judiciary and for purposes of application to the case in Chapter 4.

2.3.1. ARRANGEMENT

The first requirement that needs to be present for the GAAR to be applicable is the presence of an arrangement. The definition of the term 'arrangement' is contained in Section 80L of the Income Tax Act and reads 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 words 'transaction', 'operation', 'scheme', 'agreement' or 'understanding' are not defined in the Income Tax Act. Nevertheless, the words "transaction, operation or scheme" were also contained in the previous GAAR and were widely interpreted by courts (Pidduck, 2017:78). Reliance may be placed on the interpretation by courts on these words as the precedent created by courts is still relevant (De Koker & Williams, 2020:19.14; Langenhoven, 2016:31). In *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287, it was noted that "…scheme is a wide term and…it is sufficiently wide to cover a series of transactions...". To date there was no court case where the GAAR failed as a result of no arrangement being present, even though it is evident that in some instances the court may find that the taxpayer is not in fact a 'party' to an impermissible avoidance arrangement (*Absa Bank* case).

Individual steps within a larger arrangement are also included in the definition as provided in Section 80H of the Income Tax Act. Section 80H reads as follows: "*the Commissioner may apply the provisions of this part to steps or parts of an arrangement*". The Commissioner is thus allowed to apply the GAAR to individual steps within a larger arrangement (Clegg & Stretch, 2017; Pidduck, 2017:78). This section was intended to address the weakness of the predecessor regarding uncertainty over the application of the GAAR to a step within a larger transaction. The intention of this section is thus to prevent taxpayers from abusing the commercial nature of a transaction by inserting steps into a larger commercial transaction with the main purpose to avoid tax (Kujinga, 2013:106). However, it may be argued that the commercial substance of an arrangement is lost when part of an arrangement is considered in isolation (Pidduck, 2017:159). In the *Absa Bank case,* the GAAR was applied to a step within a larger transaction, and it was held that "an arrangement which is alleged to comprise several distinct transactions must therefore be a scheme".

The most recent GAAR case (*Absa Bank* case) shed further light with regard to the interpretation of arrangement and party to an arrangement. The term 'party' is defined in Section 80L of the Income Tax Act and states that a person will be a party to an

arrangement when that person ''…participates or takes part in an avoidance arrangement''. In the *Absa Bank* case, the court held that the taxpayer was not a party to the arrangement as they were unaware of the transaction that procured a tax benefit and could thus not have, in a state of ignorance, participated in the arrangement, nor did they have a tax avoidance motive in mind and nor did it procure a tax benefit to which it was not entitled. Sutherland ADJP held (at 39) that Absa was not a party to the arrangement, as a party must not merely be present but should participate in the arrangement to be considered a party. Furthermore, the court held that if you receive a share of the tax benefit unwittingly from the arrangement, you cannot be seen as 'taking part' in the avoidance arrangement. It is submitted that this conclusion could introduce a weakness in the current GAAR, as taxpayers may now argue that they were unaware of the arrangement resulting in them not being a party to the avoidance arrangement thereby using ignorance as a defence of the GAAR.

In addition to the above, it is evident that the inquiry into the arrangement and party to an arrangement is a subjective test as applied in the *Absa Bank* case. This assertion is evident from when Sutherland ADJP stated that:

> "*A mere series of subsequential events does not constitute a chain. Without a factual basis to allege that Absa was anything more than an investor in preference shares, no scheme is established that reaches Absa, even if it extends to some or all of the other entities."*

Therefore, while it was clear in the *Absa Bank* case that the court did not believe that the taxpayer was a party to the arrangement or scheme to which the GAAR could be applied, the same could not be said for the other parties to the arrangement or scheme. Therefore, while one party may not be successfully subjected to the GAAR (as in the *Absa Bank* case) another may be successfully attacked by the GAAR. Ultimately, this subjective or objective inquiry may have further implications for the sole or main purpose requirement as discussed under Paragraph 2.3.3 below. To determine whether an 'arrangement' exists, the framework in Paragraph 2.5 will be used and the word will be interpreted widely as noted in the applicable case law above.

2.3.2. TAX BENEFIT

Section 80A of the Income Tax Act requires that an arrangement must result in a tax benefit before it is considered to be an avoidance arrangement. The terms 'tax' and 'tax benefit' are defined in the Income Tax Act. The term 'tax' is defined in Section 80L of the

Income Tax Act as *"…any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner*". As a result of the definition, all taxes administrated by SARS will form part of the definition of 'tax'. Furthermore, the Income Tax Act defines a 'tax benefit' in Section 1 as: *"…any avoidance, postponement, or reduction of any liability for tax*". Thus, a tax benefit can be interpreted to include any transactions undertaken by a taxpayer that results in a reduction in his tax liability (Pidduck, 2017:80). Such a wide definition leaves room for uncertainty as it is unclear when a tax benefit will arise (Pidduck, 2017:80). The term 'tax benefit' has also been interpreted by the judiciary as follows:

- In *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A)), Watermeyer CJ (at 190) held that, a tax benefit only arises when a taxpayer avoids an anticipated tax liability.
- In *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) the term 'avoids an anticipated tax liability' was defined as a taxpayer who has effectively stepped out of the way of, escaped or prevented an anticipated liability.
- In order for the South African courts to determine the existence of a tax benefit, the "but for" test is applied in such a way that it is asked whether the taxpayer would have endured additional tax 'but for' the transaction (*Income Tax Case No.* 1625 (1996) 59 SATC 383; *Smith v Commissioner for Inland Revenue* (1964) (1) SA 324 (A); *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A)) (*Louw* case). This interpretation was confirmed in the *Absa Bank case* as the "but for" test was also applied.

Notwithstanding the above, the judgment in the *Absa case* held that the taxpayer was not a 'party' to the avoidance arrangement and therefore the GAAR was not successfully applied, even though the taxpayer obtained a tax benefit. Thus, if SARS attacks the wrong party to an avoidance arrangement in an attempt to apply the GAAR, even if a tax benefit is received by the party, the GAAR will not successfully be applied to the taxpayer in question.

In addition to the above, to identify the tax benefit the transaction entered into is compared to alternative arrangements that the taxpayer could have entered into that will result in the same commercial outcome (De Koker & Williams, 2020:par19.37). Thus, the onus of proof lies on the Commissioner to prove that the taxpayer obtained a tax benefit (De Koker & Williams, 2020:par:19.40).

When applying the tax benefit requirement to the case, all taxes as defined in Section 80L will be considered. The first test is thus to determine whether the taxpayer escaped or prevented an anticipated tax liability that would have arisen from the arrangement. Secondly, the 'but for' test will be applied as included in the framework contained in Paragraph 2.5.

2.3.3. SOLE OR MAIN PURPOSE

The third requirement is to determine whether an avoidance arrangement exists that resulted in a tax benefit and then it must be established whether the sole or main purpose was to obtain the tax benefit. The wording used in the current GAAR for the sole or main purpose is similar to the words contained in its predecessor (Pidduck, 2017:82). Therefore, the previous interpretation by courts should apply *mutatis mutandis* to the 'sole or main purpose' requirement *(De Koker & Williams, 2020:par 19.38; Pidduck, 2017:82)*. The difference between the 'sole or main purpose' requirement contained in the previous GAAR and the current GAAR arises due to the inclusion of Section 80G in the Income Tax Act and reads as follows:

> "(1) An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.
> (2) The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole."

This section creates a presumption that the taxpayer entered into the transaction with the intention to obtain a tax benefit. However, in the *CIR v Conhage (Formerly Tycon*) (1999) (4) SA 1149 (SCA) Hefer JA (at 392) held that "a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If e.g. the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax". In this case, the sole or main purpose of the transaction will not necessarily be to avoid tax and the sole or main purpose requirement will not be assumed if the transaction has a commercial reason (Pidduck, 2017:84).

To determine whether the sole or main purpose of the taxpayer was to obtain a tax benefit, a subjective test was applied by the previous GAAR (*Secretary for Inland Revenue v*

Gallagher (1987) 40 SATC 39). This principle was also applied subjectively in *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A), *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A) and *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A) court cases. However, some tax practitioners and academics are of the opinion that an objective test is applied (De Koker & Williams, 2020:par 19.38; Meyerowitz, 2008:par 29-12).

Furthermore, Section 80A refers to the intention of the transaction entered into and not the intention of the taxpayer, thus this requirement is intended to be an objective test in the determination of purpose of the arrangement as opposed to a subjective test required by the preceding GAAR (De Koker & Williams, 2020; Kujinga, 2013:110; Pidduck, 2017:83). The taxpayer can discharge this onus based on factual and objective means (*Commissioner for Inland Revenue v Middleman* (1989) 52 SATC 323 and *Income Tax Case* No. 1607 (1995) 58 SATC 340). Nevertheless, uncertainty arises as to whether the court will apply a subjective or objective test to the current GAAR, as this requirement has not yet been challenged in court (Pidduck, 2017:83).

Notwithstanding the above, in the *Absa Bank* case, Sutherland ADJP held (at 41) that:

> "*… 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*" (Own emphasis).

It is submitted that this wording used by the judiciary suggests that a subjective test should be applied in determining the intent of the taxpayer. While it is evident that this was considered for purposes of the arrangement requirement, one questions whether the subjective inquiry will also impact the sole or main purpose inquiry when this requirement is brought before the courts.

Since uncertainty is created as to whether the objective (effect of the transaction) or subjective test (intention of the taxpayer) should be applied, both tests are included in the framework as contained in Paragraph 2.5. Moreover, the intention of the taxpayer will be measured against the objective effect of the transaction (Pidduck, 2017:83). When applying the framework, the sole or main purpose to obtain a tax benefit will not be assumed if the transaction has a commercial substance (Pidduck, 2017:84).

2.3.4. TAINTED ELEMENTS

The last step in determining whether the GAAR is applicable, is to determine whether one of the tainted elements is present that will result in an impermissible avoidance arrangement. The burden of proof for the existence of one or more of these tainted elements lies with the Commissioner, and Sections 80C to 80E of the Income Tax Act contain the guidelines and definitions that the Commissioner may reply on to discharge the onus (Kujinga, 2013:111). Section 80A of the Income Tax Act divides tainted elements into three categories as follows:

- an arrangement that was entered into in a context of business;
- in a context other than business; or
- in any other context.

In a business context the tainted elements that are considered are the ‘abnormality’ or ‘lack of commercial substance’. In the context other than business only the ‘abnormality’ of the transaction is considered. Arrangements in any other context include the tainted elements of misuse and abuse of the Income Tax Act or arrangements that are not at arm’s length. It can be argued that splitting the tainted elements into different contexts (Section 80A(a) – (c)) is unnecessary because they all apply in both business and non-business contexts, with the exception of the commercial substance element, which is not required in a context other than business.

In comparing the ‘abnormality’ and ‘arm’s length rights and obligations’ elements of the current GAAR, it is evident that some of the terms are retained from the previous GAAR. Thus, precedent set by case law relating to these elements remains applicable (Calvert, 2011). Each of the tainted elements are discussed below.

2.3.4.1. ABNORMALITY

The first tainted element that should be considered is the abnormality element. The abnormality requirement is used to determine whether or not the arrangement was entered into or carried out in a manner that would normally be carried out for *bona fide* business purposes, other than to obtain a tax benefit (Kujinga, 2013:111). In *Income Tax Case No 1712* (2000) 63 SATC 499, it was confirmed that a business purpose test is to determine

how a transaction would have been structured for *bona fide* business purposes without only considering the tax benefit.

The wording used in the abnormality element is similar to that of the predecessor and the fundamental contextual principles have been retained (Pidduck, 2017:85). In the Discussion Document it was noted that the lack in the distinction between *bona fide* business transactions and impermissible tax avoidance resulted in an ineffective deterrent to impermissible tax avoidance (SARS, 2005:42). Furthermore, the more these transactions are entered into by taxpayers, the more normal it will become, also resulting in the GAAR not being effective (SARS, 2005:39-40). This was also noted in the *CSARS v KWJ Investment Service (Pty) Ltd* (2018) case where the court ruled against the taxpayer but concluded that the assessment was invalid due to the practice generally prevailing. As a result, the weaknesses identified in the abnormality requirement of the previous GAAR may still be present in the current GAAR. The current GAAR may thus have failed to rectify the weaknesses of the previous GAAR as the word 'normal' is still not defined (Pidduck, 2017:85). Due to the fact that the word normal is not defined, it is argued that inconsistent judicial decisions made by courts may affect the effectiveness of the current GAAR (Kujinga, 2013:112; Langenhoven, 2016:38). Due to absence of the words 'having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out' it is implied that an objective test must be performed for the abnormality requirement (Pidduck, 2017:85; SARS, 2005:56).

When testing the abnormality element with regard to the framework contained in Paragraph 2.5, the arrangement will be compared to a normal business transaction entered into without obtaining a tax benefit (Pidduck, 2017:86).

2.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element is the lack of commercial substance element. This applies to an arrangement carried out in the context of business and the provisions are contained in Section 80C of the Income Tax Act and reads as follows:

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

apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.

(2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to—

(a) the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or

(b) the inclusion or presence of—

(i) round trip financing as described in Section 80D; or

(ii) an accommodating or tax indifferent party as described in Section 80E; or

(iii) elements that have the effect of offsetting or cancelling each other."

Section 80C(1) is a general test, Section 80C(2) contains a list of indicators that a transaction may lack commercial substance, while Sections 80D and 80E contain further guidance over round trip financing and accommodating or tax indifferent parties. Section 80C(1) states that an arrangement will lack commercial substance if it results in a 'significant tax benefit' but does not have a 'significant effect' on the business risks or net cash flows of the party obtaining the tax benefit. This element is similar to the economic substance doctrine adopted in the United States which means if there is no significant effect on business risk or net cash flows resulting from the arrangement, then there is no commercial reason for the taxpayer to have entered into the transaction other than to obtain a tax benefit (Broomberg, 2007:9; Pidduck, 2017:87). However, the term 'significant' has not been defined in the Income Tax Act creating room for uncertainty regarding the interpretation of the words 'significant tax benefit' and 'significant effect' that are used to determine whether a transaction lacks commercial substance (De Koker & Williams, 2020:par 19.39).

This approach is consistent with the intention of the provision and is included in the framework in Paragraph 2.5. (Pidduck, 2017:87). The indicators are discussed below.

Substance over form

The first indicator that a transaction lacks commercial substance is contained in Section 80C(2)(a) of the Income Tax Act. The principle of legal substance over form has been developed in common law (De Koker & Williams, 2020:par 19.13). Common law requires a transaction to be explored to see whether a taxpayer disguised a transaction's true nature or intention in a legal approach. If a taxpayer disguised the true nature or intention of the

transaction, effect will be given to the substance of the transaction rather than its form (*Relier v Commissioner for Inland Revenue* (1997) 60 SATC 1 (A); *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A)). Should this be the case, the transaction should be regulated under common law and the Commissioner will not be required to apply the GAAR (Pidduck, 2017; Langenhoven, 2016; Olivier, 1996).

When applying the GAAR in the *Sasol Oil v CSARS* (2018) ZASCA 153 (A) case, the judges expressed dissenting opinions that indicated that the substance over form test is highly subjective (Pidduck, 2020:13). Although this case was still based on the previous GAAR, Pidduck (2020) is of the opinion that there will be similar controversy in applying the test for the purpose of the current GAAR.

When applying the facts of the case, consideration should be given to what the transaction's true form is and not in what form it purports to be (*Commissioner for SA revenue service vs NWK Ltd* 2010 ZASCA). Thus, the test will be to determine whether the risk and rewards resulting from the transaction are the same as expected from the transaction. Where the risk and rewards are not the same, the arrangement is considered to be simulated (Pidduck, 2017:91). This test is included in the framework contained in Paragraph 2.5.

Round trip financing

The presence of round trip financing is the second indicator that an arrangement lacks commercial substance. The term 'round trip financing' is defined in Section 80D of the Income Tax Act and reads as follows:

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

> (a) funds are transferred between or among the parties (round tripped amounts); and
>
> (b) the transfer of the funds would—
>
> > (i) result, directly or indirectly, in a tax benefit but for the provisions of this Part; and
> >
> > (ii) significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.

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

(a) whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;
(b) the timing or sequence in which round tripped amounts are transferred or received; or
(c) the means by or manner in which round tripped amounts are transferred or received.

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

Round trip financing was not contained in the previous GAAR and there is thus no court interpretation regarding this term. De Koker and Williams (2020:par19.39) describe round trip financing as a situation where:

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

Round trip financing will be applicable if all the requirements are met as set out in Sections 80D(1)(a) and 80D(1)(b). The first requirement is that funds are transferred between or among parties. The words ‘among’ and ‘between’ have not been defined in the Income Tax Act. According to Pidduck (2017:93), the words will be interpreted by courts based on the ordinary meaning and natural meaning of these words, however it can be concluded that they mean funds are transferred between parties “through some type of reciprocal action” (Pidduck, 2017:93).

Secondly, a tax benefit should arise directly or indirectly due to the transfer of funds. For Section 80D to then be applicable the transfer of funds should directly or indirectly result in a tax benefit even if the tax benefit for the arrangement as a whole has already been determined (Pidduck, 2017:93). The second requirement also refers to three undefined terms, ‘reduce’, ‘offset’ and ‘eliminate’, which results in uncertainty with regard to the interpretation thereof and creates the opportunity for a taxpayer to argue that the arrangement did not reduce, offset or eliminate any business risk. The transfer of funds must also result in the reduction, offsetting or elimination of business risk and should thus also be included in the framework developed by Pidduck (2017). The term ‘significant business risk’ is also not defined in the Income Tax Act and also not judicially interpreted

(Pidduck, 2017:93). Pidduck (2017:94) concluded that the term ‘significant’ can be interpreted as ‘’a notable or large reduction’’ in the business risk. The interpretation of the words ‘business risk’ will be based on the ordinary meaning of the words (Pidduck, 2017:94). Accordingly, there is no commercial sense of entering into an arrangement that contains round trip financing other than obtaining a tax benefit (De Koker & Williams, 2020).

When applying the framework contained in Paragraph 2.5. to the facts of the selected case, the question will be asked whether funding has been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit? In addition to the framework, it will be determined whether the transfer of funds resulted in a reduction, offsetting or elimination of business risk.

Accommodating or tax indifferent parties

The third indicator in Section 80C(2) is the lack of commercial substance or the presence of an ‘accommodating or tax-indifferent party’ as defined in Section 80E of the Income Tax Act. Section 80E(1) of the Income Tax Act 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."

It is clear from the above section that the term 'tax-indifferent' party is widely defined (Pidduck, 2017:96). SARS explained in their Discussion Document that a tax-indifferent party is typically the accommodating party to the avoidance arrangement (SARS, 2005:21). The majority of avoidance arrangements involve the use of accommodating parties or special purpose entities to either generate offsetting tax deductions, to absorb income derived from the participation in the schemes or utilising existing assessed losses (SARS, 2005:21). Section 80E(2) of the Income Tax Act provides that a person may be an accommodating or tax indifferent party irrespective of whether they are connected persons to any party in the arrangement. In an abusive transaction, the tax indifferent party typically receives a fee, often in the form of an above-market return on investment, to absorb income or otherwise sell their tax-advantaged status to the other parties in the transaction (SARS, 2005:21). Provisions for when tax accommodating or tax indifferent parties will not apply are contained in Section 80E(3) of the Income Tax Act and reads as follows:

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

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

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

Section 80F of the Income Tax Act allows the Commissioner to treat tax accommodating or tax indifferent parties as one and the same person, or to disregard any such parties.

This section is also not ambiguous and the ordinary meaning of the words will be adequate to understand the intention of the legislator (Pidduck, 2017:97).

In addition, Section 80E(3)(b) excludes a foreign business establishment in terms of Section 9D(1) of the Income Tax Act from a tax-indifferent party (Section 9D specifically deals with controlled foreign companies (CFCs) and any profits that were to be imputed will be attributable to the company situated in South Africa). This provision is problematic because the use of one or more CFC in a multinational enterprises (MNE) context is not unusual and creates the opportunity for MNEs to use these entities in such a way as to comply with Section 9D of the Income Tax Act but avoid tax. Thus, the exclusion of CFC for the purpose of tax-indifferent parties results in problematic consequences that were possibly not considered when the GAAR was drafted (Pidduck, 2020:266). Furthermore, Pidduck (2020) performed an analysis on the *Sasol Oil v CSARS* (2018) ZASCA 153 (A) where the current GAAR was applied to the facts of the case and concluded that the use of CFC for the purpose of Section 9D in a MNE context undermines the effectiveness of tax-indifferent part provision of the current GAAR (Pidduck, 2020:266). Dr Ed Liptak agreed that this exclusion creates a loophole in the GAAR itself and as a result said that this provision should be repealed (International Fiscal Association South Africa, 2021).

When the framework in Paragraph 2.5. is applied, it will be considered as to whether there is a party that sold its tax advantage to another party regardless of their relationship with other parties within the arrangement (Pidduck, 2017:96).

Offsetting or cancelling indicator

Section 80C(2)(b)(iii) of the Income Tax Act contains the last indicator of a transaction that lacks commercial substance. Arrangements that have the effect of offsetting or cancelling each other will result in a lack of commercial substance. When offsetting or cancelling is present, the arrangement, or part thereof, will not have any fiscal consequences except for the sole or main purpose to obtain a tax benefit (De Koker & Williams, 2020:par19.39).

Section 80C(2)(b)(iii) does not specify the amount or size of the elements that are offset or cancelled. Subsequently De Koker and Williams (2020:par19.39), concluded that the offsetting can be rights or obligations that are cancelled or counterbalanced against each other irrespective of a monetary value. The words ‘offsetting or cancelling each other’ are

also not defined in the Income Tax Act, subsequently the ordinary grammatical meaning of the words will be used as the words are not considered to be ambiguous (Pidduck, 2017:115).

When applying the framework as contained in Paragraph 2.5. to the requirements, consideration will be placed on the elements that offset or cancel each other with no resulting change other than to obtain a tax benefit (Pidduck, 2017:97).

2.3.4.3. RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the creation of rights or obligations that would not normally be created between persons dealing at arm's lengths. The term 'arm's length' is not defined in the Income Tax Act. However, in the *Hicklin v Secretary for Inland Revenue (1980) 1 All SA 301 (A)* Judge Trollip JA held that an arm's length transaction between persons indicates that "each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself". It can thus be concluded that if the arrangement is designed to be at market value (i.e. supply and demand) the transaction can be viewed as being at arm's length (Pidduck, 2017:98).

The test used should however be objective to determine whether the transaction is at arm's length and 'normal' (De Koker & Williams, 2020:par 19:39; Pidduck, 2017:98). As the word 'normal' is not defined in the Income Tax Act, it is relatively easy for a taxpayer to prove that a transaction is 'normal' and the Commissioner may find it difficult to prove that it is not the case (Bauer, 2018:51).

When applying the framework in Paragraph 2.5. to the facts of the case, a test as to whether unconnected persons would have entered into the same arrangement as in the situation will be applied.

2.3.4.4. MISUSE OR ABUSE OF THE ACT

The fourth tainted element is the misuse or abuse of the provisions of the Income Tax Act. The 'misuse or abuse' element was not present in the predecessor and is thus not interpreted by court and the terms are also not defined in the Income Tax Act. Due to this fact uncertainty is created on the interpretation and application of this provision. This provision was included in the current GAAR to align the South African legislation with modern international tax approaches to consider the intention of the legislation when

interpreting terms (Van Schalkwyk & Geldenhuys, 2009:169). Pidduck (2017:99) also indicated that the ordinary and natural meaning of the words 'misuse or abuse' will be used when interpreted.

The 'misuse or abuse' element implies that the GAAR cannot be applied if there is no misuse or abuse of the act (Kujinga, 2013:48). The misuse or abuse element was inspired by the Canadian GAAR and thus the interpretation by the Canadian courts will be used to determine how the South African courts might apply the interpretation (Van Schalkwyk & Geldenhuys, 2009:173). The Supreme Court of Canada determined in *Canada Trustco Mortgage Co. v Canada* (2005) SSC 54 that misuse or abuse exists where the transaction defeats or frustrates the purpose of the relevant provision in the legislation. This interpretation is consistent with the intention of the provision in the Income Tax Act (Van Schalkwyk & Geldenhuys, 2009:172).

To determine whether there has been misuse or abuse of the act, the framework in Paragraph 2.5. will consider the intention of the legislation, to determine whether the taxpayer has defeated or frustrated the purpose of the act.

2.4. WEAKNESSES OF THE SOUTH AFRICAN GAAR

The following weaknesses are identified in the current South African GAAR based on the analysis performed and is summarised as follows:

- Section 80H of the Income Tax Act states that the GAAR may be applied to steps within a wider arrangement. However, Pidduck (2017:159) argued that the commercial substance may be lost when a step within a larger arrangement is considered in isolation and currently there is no clarification on how the application of this provision should be implemented to steps within a wider arrangement (Pidduck, 2017:322).

  As noted in the *Absa Bank* case a taxpayer can merely argue that they were unaware of the arrangement in which they obtained a tax benefit and use ignorance as a defence, resulting in the GAAR not being applied as they are not a party to the arrangement.
- It remains uncertain whether a subjective or objective approach should be followed when applying the 'sole or main purpose' requirement to an arrangement.

- The abnormality requirement remains a weakness of the GAAR as the terms normal or abnormal remain undefined. Therefore, transactions may become commercially acceptable if taxpayers frequently enter into these transactions resulting in these transactions becoming ‘normal’ due to frequent use. This results in the same weakness identified in the predecessor.
- As the South African GAAR has not yet been tested in court to its full extent and the Income Tax Act does not provide guidance, uncertainty is created on how the indicators for lack of commercial substance should be interpreted and applied to an arrangement.
- Similar to the weakness contained in the predecessor, the sole or main purpose requirement and the tainted elements (previously the abnormality requirement) remain two separate tests and both need to be met before the GAAR may be applied (Pidduck, 2017:72). Therefore it is relatively easy for the taxpayer to escape either of the two requirements (Pidduck, 2017:73). As a result, it is more difficult for the Commissioner to apply the GAAR successfully due to the taxpayer being in a more powerful position.
- The GAAR contains many terms that have not been defined in the Income Tax Act such as ‘transaction’, ‘operation’, ‘scheme’, ‘agreement’, ‘understanding’, ‘among’, ‘between’, ‘reduce’, ‘offset’, ‘eliminates’, ‘significant’, ‘business risk’, ‘cancel’, ‘misuse’, and ‘abuse’ resulting in uncertainty with regard to the interpretation thereof. This could result in the same weaknesses as identified in the predecessor (Bauer, 2018:69; Pidduck, 2020:32).
- The exclusion of CFC for the purpose of tax-indifferent parties results in problematic consequences that were possibly not considered when the GAAR was drafted. This provision is problematic because the use of one or more CFC by a MNE is not unusual and creates the opportunity for MNEs to use these entities in such a way that it complies with Section 9D of the Income Tax Act but still avoids tax (Pidduck, 2020:266).
- There is uncertainty regarding how the element of misuse or abuse should be applied (Pidduck, 2017:322).

2.5. FRAMEWORK FOR THE SOUTH AFRICAN GAAR

Pidduck (2017:102-104) developed a framework that may be used to apply the current South African GAAR to the facts of selected court cases. The framework will be used as a basis in this study to apply the South African GAAR to the facts of the selected case. The following amendments to the framework have been made as a result of the research performed in this chapter:

Arrangement:

As discussed in Paragraph 2.3.1, a taxpayer must not merely be present but should participate in the arrangement to be considered a party to the arrangement (*Absa Bank* case). Furthermore, the taxpayer should also be aware of the arrangement and act with volition to be considered a party to the arrangement (*Absa Bank* case). Thus, when applying the framework, the following questions will be asked:

- Did the taxpayer participate in the arrangement with volition?

Round trip financing:

As discussed in Paragraph 2.3.4.2, the transfer of funds must also result in the reduction, offsetting or elimination of business risk and should thus also be included in the framework developed by Pidduck (2017). Thus, when applying the framework the following question will be asked:

- Did the transfer of funds result in the reduction, offsetting or elimination of business risk?

Table 2: Framework for the 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. • Did the taxpayer participate in the arrangement with volition? (*Absa Bank* case)

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

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

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

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

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

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

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

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

4 - Tainted elements requirement

- One of the following with regard to business transactions:

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

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

Does the transaction lack commercial substance?

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

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

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

- ***Has the arrangement been entered into in a manner not normal for bona fide purposes?***
  - Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration? (Louw, 2007:27).

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

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

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

- Each of the parties is not striving to get the utmost possible advantage out of the

transaction for themselves? (*Hicklin* case)

- Would unconnected persons have done the same in this situation? (*Hicklin* case)

Is there misuse or abuse of provisions of the Act?

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

Adapted: (Pidduck, 2017:102-104)

2.6. CONCLUSION

An analysis of the previous and current South African GAAR was provided using case law and existing literature. It is evident that some of the elements contained in the previous GAAR are also contained in the current GAAR. Elements such as the purpose requirement, the abnormality requirement and the fact that the purpose and tainted element requirements are still two separate tests. This resulted in the weaknesses identified in the previous GAAR still being contained in the current GAAR and additional weaknesses are also present. The weaknesses identified may result in the current South African GAAR not being an effective deterrent to impermissible tax avoidance.

CHAPTER 3:
THE NEW ZEALAND GENERAL ANTI-AVOIDANCE RULE

3.1. INTRODUCTION

The main objective of this study is to identify the weaknesses in the current South African GAAR and then to provided recommendations for improvement, using lessons from New Zealand. In Chapter 2 an analysis was performed on the South African GAAR and the theoretical weaknesses were identified. This chapter will focus on New Zealand where the New Zealand GAAR is critically analysed and compared to the South African GAAR. This chapter concludes with recommendations to improve the efficacy of the South African and New Zealand GAAR.

3.2. THE NEW ZEALAND GAAR

Before income tax was introduced, New Zealand developed and introduced their first GAAR in 1878 (Elliffe, 2014:148). According to Tretola (2018:3), New Zealand can lay claim that they developed and introduced the first GAAR anywhere in the word. This GAAR was contained in Section 62 of the Land Tax Act 1878 and later in Section 29 of the New Zealand Property Assessment Act 1879 (Elliffe, 2014:148; Tretola, 2018:3). With the introduction of income tax, the GAAR was brought over into Section 40 of the Land and Income Assessment Act 1891 and subsequently Section 108 of the Land and Income Tax Act 1954 (Elliffe, 2014:148; Tretola, 2018:3). Section 108 was subsequently amended in 1976 and become Section 99 of the Income Tax Act (Prebble & McIntosh, 2015:1029). Thereafter it was carried forward into Section BG 1 and GB 1 of the Income Tax Act 1994. The current New Zealand GAAR is contained in Section BG 1, GA 1 and YA 1 of the Income Tax Act No. 97 of 2007 (Income Tax Act 2007).

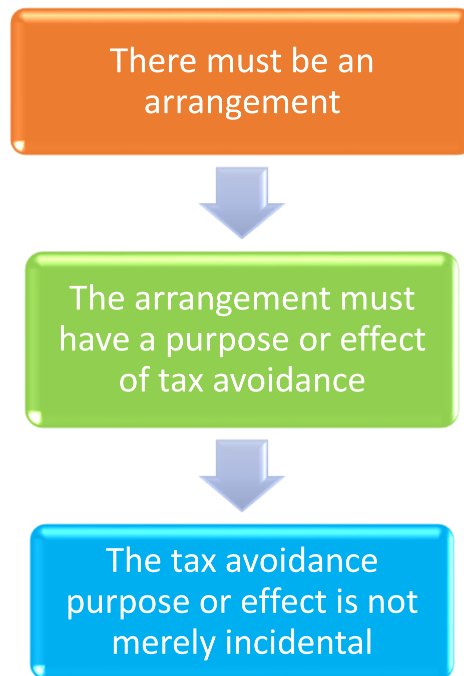
The current New Zealand GAAR is applicable to tax avoidance arrangements and the term 'tax avoidance arrangement' is defined in Section YA 1 of the Income Tax Act 2007. Section YA 1 of the Income Tax Act 2007 reads as follows:

> "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 elements that must thus be present for the New Zealand GAAR to be applicable are presented in Figure 2 below:

Figure 2: The New Zealand GAAR



Source: (Own design)

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

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

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

Unlike the South African GAAR, the New Zealand GAAR does not contain indicators as to when the arrangement might constitute tax avoidance and as a result, the interpretation thereof is left for the courts (Cassidy, 2012:8). This discretion granted to the courts is the intention of Parliament (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2008) NZSC 115). The reason for this is that no matter how well-drafted a provision is, the ingenuity of taxpayers cannot be predicted (Keating & Keating, 2011:13).

If an arrangement is found to constitute tax avoidance, the arrangement will be considered invalid in terms of Section BG 1(1) of the Income Tax Act 2007. This section reads as follows:

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

However, as noted in *Peate v Federal Commissioner of Taxation* (1967) 1 AC 308, (1966) ALR 1199 (PC), merely voiding the arrangement is not enough to nullify the tax advantage it has produced. As a result, Section BG 1 of the Income Tax Act 2007 was introduced which provides that the Commissioner may "counteract a tax advantage that a person has obtained from or under a tax avoidance arrangement" (Littlewood, 2011:268). In addition, Section GA 1(2) of the Income Tax Act 2007 states that the Commissioner "may adjust the taxable income of a person affected by the arrangement in a way the Commissioner thinks appropriate, in order to counteract a tax advantage obtained by the person from or under the arrangement." Thus, an arrangement that contains a tax benefit will either be treated as if the taxpayer never entered into the transaction or the taxpayer will be taxed on a hypothetical arrangement that the taxpayer could have entered into (Datt & Keating, 2018:467; Littlewood, 2011:268).

In 2008 the New Zealand GAAR was for the first time considered in the Supreme Court of New Zealand in the *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2008) NZSC 115, (2009) 2 NZLR 289 (*Ben Nevis* case*)*. A detailed discussion of each of the elements of the New Zealand GAAR will follow below.

3.2.1. ARRANGEMENT

The first requirement that should be present for the New Zealand GAAR to be applicable is that there must be an arrangement. The term is defined in Section YA 1 of the Income Tax Act 2007 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 arrangement is a wide term including various degrees of enforceability and formality, allowing for a wide interpretation (Inland Revenue, 2013:25; Littlewood, 2013:525). This is similar to the South African GAAR, as discussed in Chapter 2 (Paragraph 2.3.1), where an 'arrangement' is also widely interpreted and is sufficient to

cover a series of transactions. It is also evident in the *Commissioner of Inland Revenue v BNZ Investments Ltd* (2002) 1 NZLR 450 (CA) case, where Richardson P (at 46) held that an arrangement is wide enough to include all actions that parties may enter into to achieve a specific purpose or effect (*Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548). No court cases have been heard in New Zealand where the GAAR failed as a result of no 'arrangement' being present (Hwong & Li, 2020). An arrangement between parties may be concluded orally or in writing (*Ashton v Commissioner of Inland Revenue* (1975) 2 NZLR 717 (PC)**.**

In addition, a taxpayer might be considered a party to an 'arrangement' even if the taxpayer 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). In the *Peterson v Commissioner of Inland Revenue* (2005) UKPC 5, (2006) 3 NZLR 433 (*Peterson* case) the Privy Council held (at 34) that:

> *'' Their Lordship does not consider that the 'arrangement' requires a consensus or meeting of minds; the taxpayer need not be a party to 'the arrangement' and in their view he need not be privy to its details either''*

However, this is in contradiction to the South African GAAR, as it was held in the *Absa Bank case* that you cannot be a party to an arrangement if you were an unwitting participant or were ignorant of the arrangement. It is submitted that the efficacy of the South African GAAR may be improved by following a similar approach as that adopted by New Zealand, thereby ensuring that the taxpayers are unable to use ignorance as a defence.

The definition of the word 'arrangement' for purposes of the New Zealand GAAR includes all steps within a transaction and is thus similar to the South African GAAR as discussed in Chapter 2 (Paragraph 2.3.1). In terms of Section 80H of the South African Income Tax Act, the GAAR may be applied to steps within an arrangement. The New Zealand GAAR does not specifically include this, however the principle was set in the *Ben Nevis* case.

3.2.2. TAX AVOIDANCE

Before the New Zealand GAAR will be applicable, the arrangement entered into should have a tax avoidance as its purpose or effect (Tretola, 2018:5). The definition of 'tax

avoidance' is contained in Section YA 1 of the Income Tax Act 2007 and defines it 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 or prospective liability to pay any future income tax;

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

As a result of this definition, the New Zealand GAAR is only applicable to income tax and not to any other type of tax. However, the South African GAAR is applicable to any type of tax within the Income Tax Act of South Africa as discussed in Chapter 2 (Paragraph 2.3.2). The definition of tax benefit in the South African GAAR is similar to Paragraph (c) of the definition of tax avoidance, as both include the words "avoidance, postponement or reduction of any liability for tax". Similarly, in the *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 and *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) case, the courts ruled that a tax benefit arises when the taxpayer avoids an anticipated tax liability. This is also the case in the New Zealand GAAR. It is submitted that South Africa can improve the efficacy of the GAAR by amending the current wording of the definition of 'tax' in Section 80L of the Income Tax Act to include 'anticipated, potential or prospective' as opposed to 'liability for tax'. The amendment to the wording will result in a more encompassing definition for 'tax'.

The definition of tax avoidance in the New Zealand GAAR is problematic for various reasons. The first issue that arises was noted in the *Elmiger v Commissioner of Inland Revenue* (1966) NZLR 683 (SC) case, where it was held that almost every transaction alters the potential incidence of tax and as a result the GAAR may be applicable to virtually every transaction entered into. However, this could not have been the intention of the legislature (Littlewood, 2011:269). Secondly, the definition of tax avoidance in the Income Tax Act 2007 Paragraph (b) describes tax avoidance as relief from a future tax liability. As a result once a tax liability is created the taxpayer cannot do anything about it (Littlewood, 2011:269). However, the Income Tax Act 2007 provides the taxpayer with the right to structure their affairs to reduce their tax liability in a legal manner within the act's purpose and scope (Elliffe & Cameron, 2010). This is in contradiction with Paragraph (b) of the Income Tax Act 2007, as once a taxpayer structures their affairs the GAAR will be applied

to the arrangement. Applying the GAAR to these arrangements is absurd (Elliffe, 2011:270).

Due to the problems identified with regard to the literal meaning of tax avoidance above, the interpretation has been left to courts to determine and restrict the broad meaning of tax avoidance (Tretola, 2018:4). This was confirmed in the judgment of *Mangin v Inland Revenue Commissioner* (1971) AC 739 at 749, (1971) 1 All ER 179 (PC) at 185 where Lord Donovan said that:

> *"… in consequence … of some of the absurdities to which a strictly literal interpretation of Section 108 [the predecessor to s BG 1] would lead, judges have been compelled to search for an interpretation which would make the section both workable and just."*

To enact this, the Parliament contemplation test was developed in the *Ben Nevis* case (Elliffe, 2014:154). This test contains a two-step approach to determine whether or not there has been tax avoidance:

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

To determine whether an arrangement is a tax avoidance arrangement, it must be determined whether the arrangement is carried out in a commercially or economically acceptable way and whether the transaction is within the intention of the legislator (Tretola, 2018:6). This approach may be considered similar to the 'misuse or abuse' element contained in the South African GAAR that intends to apply the GAAR when the arrangement utilises provisions in a manner that was not intended by the legislator. In the *Ben Nevis* case guidance was provided as to when an arrangement is not within Parliament contemplation (Cassidy, 2012:24). The court noted (at 108) that:

> *"a classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial*

or contrived way. It is not within Parliament's purpose for the specific provisions to be used in that manner."

This is a key yardstick as to whether the arrangement is artificial and contrived to determine if it has fallen foul of the GAAR (Cassidy, 2012:24). However, from a South African perspective no guidance is provided on the interpretation and application of the 'misuse or abuse' element as discussed in Paragraph 2.3.4.4. It is submitted that the South African GAAR can be improved by following a similar approach to New Zealand by including reference to artificiality and contrivance.

However, while the Parliamentary contemplation test usually entails a two-step approach, in the *Penny v. Commissioner of Inland Revenue*, (2011) case the Supreme Court found that there was no use of a specific provision and held (at 33) that:

"... it is possible to move straight to s BG 1 and to ask whether the use of the structure which was adopted ... was beyond parliamentary contemplation and resulted in a tax avoidance arrangement."

Equally important the Supreme Court of New Zealand noted (at 109) that the commercial reality, or more so lack thereof, would be an important consideration (Cassidy, 2012:24). Returning to *Ben Nevis* (at 108), a non-exhaustive list of factors were considered to determine whether an arrangement lacks commercial reality and whether the transaction could be considered artificial or contrived (Cassidy, 2012:28; Tretola, 2018:6). These factors are:

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

Furthermore, the court indicated that each factor would depend significantly on the factors of the specific arrangement (Cassidy, 2012:28). Tretola (2018:6), stated that the degree of artificiality is significant in determining the difference between tax mitigation and tax avoidance and suggested that it is likely to be artificial or contrived when the arrangement has:

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

These factors that are considered by the courts may be considered to serve a similar purpose to that of the South African GAAR's lack of commercial substance and its indicators and the tainted elements. An analysis between the New Zealand and South African GAARs is included below:

- **The manner in which the arrangement is carried out:** This test includes the manner in which the arrangement has been structured (*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC)). It will be relevant to determine whether the transaction is different from usual commercial practice, whether the arrangement consists of any unusual features, whether the manner in which the arrangement is structured is hard to understand when a commercial point of view is adopted and whether the structure adopted in the arrangement has the effect that specific sections within the Income Tax Act 2007 are applicable or not (Inland Revenue, 2013:62). Although this factor may be considered to be similar to the 'abnormality' in the South African GAAR, it is submitted that the implementation of this factor may address the weakness identified with regard to abnormality discussed in Chapter 2 (Paragraph 2.3.4.1). Therefore, it is submitted that the word 'abnormal' should be replaced with the New Zealand "manner in which the arrangement is carried out" factor.
- **The role of all relevant parties and any relationship they may have with the taxpayer:** This test considers the role and any relationship that the parties may have with the taxpayer and whether the transactions are at arm's length (Coleman, 2013:94). It is possible that the parties are unrelated, but nonetheless negotiated to share in a tax benefit (Coleman, 2013:95). For example, in *BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC), the parties were unrelated, but the tax benefits procured under the arrangement were split between the parties. The current South African GAAR does not consider the role of all relevant parties and any relationships they may have with the taxpayer. However, this requirement may be considered similar to the 'accommodating or tax indifferent party' and the 'rights and

obligations not at arm's length' requirement. As discussed in Chapter 2 (Paragraph 2.3.4.3) the 'rights and obligations not at arm's length' requirement contains many undefined terms. Moreover, the 'accommodating or tax indifferent party' requirement is long and contains many provisions. It is therefore submitted that a similar approach should be followed by New Zealand where the interpretation should be left for the courts. If the South African legislator wants to include these provisions, the undefined terms should be defined and guidance should be provided with regard to the interpretation thereof.

- **The economic and commercial effect of documents and transactions:** This test considers the economic and commercial effect created by the documents and the transaction entered into. This test may be considered similar to the substance over form element in the South African GAAR. According to the South African GAAR, the legal substance of the transaction should be significantly different from its legal form. Once more, the word 'significant' features in this paragraph and brings with it the uncertainty as discussed in Chapter 2 (Paragraph 2.3.4.2). It is therefore submitted that the efficacy of the South African GAAR will be improved by adopting a similar approach followed by New Zealand and thereby excluding the word 'significant'.
- **The duration of the arrangement:** This test considers the timing aspects of the transaction that include the duration of the arrangement, the time at which the arrangement is entered into and the intervals between particular events in the transaction (*Ben Nevis* case). These timing considerations might indicate as to when an avoidance arrangement is present. For example, in the *Ben Nevis* case, the tax benefit was determined by taking the timing difference between the date the tax benefit was obtained and the actual outflow of economic resources into accounts. The current South African GAAR does not include the consideration of the duration of the avoidance arrangement. This consideration may be useful in curbing the innovative schemes entered into by taxpayers, including schemes entered into that may have similar features to that of the *Ben Nevis* case. It is submitted that the lack of commercial substance requirement should be amended to include timing related aspects such as the factor of the New Zealand GAAR's "duration of the arrangement".

- **The nature and extent of the financial consequences for the taxpayer:** This test includes the consideration as to whether the taxpayer suffered financial losses or whether the nature of the transaction is what the taxpayer claims it to be. For example, where an amount is actually paid for something other than what is claimed (Inland Revenue, 2013:66). Similar to this requirement, the South African GAAR has Section 80C(1) in the Income Tax Act that considers whether the arrangement had a significant effect on the taxpayer's net cash flow. As discussed in Chapter 2 (Paragraph 2.3.4.2), the word 'significant' is not defined and as a result uncertainty is created and this uncertainty may be addressed by considering the nature and extent of the financial consequences for the taxpayer for purposes of the New Zealand GAAR, as opposed to the significant effect.
- **No commercial purpose:** This test includes the consideration as to whether the steps inserted into an arrangement have no commercial (business) purpose. This test therefore determines whether the arrangement achieved any commercial outcome instead of just procuring a tax benefit. This test can be considered similar to the 'lack of commercial substance' element contained in Section 80C(1) of the Income Tax Act. Section 80C(1) states that an arrangement will lack commercial substance if it results in a 'significant tax benefit' but does not have a 'significant effect' on the business risks or net cash flows of the party obtaining the tax benefit. However, the term 'significant' has not been defined in the Income Tax Act, creating room for uncertainty. It is therefore submitted that the efficacy of the South African GAAR will be improved by adopting a similar approach to that followed by New Zealand and thereby excluding the word 'significant'.
- **Money flows in a circle:** Arrangements where money flows in a circle may be considered similar to the round trip financing indicator of lack of commercial substance of the South African GAAR. The round trip financing indicator contained in the South African GAAR contains many undefined terms and may result in uncertainty regarding the correct interpretation and application thereof, as discussed in Chapter 2 (Paragraph 2.3.4.2). It is submitted that the efficacy of the South African GAAR will be improved by following the 'arrangements where money flows in a circle' factor as adopted by New Zealand, as this will resolve the uncertainty created by the undefined words.

- **Offsetting effects:** Arrangements that have offsetting effects may be considered similar to the indicator that considers the presence of offsetting or cancelling elements within the transaction as contained in the South African GAAR. The Income Tax Act does not provide any guidance on the interpretation of this element. It is therefore submitted that this test is consistent with the New Zealand approach, as this test is left for judicial interpretation.
- **Investor has no risk:** Arrangements where the investor has no risk may be considered similar to the significant effect on the business risks of the party obtaining a tax benefit as contained in Section 80C(1), lack of commercial substance, and Section 80D(1), round trip financing of the South African GAAR. However, the word ‘significant’ is not defined in the South African GAAR which results in uncertainties in its application that may limit its efficacy. This uncertainty may be reduced by following the approach of New Zealand and applying the GAAR to arrangements that result in no effect on the risks of the parties involved. This can be achieved by excluding the word ‘significant’ from the ‘lack of commercial substance’ and ‘round trip financing’ indicators resulting in the GAAR still being applicable even if there is no effect on the business risk. Furthermore, the taxpayer cannot then argue that the effect was not significant in a manner to escape the GAAR.
- **Tax asymmetrical parties:** The arrangements between tax asymmetrical parties are similar to the indicator of accommodating or tax-indifferent parties as contained in the South African GAAR. However, the South African GAAR contains an exhaustive definition of an accommodating or tax indifferent party in Section 80E of the Income Tax Act. It is therefore submitted that the efficacy of the South African GAAR will be improved by adopting a similar approach followed by New Zealand and thereby excluding the strict requirements to be considered an accommodating or tax indifferent party.
- **Not at arm’s length:** The term arm’s length considers whether the same terms and conditions, which would have been agreed to between non-related entities, are agreed to. The arrangements that are not at arm’s length may be considered similar to the tainted element that considers whether the rights or obligations created in the arrangement are not those that would arise between parties dealing at arm’s length as contained in the South African GAAR. The Income Tax Act doe not provide any

guidance on how the concept of ‘arm’s length’ should be interpreted in the context of the GAAR. It is therefore submitted that this test is consistent with the New Zealand approach as this test is left for judicial interpretation.

Notwithstanding the differences and similarities identified above, the New Zealand GAAR has included these factors as to when an arrangement might be artificial in one cohesive place, namely to determine ‘tax avoidance’. On the other hand, the South African GAAR clearly separates commercial substance indicators and tainted elements, where commercial substance is one tainted element and misuse or abuse (that may include some aspect of artificiality) is another. Lastly, these are also included as part of a fourth requirement of the South African GAAR as opposed to considerations or factors of the existing three requirements (as used in the New Zealand GAAR). As a result, the South African GAAR is more complex and thus unnecessary difficulty is created in the application thereof. It is thus submitted that South Africa should follow a similar approach as adopted by New Zealand and include these indicators and tainted elements as part of the ‘tax benefit’ requirement. Nevertheless, while the New Zealand courts use these factors to consider when an arrangement is artificial or contrived as was applied in numerous GAAR cases, there is no clear guidance provided by court as to how these factors should be applied and interpreted. It is submitted that while these indicators improve the efficacy of the GAAR, this may also lead to inconsistencies by the judiciary in their application of these factors. Therefore, New Zealand should consider providing further guidance on how the indicators should be interpreted and applied to ensure consistent application thereof by the courts.

In addition, when considering the analysis above, it appears that while similarities exist between the requirements of ‘tax benefit’ in the South African GAAR and ‘tax avoidance’ in the New Zealand GAAR, the New Zealand GAAR considers additional factors that could be incorporated into the South African GAAR in order to improve its efficacy.

3.2.3. PURPOSE OR EFFECT

For the New Zealand GAAR to be applicable to an arrangement, the purpose of effect should be to avoid tax (Littlewood, 2013:525). However, the words ‘purpose’ and ‘effect’ have not been defined in the Income Tax Act 2007 and reliance is placed on the judicial

interpretation of the words. In *Ashton v Commissioner of Inland Revenue* (1975) 2 NZLR 717 (PC) the Privy Council (at 721) stated that:

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

It is thus evident that the purpose of an arrangement is determined by the effect of an arrangement, and the motive is therefore irrelevant (Inland Revenue, 2013:40). This statement remained unchanged following the *Ben Nevis* case. Thus, the purpose of the arrangement is relevant and not the purpose of the parties (Hwong & Li, 2020:550; Inland Revenue, 2013:40). The Supreme Court held in *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 that the purpose test is an objective test as opposed to a subjective test. Consequently the focus is placed on the characteristics and outcome of the arrangement and not on the motive of the taxpayer (Littlewood, 2011:279).

As noted in Chapter 2 (Paragraph 2.3.3.) the legislator of the South African GAAR intended to apply an objective test to the 'sole or main purpose requirement' (De Koker & Williams, 2020:par 19.38). Nevertheless, uncertainty arises as to whether the court will apply this requirement subjectively or objectively, as it has not yet been challenged in court (Pidduck, 2017:83). It is submitted that a purely objective test should be applied in order to improve the efficacy of the South African GAAR.

3.2.3.1. MERELY INCIDENTAL

For arrangements that have multiple purposes or effects, the GAAR may only be successfully applied if the purpose of tax avoidance is not merely incidental to the other purposes (Littlewood, 2013:526). In the *Ben Nevis* case, the Supreme court of New Zealand held (at 114) that:

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

Thus if an arrangement is outside the Parliamentary contemplation it is most probably that the arrangement would fail the merely incidental test (Inland Revenue, 2013:92). However, in *Penny v Commissioner of Inland Revenue* (2011) NZSC 95 it was

concluded that the ‘merely incidental’ test has a continuing and important role in the application of Section BG 1 (Inland Revenue, 2013:92). The meaning of ‘merely incidental’ was judicially interpreted in *Challenge Corporation Ltd v Commissioner of Inland Revenue* (1986) 2 NZLR 513 where Woodhouse P said that:

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

When applying the merely incidental test the Commissioner will still give regard to this interpretation (Inland Revenue, 2013:89). Subsequently, the Commissioner will consider all non-tax avoidance purposes and then determine whether the tax avoidance purpose or effect flows from, or is concomitantly linked, without contrivance, to those other commercial purpose or effects (Elliffe, 2014:156). Furthermore, in *Hadlee and Sydney Bridge Nominees Ltd v C of IR* (1989) 11 NZTC 6,155 (HC), Eichelbaum CJ held (at 6,175) that the size of the tax benefit was “the key factor to determine whether the tax avoidance purpose was merely incidental to the arrangement”.

It is thus evident that both New Zealand and South Africa’s GAAR will be applicable when the sole or main purpose was to obtain a tax benefit or to avoid tax. However, the South African GAAR will be applicable when the sole or main purpose is to obtain a tax benefit, whereas the New Zealand GAAR will be applied if the tax avoidance purpose is not merely incidental. As noted by Pidduck (2017:73), it is relatively easy for a taxpayer to escape the sole or main purpose requirement, thus the efficacy of the South African GAAR will be improved if the “not merely incidental” approach as followed in New Zealand is applied. This will also result in the GAAR being more effective in curbing tax avoidance arrangements.

A comparison between the South African GAAR and the New Zealand GAAR will follow, identifying any theoretical differences and similarities between the two GAAR’s.

3.3. COMPARISON OF NEW ZEALAND AND SOUTH AFRICA GAARs

A comparison is done in order to identify the strengths of the New Zealand GAAR that could be incorporated into the South African GAAR to address its weaknesses. This comparison addresses the second and last objectives as stated in Chapter 1 (Paragraph 1.5).

3.3.1. HIGH LEVEL COMPARISON

The South African GAAR contained in Section 80A to 80L in the Income Tax Act is much lengthier than the New Zealand GAAR as contained in Sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007. This is due to the fact that the South African GAAR contains detailed provisions for each of the elements (Calvert & Dabner, 2012:54). On the other hand, the New Zealand GAAR is simpler and relies on the interpretation of courts to determine whether or not tax avoidance is present (Cassidy, 2012:31). This approach allows for flexibility as the interpretation of tax avoidance may be altered by the court as new schemes are adopted by taxpayers (Elliffe, 2014:163). According to Littlewood (2019:3) and Tretola (2018:26), countries with a GAAR indicated that the approach adopted by New Zealand is the most effective. It is also noted that the short and simple wording used by New Zealand is effective and efficient (Tretola, 2018:26).

As a result, after the establishment of the New Zealand Supreme Court, the New Zealand GAAR has proven in the following cases to be an effective deterrent to impermissible tax avoidance: *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), and *Krukziener v Commissioner of Inland Revenue* (2010) 24 NZTC 24,563 (HC). Although the GAAR failed in *White v Commissioner of Inland Revenue* (2010) 24 NZTC 24,600 (HC) it is submitted that South Africa can learn lessons from New Zealand and should consider a similar less prescriptive and detailed approach.

The following similarities are evident in the New Zealand and South African GAAR's:

- Both of the GAAR's require an arrangement to be present with the term being very similar and widely interpreted.
- Both of the GAAR's require either a tax benefit to be present or tax avoidance. A tax benefit in the South African GAAR is defined as any avoidance, postponement or reduction of any liability of tax. The definition of tax avoidance in the New Zealand GAAR includes the words "avoids, postpones or reduces any liability to income tax". Thus, the statutory definitions of these two terms are similar.
- For both GAAR's to be applicable to an avoidance arrangement, the arrangement should result in a tax benefit or tax avoidance. The South African GAAR requires that the transaction's sole or main purpose should be to obtain a tax benefit, whereas the New Zealand GAAR states that the tax avoidance should not be merely incidental.

One of the most striking differences between the two GAAR's is that the South African GAAR follows a four-step approach whereas the New Zealand GAAR follows a three-step approach. It is argued that the additional requirement of the South African GAAR may favour the taxpayer when compared to the New Zealand GAAR, as the additional step makes it more difficult for the GAAR to be applied successfully. The fourth requirement in the South African GAAR is that one or more of the tainted elements should be present. Although the New Zealand GAAR does not contain the tainted elements, the New Zealand courts consider similar requirements as noted in the discussion of tax avoidance in Paragraph 3.2.2.

3.3.2. RECOMMENDATIONS FOR THE SOUTH AFRICAN GAAR

Although it is evident that the two GAAR's contain similarities, the application thereof is different. Table 3 contains an overview of the differences between the two GAARs, including recommendations to improve the efficacy of the South African GAAR:

Table 3: OVERVIEW OF THE DIFFERENCES AND RECOMMENDATIONS	
ARRANGEMENT	
South Africa	**New Zealand**
The South African GAAR requires prior knowledge and volition from the	The New Zealand GAAR will be applicable to an avoidance arrangement

taxpayer to be considered a party to the arrangement (*Absa Bank* case).	even if the taxpayer did not know of some or all of the details of the arrangement (*Peterson* case).
RECOMMENDATION	
It is submitted that the efficacy of the South African GAAR may be improved by following a similar approach as adopted by New Zealand where the taxpayer need not be privy to its details in order to be considered a party to an arrangement (Paragraph 3.2.1).	

TAX BENEFIT	
South Africa	**New Zealand**
For the South African GAAR to be applicable, a tax benefit should arise. The South African courts determine whether a tax benefit has arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability and have developed a 'but for' test in determining whether a tax benefit has resulted from the arrangement. The tainted elements requirement is considered a fourth step of the GAAR and is not considered as part of the remaining other steps. One of the tainted elements is that of "misuse and abuse" for which no guidance is provided with regards to the application and interpretation.	The New Zealand GAAR requires tax avoidance to be present. The New Zealand courts employ a two-step parliamentary contemplation test to determine whether tax avoidance is present. The parliamentary contemplation test considers whether the arrangement is artificial and contrived.
RECOMMENDATIONS	

It is submitted that efficacy of the South African GAAR may be improved by amending the current wording of the definition of 'tax' in Section 80L of the Income Tax Act to include 'anticipated, potential or prospective' as opposed to 'liability for tax' to reduce inconsistent application of the term tax liability (Paragraph 3.2.2).

The factors considered by New Zealand courts may be considered similar to some of the tainted elements in the South African GAAR. However, it is submitted that these tainted elements should be considered as part of the tax benefit requirement instead of a separate fourth requirement that would make the South African GAAR more onerous to apply (Paragraph 3.2.2).

Furthermore, it is submitted that a similar approach should be adopted to New Zealand's parliamentary contemplation test by considering the provision in the light of the arrangement as a whole and then to determine whether it was used within the contemplation and purpose of the legislator when it enacted the provision (Paragraph 3.2.2).

PURPOSE REQUIREMENT	
South Africa	**New Zealand**
The South African GAAR requires the sole or main purpose of the arrangement to be to obtain a tax benefit. Uncertainty arises as to whether the South African courts will apply the sole or main purpose requirement subjectively or objectively.	The New Zealand GAAR requires that the tax benefit obtained should not be merely incidental. The New Zealand GAAR applies an objective test to the purpose requirement by looking at the outcome of the arrangement.

RECOMMENDATIONS

It is submitted that the efficacy of the South African GAAR may be improved by also requiring a purpose that is more than merely incidental rather than the current sole or main purpose requirement (Paragraph 3.2.3.1).

In addition, it is submitted that a purely objective test should be applied that considers only the purpose of the arrangement and not the intent of the taxpayer in order to

improve the efficacy of the South African GAAR (Paragraph 3.2.3).	
TAINTED ELEMENTS	
South Africa	**New Zealand**
The South African GAAR contains a prescriptive list of tainted elements and detailed indicators of lack of commercial substance.	The New Zealand GAAR does not contain any factors or criteria in its legislation, and it has been left to the courts to determine what constitutes a tax avoidance arrangement. Certain factors have been determined by the courts to date that may be considered relevant for the South African GAAR as part of its tax avoidance requirement.
RECOMMENDATION	
It is submitted that these additional factors considered by New Zealand would strengthen the South African GAAR, as they would allow the courts to consider more characteristics and not restrict them to the defined tainted elements that would be considered a separate fourth requirement.	

Source: (Own design)

The South African GAAR contains a prescriptive list of tainted elements and detailed indicators of lack of commercial substance. While the New Zealand GAAR does not include this fourth separate requirement it was noted that many of these elements and indicators are incorporated as factors by the courts in determining the tax avoidance requirement. Therefore, it was suggested that the approach in New Zealand is followed by incorporating the relevant elements and indicators as part of South Africa's tax benefit requirement to improve its efficacy. However individual recommendations to improve the individual elements and indicators are summarised in Table 4 below.

Table 4: OVERVIEW OF THE DIFFERENCES AND RECOMMENDATIONS FOR TAINTED ELEMENTS	
The manner in which the arrangement is carried out:	
South Africa	**New Zealand**
This test may be considered similar to the abnormality requirement. The South African GAAR does not define the word 'normal' and therefore uncertainty is created.	The New Zealand courts consider the manner in which an arrangement is

Furthermore, it was noted that the more these avoidance transactions are being entered into, the more normal it will become, resulting in the abnormality element not being applicable (Paragraph 2.3.4.1).	carried out (Paragraph 3.2.2).
RECOMMENDATION	
It is submitted that the word ‘abnormal’ should be replaced with the New Zealand “manner in which the arrangement is carried out” factor (Paragraph 3.2.2).	
The role of all relevant parties and any relationship they may have with the taxpayer:	
South Africa	**New Zealand**
This test may be considered similar to the ‘accommodating or tax indifferent party’ and the ‘rights and obligations not at arm’s length’ requirement. The ‘rights and obligations not at arm’s length’ requirement contains many undefined terms (Paragraph 2.3.4.3). Moreover, the ‘accommodating or tax indifferent party’ requirement is long and contains many provisions (Paragraph 2.3.4.2).	The New Zealand courts consider the role and any relationship that the parties may have with the taxpayer and whether the transactions are at arm’s length.
RECOMMENDATION	
It is therefore submitted that the South African GAAR should consider the role of all relevant parties and any relationships they may have with the taxpayer. Furthermore, a similar approach should be followed as adopted by New Zealand where the interpretation should be left for the courts. If the South African legislator wants to include these provisions, the undefined terms should be defined and guidance should be provided with regard to the interpretation thereof (Paragraph 3.2.2).	
The economic and commercial effect of documents and transactions:	
South Africa	**New Zealand**
This test may be considered similar to the substance over form element in the South African GAAR. According to the South African GAAR, the legal substance of the transaction should be significantly different from its legal form. Once more, the word ‘significant’ features in this paragraph and brings with it uncertainty (Paragraph 2.3.4.2).	The New Zealand courts consider the economic and commercial effect of documents and transactions.

RECOMMENDATION	
It is submitted that the efficacy of the South African GAAR will be improved by adopting a similar approach to that followed by New Zealand and thereby excluding the word ‘significant’ (Paragraph 3.2.2).	
The duration of the arrangement:	
South Africa	**New Zealand**
The current South African GAAR does not include the consideration of the duration of the avoidance arrangement.	The New Zealand courts consider the duration of the arrangement. This test includes the timing aspects of the transaction that include the duration of the arrangement, the time at which the arrangement is entered into and the intervals between particular events in the transaction.
RECOMMENDATION	
It is submitted that the lack of commercial substance requirement should be amended to include timing related aspects such as the factor of the New Zealand GAAR’s “duration of the arrangement” (Paragraph 3.2.2).	
The nature and extent of the financial consequences for the taxpayer:	
South Africa	**New Zealand**
This test may be considered similar to the lack of commercial substance element. The South African GAAR considers whether the arrangement lacks commercial substance and whether the arrangement had a significant effect on the taxpayer’s net cash flow. The word ‘significant’ is not defined and as a result uncertainty is created (Paragraph 2.3.4.2.).	The New Zealand courts consider the nature and extent of the financial consequences for the taxpayer.
RECOMMENDATION	
It is submitted that this uncertainty may be addressed by considering the nature and extent of the financial consequences for the taxpayer for purposes of the New Zealand GAAR as opposed to the significant effect (Paragraph 3.2.2).	
No commercial purpose:	
South Africa	**New Zealand**

This test can be considered similar to the 'lack of commercial substance' element contained in Section 80C(1) of the Income Tax Act. However, this section contains the word 'significant' and therefore uncertainty is created (Paragraph 2.3.4.2).	The New Zealand courts consider whether the arrangement has no commercial purpose.

RECOMMENDATION

It is submitted that the efficacy of the South African GAAR will be improved by adopting a similar approach followed by New Zealand and thereby excluding the word 'significant' (Paragraph 3.2.2).

Money flows in a circle:

South Africa	New Zealand
This test may be considered similar to the round trip financing indicator of lack of commercial substance of the South African GAAR. The round trip financing indicator contains many undefined terms and may result in uncertainty regarding the correct interpretation and application thereof (Paragraph 2.3.4.2).	The New Zealand courts consider whether money flows in a circle.

RECOMMENDATION

It is submitted that the efficacy of the South African GAAR will be improved by following the 'arrangements where money flows in a circle' factor as adopted by New Zealand, as this will resolve the uncertainty created by the undefined words (Paragraph 3.2.2).

Investor has no risk:

South Africa	New Zealand
Arrangements where the investor has no risk may be considered similar to the significant effect on the business risks of the party obtaining a tax benefit as contained in Section 80C(1), lack of commercial substance, and Section 80D(1), round trip financing of the South African GAAR. However, the word 'significant' is not defined in the South African GAAR which results in uncertainties in its application that may limit its efficacy.	The New Zealand courts consider whether the investor has no risk.

RECOMMENDATION

It is submitted that South Africa should follow the approach adopted by New Zealand. This can be achieved by excluding the word 'significant' from the 'lack of commercial

substance' and 'round trip financing' indicators resulting in the GAAR still being applicable, even if there is no effect on the business risk (Paragraph 3.2.2).	
Tax asymmetrical parties:	
South Africa	**New Zealand**
Tax asymmetrical parties may be considered similar to the accommodating or tax-indifferent parties as contained in Section 80E of the Income Tax Act. However, the South African GAAR contains an exhaustive definition of an accommodating or tax indifferent party.	The New Zealand courts consider whether the parties to the arrangement are tax asymmetrical parties.
RECOMMENDATION	
It is submitted that the efficacy of the South African GAAR may be improved by adopting a similar approach to that followed by New Zealand and thereby excluding the strict requirements to be considered an accommodating or tax indifferent party (Paragraph 3.2.2).	

Source: (Own design)

3.3.3. RECOMMENDATIONS FOR THE NEW ZEALAND GAAR

While the New Zealand courts use factors to consider when an arrangement is artificial or contrived for purposes of the tax avoidance requirement, as was applied in numerous GAAR cases, there is no clear guidance provided by court as to how these factors should be applied and interpreted. It is submitted that while these indicators improve the efficacy of the GAAR, this may also lead to inconsistencies by the judiciary in their application of these factors. Therefore, New Zealand should consider providing further guidance on how the indicators should be interpreted and applied to ensure constant application thereof by the courts (Paragraph 3.2.2).

3.4. CONCLUSION

A doctrinal research method was applied to this chapter to compare the New Zealand and South African GAAR, and to make recommendations to improve these GAARs. The recommendations to improve the South African GAAR were provided using lessons from New Zealand. This chapter therefore achieves the second and fourth research objectives and concludes the doctrinal aspect of this study.

In Chapter 5 a reform-oriented approach is applied 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. The triangulation of the findings in these two chapters will provide a strong validation for the suggestions made in this study to improve the efficacy of the South African GAAR.

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

4.1. INTRODUCTION

In Chapter 3 the New Zealand GAAR was analysed and the similarities and differences between the New Zealand and South African GAAR were highlighted. This chapter will use the framework in Chapter 2 (Paragraph 2.5.) to apply the requirements of the South African GAAR to the facts of the selected New Zealand case, in order to identify where the South African GAAR may be improved. This chapter will therefore address the third research objective as stated in Chapter 1 (Paragraph 1.5), as the South African GAAR will be applied to the facts of the *Penny v Commissioner of Inland Revenue*, (2011) (*Penny* case). This chapter will allow a comparison between the two jurisdictions' GAARs in order to assess the efficacy of the South African GAAR from a practical perspective.

4.2. FACTS OF THE *PENNY* CASE

Penny and Hooper were two orthopaedic surgeons who practised in their own capacity and all of the income generated by the practice was part of their personal income. Shortly after the personal income tax rate increase in New Zealand from 33% to 39% on 1 April 2000, the taxpayers adopted a structure to restructure their personal income. Each sold their practice, from which they earned substantial income, to an incorporated company (the family trust held almost all of the share capital) and became employees of the company and the sole directors. Thereafter, Penny's salary dropped from NZ$300 000 to NZ$100 000 while Hooper's salary dropped from NZ$650 000 to NZ$120 000 per annum. The balance of the income was declared as a dividend to the family trust and taxed at a rate of 33% or the rate of the individual beneficiaries. As a result, the taxpayers were relieved from the additional 6% increase in the tax rate. The trust income was then used to fund their houses and to advance loans and pay dividends to them and other family members. Due to this restructuring the taxpayers saved between NZ$20 000 and NZ$30 000 per annum in taxes.

Although each of the taxpayers had different circumstances, both had common features, namely a company registration of which the taxpayers were the sole directors and the shares of the company were held by a family trust. In the case of Mr Penny, the additional features (that were not present in the case of Hooper) were:

- Mr Penny established the company-trust structure several years prior to the increase in the individual tax rate.
- In 1997 he formed Penny Orthopaedic Ltd (POS) and Orthopaedic Surgical Consultancy Ltd (OSCL). In April 1997, he sold the practice to POS. POS on-sold the practise to OSCL. At that time Mr Penny obtained no tax benefit from the use of this structure.
- When the change in the tax rate took effect in April 2000, he limited his income from the company and received an interest free loan from the trust with no repayment terms.

However, Mr Hooper restructured his practice in 2000 and the family trust (hereafter referred to as the Hooper Trust) held almost all of the issued share capital of the new company, Hooper Orthopaedic Ltd. The income earned by the trust was used to invest in Mr Hooper's family home, family holiday home and in bank deposits. The amounts distributed by the Hooper Trust were distributed to Mr Hooper's three daughters and were taxed in their hands. However, the Penny Trust substantially retained all of the income as trustee income. Although the Mr Penny and Mr Hooper cases were unrelated but similar in nature, they were heard together and a single conclusion was given.

The Commissioner of Inland Revenue contended that their actions amounted to tax avoidance and made assessments increasing the taxable income of Mr Penny and Mr Hooper for the tax years ending 31 March 2002, 2003 and 2004 by an amount equal to the difference between the salaries actually paid and what the Commissioner assessed as commercially realistic salaries for their services. The Commissioner contended that the actions considered were those of the creation of the company-trust structure together with the reduced income, in totality and the cumulative effect thereof (*Penny v Commissioner of Inland Revenue* (2009) 3 NZLR 523 (HC) at 12). After investigations began by the Commissioner, Mr Hooper and Mr Penny declared a larger salary reflecting the actual salary earned to avoid any penalties onwards if the Commissioner's view prevailed.

The interest free loans with no repayment terms provided to Mr Penny are not considered for purposes of this study due to the fact that the South African GAAR is applied to the facts of the case as was presented to the Supreme Court in New Zealand and additional grounds were likewise not considered. The Commissioner only became aware of the loans

provided to Mr Penny after the statement of position had been issued to the court. Subsequently when the Commissioner wanted to rely on the loans and consider it as part of the arrangement Mr Penny objected and the court accepted the argument provided by Mr Penny (*Penny* case at 29-32). The progress of the case is presented in Table 4 below:

TABLE 5: PROGRESS OF THE *PENNY* CASE

	High Court	Supreme Court
Decision	Held in favor of the taxpayers	Held in favor of the Commissioner

Source: (Own design)

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

4.3.1. ARRANGEMENT

The first requirement for the South African GAAR to be applicable is the presence of an arrangement. In the *Penny* case the Commissioner particularised the arrangement as the totality of the creation of the company-trust structure together with the reduced income and the cumulative effect thereof (*Penny v Commissioner of Inland Revenue* (2009) 3 NZLR 523 (HC) at 12). Therefore, all of the following steps were considered as part of the arrangement:

1. the sale of the orthopaedic practice to the company, where the taxpayer is the only director;
2. the registration of the family trust, where the trust is a shareholder of the company incorporated by the taxpayer;
3. the reduced salary paid to the taxpayer when compared to the income prior to the restructuring; and
4. the payment of dividends from the company to the family trust for the benefit of the director (taxpayer) of the company and their families.

In applying the framework of the South African GAAR as contained in Chapter 2 (Paragraph 2.5) to the facts of the *Penny* case, the steps described above will constitute a transaction, operation or scheme as contemplated in the definition of an ‘arrangement’ in Section 80L of the Income Tax Act. Furthermore, it is evident that the taxpayers participated with volition and intent as they were the parties who created the structure.

4.3.2. TAX BENEFIT

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

The net earnings before interest and tax from the practice in 2000 prior to the restructuring was NZ$ 651 000 and NZ$ 633 000 respectively for Mr Hooper and Mr Penny, and would have been taxed at the maximum personal income tax rate of 39%. After the restructuring their salaries from the company reduced to NZ$120 000 and NZ$100 000 respectively, despite the fact that they continued working exactly as before and were taxed at 39%. The balance of the annual income of the company was distributed to the family trust as a dividend and was taxed at 33% as trustee income or the rate of the individual beneficiaries if distributed to them.

The retained earnings by the Hooper Trust were invested in the family home and holiday home. The retained income of the trust was taxed at 33% instead of the personal income rate of 39%. The retained earnings of the Penny Trust were taxed in the hand of the trust at 33% instead of the personal income tax rate of 39%. It is therefore submitted that the taxpayers effectively stepped out of the way and escaped the anticipated tax liability by reducing the income on which they were taxed. In addition, in applying the ''but for'' test, it is submitted that if the scheme had not occurred, the taxpayers would have been liable for a higher amount of tax as the taxpayers would have been taxed on more income and taxed at higher rates (considering the differences between the income taxes at 39% instead of 33%).

Therefore, it may be concluded that a tax benefit exists when applying the framework of the South African GAAR to the facts of the *Penny* case and therefore the arrangement is considered an avoidance arrangement.

4.3.3. SOLE OR MAIN PURPOSE

The third requirement for the South African GAAR to be applicable is that the sole or main purpose of the arrangement must have been to obtain the tax benefit. The framework of the South African GAAR uses two tests to determine whether the sole or main purpose of the arrangement is to obtain a tax benefit. The subjective test uses the stated intention of the taxpayers to determine whether the sole or main purpose of the arrangement was to obtain the tax benefit. The objective test is used in conjunction with the subjective test to determine whether the objective effect of the transactions supports the intention provided by the taxpayer.

The stated intention (subjective test) of the taxpayers, Mr Hooper and Mr Penny, is evident from the *Penny* case (at 16) when it was noted that both taxpayers said under cross-examination that the restructuring of their practices was:

> *"…because of a concern about exposure to medical negligence claims which might not be covered by the accident compensation scheme."*

In analysing the facts presented in the Penny case it is evident that upon cross examination by Mr Goddard in the High Court (*Penny v Commissioner of Inland Revenue* (2009) 3 NZLR 523 (HC) at 46) both Mr Penny and Mr Hooper were able to point to evidence that supported their claims of increased propensity and risks related to litigation by patients after 1996 and 1990 respectively and the company structure provided protection against these risks. However, the reduced income earned by the taxpayer, the interposition of the trust and the distribution of the retained earnings to the trust do not support their intent, as this could have been achieved without the creation of the trust or the reduced income as stated by the Commissioner (*Penny* case at 25).

In considering the sole or main purpose of Mr Penny it is evident that he restructured his practice in 1997, three years prior to the change in the personal income tax rate. It is therefore submitted that the subjective intention of Mr Penny may have been to restructure his practice due to a concern about exposure to medical negligence and that the sole or main purpose was not to avoid tax. However, Mr Penny only reduced his income (income from the practice when compared to salary earned from company) once the tax rate changed in 2000 and therefore the objective factors do not support the stated intention of Mr Penny. Moreover, there was no evidence provided to the court by the taxpayer that

could substantiate the reduction in the salary. Therefore, it is submitted that Mr Penny's sole or main purpose was to obtain a tax benefit.

Furthermore, Section 80G of the Income Tax Act creates a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit and the taxpayer would be required to provide affirmative or conclusive evidence to discharge this onus. It is clear that the taxpayers were able to justify the specific use of the company structure, but it is evident that they were unable to discharge the onus created by Section 80H to justify the interposition of the trust, the low salaries received and the distribution of the remainder of the income to the family trust.

Nevertheless, the principles of the *Conhage* case are particularly relevant for Mr Hooper: 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, it may indicate that the obtaining of the tax benefit was not the sole or main purpose of the arrangement. In the case of Mr Hooper, who did not have a company-trust structure beforehand, it may have been argued with relative ease that he did achieve the benefit of managing risk related to medical negligence claims and merely used an option available to him that afforded less tax. Therefore, in the case of Mr Hooper it is possible that he may have successfully argued that his sole or main purpose was not to have obtained the tax benefit by means of relying on the *Conhage* case. However, in light of the arguments above, it is submitted that the sole or main purpose of the arrangement in the *Penny* case for Mr Hooper and Mr Penny was to obtain a tax benefit.

The New Zealand Supreme Court in the *Penny* case held (at 24) that the purpose to obtain the tax benefit was not merely incidental, as it was at least one of its purposes and as a result the arrangement constituted a tax avoidance arrangement. It is however submitted that the efficacy of the South African GAAR may be improved by following the New Zealand approach where the tax benefit must have been just one of the purposes, provided it is not merely incidental. This will place the Commissioner in a more favourable position as it is submitted that if the taxpayers had been able to provide other objective factors in support of their subjective intent (a commercial reason as to why they accepted the lower salary and distributed the retained earnings to the trust), the South African GAAR may not have been applicable to this arrangement. This recommendation is

particularly relevant in light of the principles of the *Conhage* case as it may be argued that the taxpayers (particularly Mr Hooper who did not have a company-trust structure beforehand) did achieve the benefit of managing risk related to medical negligence claims and only used an option available to him that afforded less tax. This supports the recommendation made in Chapter 3 (Paragraph 3.3.2) that the South African GAAR could be improved by following the New Zealand approach.

4.3.4. TAINTED ELEMENTS

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

4.3.4.1. ABNORMALITY

The first tainted element considers whether the arrangement was entered into in a manner normally employed for *bona fide* business purposes. To test this element, the framework for the South African GAAR considers whether there is a difference between the transaction entered into by the taxpayer and a transaction that would be entered into for *bona fide* purposes in the absence of a tax consideration.

Evidence provided by the accountancy expert, Mr Shewan, called for by the taxpayer, (at 28) suggested that what occurred here was consistent with commercial practice as the principal family person working for a family business does not always derive close to what the Commissioner may treat as being commercially realistic. However, while the assertions by Mr Shewan may be accepted and there may be no valid criticism of the adoption of the corporate structure provided, there remains a significant *reduction* in the net income for each taxpayer from the period immediately before the increase in the personal income tax rate to immediately after the increase in the personal income tax rate. This difference was not explained or rationalised by Mr Shewan. Therefore, it is submitted that there is a difference between a transaction entered into for *bona fide* purposes in the

absence of a tax consideration and it may be concluded that the arrangement is considered abnormal.

4.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element determines whether the arrangement lacked commercial substance in terms of Section 80C(1) of the Income Tax Act. The framework for the South African GAAR considers whether there is a significant effect on the net cash flows and business risks of the party obtaining the tax benefit.

As discussed under 'tax benefit' in Paragraph 4.3.2, Mr Penny and Mr Hooper were the parties who obtained the tax benefit, therefore it should be determined whether there is a significant effect on the net cash flows and business risk for them. It is evident that there is an effect on the business risk related to exposure to medical negligence claims as experienced by the taxpayers. Furthermore, it is submitted that there is an effect on the business risk of Mr Penny and Mr Hooper as they are the directors of the companies and could be held liable for decisions made by the company. Moreover, there could be claims imposed on the company that result in liquidation. It is submitted that these would be considered 'significant' for the taxpayers, but it is not possible to conclude this with absolute certainty.

The reduction of salaries enabled the companies to distribute the profits by way of dividends to the family trusts, avoiding payment of the highest personal tax rate (for the taxpayers) and were then used by the trust for the taxpayer's family purposes, including benefiting Mr Penny by loans and Mr Hooper by funding the family home and holiday home. Therefore, the arrangement had an effect on their net cash flows as they did not receive all of the income that they would have received had they not entered into the arrangement. It is submitted that there was an effect on the net cash flows for the parties. This reveals a potential weakness in the South African GAAR as a taxpayer may exercise indirect control over funds or cash flows. In this case it may have been through influence over the decisions made by trustees or even influence over the use of the funds when received by the beneficiaries of the trust. It is therefore submitted that this weakness may be addressed if the GAAR considers whether the taxpayer has direct or indirect control over the funds even if the amounts were not received by him/her or even the relationships between the taxpayer and the recipients of the funds or how the funds are applied.

In applying the general test it is submitted that the avoidance arrangement is considered not to lack commercial substance as there is an effect on the business risks and net cash flows for the parties within the arrangement. Although it is evident that there is an effect on the business risk and net cash flows, it cannot be concluded with absolute certainty that the arrangement resulted in a ‘significant’ effect on the net cash flows and business risks of the parties. This is due to the fact that the term ‘significant’ is not defined in the Income Tax Act. Therefore, it is submitted that guidance should be provided with regard to the meaning of the word ‘significant’, to eliminate uncertainty and thereby improve the effectiveness of the South African GAAR.

Substance over form

To test the substance over form indicator contained in Section 80C(2)(a) of the Income Tax Act, the framework of the South African GAAR considers whether the true intentions of the parties are reflected in the agreement. Thus, the substance over form test is met when the true intentions of the parties are not reflected in the agreement. In applying this indicator, it is necessary to consider whether the risks and rewards arising from the arrangement are those that can be expected from such a transaction.

It is submitted that the true intention of the parties is reflected in the arrangement, as the taxpayer’s intention was to sell the practice to the company and that all the shares in the company would be held by the trust in order to protect themselves against liability claims. Therefore, it may be argued that the substance of the arrangement does not differ from its form.

Round trip financing

In terms of the framework of the South African GAAR it refers to the transfer of funds between parties, through some type of reciprocal action, resulting directly or indirectly in a tax benefit and whether the funds transferred resulted in the reduction, offsetting or elimination of business risk. The round trip financing indicator is further expanded in Section 80D of the Income Tax Act with Section 80D(3) stating that the term “funds” includes cash, cash equivalents, and any right or obligation to receive or pay an amount.

In the context of the *Penny* case, it is evident that the taxpayers accepted a below market related salary from the company, thereafter the remainder of the income earned by the company was distributed as a dividend to the family trusts. Moreover, the income that would have been taxed in the hands of Mr Penny or Mr Hooper (prior to the restructuring at 39%) was now taxed in the hands of the trust at a rate of 33%, resulting in a tax benefit. However, it is uncertain whether the transfer of the funds by the trust to the beneficiaries would be considered a reciprocal action, as Mr Penny and Mr Hooper were not beneficiaries of the trust. While it is possible to argue that Mr Penny and Mr Hooper are indirectly in control of the trust, even though neither of them were trustees of the trust, it is expected that the trustees chosen by them may act according to their instructions. However, the South African GAAR does not consider the role of all relevant parties and any relationship that they may have with the taxpayer, whereas the New Zealand courts do consider the role of all relevant parties and any relationship they may have. Moreover, (at 35) the court in the *Penny* case held that they could be expected to control the trust and therefore they were in control of the funds. This reveals a weakness in the current South African GAAR, as they do not consider the role of all relevant parties to the arrangement. It is therefore submitted that the South African GAAR should consider the role of all relevant parties and any relationship that they may have in order to improve the efficacy of the South African GAAR.

Accommodating or tax-indifferent parties

Prior to the restructuring Mr Penny and Mr Hooper should have been taxed at the maximum individual tax rate of 39% on all of the income generated. However, as a result of the restructuring the trust income was taxed at 33% on the retained earnings (or if distributed, the rate of the individual beneficiaries). Therefore, it is evident that Mr Penny, Mr Hooper, the companies, the trusts and beneficiaries are subject to normal tax albeit at differing rates at certain instances. Therefore, as they are subject to normal tax the trust and the company cannot be considered an accommodating or tax indifferent party according to the strict requirements in Section 80E(1) of the Income Tax Act, as what would be considered the tax indifferent of the accommodating party in this case are still subject to normal tax. This reveals a weakness in the current South African GAAR and it is therefore submitted that the requirement should be amended to included parties that are subject to normal tax at a lower rate.

In applying the framework of the South African GAAR there are no accommodating or tax indifferent parties present in the *Penny* case.

Offsetting or cancelling effects

The framework of the South African GAAR considers whether there are elements within the arrangement that have the effect of offsetting or cancelling each other as contemplated in Section 80C(2)(b)(iii) of the Income Tax Act.

- The restructuring of the practice resulted in a lower personal income for the taxpayers and an increase in the company's profits resulting in a higher amount of tax for the company. It may thus be argued that the increase on the company's tax is offset against the lower personal income tax for Mr Penny and Mr Hooper.
- In the case of Mr Penny, it may be argued that the dividends paid to the trust by the company were offset against the benefit that Mr Penny had to use the funds in the trust to his discretion.
- In the case of Mr Hooper, the dividends received by the trust from the company were distributed for the benefit of Mr Hooper's family members and invested in their family home and holiday home. Therefore, it may be argued that the benefits obtained from the trust were offset against the dividends paid to the trust from the company.

Thus, according to the framework of the South African GAAR, the arguments above may be an indication that parts of the arrangement had the effect of offsetting or cancelling each other, but it is not possible to conclude this with absolute certainty.

When considering the general test of lack of commercial substance, it was concluded that the arrangement did not lack commercial substance due to an effect on the business risk and net cash flows of Mr Penny and Mr Hooper. However, in light of the discussion of the indicators of commercial substance above, it may be concluded that the arrangement in this case lacked commercial substance due to the presence of offsetting and the cancelling effect within the arrangement.

4.3.4.3. RIGHT AND OBLIGATIONS NOT AT ARM'S LENGTH

The third tainted element is the creation of rights or obligation that would not normally be created between persons dealing at arm's length. Using the framework for the South African GAAR, a transaction is tainted by the creation of rights and obligations that are not at arm's length if each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves, or if unconnected persons would not have agreed to the same terms in the same situation. The following terms of the arrangement indicate the creation of rights and obligations that would not be created between parties dealing at arm's length:

- The salaries earned by Mr Penny and Mr Hooper are not commercially realistic. Mr Penny and Mr Hooper admitted to the High Court (at 52) that the salaries paid were not commercially realistic.
- The investment by the Hooper trust in the family home and holiday home of the Hooper family.

This arrangement thus created rights and obligations that were not at arm's length, as it is doubtful that unconnected persons would have agreed to these terms in the same situation.

4.3.4.4. MISUSE OR ABUSE OF THE ACT

The last tainted element is the misuse or abuse of the Income Tax Act. The framework considers whether the arrangement frustrated or manipulated the provisions of the Income Tax Act it used or whether the provisions were used in a manner not intended by the legislator.

The declaration of the dividend to the trust and the distribution of the income for the benefit or Mr Penny and Mr Hooper is not considered 'misuse or abuse of the act' as such. However, it is submitted that the adoption of business structures and other means which had the effect of diverting or splitting the income generated by the individuals resulted in the misuse or abuse of the act, as income derived from personal exertion should be taxed in its appropriate taxation band and should not be inappropriately diverted away. Moreover, when the personal income tax increased, the taxpayers deliberately took themselves out of the higher tax bracket. It is thus submitted that Mr Hooper and Mr Penny

misused and abused the provisions of the act as they inappropriately diverted income that should have been taxed in their hands.

4.4. SUMMARY OF THE APPLIED CASE

A summary of the results from applying the South African GAAR to the *Penny* case is contained in Table 5 below:

Table 6: Framework for applying the GAAR to the facts of the *Penny* case	**Mr Penny**	**Mr Hooper**
1 - Is there an arrangement?	Yes	Yes
2 - Does the transaction/operation/scheme result in a tax benefit?	Yes	Yes
3 - Is the sole or main purpose to obtain such tax benefit?	Yes	Yes
4 - Tainted elements requirement	Yes	Yes
One of the following with regard to business transactions:		
- Entered into in a manner not normal for *bona fide* business purposes?	Yes	Yes
- Does the transaction lack commercial substance?	Yes	Yes
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?	Yes	Yes
- Is there misuse or abuse of provisions of the Act?	Yes	Yes

Source: (Own design)

4.5. CONCLUSION

In analysing the results from applying the South African GAAR to the facts of the *Penny* case, it is evident that the transactions entered into by the taxpayers fall within the

definition of an impermissible avoidance arrangement for purposes of the framework for the South African GAAR.

While the taxpayers stated that they were attempting to restructure their practice due to a concern of medical negligence claims, they accepted salaries below what is commercially acceptable and still benefited from the difference between the salary received and the market related salary. Moreover, the taxpayers were unable to provide objective evidence as to why they reduced their income once the personal income tax rate decreased. This led to the conclusion that the sole or main purpose of the arrangement was to take advantage of the tax benefits resulting from the transaction. Nevertheless, it was noted that the principles of the *Conhage* case were particularly relevant for Mr Hooper where it may be argued that he did achieve the benefit of managing risk related to medical negligence claims and merely used an option available to him that afforded less tax. But it is not possible to conclude this with absolute certainty and revealed a weakness of the South African GAAR. It is submitted that the efficacy of the South African GAAR may be improved by following the New Zealand approach where the tax benefit must have been just one of the purposes, provided it is not merely incidental.

Furthermore, for the purpose of the sole or main purpose requirement, it was identified that the objective effect of the transaction supported the intention of the taxpayer, but the inclusion of the trust was not necessary to achieve this. Moreover, objective factors were considered when determining whether the sole or main purpose of the arrangement was to obtain a tax benefit. This limits the applicability of the South African GAAR as the taxpayer can with relative ease discharge the onus by reasoning that the transaction had a commercial reason. Therefore, it is submitted that clear guidance should be provided to ensure that an objective approach is applied instead of the subjective test.

In addition to the above, the arrangement included tainted elements such as abnormality, rights and obligations not at arms lengths and misuse and abuse. In addition, there was lack of commercial substance regarding the scheme entered into in the *Penny* case due to the fact that offsetting or cancelling effects were present in the arrangement. Nevertheless, in applying the general test of lack of commercial substance, it cannot be concluded with absolute certainty that the arrangement in the *Penny* case resulted in a significant effect on the net cash flows and business risks of the parties. Firstly, this is due to the fact that

the term ‘significant’ is not defined in the Income Tax Act. Secondly, it may be argued that the taxpayers do have a significant effect on their net cash flows due to the fact that they did not actually receive the amounts, however they may still directly or indirectly be in control of the amounts due to the relationships that they hold with the trustees and the beneficiaries of the trust. Therefore, it is submitted that guidance should be provided with regard to the meaning of the word ‘significant’, to eliminate uncertainty and thereby improve the effectiveness of the South African GAAR. Furthermore, it is submitted that the lack of commercial substance element considers whether the taxpayer has direct or indirect control over the funds, even if the amounts were not received by him/her or even the relationships between the taxpayer and the recipients of the funds or how the funds were applied.

Moreover, the accommodating or tax indifferent party element revealed another weakness of the South African GAAR, as the trust was subject to normal tax but at a lower rate than Mr Penny or Mr Hooper, resulting in the strict definition of Section 80E(1) of the Income Tax Act not being applicable. It is therefore submitted that the requirement should be amended to include parties that are subject to normal tax at a lower rate.

In conclusion, it is evident that the avoidance arrangement entered into by the taxpayers in the *Penny* case constitutes an impermissible avoidance arrangement in terms of the framework for the South African GAAR. The New Zealand Supreme Court similarly applied the New Zealand GAAR and found that the arrangement was an impermissible avoidance arrangement.

CHAPTER 5: CONCLUSION

5.1. INTRODUCTION

The South African GAAR has been included in tax legislation since 1941, but was most recently amended in 2006 by the Revenue Laws Amendment Act 20 of 2006, to address the weaknesses of its predecessor. Since the latest amendments, the South African GAAR has not been challenged in court to its full extent and there is uncertainty as to whether it is an effective deterrent to impermissible tax avoidance. Moreover, there is uncertainty regarding its interpretation and application. Therefore, this study fills a gap that exists by testing the efficacy of the South African GAAR using lessons from New Zealand and suggesting amendments to address the weaknesses of the current GAAR. The research objectives that this study achieved were described as follows:

1. To identify the primary weaknesses of the South African GAAR;
2. To analyse the New Zealand GAAR for the purpose of describing and comparing its elements with the South African GAAR;
3. To apply the South African GAAR to the facts of a case from New Zealand in order to determine elements that require improvement in either jurisdiction; and
4. To suggest improvements to the South African GAAR to address the identified weaknesses.

The research methodology adopted in this study was a SPA that combined doctrinal and reform-oriented approaches. Doctrinal research was adopted in order to analyse the South African and New Zealand GAARs, and reform-oriented research was followed in order to apply the South African GAAR to the New Zealand case in order to recommend improvements to address any identified weaknesses in the South African GAAR.

5.2. ACHIEVEMENT OF THE RESEARCH OBJECTIVES

Chapter 2 of this study analysed the requirements of the current South African GAAR where it was noted that the current GAAR contains elements and terms that were present in its predecessor. Therefore, many of the weaknesses identified in the previous GAAR may have thus been inherited by the current GAAR. A comparison of the provisions of the current South African GAAR to its predecessor reveals that although additional indicators have been incorporated, both the previous ‘abnormality’ and ‘purpose’ requirements are

still essentially present. The theoretical principles of the current South African GAAR were compared to the New Zealand GAAR in Chapter 3. This analysis indicated similarities between the two GAARs, such as arrangement, tax benefit and the purpose requirement. Differences between the two GAARs were also identified, where it was evident that the South African GAAR has four requirements while the New Zealand GAAR only has three. The following additional differences were identified:

- **Length and complexity:** The New Zealand GAAR is shorter than the South African GAAR and the South African GAAR is considered to be more complex. Furthermore, the South African GAAR contains detailed legislated provisions whereas the New Zealand GAAR relies on the interpretation of the courts to determine whether an arrangement is an avoidance arrangement. The approach followed by New Zealand is argued to be more effective and efficient. The South African GAAR could arguably learn lessons from its New Zealand counterpart and consider a less prescriptive and less detailed approach, given the success of the New Zealand GAAR.
- **Arrangement:** The South African GAAR requires prior knowledge and volition from the taxpayer to be considered a party to the arrangement (Absa Bank case). The New Zealand GAAR will be applicable to an avoidance arrangement even if the taxpayer did not know of some or all of the details of the arrangement (*Peterson* case).
- **Taxes:** The South African GAAR is applicable to all taxes administrated by SARS, whereas the New Zealand GAAR is only applicable to income tax.
- **Tax benefit:** For the South African GAAR to be applicable, a tax benefit should arise whereas the New Zealand GAAR requires tax avoidance to be present. The two GAARs have similar statutory definitions for these terms, however, they are determined differently in the two jurisdictions. For the South African GAAR to be applicable a tax liability should have existed ‘but for’ the arrangement and the taxpayer should have effectively stepped out the way of an anticipated tax liability. To test whether there is tax avoidance for purposes of the New Zealand GAAR, the courts consider whether the taxpayer used the provisions of the legislation within its intended scope and whether the use of the provision in light of the arrangement as a whole was used within the contemplation and purpose of Parliament when it enacted the provision.
- **Purpose:** The South African GAAR requires the sole or main purpose of the arrangement to be to obtain a tax benefit, whereas the New Zealand GAAR requires

that the tax benefit obtained should not be merely incidental. The New Zealand purpose is arguably better than the South African purpose requirement, as it does not require it to be the dominant purpose, and it is submitted that the South African GAAR could benefit from the use of the New Zealand purpose requirement. Moreover, the New Zealand test is purely objective, but it is not clear whether an objective or subjective approach should be applied in South Africa.

- **Tainted elements:** The South African GAAR contains indictors as to when an arrangement is considered to be an impermissible tax avoidance arrangement, known as the tainted elements as a separate fourth requirement. The New Zealand GAAR does not contain these indicators in its legislation and leaves it to the courts to determine whether the arrangement is an avoidance arrangement. However, in the *Ben Nevis* case there were factors used that may be considered similar to those of the tainted elements of lack of commercial substance indicators. Moreover, there are some additional factors considered by New Zealand that could be considered for inclusion in the South African GAAR.

Furthermore, the South African GAAR was applied to the facts of the *Penny* case from New Zealand in order to determine elements that require improvement. The outcome of the case is summarised below:

5.2.1. CASE OUTCOME

The framework of the South African GAAR described in Chapter 2 was used to apply the South African GAAR to the facts of the *Penny* case in Chapter 4. It was concluded that the South African GAAR would be successful to curb this impermissible avoidance arrangement. The framework of the South African GAAR was applied as follows:

- An arrangement as defined in Section 80G of the Income tax Act was present. This was expected as the term ‘arrangement’ is widely defined.
- The arrangement resulted in a tax benefit due to a reduced tax rate as a result of the restructuring.
- The sole or main purpose of the arrangement was to obtain a tax benefit. Nevertheless, the principles of the *Conhage* case are particularly relevant for Mr Hooper where it may have been argued with relative ease that he did achieve the benefit of managing risk

related to medical negligence claims and merely used an option available to him that afforded less tax. This could however not be concluded with absolute certainty.

- Each of the four tainted elements were present in the arrangement as follows:
  - The arrangement was found to be abnormal, as it was different from an arrangement that a different taxpayer would have entered into in the absence of tax considerations.
  - The arrangement contained indicators of lack of commercial substance due to the presence of offsetting elements.
  - The arrangement created rights or obligations not at arm's length, as it is doubtful that unconnected persons would have agreed to these terms in the same situation.
  - Mr Hooper and Mr Penny misused and abused the provisions of the act, as they inappropriately diverted income that should have been taxed in their hands.

It is submitted that the findings from the reform-oriented research preformed in Chapter 4 provided validation for the recommendations suggested to improve the efficacy of the South African GAAR in the doctrinal research phase in Chapter 3. The weaknesses identified in both the doctrinal and reform-oriented phases of the research (including the *Penny* case) are included below.

5.2.2. WEAKNESSES OF THE CURRENT SOUTH AFRICAN GAAR

The following weaknesses were identified in the current South African GAAR based on the analysis performed in Chapters 2, 3 and 4 and are summarised as follows:

- Section 80H of the Income Tax Act states that the GAAR may be applied to steps within a wider arrangement. However, Pidduck (2017:159) argued that the commercial substance may be lost when a step within a larger arrangement is considered in isolation, and currently there is no clarification on how the application of this provision should be implemented to steps within a wider arrangement (Pidduck, 2017:322).
- As noted in the *Absa Bank* case, a taxpayer may argue that they were unaware of the arrangement in which they obtained a tax benefit and use ignorance as a defence, resulting in the GAAR not being applied, as they are not considered a party to the arrangement (Paragraph 2.3.1 and Paragraph 3.2.1).
- The South African GAAR is only applicable if the 'sole or main purpose' was to obtain a tax benefit. Thus, if the transaction had both a tax and commercial purpose, this requirement is only applicable if it can be proven that the tax purpose was the

predominant one. This results in the same weakness identified in the predecessor (Paragraph 2.2). Moreover, this weakness was confirmed in Chapter 3 and 4 (Paragraph 4.3.3 and Paragraph 3.2.3.1).

- It remains uncertain whether a subjective or objective approach should be followed when applying the 'sole or main purpose' requirement to an arrangement (Paragraph 2.2, 2.3.3 and 4.3.3).
- The abnormality requirement remains a weakness of the GAAR, as the terms normal or abnormal remain undefined (Paragraph 2.3.4.1). Therefore, transactions may become commercially acceptable if taxpayers frequently enter into these transactions resulting in these transactions becoming 'normal' due to frequent use. This results in the same weakness identified in the predecessor (Paragraph 2.2 and 3.2.2).
- As the South African GAAR has not yet been tested in court to its full extent and the Income Tax Act does not provide guidance, uncertainty is created on how the indicators for lack of commercial substance should be interpreted and applied to an arrangement (Paragraph 2.3.4.2, 3.2.2 and 4.3.4.2).
- The lack of commercial substance element results in a weakness due to the 'significant effect on the net cash flows' requirement. This requirement will not be applicable when a taxpayer is in control of the funds, that resulted in an effect on the net cash flows, but he/she did not actually receive the funds to conclude that there was no effect on the net cash flows (Paragraph 4.3.4.2). The following factors considered by the New Zealand courts are not considered by the South African GAAR to determine whether an arrangement lacks commercial reality and whether the transaction can be considered artificial or contrived (Paragraph 3.2.2):

    - **The manner in which the arrangement is carried out:** this test may be considered to be similar to the abnormality element that the South African GAAR considers, however the word normal is not defined in the Income Tax Act.
    - **The role of all relevant parties and any relationship they may have with the taxpayer:** this test may be considered similar to the 'accommodating or tax indifferent party' and the 'rights and obligations not at arm's length' requirement, however the 'rights and obligations not at arm's length' requirement contains many undefined terms. Furthermore, the 'accommodating or tax indifferent party' requirement is long and contains many provisions.

- **The economic and commercial effect of documents and transactions:** this test may be considered similar to the substance over form element in the South African GAAR, however this element contains the word ‘significant’ that is not defined in the Income Tax Act.
- **The duration of the arrangement:** the South African GAAR does not consider the duration of the arrangement that includes the timing aspects of the transaction. This test includes the duration of the arrangement, the time at which the arrangement is entered into and the intervals between particular events in the transaction.
- **The nature and extent of the financial consequences for the taxpayer:** this test may be considered similar to the lack of commercial substance element, however this element contains the word ‘significant’ that is not defined in the Income Tax Act.
- **No commercial purpose:** this test can be considered similar to the ‘lack of commercial substance’ element, however this element contains the word ‘significant’ that is not defined in the Income Tax Act.
- **Money flows in a circle:** this test may be considered similar to the round trip financing indicator, however this element contains many undefined terms.
- **Investor has no risk:** this test may be considered similar to the significant effect on the business risks of the party obtaining a tax benefit as contained in the lack of commercial substance element and the round trip financing element, however these elements contain the word ‘significant that’ is not defined in the Income Tax Act.
- **Tax asymmetrical parties:** this test may be considered similar to the accommodating or tax-indifferent parties, however this element contains an exhaustive definition of an accommodating or tax indifferent party.

- Similar to the weakness contained in the predecessor, the sole or main purpose requirement and the tainted elements (previously the abnormality requirement) remain two separate tests and both need to be met before the GAAR is successfully applied (Paragraph 2.2, 2.3.3, 3.2.2 and 3.2.3.1). Therefore it is relatively easy for the taxpayer to escape either of the two requirements (Pidduck, 2017:73). As a result, it is more difficult for the Commissioner to apply the GAAR successfully due to the taxpayer being in a more powerful position.

- The GAAR contains many terms that have not been defined in the Income Tax Act such as ‘transaction’, ‘operation’, ‘scheme’, ‘agreement’, ‘understanding’, ‘among’, ‘between’, ‘reduce’, ‘offset’, ‘eliminates’, ‘significant’, ‘business risk’, ‘cancel’, ‘misuse’, and ‘abuse’ resulting in uncertainty with regard to the interpretation thereof (Paragraph 2.4 and 3.2.2).
    - The term ‘significant’ resulted in uncertainty when the South African GAAR was applied to the *Penny* case (Paragraph 4.3.4.2).
- The exclusion of CFC for the purpose of the definition of tax-indifferent parties results in problematic consequences that were possibly not considered when the GAAR was drafted. This provision is problematic because the use of one or more CFC by a MNE is not unusual and creates the opportunity for MNEs to use these entities in such a way that it complies with Section 9D of the Income Tax Act but still avoids tax (Paragraph 2.3.4.2).
- The ‘accommodating or tax-indifferent parties’ element will not be applicable to an arrangement when the accommodating or tax-indifferent party is subject to normal tax at a lower rate due to the strict definition of this element (Paragraph 4.3.4.2).
- There is uncertainty regarding how the element of misuse or abuse should be applied (Paragraph 2.3.4.4).

5.2.3. RECOMMENDATIONS

A doctrinal analysis was performed in Chapters 2 and 3 in order to identify elements in the New Zealand GAAR than may be adopted in the South African GAAR to improve the efficacy thereof and thereby address the identified weaknesses. The reform-oriented research in the form of applying the South African GAAR to the New Zealand case was performed in Chapter 4, also to aid in making recommendations to the South African GAAR. The suggestions made to improve the efficacy of the South African GAAR after both these different approaches were undertaken were:

- The efficacy of the South African GAAR may be improved by following a similar approach as adopted by New Zealand where the taxpayer need not be privy to its details in order to be considered a party to an arrangement (Paragraph 2.3.1 and 3.2.1).
- The current wording of the definition of ‘tax’ in Section 80L of the Income Tax Act should be amended to include ‘anticipated, potential or prospective’ as opposed to ‘liability for tax’ to reduce inconsistent application of the term tax liability (Paragraph 3.2.2).

- As taxpayers are able to prove a commercial reason as the main purpose for entering into an arrangement with relative ease, it is submitted that the approach of New Zealand should be followed where the purpose to obtain a tax benefit must have just been one of the purposes, provided that it is not merely incidental (Paragraph 3.2.3.1 and 4.3.3).
- Guidance should be provided on whether the sole or main purpose requirement is a subjective or an objective test. Alternatively, guidelines should be provided to ensure that the test is an objective one, as it is submitted that this is more effective (Paragraph 2.3.3, 3.2.3. and 4.3.3).
- The tainted elements should be considered as part of the tax benefit requirement instead of a separate fourth requirement that would make the South African GAAR more onerous to apply (Paragraph 3.2.2).
- The lack of commercial substance element should be amended to consider whether the taxpayer has direct or indirect control over the funds, even if the amounts were not received by him/her, or even the relationships between the taxpayer and the recipients of the funds or how the funds are applied (Paragraph 4.3.4.2).
- The exclusion of foreign business establishments from the accommodating or tax indifferent party element should be repealed as the use of one or more controlled foreign companies in a multinational enterprise context is not unusual and the adoption thereof may result in this element not being applicable (Paragraph 2.3.4.2).
- The ‘accommodating or tax indifferent party’ element should be amended to include parties who are subject to normal tax at a lower tax rate (Paragraph 4.3.4.2).
- Additional factors should be incorporated into the tainted elements, thereby allowing courts to consider more characteristics of an arrangement so as to draw an accurate conclusion on the parliamentary contemplation test for purposes of the tax benefit requirement. These factors may include those relating to:
    - the manner in which the arrangement was carried out;
    - the role of all relevant parties and any relationship they may have with the taxpayer;
    - the economic and commercial effect of documents and transactions;
    - the duration of the arrangement;
    - the nature and extent of the financial consequences for the taxpayer;
    - no commercial purpose;
    - where money flows in a circle;

  - where the investor has no risk; and
  - tax asymmetrical parties at prices.
- Consideration should be given to defining undefined terms, to increase certainty and to ensure a consistent application of the South African GAAR (Paragraph 2.4, 3.2.2, 4.3.4.2).

5.3. LIMITATIONS OF THIS STUDY

As highlighted in Chapter 1 (Paragraph 1.7) there are certain limitations to this study. Firstly, the use of a case in Phase 2 resulted in a limitation as it may be difficult to generalise the outcome of a study that uses a case. Nevertheless, there is an argument that the findings of these cases may be indicative of characteristics included in the population of cases as a whole. Therefore, this study did not address all possible cases that come before court, but an insight into the practical workings of the South African GAAR is provided.

5.4. FUTURE AREAS OF RESEARCH

During the course of this study additional potential topics have been identified for future research:

- The South African GAAR could be compared to the GAARs of other countries/jurisdictions where their GAAR is an effective deterrent to impermissible avoidance arrangements. This can be achieved by using a methodological approach similar to that adopted in this study. This will aid in identifying further areas of improvement in order to address the weaknesses of the South African GAAR.
- A study could be performed to determine whether the specific inclusion of the tainted elements results in a more effective GAAR. This can be compared to the effectiveness of a GAAR when characteristics that indicate impermissible avoidance arrangements are considered by the courts instead of the indicators.
- A study could be performed to determine when an avoidance arrangement should be attacked under common law principles instead of the GAAR.

5.5. CONCLUSION

Although the South African GAAR has been amended several times to improve its efficacy, it still contains areas of weakness as identified in this study. The areas that can be improved are not limited to amendments to the legislation but include guidance on the interpretation and application thereof. The recommendations made in this study to address the identified weaknesses include legislative amendments, as well as guidance on the interpretation of some of the components of the GAAR.

The findings suggest that to be a party to an arrangement, the taxpayer need not be privy to its details in order to be considered a party to an arrangement. Moreover, the sole or main purpose requirement should be amended to improve the efficacy of the GAAR. This requirement should be amended so that obtaining a tax benefit is not the sole or main purpose, but rather one of the purposes, provided that it is not merely incidental. Moreover, guidance should be provided in order to ensure that the test is applied objectively and not subjectively. Furthermore, it is submitted that the tainted elements should be considered as part of the tax benefit requirement instead of a separate fourth requirement that would make the South African GAAR more onerous to apply. In addition to this, additional factors (similar to those used by the New Zealand courts in determining the tax avoidance requirement and its Parliamentary contemplation test) may be used to expand what is considered in determining that which is tainted for purposes of the GAAR.

In conclusion, the South African GAAR contains many weaknesses that may render it to be an ineffective deterrent to impermissible tax avoidance arrangements. Therefore, the current GAAR still requires further amendment.

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