

**Analysing the South African General Anti-Avoidance Rule as a
Pre-emptive Base Erosion and Profit Shifting (BEPS) Measure**

by

Henrike De Vos

Student Number: 29023557

**Mini-Dissertation in partial fulfilment with the requirements for a Legum Magister in
International Trade and Investment Law in Africa**

at the

University of Pretoria

June 2016

The financial assistance of the National Research Foundation (NRF) towards this research is hereby acknowledged. Opinions expressed and conclusions arrived at, are those of the author and not necessarily to be attribute to the NRF.

Certification

I declare that this Mini-Dissertation which is hereby submitted for the award of *Legum Magister* (L.L.M) in International Trade and Investment Law in Africa at International Development Law Unit, Centre for Human Rights, Faculty of Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institution.

Henrike de Vos

List of Abbreviations

BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CIPC	South African Companies and Intellectual Property Commissioner
CRS	Common Reporting Standard
DTC	Davis Tax Committee
FACTA	Foreign Account Tax Compliance Act
FDI	Foreign Direct Investment
FHTP	Forum on Harmful Tax Practices
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product
GFI	Global Financial Integrity
HMRC	Her Majesty's Revenue and Customs
IGA	Intergovernmental Agreement
IRS	Internal Revenue Service
LDCs	Least Developing Countries
MAAL	Multinational Anti-Avoidance Law
MNEs	Multinational Enterprises
OECD	Organisation for Economic Co-operation and Development
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARS	South African Revenue Service
UK	United Kingdom
USA	United States of America
THE ACT	The South African Income Tax Act, 58 of 1962

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Table of Content

Chapter 1: Introduction	10
1.1 Introduction and Background to the Research	10
1.2 Research Problem	13
1.3 Justification and Significance of the study	14
1.4 Research Questions	15
1.5 Thesis Statement	16
1.6 Literature Review	16
1.7 Research Methodology	18
1.8 Overview of Chapters	18
Chapter 2: Base Erosion and Profit Shifting (BEPS)	20
2.1 Definition of BEPS	20
2.2 BEPS: An international dilemma	21
2.2.1 Stakeholders	22
2.2.1.1 Governments	22
2.2.1.2 The Individual Taxpayer	22
2.2.1.3 Domestic Businesses	22
2.2.2 An International Solution	23
2.3 The effect of BEPS activities on South Africa	24
2.4 Must South Africa abide with the OECD's BEPS action plan?	26
2.4.1 What is the OECD	26
2.4.2 South Africa and the OECD	28
2.4.3 Must South Africa abide with the OECD's BEPS Action Plan?	28
2.5 The OECD's Action Plan on Base Erosion and Profit Shifting	30
2.5.1 Action Plan 1: Address the Tax Challenges of the Digital Economy	31
2.5.2 Action Plan 2: Neutralise the Effects of Hybrid Mismatch Arrangements	32
2.5.3 Action Plan 3: Strengthen Controlled Foreign Companies Rules	32
2.5.4 Action Plan 4: Limit Base Erosion via Interest Deductions and Other Financial Payments	33
2.5.5 Action Plan 5: Counter armful Tax Practices More Effectively, Taking into Account Transparency and Substance	33

2.5.6	Action Plan 6: Prevent Treaty Abuse	34
2.5.7	Action Plan 7: Prevent the artificial avoidance of ‘Permanent Establishment’ status	34
2.5.8	Action Plan 8, 9 and 10: Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles / Risks and Capital and Other High-Risk Transactions.	34
2.5.9	Action Plan 11: Establish Methodologies to Collect and Analyse Data on BEPS and the actions to address it	35
2.5.10	Action Plan 12: Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements	36
2.5.11	Action Plan 13: Re-examine Transfer Pricing Documentation	36
2.5.12	Action Plan 14: Make Dispute Resolution Mechanisms More Effective	36
2.5.13	Action Plan 15: Develop a Multilateral Instrument	37
2.6	Conclusion	37
	Chapter 3: The South African General Anti-Avoidance Rule	40
3.1	The need for a General Anti-Avoidance Rule	40
3.1.1	The difference between Tax Evasion, Tax Avoidance and Tax Planning	41
3.2	Overview of the South African General Anti-Avoidance Rule	42
3.3	Requirements	44
3.3.1	There must be an avoidance arrangement	44
3.3.1.1	What constitutes an Arrangement	45
3.3.1.2	Enforceability of an Arrangement	45
3.3.1.3	An Arrangement includes all steps or parts thereof	46
3.3.2	The arrangement must result in a tax benefit and constitutes an avoidance arrangement entered into on or after 2 November 2006	47
3.3.3	The sole or main purpose of the arrangement is to obtain a tax benefit	48
3.3.3.1	Sole or main purpose	49
3.3.3.2	Objective Test v Subjective test	49
3.3.4	The arrangement must include an abnormality element.	51
3.3.4.1.	In a business context	51
A.	Business Purpose – Requirement	53

B.	Commercial Substance –Requirement	54
a)	General Rule	54
b)	List of indicators	55
(i)	Substance over Form	56
(ii)	Round Trip Financing	58
(iii)	Tax indifferent parties	59
(iv)	elements offsetting or cancelling each other	60
3.3.4.2	In a non-business context:	62
3.3.4.3	In any other context:	62
A.	Creating Abnormal Rights and Obligations	63
B.	Misuse or Abuse of the Provisions of the Act	64
3.4	Analysing the GAAR as a pre-emptive BEPS measure	64
3.5	Conclusion	67
	Chapter 4: The Australian Multinational Anti-Avoidance Law	69
4.1	Introduction	69
4.2	Australia and the OECD BEPS Action Plan	70
4.3	The reason for the Multinational Anti-Avoidance Law (MAAL)	71
4.4	A critical analysis of the Australian Multinational Anti-Avoidance Law (MAAL)	72
4.4.1	Overview of the MAAL provisions	72
4.4.1.1	The provisions of the MAAL only applies to an entity that meets certain requirements	74
4.4.1.2	The structure of a Scheme	76
4.4.1.3	The principle purpose requirement	77
4.4.2	Effects of the MAAL	79
	Chapter 5: Should South Africa follow Australia’s lead?	82
5.1	Summary of the previous Chapters	82
5.2	Should South Africa follow Australia’s lead?	85
5.3	Conclusion and Recommendations	89
	Bibliography	91
	Turnitin Originality Report	99

Chapter 1: Introduction

1.1 Introduction and Background to the Research

Tax avoidance is an ancient problem, dating back to the earliest recorded history.¹ It has been defined as the legal arrangement of one's financial affairs in order to minimize tax liability.²

For centuries, governments have created and implemented statutory measures in an attempt to effectively regulate these avoidance activities.

However, despite the negative impact tax avoidance activities have on a government's revenue income, and despite the need to address it, courts have recognised that every person is allowed to arrange his financial affairs in such a way to pay the minimum taxes.

In the famous case of IRC v Duke of Westminster the Court held:

*“Every man is entitled, if he can, to order his affairs so that tax attaching under the appropriate Act is less than it would otherwise be. If he succeeds in ordering them so as to secure this result, then, however, unappreciative the Commissioners for Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”*³

The current trend of globalisation of economies has led to the increase in foreign direct investments (hereinafter referred to as FDI) and cross border transactions. Hand in hand with these developments comes an increased scope for international tax avoidance activities, on a national and international level.⁴

An example of these international avoidance activities is base erosion and profit shifting (hereinafter referred to as BEPS). This is where taxpayers, especially multinational enterprises (hereinafter referred to as MNEs) enter into cross border transactions to take advantage of the differences and irregularities that exist between different tax regimes, and

¹ Available at http://www.academia.edu/6743295/International_Tax_Avoidance_Business_Structures_and_Ethics, accessed 24 November 2015.

² Available at <http://www.businessdictionary.com/definition/tax-avoidance.html>, accessed 24 November 2015.

³ IRC v Duke of Westminster (1936) AC 1, p. 19.

The Duke of Westminster- principle has been confirmed by the South African Courts: CIR v Este Kohler 1953 2 SA 584 (A) p. 591E-592H; CIR v King 1947 2 SA 196 (A) p. 212; SIR v Hartzenberg 1966 1 SA 405 (A) p. 408 F-G; Western Bank Ltd v Registrar of Financial Institutions 1975 4 SA 37 (T) p. 45A.

⁴ Olivier, L. and Honiball, M. (2008) p. 384.

shift their profits from high to low or no tax jurisdictions.⁵ This type of conduct usually results in situations where MNEs carries out their economic activities in one jurisdiction, but shift and report their profits in another jurisdiction. Thus, no value is created in the jurisdiction where the economic activities took place, despite the fact that it's resources was used in generating the profits.⁶

The free movement of capital, harmonisation of business laws and globalisation of trade has widened the scope for taxpayers to engage in BEPS activities.⁷

This has raised the question as to what extent should the Duke of Westminster-principle be allowed and enforced? And, if a principle that is more than 80 years old, is still relevant in the 21st century?

The OECD estimates the annual global revenue losses, as a result of BEPS activities, to be between USD 100 billion and 240 billion.⁸ Hereby, admitting that BEPS activities are an international problem that needs to be addressed.

As a result of the effect of BEPS activities, the OECD, in collaboration with the G20 countries, have identified and recognised the need for multilateral efforts to improve and develop tax legislation, with the goal of harmonising it with the developments of the globalised world.⁹ Also creating a system which ensures and compels MNEs to report their profits in the jurisdiction where its economic activities are carried out and economic value is created.¹⁰ Thus the OECD's Action Plan on BEPS was issued in 2013, identifying 15 action steps assisting governments in designing and creating their own pre-emptive BEPS measures, which will, when implemented in domestic legislation, help countries regulate, control and prevent BEPS activities.

South Africa, as a member of the G20, has associated itself with the BEPS Action Plan, actively taking part in the discussions and development thereof.¹¹ Despite South Africa's

⁵ Davis Tax Committee Interim Report (2014) p.9.

⁶ OECD/G20 Information brief (2015) p. 3.

⁷ Olivier, L. and Honiball, M. (2008) p. 384.

⁸ OECD Policy Brief (2015) p.1.

⁹ OECD/G20 Information brief (2015) p. 3.

¹⁰ *Ibid* n9.

¹¹ Available at <http://www.oecd.org/ctp/all-interested-countries-and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm>, accessed 18 April 2016.

commitment towards and enthusiastic participation in the BEPS Action Plan, the Davis Tax Committee (DTC) warns against a unilateral effort from South Africa in amending its domestic legislation in light of global reforms.¹² The Davis Tax Committee urges the legislator to wait with any drastic legislative reforms to give effect to the OECD Action Plan.¹³ Instead, the Davis Tax Committee suggests that the legislator rather make use of and improve measures that are already in place.¹⁴

One of the suggestions made by the DTC is to address BEPS by applying South Africa's General Anti-Avoidance Rules (herein after referred to as the GAAR) and the substance over form principles.

A General Anti-Avoidance rule is usually implemented by domestic laws in order to regulate tax avoidance activities. This is done by giving Revenue Authorities the right and power to question transactions and financial arrangements and disregard their form, to deny the permitted tax benefit unless the taxpayer can establish the commercial essence and legitimacy of the transaction.¹⁵ The GAAR has been regarded as being the most important statutory anti-avoidance legislation a country can have.¹⁶ However, it should be noted from the outset that different countries have used different methods and techniques in drafting their GAAR provisions.

Against the background of globalisation and the free movement of capital one should determine the scope and extent of the South African GAAR provisions as a pre-emptive measure of BEPS. This have lead to the question, if the GAAR, in its current form, is able to successfully regulate BEPS activities? Or should the threshold established by the GAAR provisions be amplified in order to combat the sophisticated form and drastic increase in BEPS activities, more successfully?

On the other hand, countries have to establish themselves as attractive investment destinations. FDI is a major source of and contributor to economic development. Therefore the GAAR provisions should be drafted in such a way that balance the need of effectively

¹² Davis Tax Committee Interim Report (2014) p. 27.

¹³ *Ibid* n12.

¹⁴ *Ibid* n12.

¹⁵ Garg, R. and Mukerjee, K. (2012) p. 1.

¹⁶ Satumba, R. (2011) p. 4.

regulating tax avoidance activities (specifically BEPS activities) in the new globalised world, and attracting foreign investors.

In this study, the impact of BEPS activities on South Africa, as well as in an international arena, will be investigated. As a reaction to the OECD's Action Plan on BEPS, the South African GAAR provisions, in its current form, will be analysed as a pre-emptive measure of BEPS activities. This will be done by determining the threshold and applicability thereof.

This study will further include discussions regarding the possibility of implementing a similar measure as Australia: A Multinational Anti-Avoidance Rule (MAAL). This is a general anti-avoidance rule which specifically targets multinational transactions and cross border activities.

1.2 Research Problem

The increase in BEPS activities, due to the developments of globalisation and the free movement of capital, have negatively impacted the economic welfare of countries worldwide.¹⁷

Statistics indicate that corporate taxes in South Africa has declined from 7.3% of GDP in 2009 to 4.9% of GDP in 2013.¹⁸ This decline of corporate taxes is a major concern for the government, and absolute proof that BEPS activities exist in South Africa.¹⁹

In his 2015/2016 budget speech the South African Minister of Finance, Nhlanhla Nene, announced that South Africa has a budget deficit of 3.9 percent of GDP for the financial year.²⁰ Some are of the opinion that the main reason for the budget deficit is the major tax gap²¹ South Africa is experiencing as a result of BEPS activities.²² If South Africa was able to minimise BEPS activities it would be more than enough to plug the budget deficit.²³

¹⁷ National Treasury Budget (2013).

¹⁸ *Ibid* n17.

¹⁹ Davis Tax Committee Interim Report (2014) p. 20.

²⁰ Available at <http://www.biznews.com/budget/2015/02/25/sa-widens-201516-budget-deficit-forecast-to-3-9/>, accessed 29 October 2015.

²¹ The United Kingdom's Her Majesty's Revenue and Customs (HMRC) defines a tax gap as the "*difference between tax collected and the tax that should be collected if all individuals and companies complied with the letter of the law and the spirit of the law as set out by parliament's intention of enacting law*".

²² Available at <http://mg.co.za/article/2014-11-20-clampdown-on-tax-avoidance>, accessed 9 November 2015.

²³ *Ibid* n22.

South Africa, being a developing country, is in urgent need to control BEPS activities and to regulate the collection of government revenues.

Seeing that the Davis Tax Committee urges the legislator to wait with any drastic legislative reforms to give effect to the OECD action plan, other measures need to be examined as pre-emptive BEPS measures.²⁴

1.3 Justification and Significance of the Study

A country's GAAR provisions are probably its most important anti-avoidance legislation.²⁵ The substance of this statement lies within the fact that the GAAR provisions give the Revenue Authorities the authority to question the form and legality of a transaction and to deny the tax benefits under those transactions if it does not have any commercial value other than achieving the tax benefit.²⁶ Therefore it is extremely important that a country's GAAR provisions stay up to date with recent global developments to be able to effectively regulate avoidance activities.

The essence of this research is to examine the South African GAAR provisions to determine its sufficiency as a pre-emptive BEPS measure. Its scope and applicability will be analysed in light of the current trend of globalisation and increased cross border activities. The study will establish if the South African GAAR provisions are capable of regulating the increased scope of BEPS activities.

The research will provide insight for the South African Revenue Service (SARS) in determining whether or not the GAAR is a sufficient alternative to the OECD Action Plan in regulating BEPS activities, thus complying with the Davis Tax Committee's request. It will assist SARS to identify loopholes in the current GAAR provisions that are being exploited by taxpayers in an international environment and the shortcomings of the legislation.

Should it be determined that the South African GAAR, in its current form, cannot be used as a pre-emptive BEPS measure, amendments will be identified to address these shortcomings.

On the other hand, if the GAAR is identified as a sufficient alternative to the OECD Action Plan, it can be used as a pre-emptive BEPS measure.

²⁴ Davis Tax Committee Interim Report (2014) p. 27.

²⁵ Satumba, R. (2011) p. 4.

²⁶ Garg, R. and Mukerjee, K. (2012) p. 1

Either way, any of these two situations will assist SARS in identifying and creating measures that will help resolve the South African tax gap.

1.4 Research Questions

The key question that underlines this research is if the South African GAAR can be used as an alternative measure to the OECD's Action Plan to sufficiently regulate the increased scope of BEPS activities that goes hand in hand with the recent developments of globalisation of economies?

In order to answer this question one should firstly determine the impact of BEPS activities in South Africa. Thereafter it should be determined if South Africa, not being a member to the OECD, is obliged to comply with the OECD Action Plan on BEPS? And if so, is it logical for South Africa to implement drastic reforms to its domestic legislation to give effect to the OECD Action Plan?

One should also determine the scope and extend of the current South African GAAR provisions. To what extent does the South African GAAR provisions allow MNE's to enter into transactions and to arrange their financial affairs to obtain a tax benefit in an international environment? What are the requirements that must be met before SARS can apply the GAAR provisions? What are the threshold established by the South African GAAR provisions?

To do a sufficient analysis of the South African GAAR provisions, one must keep in mind the feasibility thereof in an international environment. This leads to the question if South Africa should consider alternative measures recently implemented by other countries in order to regulate BEPS.

As a result of the publishing of the OECD's Action Plan, Australia have amended its GAAR provisions to target BEPS activities of multinationals. Australia have named this the Multinational Anti-Avoidance Rule (MAAL). Therefore one should consider the implementation of a similar measure.

In order to do same, it is necessary to establish the scope and extent of the Australian MAAL. What are the requirements that must be met before the Australian MAAL provisions are applicable and how does the South African GAAR provisions compare to it?

1.5 Thesis Statement

The OECD, in collaboration with the G20 countries, have identified and recognised the need for multilateral efforts to improve and develop tax legislation, with the goal of harmonising it with the developments of the globalised world.²⁷ As a result hereof the OECD issued an Action Plan on addressing BEPS.

However, the Davis Tax Committee urges the South African legislator to wait with any drastic legislative reforms to give effect to the OECD Action Plan on BEPS. Therefore there is an urgent need to examine other, existing measures as pre-emptive BEPS measures.²⁸

Due to the above, the South African GAAR provisions needs to be analysed as a pre-emptive BEPS measure.

It is my opinion that, as the South African GAAR was initially drafted in order to target domestic avoidance activities, it will most probably not be capable of sufficiently regulating the increase in BEPS activities, being international avoidance activities.²⁹

Therefore the possibility of implementing other measures, drafted specifically to target international avoidance activities should be explored and examined.

1.6 Literature Review

In this dissertation a number of literature will be used to complete the research.

The OECD issued a number of reports, information briefs and public discussions regarding its Action Plan on BEPS. As a result of all these publications, The Davis TAX Committee issued an Interim Report Addressing Base Erosion and Profit Shifting in South Africa. These publications will be the main source in my study in order to determine the effects of BEPS on South Africa; if South Africa should comply with the OECD Action Plan; and if so, how it should be implemented.

In order to determine the scope of the South African GAAR provisions, I will focus on the work of various scholars, including Benn,³⁰ Haffejee,³¹ and Loof.³² All of them have done an

²⁷ OECD/G20 Information brief (2015) p. 3.

²⁸ Davis Tax Committee Interim Report (2014) p. 27.

²⁹ Olivier, L. and Honiball, M. (2008) p. 384.

³⁰ Benn, D.J. (2013).

³¹ Haffejee, Y. (2009).

in-depth study on the South African GAAR provisions identifying and explaining the requirements of the GAAR provisions as found in sections 80A to 80L in the Income Tax Act.³³ According to Benn, the new South African GAAR provisions are only applicable if four requirements are met: (1) the existence of an avoidance agreement or arrangement; (2) the arrangement must have been entered into on or after the effective date (2 November 2006); (3) the sole or main purpose of the arrangement or agreement has to be to obtain a tax benefit; and (4) the arrangement must include an abnormality element. He comes to the conclusion that the South African GAAR provisions are extremely broad and he confirms Drummond's criticism of the South African GAAR provisions being too complex and too wide, even so to "*perplex even the most impressive minds*" leading to the exploitation of the law.³⁴

On the 3rd of December 2015, Australia implemented the Tax Law Amendment Bill 2015.³⁵ This Bill introduced an amendment to the current Australian GAAR provisions to implement a Multinational Anti-Avoidance Law (MAAL). This was done as a reaction to the criticism of the absence of a proper threshold. This amendment is aimed at specifically targeting multinationals. MNE's were given the time to comment on these proposed amendments. These comments, together with the Government's explanatory memorandum on the amendments, shall be used mainly to analyse the scope and effects of the MAAL provisions.

As the Australian Tax Law Amendment Bill has been implemented recently (on the 3rd of December 2015), very little has been written on the success or failure of the legislation.³⁶ Furthermore, no statistics have been made available on the actual impact of the new legislation. In order to analyse the provisions I will focus on the legal text of the provisions, court cases interpreting the wording, and comments of the public, established scholars and the government explanatory memorandum.

³² Loof, G. (2013).

³³ Act 58 of 1962.

³⁴ Drummond, B. (2006) p. 10-11.

³⁵ Drysdale, D. (2015) p. 1.

³⁶ *Ibid* n35.

1.7 Research Methodology

The research is carried out by way of a critical theoretical analysis of the OECD's Action Plan on BEPS and the scope, effect and applicability thereof in South Africa. It is conducted by an in-depth study of all the OECD's publications and commentary on BEPS.

This research also requires a critical theoretical analysis of the South African GAAR provisions as provided for in section 80A-80L of the Income Tax Act in order to determine if it can be used as a pre-emptive BEPS measure. This discussion will include the analysis of the provisions of the Act, South African case law relating to the interpretation of the wording contained in the provisions and the writings of respected experts in the field of taxation. The analysis will be conducted to determine the scope, application and threshold of the GAAR provisions, in its current form. This will be done in light of the current developments of globalisation of economies and the free movement of capital.

Further to the above, a comparative approach will be used to determine the differences, similarities, and contradictions between the legislative provisions of the South African GAAR, and the newly drafted Australian MAAL provisions. Australia has specifically been selected as its MAAL legislation has been drafted as a direct result of the OECD's Action Plan on BEPS in order to address the problems of globalisation and free movement of capital.³⁷

1.8 Overview of Chapters

Chapter One will essentially highlight the importance of this research. This will be done by providing a short introduction and reasoning on the subject matter. It introduces the research problem and justification thereof. It further sets out the analysis that will be performed.

Chapter Two will focus on the OECD's Action Plan on BEPS. The chapter identifies that BEPS is a global problem that needs to be addressed urgently. Therefore the scope, effect and applicability of the OECD Action Plan will be analysed. This chapter will answer the questions as to what the OECD is, what the impact of BEPS is, if South Africa obliged to follow the OECD Action Plan, and what other alternatives are available to South Africa.

³⁷ South African Institute of Chartered Accountants (2015) p.1.

Chapter Three will focus on analysing the South African GAAR provisions, as contained in sections 80A-80L of the Income Tax Act, 58 of 1962, as a pre-emptive BEPS measure. The text of the GAAR provisions will be analysed to determine the scope and application thereof. This analysis will be done, taking into account the sophisticated form of BEPS activities and the increase in BEPS opportunities due to globalisation.

Chapter Four will focus on the Australian MAAL provisions. On the 3rd of December 2015, Australia amended its GAAR provisions to introduce the MAAL.³⁸ This amendment was done as a reaction to the criticism of the absence of a proper threshold.³⁹ In this chapter I will compare the South African GAAR provisions with the Australian MAAL provisions to determine whether or not South Africa should amend its GAAR provisions to include and specifically address multinational avoidance activities.

I will conclude in Chapter Five with a summary of my findings, and recommendations to SARS and the South African Government.

³⁸ Drysdale, D. (2015) p. 1.

³⁹ South African Institute of Chartered Accountants (2015) p.1.

Chapter 2: Base Erosion and Profit Shifting (BEPS)

2.1 Definition of BEPS

The OECD define BEPS activities as:

“The use of legal arrangements that make profits disappear for tax purposes or allow profits to be artificially shifted to low or no-tax locations where the business has little or no economic activity.”⁴⁰

The shifting of profits from a high tax jurisdiction to a low or no-tax jurisdiction results in the erosion of the tax base of the country with the high tax jurisdiction. Hence the name: Base Erosion and Profit Shifting.

Flowing from this, BEPS activities can be categorised as a type of tax avoidance activity, as it falls within the definition as mentioned in Chapter 1, and involves the engagement into legal tax arrangements to minimise the taxpayer’s tax obligations.⁴¹ Therefore it should be noted that, within the scope of this thesis, whenever there is referred to ‘tax avoidance activities’ or ‘tax planning’, this reference includes and specifically focus on BEPS activities.

BEPS activities are mainly conducted when the taxpayer takes advantage of the differences, and exploits the irregularities that exist between the tax regimes of different countries.⁴² As BEPS activities takes place through the shifting of profits between different countries, the major culprits of these activities are known to be MNEs.

Due to the advanced nature of BEPS activities, MNEs often chose to invest in specific jurisdictions purely for tax reasons.⁴³ In order to justify such actions, MNEs are of the opinion that they have a responsibility towards their shareholders to act in such a way that will result in the payment of the minimum possible taxes.⁴⁴ MNEs blame Governments for creating weak tax regimes that provide incentives for BEPS.⁴⁵ Thus, it has been argued that excessive tax avoidance is an indication of defective legislation.⁴⁶

⁴⁰ OECD Policy Brief (2015) p.1.

⁴¹ The difference between tax planning, tax avoidance, and tax evasion is explained on page

⁴² Davis Tax Committee Interim Report (2014) p. 14.

⁴³ OECD/G20 Information brief (2015) p. 3.

⁴⁴ Davis Tax Committee Interim Report (2014) p. 9.

⁴⁵ *Ibid* n44.

⁴⁶ Olivier, L. and Honiball, M. (2008) p. 384.

2.2 **BEPS: An international dilemma**

The globalisation of economies and free movement of capital has boosted international trade , resulting in the increased of foreign direct investment in most countries.⁴⁷ The gradual removal of trade barriers and the harmonisation of business laws, together with the free movement of labour and capital has influenced the way in which companies and MNEs do business, especially the way they conduct their cross border activities.⁴⁸

Unfortunately, hand in hand with these global developments comes an increased scope for tax avoidance activities, especially BEPS activities.⁴⁹

The problem is however that tax legislation, (nationally and internationally) has not kept up with these developments, creating more loopholes and shortcomings that can be exploited.⁵⁰ This have resulted in BEPS activities being too sophisticated, and the legislation failing to effectively regulate and control these activities.

MNEs are the biggest source of foreign direct investment and represents the a major portion of the global GDP.⁵¹ It can be assumed that they are thus the biggest source of corporate taxes, and thus a major contributor to government revenues. Unfortunately, linked to the foreign direct investments are the ease of taking part in other cross-border activities, whether it being intra-firm trade or general trade.⁵² This makes it easy for MNEs to move their profits from high tax jurisdictions to low tax jurisdictions, thus avoiding tax liability in the jurisdiction where the economic activity took place.⁵³

The OECD estimates the annual global revenue losses, as a result of BEPS activities, to be between USD 100 billion and 240 billion.⁵⁴ Hereby, recognising and admitting that BEPS activities are an international problem that needs to be addressed.

⁴⁷ Davis Tax Committee Interim Report (2014) p. 9.

⁴⁸ OECD Action Plan (2013) p. 7..

⁴⁹ Olivier, L. and Honiball, M. (2008) p. 384.

⁵⁰ OECD Policy Brief (2015) p.1.

⁵¹ *Supra* n48 at p. 7.

⁵² *Supra* n49 at p. 385.

⁵³ *Supra* n48 at p. 7.

⁵⁴ *Supra* n50 at p.1.

2.2.1 Stakeholders

BEPS activities are an unavoidable problem occurring worldwide. Although this is a global epidemic affecting almost everyone, certain major stakeholders can be identified: Governments, the individual tax payer and domestic businesses:⁵⁵

2.2.1.1 Governments:

Governments plan and structure their budgets on estimated tax revenues to be collected. BEPS activities reduces the actual fiscal earned and hereby causing a national budget deficit.

As a result hereof, Government will be forced to cut their expenses. This will include expenses on public services, thus effecting all residents. Furthermore the lack of funds in a country will inevitably harm public investment, and will cause government to borrow from multilateral organisations, which in turn affect the interest rates, and thus the individual.

2.2.1.2 The Individual taxpayer:

In order to resolve their loss in revenues, governments are most likely to place a higher tax burden on individual taxpayers. This shift of tax obligations are unfair and an individual should not be held accountable for an international MNE's avoidance behaviour. An increase in tax rates will cause mistrust between a government and its nationals.

Most MNEs invest in developing or least developed economies, as it is there where the most opportunities lie. In a developing economy, governments usually get most of their revenues from the middle class who are already struggling to make ends meet. By imposing a higher tax burden could be detrimental as this burden could downgrade the middle class earner.

2.2.1.3 Domestic Businesses:

MNEs gain a major advantage when their cross border activities allow them to shift their profits to low tax jurisdictions. Having a lower tax burden, will allow MNEs to

⁵⁵ OECD Action Plan (2013) p. 7.

produce goods and services at lower input costs. This advantage makes it extremely difficult for local firms to be competitive. Even though consumers could benefit from cheaper goods and services it is important for any government to motivate and encourage local ownership as this creates local empowerment and development. It also enhances economic stability, should MNEs withdraw their investments.⁵⁶ A fair, competitive environment is distorted by the effect of BEPS activities.⁵⁷

2.2.2 An International Solution:

The OECD is of the opinion that no single rule can be identified as being the root cause of BEPS activities.⁵⁸ It is the interaction between various rules and jurisdictions that generates BEPS.⁵⁹ The OECD blames uncoordinated domestic laws, international standards which have not kept pace with the changing international business environment, low transparency and lack of data and information.⁶⁰

As a result of the effect of BEPS activities, the OECD, in collaboration with the G20 countries, have identified and recognised the need for multilateral efforts to improve and develop tax legislation, with the goal of harmonising it with the developments of the globalised world.⁶¹ Also creating a system which ensures and compels MNEs to report their profits in the jurisdiction where its economic activities are carried out and economic value is created.⁶²

In February 2013, the OECD issued a report, titled *Addressing Base Erosion and Profit Shifting* in which it identifies and recognises that BEPS constitutes a serious risk to tax revenues and tax sovereignty globally.⁶³ As a result of this report, the OECD issued an Action Plan, identifying 15 action steps assisting governments in designing and creating their own pre-emptive BEPS measures, which will, when implemented in domestic legislation, help countries regulate, control and prevent BEPS activities.

The OECD Action Plan on BEPS will be discussed in greater detail later in this chapter.

⁵⁶ Bartell, E. (1993) p. 7.

⁵⁷ OECD Action Plan (2013) p. 8.

⁵⁸ OECD/G20 Information brief (2015) p. 3.

⁵⁹ *Ibid* n58.

⁶⁰ *Ibid* n58.

⁶¹ *Ibid* n58.

⁶² *Ibid* n58.

⁶³ OECD Action Plan (2013) p. 9.

2.3 The effect of BEPS activities on South Africa

The Davis Tax Committee (DTC) of South Africa, is a committee established in July 2013, as a result of the Minister of Finance's announcement that there is a need to establish a tax review committee to *'inquire into the role of South Africa's tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability'*.⁶⁴

As an affect of the OECD's report on BEPS, the DTC issued an interim report in 2014, titled *Addressing Base Erosion and Profit Shifting*.⁶⁵ This report addressed the question as to what extent is BEPS a problem in South Africa. Despite the fact that the report quotes statistics of several national financial departments and authorities, it fails to provide a quantifiable or definitive answer as to the occurrence of BEPS in South Africa.⁶⁶

According to the report. The sophisticated and integrated nature of BEPS activities makes it difficult to measure and therefore it is extremely difficult to establish how much BEPS activities actually occurs in South Africa.⁶⁷

It refers to research done by the National Treasury of South Africa which indicates that corporate tax revenues in South Africa have declined from 7,3% of GDP in 2008/2009 to 5.5% in 2009/2010 and to 4,9% in 2010/2011 and that this could be evident that BEPS activities exist.

However, the report⁶⁸ also quotes SARS' opinion that this decline in GDP is not an absolute indication that BEPS activities may or may not exist. The reason for this opinion is that this decline occurred directly after the 2008 global financial crisis, and could merely be an aftershock of the said crisis. But then again, the report admits that the South African economy did not feel the 'full brunt of the aftermath of the financial crisis'.⁶⁹

Despite the above, it should be remembered that the Minister of Finance, Pravin Gordhan, announced in his 2013 Budget Speech that South Africa, as well as Africa as a whole, are

⁶⁴ Davis Tax Committee Interim Report (2014) p. 1.

⁶⁵ *Ibid* n64.

⁶⁶ Dachs, P. (2015) p. 1

⁶⁷ *Ibid* n64 at p. 19.

⁶⁸ *Ibid* n67.

⁶⁹ *Ibid* n67 at p. 20.

severely affected by base erosion actions of MNEs,⁷⁰ and this statement is the reason for the creation of the DTC.

It raises the question as to why would a government spend so much time, funding and resources to establish a committee to review a specific problem, if that problem was not a fundamental concern? There is enough reason to believe that BEPS activities are occurring in the Republic of South Africa, and that it has a negative impact on our economy.

In his 2015/2016 Budget Speech, the Minister of Finance, announced that South Africa has a budget deficit of 3,9% of GDP.⁷¹ It is said that the reason for this budget deficit, is the tax gap we are experiencing. A tax gap is defined by United Kingdom's Her Majesty's Revenue and Customs (HMRC) as follow:

“The difference between tax collected and the tax that should be collected if all individuals and companies complied with the letter of the law and the spirit of the law as set out by parliament's intention of enacting law.”⁷²

If one considers the definition of a tax gap it seems only logical to come to the conclusion that BEPS activities are not only existing, but has a major impact on our country's fiscal income. This assumption is confirmed by the result of the South African Nation Budget deficit.

Only 1.6 million out of 2 million registered companies in South Africa abide with their tax obligations.⁷³ This means that 400 000 registered companies are not paying taxes. Although there might be many reasons for this, BEPS is said to be the main one.⁷⁴

According to research done by the Global Financial Integrity (GFI), it is estimated that a Sub-Saharan Africa has lost a total of \$530-billion as a result of BEPS activities.⁷⁵ South Africa, being the gateway into Africa and especially Sub-Saharan Africa, will inevitably suffer the most from these losses.

⁷⁰ Available at <http://www.fin24.com/Budget/Budget-could-tackle-foreign-tax-avoiders-20140217>, accessed 23 April 2016.

⁷¹ <http://www.biznews.com/budget/2015/02/25/sa-widens-201516-budget-deficit-forecast-to-3-9/>, accessed 29 October 2015.

⁷² HMRC (2012) p. 11.

⁷³ Available at http://www.un.org/esa/ffd/tax/Beps/CommentsEJNandOxfamSA_BEPS.pdf, accessed 21 April 2016.

⁷⁴ *Ibid n73*.

⁷⁵ Steyn, L. (2015) p. 1.

Consider the following example: Investors want to invest in countries that offer the best possible growth opportunities. This will typically be developing and least developed countries (LDCs), such as African countries. However, investors are hesitant to invest in Africa due to the political, financial and economic instability and uncertainty the countries offer. In contrast to the rest of Africa, South Africa is known to have sound and robust financial and business legislation, and has, for a number of years, proved to be politically and economically stable (well at least more so than the other African countries).⁷⁶ Furthermore, South Africa is a member to the Southern African Customs Union which allows tariff-free trade between member countries.⁷⁷ This has resulted in South Africa to be a popular investment jurisdiction, and a gateway into Africa. Investors use South Africa to set up their businesses and companies in a safe(r) environment, developing their products and conducting their economic activities within South Africa, thus creating value here. They also make use of the advantage of tariff-free trade between member countries to further enhance their profits in other African Countries. However, once profits are made, all profits are moved back to South Africa and then extracted and moved to low or no-tax jurisdictions. Hereby, as South Africa is the entry-level as well as the exit-level, and as all the economic activities are conducted within South Africa, it will inevitably suffer the most. South Africa is merely used as an instrument to channel the profits to low or no-tax jurisdictions.

Based on the above statistics and research, I can with utmost confidence advocate that BEPS activities are actively taking place in South Africa, and the effect thereof is worrisome. Therefore it is extremely important for South Africa to address BEPS activities and engage in some legislative reform to implement BEPS control measures.

2.4 Must South Africa abide with the OECD's BEPS action plan?

In order to answer this question it is firstly important to identify what the OECD is, and what authority it bears.

2.4.1 What is the OECD

The OECD (The Organisation for Economic Co-operation and Development) is an international organisation that was established in 1961. Through its constitution,⁷⁸ the

⁷⁶ Marcus, G. (2011) p. 1.

⁷⁷ Mathis, J. (2005) p. 1.

⁷⁸ Article 15, Convention on the Organisation for Economic Co-operation and Development, 1960.

organisation is awarded legal personality which enables it to publish and issue legal instruments, in order to achieve its objective.

According to article 1 of the OECD's Convention,⁷⁹ the aim of the organisation is to promote policies which are designed to:

- (a) *“Achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;*
- (b) *Contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and*
- (c) *Contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.”*

The OECD focus on promoting and issuing international policies, advice and guidelines that will enhance the economic development and social well-being of countries world wide.⁸⁰ It creates a platform where multinational and inter-governmental discussions can take place in order to generate and improve such documents.⁸¹

Hereby, the OECD is known to set international standards, that if complied with, could truly enhance the economic situation of a country.⁸²

The OECD mainly focus on the economic development of its members. But since international trade, and the global economy is a major focus point of the OECD, the OECD's policies will inevitably affect all countries, members and non-members.⁸³

The OECD's policies, advice and guidelines are published in different forms of legal instruments,⁸⁴ which vary in nature. Some are legally binding on member countries,⁸⁵ and other instruments are not legally binding. Non-members can associate themselves with the

⁷⁹ The Convention on the Organisation for Economic Co-operation and Development, 1960.

⁸⁰ Davis Tax Committee Interim Report (2014) p. 18.

⁸¹ *Ibid* n80 at p. 9.

⁸² Available at <http://www.oecd.org/about/whatwedoandhow/> accessed 14 April 2016.

⁸³ Davis Tax Committee Interim Report (2014) p. 18.

⁸⁴ *Supra* n82.

⁸⁵ Legal instruments which are legally binding on member countries includes decisions by the OECD Council and formal agreements.

legal instruments, and thereby committing to implement such instrument in an international arena.⁸⁶

2.4.2 South Africa and the OECD

South Africa is not a member of the OECD, which means the decisions and formal agreements of the OECD are not legally binding on South Africa.⁸⁷

However, South Africa has been awarded OECD observer status in 2004, has associated itself with seven OECD Bodies and Projects, and are actively participating in thirteen.⁸⁸ South Africa has also adhered to eleven OECD instruments and are participating in several OECD flagship projects, publications and databases.⁸⁹

On 16 May 2007, the OECD Council adopted a resolution to reinforce the collaboration with South Africa. This have resulted in the ‘partnership’ between the OECD and South Africa to cover a wide selection of policy issues, including the following: “macroeconomic policy and structural reform, debt management, fiscal policy, domestic resource mobilisation, competition policy, agricultural policy, public governance, rural and urban development, the fight against bribery, development, science, technology and innovation, chemicals testing and tourism.”⁹⁰

South Africa’s participation and collaboration with the OECD allows South Africa to gain access to the OECD’s expertise and advice, thereby obtaining a major advantage. No wonder South Africa is so actively taking part in most of the OECD activities.

2.4.3 Must South Africa abide with the OECD’s BEPS Action Plan?

As already mentioned, South Africa is not a member of the OECD and thus the legal instruments, issued by the OECD, are not legally binding on South Africa. Based on face value, it seems as if South Africa does not have to comply with the OECD BEPS Action Plan, as there is no legal obligation that forces it to comply with it.

⁸⁶ Legal instruments which are not legally binding includes recommendations, declarations and understandings

⁸⁷ Davis Tax Committee Interim Report (2014) p. 18.

⁸⁸ Available at <http://www.oecd.org/southafrica/south-africa-and-oecd.htm>, accessed 16 April 2016.

⁸⁹ *Ibid* n88.

⁹⁰ *Ibid* n88.

However, South Africa has associated itself with the BEPS Action Plan.⁹¹ The effect of associating oneself with an OECD action plan, merely means that the country will work on an equal footing with the OECD and its member countries on the standard setting and requirements under that specific project, participate in the discussions and decision-making process, as well as the monitoring of the implementation of that project.⁹²

South Africa is also a member of the OECD BEPS Committee, thereby actively taking part in the creation, implementation and monitoring process of the BEPS Action Plan.⁹³

This clearly indicates a serious level of commitment from South Africa. And even though this commitment is purely voluntarily, it could be interpreted as South Africa committing itself with the intention to abide with the BEPS Action Plan.

At their meeting on 5-6 September 2013 in St. Petersburg, the G20 Leaders approved the BEPS Action Plan, and issued a report that included the following statement:

“In a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled. The growth of the digital economy also poses challenges for international taxation. We fully endorse the ambitious and comprehensive Action Plan – originated in the OECD – aimed at addressing base erosion and profit shifting with mechanism to enrich the Plan as appropriate. We welcome the establishment of the G20/OECD BEPS project and we encourage all interested countries to participate. Profits should be taxed where economic activities deriving the profits are performed and where value is created. In order to minimize BEPS, we call on member countries to examine how our own domestic laws contribute to BEPS and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions.”⁹⁴

⁹¹ Available at <http://www.oecd.org/ctp/all-interested-countries-and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm>, accessed 18 April 2016.

⁹² *Ibid* n91.

⁹³ Davis Tax Committee Interim Report (2014) p. 18.

⁹⁴ G20 Leaders’ Declaration, (2013) p. 12.

South Africa's membership to the G20, places an obligation on it to work together and cooperate with the international community to come up with an idealistic, but realistic approach to properly address the BEPS problems.⁹⁵

Section 233 of the South African Constitution⁹⁶ reads as follow:

“When interpreting legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.”

This section have caused South African Courts to recognise and apply OECD commentary and legal instruments in its authority.⁹⁷ South African Tax legislation also defines certain terms with reference to OECD definitions.⁹⁸ By incorporating OECD commentary into South African legislation and case law, the South African Courts and Legislator clearly intended to recognise and admit to the OECD's authority, making it applicable in the South African legislation.

It is my submission that based on South Africa's actions it created and brought upon itself an obligation to comply with the OECD BEPS Action Plan, which compliance is more than merely a participation or conference thereof.

2.5 The OECD's Action Plan on Base Erosion and Profit Shifting

The OECD identifies and recognises that BEPS constitutes a serious risk to tax revenues and tax sovereignty globally.⁹⁹ As a result of this the OECD issued an action plan, in which it identifies 15 action steps assisting governments in designing and creating their own pre-emptive BEPS measures, which will, when implemented in domestic legislation, help countries regulate, control and prevent BEPS activities.

The OECD admits that no single country can act alone and successfully address the BEPS problems.¹⁰⁰ It also raises the concern that uncoordinated, one-sided actions taken by governments could cause even more harm, as it can lead to double or even multiple

⁹⁵ Davis Tax Committee Interim Report (2014) p. 18.

⁹⁶ The Constitution of the Republic of South Africa, 108 of 1996.

⁹⁷ ITC 1503 53 SATC 342 p. 348.

⁹⁸ Definition of “permanent residence” in the Income Tax Act, 58 of 1962.

⁹⁹ OECD Action Plan (2013) p. 9.

¹⁰⁰ *Ibid* n99 p. 13.

taxation.¹⁰¹ The need in creating an internationally coordinated approach, is fatal to the success of combating BEPS.

The G20 leaders pointed out that:

*“Despite the challenges we all face domestically, we have agreed that multilateralism is of even greater importance in the current climate, and remains our best asset to resolve the global economy’s difficulties.”*¹⁰²

The aim of the action plan was to provide countries with domestic and international mechanisms to enable a country to execute its right to taxation where the economic activity took place.¹⁰³

The OECD’s action plan consists of 15 actions. Bellow follows a short overview and description of each action plan.

2.5.1 Action Plan 1: Address the Tax Challenges of the Digital Economy

The OECD recognises that the vast development of the digital economy and e-commerce brings about new challenges and difficulties to tax legislation.

The feasibility and legitimacy of tax legislation is based on the fact that it relies on geographic boundaries,¹⁰⁴ as is evident from the ‘permanent establishment’ requirement.¹⁰⁵

E-commerce has been defined as:

*“The wide array of commercial activities carried out by electronic means that enable trade without the confines of geographical boundaries.”*¹⁰⁶

From the definition above it is clear that the digital economy and e-commerce does away with geographical boundaries in the sense that it makes it almost impossible to identify where transactions are concluded; who the parties to the agreement are; where the parties are

¹⁰¹ OECD Action Plan (2013) p. 14.

¹⁰² G20 (2012) p. 2.

¹⁰³ OECD Action Plan (2013) p. 11.

¹⁰⁴ Davis Tax Committee, Interim Report on Action 1 (2014) p. 2.

¹⁰⁵ The ‘permanent establishment’ requirement provides for a basic rule when a country has the right to tax business profits of a non-residence. If it can be established that the business or company has a permanent establishment in a specific jurisdiction, then that jurisdiction will be allowed to tax the business profits generated in that jurisdiction, despite the fact that the business or company is not a resident of that jurisdiction.

¹⁰⁶ Fawcett, J.W. and others (2005) p.493.

located; the verification of taxable transactions and the link between all of the above, and thus creating opportunities for BEPS activities.¹⁰⁷

In its report on BEPS activities, the OECD recommends that:

*“countries need to identify the main difficulties that the digital economy poses in the application of existing international tax rules and develop detailed options to address these difficulties. A holistic approach needs to be taken that considers both direct and indirect taxation.”*¹⁰⁸

2.5.2 Action Plan 2: Neutralise the Effects of Hybrid Mismatch Arrangements

The OECD recognises that international mismatch agreements could lead to a tax arbitrage.¹⁰⁹ A mismatch arrangement is defined as:

*“An arrangement that exploits a difference in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to produce a mismatch in tax outcomes where that mismatch has the effect of lowering the aggregate tax burden of the parties to the arrangement.”*¹¹⁰

The OECD recommends countries to examine the design of domestic rules and to develop model treaty provisions and rules which, if implemented effectively, could neutralise the effects of (for example double non-taxation, double deduction, and long-term deferral) of hybrid instruments and entities created and used to establish a mismatch situation.¹¹¹

2.5.3 Action Plan 3: Strengthen Controlled Foreign Companies Rules

The OECD notes that groups of companies create non-resident subsidiaries in low tax jurisdictions. This enables the mother company to shift income and profits to these low tax subsidiaries. Controlled foreign company (“CFC”) rules are designed to combat these actions by enabling jurisdictions to tax income and profits earned by foreign subsidiaries where the economic activity took place, provided that certain conditions are met.¹¹² Some jurisdictions do not have any CFC rules in place, and others’ are drafted in such a manner that

¹⁰⁷ Davis Tax Committee, Interim Report on Action 1 (2014) p. 3.

¹⁰⁸ OECD Action Plan (2013) p. 14.

¹⁰⁹ Davis Tax Committee, Interim Report on Action 2 (2014) p. 1.

¹¹⁰ *Supra* n108 p. 15.

¹¹¹ *Ibid* n110.

¹¹² OECD Public Discussion Draft Action 3 (2015) p. 6.

they do not counter and control BEPS as desired. Action 3 of the OECD Action Plan on BEPS called for the development of recommendations regarding the design of controlled foreign company rules.¹¹³

2.5.4 Action Plan 4: Limit Base Erosion via Interest Deductions and Other Financial Payments

The OECD notes that multinational groups of companies adjust their amount of debt in the group in order to increase their debt and expenditures which will in turn lead to a favourable tax result.¹¹⁴ Therefore, action 6 of the OECD report on BEPS, calls on

“The development of recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments.”¹¹⁵

2.5.5 Action Plan 5: Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

In 1998 the OECD issued a report titled *Harmful Tax Competition: An Emerging Global Issue*. As a result of this report the Forum on Harmful Tax Practices (“FHTP”) was created with the goal of combating harmful tax practices.¹¹⁶

Now, years later, harmful tax practices are still occurring and are, more than ever, leading to the erosion of tax bases. Action 5 of the OECD Action Plan commits the FHTP to *“counter and identify harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.”¹¹⁷*

Action 5 emphasises the continued importance of this matter and requires a constant review of tax legislation implemented to counter harmful tax practices.

¹¹³ OECD/G20 Executive Summary (2015) p.13.

¹¹⁴ *Ibid* n113 at p.15.

¹¹⁵ OECD Public Discussion Draft Action 4 (2015) p. 6.

¹¹⁶ Available at <http://www.klgates.com/action-5---countering-harmful-tax-practices-11-20-2014/>, accessed 25 April 2016.

¹¹⁷ OECD/G20 Executive Summary (2015) p.19.

2.5.6 Action Plan 6: Prevent Treaty Abuse

Action 6 of the OECD Action Plan, identifies treaty abuse, especially treaty shopping, as a major contributor to BEPS.¹¹⁸ Treaty abuse refers to situations where taxpayers claim certain tax benefits under the treaty, which benefits were not actually intended to be granted to them. Hereby taxpayers deprive countries from their tax revenues.

Action 6 call on countries to *“develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.”*¹¹⁹

2.5.7 Action Plan 7: Prevent the Artificial Avoidance of ‘Permanent Establishment’ status

Ordinarily, tax treaties authorises countries to tax business profits of a foreign enterprise, provided that the enterprise has a permanent establishment in that country.¹²⁰ The definition of a permanent establishment is therefore of high importance in any tax treaty as it bestows upon a country the right to tax.

Action 7 of the OECD Action Plan on BEPS calls for a review of the definition of ‘permanent establishment’ in order to “prevent artificial avoidance of the permanent establishment status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.”¹²¹

2.5.8 Action Plan 8, 9 and 10: Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles / Risks and Capital and Other High-Risk Transactions

In its most simplest form, transfer pricing rules can be described as those rules which regulates transactions within a MNE group of companies.¹²² The transfer price will thus be the price at which goods or services are transferred from one company to another within the same group. The OECD recognises the importance of transfer pricing rules, especially as intra-group trade is the biggest form of international trade.¹²³ The OECD is concerned that

¹¹⁸ OECD/G20 Executive Summary (2015) p.21.

¹¹⁹ OECD Action Plan (2013) p. 19.

¹²⁰ OECD/G20 Executive Summary (2015) p.23.

¹²¹ OECD Action Plan (2013) p. 19.

¹²² Available at <http://www.investopedia.com/terms/t/transferprice.asp>; accessed 27 April 2016.

¹²³ OECD/G20 Executive Summary (2015) p.27.

transfer pricing rules can be misapplied, and would lead to situations where profits are allocated but which is not in line with the economic activity that generated those profits.¹²⁴

In a nutshell the OECD has formulated three action plans to target this problem: it will ensure that transfer pricing rules align the allocation of profits with the economic activity which generates them.¹²⁵

Action 8 of the OECD Action Plan on BEPS focuses on developing rules “*to prevent BEPS by moving intangibles among group members*”.¹²⁶

Action 9 focuses on the contractual allocation of risks, and allocating profits to that risks.¹²⁷

Action 9 intends to develop rules “*to prevent BEPS by transferring risks among, or allocating excessive capital to, group members*”.¹²⁸

Action 10 focuses on developing rules “*to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties*”.¹²⁹

2.5.9 Action Plan 11: Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It

Due to the complexity of BEPS it is difficult to measure and monitor it. However, if one considers the fiscal effects thereof, there is no doubt that BEPS exists.¹³⁰

The OECD recognises, that only after successfully monitoring and measuring BEPS, will one be able to effectively regulate it. Therefore Action 11 of the OECD Action Plan on BEPS, focuses on developing indicators of BEPS activities and wishes to ensure that tools are available to evaluate the measures in place to regulate BEPS.¹³¹

¹²⁴ *Ibid* n123.

¹²⁵ *Ibid* n123 at p.28.

¹²⁶ OECD Action Plan (2013) p. 20.

¹²⁷ OECD/G20 Executive Summary (2015) p.28.

¹²⁸ OECD Action Plan (2013) p. 20.

¹²⁹ *Ibid* n128.

¹³⁰ OECD/G20 Executive Summary (2015) p.31.

¹³¹ OECD Action Plan (2013) p. 21.

2.5.10 Action Plan 12: Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements

One of the major issues tax authorities worldwide are challenged with, are taxpayers who do not report aggressive tax planning schemes on a timely and comprehensive manner.¹³²

It is therefore that Action 12 focuses on *“Developing recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.”*¹³³

The OECD hopes that their recommendations will help countries with mandatory disclosure rules, to receive information on aggressive tax planning at an early stage, which will enable them to respond quickly to such problems.

2.5.11 Action Plan 13: Re-examine Transfer Pricing Documentation

The OECD notes that one of the main problems with regards to effective transfer pricing rules is the irregular flow of and access to information between taxpayers and tax authorities. This asymmetrical flow of information creates opportunities for BEPS activities.¹³⁴

As a result of this the OECD recognises the need to develop rules regarding transfer pricing documentation to enhance the transparency between tax authorities and taxpayers.¹³⁵

2.5.12 Action Plan 14: Make Dispute Resolution Mechanisms More Effective

The OECD recognises that developing effective dispute resolution mechanisms is an integral part of regulating BEPS.¹³⁶ Tax dispute resolution mechanisms should be developed to ensure the consistent and proper implementation of tax legislation and treaties. This will minimise the risk of uncertainty of taxpayers, thus minimising opportunities for BEPS activities.

¹³² OECD/G20 Executive Summary (2015) p.33.

¹³³ OECD Action Plan (2013) p. 22.

¹³⁴ OECD/G20 Executive Summary (2015) p.37.

¹³⁵ *Ibid* n134.

¹³⁶ *Ibid* n134 at p.41.

2.5.13 Action Plan 15: Develop a Multilateral Instrument

As most countries' tax treaties are based upon the OECD's model tax treaty, the amendment of the model tax treaty will not be feasible or logical. Therefore the OECD recognises the need for the development of a multilateral instrument that would have a similar effect as a simultaneous renegotiation of thousands of bilateral tax treaties.¹³⁷

The OECD undertook to *“analyse the tax and public international law issues related to the development of a multilateral instrument so as to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to: provide an innovative approach to international tax matters that reflects the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.”*¹³⁸

2.6 Conclusion

As is evident from the overview of the 15 actions, the OECD's Action Plan is clearly a non-binding instrument, merely providing guidance for countries on how to regulate BEPS activities and assisting governments in creating and implementing measures to do so. It is up to each country to decide for themselves if they are going to make use of the recommendations and implement legislative reforms and measures to give effect thereto.

Due to the current state of the South African economy, the need for the implementation of measures to regulate BEPS is inevitable.

It should however, be remembered that it is impossible to create a solution to an international problem on a 'one size fits all' basis. Each country has its own history, circumstances and characteristics which must be considered.

When South Africa complies with the OECD Action Plan on BEPS, it should be done in light of South Africa's specific needs and unique circumstances. Therefore I suggest that, as South Africa is not legally bound to follow the OECD Action Plan, but also taking into consideration South Africa's voluntary commitment to it, the legislature should implement

¹³⁷ *Ibid* n134 at p.43.

¹³⁸ OECD Action Plan (2013) p. 24.

measures to regulate BEPS, formulated upon the OECD Action Plan. Hereby the legislator can create measures which are custom made for country-specific needs.¹³⁹

It is important to note, that when creating such measures, the legislator must also do so in light of the objective of attracting and encouraging foreign direct investment.¹⁴⁰ Hereby enhancing South Africa's economic competitiveness.¹⁴¹

However, the Davis Tax Committee warns against a unilateral effort from South Africa in amending its domestic legislation in light of global reforms.¹⁴² The Committee notes that such actions could establish South Africa as an investor unfriendly tax environment, and may place South Africa in the back seat when it comes to choosing investment jurisdictions.¹⁴³ In order to remain competitive South Africa has to developed a balanced tax policy that ensures the attraction of foreign direct investment, while effectively regulating BEPS activities.¹⁴⁴ This is especially relevant, seeing that South Africa is the gateway into Africa, the continent which is recognised as the vehicle to global investment reforms.¹⁴⁵

Another problem however is, it seems as if other countries are taking a 'wait and see' approach as to the implementation of the OECD Action Plan. South Africa must consider this hesitation carefully.¹⁴⁶ If we engage in the amendments of our domestic legislation to hastily, South Africa might be the guinea pig to a global reform that could be vital.

As South Africa is not a member to the OECD, the Davis Tax Committee strongly recommends South Africa to wait with any drastic legislative reforms to give effect to the OECD action plan, and rather make use of and improve measures that is already in place.¹⁴⁷

One of the suggestion made by the Committee is to address BEPS by applying South Africa's General Anti-Avoidance Rules and the substance over form principles.¹⁴⁸

¹³⁹ Davis Tax Committee Interim Report (2014) p. 18.

¹⁴⁰ *Ibid* n139 at p. 26.

¹⁴¹ *Ibid* n139 at p. 26.

¹⁴² *Ibid* n139 at p. 27.

¹⁴³ *Ibid* n139 at p. 27.

¹⁴⁴ *Ibid* n139 at p. 27.

¹⁴⁵ *Ibid* n139 at p. 27.

¹⁴⁶ *Ibid* n139 at p. 28.

¹⁴⁷ *Ibid* n139 at p. 29.

¹⁴⁸ *Ibid* n139 at p. 37.

Before all the drastic global developments and globalisation, countries implemented GAAR legislation to target domestic avoidance activities.

However, the South African GAAR has undergone amendments in 2006, with the goal of establishing a rule that is broad and wide enough to cover even the most complex tax avoidance arrangements. Although these amendments widened the scope of the GAAR, it is uncertain if it was the legislator's intention to include international avoidance activities, like BEPS, in the scope. The reason for this statement is, because the Revenue Laws Amendment Bill containing the amended GAAR was only published in 2006¹⁴⁹ being some time before the 2008 financial crisis, which crisis was the main factor forcing governments and international organisations like the OECD, to focus on revenue collections. Therefore the amendments was done before the global awareness of BEPS.

Even though it was not the legislator's intention to include BEPS activities in the scope of the South African GAAR, it is still necessary to analyse the GAAR provisions in order to determine if the GAAR can effectively regulate BEPS activities.

In the following chapter, I will a critical analyse the provisions and requirements that must be met before the GAAR can be applied. Thereby, in light of the current background and the OECD Action Plan, analysing the South African GAAR as a pre-emptive BEPS measure.

¹⁴⁹ Haffejee, Y. (2009) p. 10.

Chapter 3: The South African General Anti-Avoidance Rule

3.1 The need for a General Anti-Avoidance Rule

In his book titled *The Wealth of Nations*, Adam Smith states the following:

*“The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of the government to the individuals of a great nation is like the expense of management to the joint ventures of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observance or neglect of this maxim consists what is called the equality or inequality of taxation”.*¹⁵⁰

Every jurisdiction has the right to determine and regulate its own tax regime.¹⁵¹ However, despite this sovereign right of a country, no Court (nationally or internationally) has since 1936, discard the Duke of Westminster principle, thereby allowing tax payers to organise their tax affairs in such a way to pay the minimum taxes.¹⁵²

The problem with these activities are the fact that it violates economic substance and undermines an important function of public finance of collecting revenues which will result in Government failing to achieve its fiscal budget. These activities are thus detrimental and undesirable.¹⁵³

Governments needs to balance the recognition of lawful transactions with commercial value, against the necessity of combating tax avoidance arrangements.¹⁵⁴ In this balancing act, countries also has to establish themselves as attractive investment jurisdictions.¹⁵⁵

¹⁵⁰ Smith, A. (1776) p. 350.

¹⁵¹ In the OECD’s report on *Addressing Base Erosion and Profit Shifting* (2013) p. 28, it stated that “a tax policy is an expression of national sovereignty, and each country is free to devise its tax system in the way it considers most appropriate.”

¹⁵² This so called Duke of Westminster-principle has been confirmed by a number of South African courts: CIR v Este Kohler 1953 2 SA 584 (A) p. 591 E-592H; CIR v King 1947 2 SA 196 (A) p. 212; SIR v Hartzenberg 1966 1 SA 405 (A) p. 408 F-G; Westerns Bank Ltd v Registrar of Financial Institutions 1975 4 SA 37 (T) p. 45 A.

¹⁵³ Garg, R. and Mukerjee, K. (2012) p. 8.

¹⁵⁴ Satumba, R. (2012) p. 9.

¹⁵⁵ Davis Tax Committee Interim Report (2014) p. 26.

In order to achieve same, countries have developed and made use of a General Anti-Avoidance Rule (GAAR) in their legislation. A GAAR was described in Chapter One as a statutory rule which empowers Revenue Authorities to query transactions and financial arrangements and disregard their form to reject the permitted tax advantage unless the taxpayer can prove the commercial essence and necessity of the transaction.¹⁵⁶

The requirements set out in GAAR legislation is thus the threshold against which a transaction will be measured to determine when it crosses over from legal tax avoidance and tax planning activities to illegal tax evasion activities. There is a very fine line between tax evasion, avoidance and planning and the differences between them needs to be identified. It should be noted however, that in practice the lines between tax evasion, avoidance and legitimate tax planning sometimes becomes blurred, almost that it is impossible to differentiate between the three.¹⁵⁷ This is especially true in an international context, as what may constitute unacceptable tax planning or even criminal action, varies from state to state.¹⁵⁸

3.1.1 The difference between Tax Evasion, Tax Avoidance and Tax Planning

Tax evasion is the wilful and deliberate engagement in deceitful and illegal activities by a taxpayer with the aim of freeing himself from the obligation to pay taxes.¹⁵⁹ The evasion is illegal and criminalised in most jurisdictions.

On the other hand, a taxpayer is allowed to enter into a legal, *bona fide* transaction which, when executed, results in the avoidance or reducing of his tax obligations.¹⁶⁰ This is called legitimate tax planning. Tax planning has been defined as follow:

*“The organising of a taxpayer’s affairs (or the structuring of transactions) so that they give rise to the minimum tax liability within the law without resort to the sort of impermissible tax avoidance.”*¹⁶¹

Tax planning is legal and no consequences will follow from the conducting of tax planning activities.¹⁶²

¹⁵⁶ Garg, R. and Mukerjee, K. (2012) p. 1.

¹⁵⁷ Olivier, L. and Honiball, M. (2008) p. 383.

¹⁵⁸ *Ibid* n157.

¹⁵⁹ Stiglingh, M and Others (2015) p. 805.

¹⁶⁰ *Ibid* n159.

¹⁶¹ SARS (2005) p. 4.

Tax avoidance is a form of tax planning. When a taxpayer seeks to acquire a tax benefit in a way that is contrary to the legislature's intention, then the tax planning becomes avoidance.¹⁶³ These types of avoidance activities are morally repulsive and impermissible.¹⁶⁴ SARS describes tax avoidance activities as:

*“Artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived loopholes in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament”.*¹⁶⁵

GAAR legislation is designed to distinguish between permissible and impermissible tax avoidance arrangements and to penalize any taxpayer who engage in impermissible tax avoidance arrangements.¹⁶⁶

Avoidance arrangements that meets all the requirements of the GAAR are considered to be impermissible tax avoidance, and will be disregarded.¹⁶⁷

However, when applying the GAAR, it should always be kept in mind that to a certain extent it is easier to engage in tax planning in an international arena, than it is in a national context.¹⁶⁸ This is true, because in an international arena the taxpayer is dealing with at least two different tax regimes which may allow different types of deductions and / or classification of transactions, providing for a bigger tax advantage for the taxpayer.¹⁶⁹

3.2 Overview of the South African General Anti-Avoidance Rule

The first South African GAAR was introduced in legislation in 1949 in section 90 of the Income Tax Act, 31 of 1941.¹⁷⁰ Since this date a few amendments have been made to this section and its successors.¹⁷¹ The latest amendments have been made in 2006 when the new

¹⁶² Stiglingh, M and Others (2015) p. 805.

¹⁶³ Murray, R. (2012) p. 1.

¹⁶⁴ *Ibid* n163.

¹⁶⁵ SARS (2006) p. 20.

¹⁶⁶ Olivier, L. and Honiball, M. (2008) p. 383.

¹⁶⁷ West, C. And Roeleveld, J (2016) , p.1.

¹⁶⁸ *Supra* n166.

¹⁶⁹ *Supra* n166.

¹⁷⁰ Satumba, R. (2012) p. 23.

¹⁷¹ Benn, D.J. (2013) p. 9.

GAAR provisions were introduced in Part II A of Chapter III of the Income Tax Act, 58 of 1962 in sections 80A-80L of the Act.¹⁷²

The motivation for the latest amendments were the fact that the previous / old GAAR contained in section 103(1) “*has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance*” and “*has not kept up with international developments*”.¹⁷³

Please note that when, in this thesis, there is referred to ‘the new GAAR’ of ‘the GAAR’, I am referring to the amended GAAR contained in sections 80A-80L of the Act.¹⁷⁴ This is in actual fact not a new GAAR, but merely an amendment to the old GAAR contained previous section 103 of the Act.¹⁷⁵ The reference to the ‘new GAAR’ is done for the sole purpose of distinguishing between the ‘old GAAR’ contained in section 103 and the ‘new GAAR’ in section 80A-80L.

The new GAAR was drafted in such a manner to be broad and wide enough to cover even the most complex tax avoidance arrangements.¹⁷⁶ This have resulted in the GAAR provisions to be criticised as being too complex and too broad, creating more loopholes that could be exploited.¹⁷⁷ It has been suggested that a GAAR that is too broad could undermine the true character of the GAAR as being a general, broad principle and turn into a complex set of rules which will damage its essence.¹⁷⁸

As mentioned in Chapter 2 the globalisation of economies has created an increased scope for opportunities to engage in tax avoidance activities, on a national and international level.¹⁷⁹

As the Davis Tax Committee warns the South African legislator to engage in a unilateral effort to amend its domestic legislation in light of the global BEPS reforms, it needs to be determined if the new South African GAAR can be used as a pre-emptive BEPS measure.¹⁸⁰

¹⁷² Satumba, R. (2012) p. 19.

¹⁷³ SARS, Explanatory Memorandum on the Revenue Laws Amendment Bill, (2006), p . 62

¹⁷⁴ Act 58 of 1962.

¹⁷⁵ *Ibid* n174.

¹⁷⁶ Loof, G. (2013) p. 8.

¹⁷⁷ Drummond, B. (2006) p. 10.

¹⁷⁸ Freedman, J. (2007) p. 21.

¹⁷⁹ Olivier, L. and Honiball, M. (2008) p. 384.

¹⁸⁰ Davis Tax Committee Interim Report (2014) p. 27.

The provisions and requirements of the new South African GAAR, contained in section 80A-80L of the Act¹⁸¹ will now be critically analysed in order to determine if it is indeed a pre-emptive BEPS measure.

It should be noted, that some of the provisions contained in the GAAR's predecessors (especially provisions of the old GAAR in the previous section 103 of the Act) have been included in the new provisions. Therefore, the case law analysing these provisions will still be applicable and a reliable source, even if it dates back to a year prior to the implementation of the new GAAR.

3.3 Requirements

As previously mentioned, the new GAAR provisions can be found in sections 80A-80L of the Income Tax Act.¹⁸² These sections sets out four requirements that must be met to enable the Commissioner of Tax Revenues (herein after referred to as the Commissioner) to apply the GAAR in order to deny a tax benefit established under a financial arrangement. These requirements are as follow:¹⁸³

- There must be an avoidance arrangement;
- The arrangement must result in a tax benefit and constitutes an avoidance arrangement entered into on or after 2 November 2006;
- The sole or main purpose of the arrangement is to obtain a tax benefit;
- The arrangement must include an abnormality element. This requirement must be analysed in a business context and a non-business context.

3.3.1 There must be an avoidance arrangement

Section 80L defines an arrangement as follow:

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

¹⁸¹ Act 58 of 1962.

¹⁸² *Ibid* n181.

¹⁸³ Stiglingh, M and Others (2015) p. 806.

3.3.1.1 What constitutes an arrangement

The definition of an arrangement must be read together with the court's decision in the case of *FCT v Newton* where the Court defined an 'arrangement' as:

*"A conscious involvement of two or more participants who arrive at an understanding. It cannot exist in a vacuum and presupposes a meeting of minds, which embodies an expectation as to future conduct between the parties, that is, an expectation by each that the other will act in a particular way."*¹⁸⁴

The legislature specifically included the terms 'transactions, operations, schemes, agreements and understandings' in the definition of an arrangement.¹⁸⁵ The common characteristic found in all of these arrangements is a 'meeting of minds'. It seems as if the legislator, by doing so, wanted the word 'arrangement' to be interpreted as wide as possible and to include any situation where there is a 'meeting of minds'.¹⁸⁶ This is also confirmed by case law where the Court held that these types of arrangements are wide terms and that there is little doubt that it is adequately wide enough to cover a series of transactions.¹⁸⁷

Broomberg, submits that never has there been a case where the Commissioner has failed on the grounds that he was not able to prove that there was an arrangement.¹⁸⁸ This gives the idea that this requirement is quite easy to establish.

BEPS activities will always be conducted as a result of some sort of an arrangement between subsidiaries or individual taxpayers. Hereby fulfilling this requirement.

3.3.1.2 Enforceability of an Arrangement

It should be noted that the legislature expressly stated that the legality and enforceability of an avoidance arrangement is irrelevant and will not affect the existence thereof.¹⁸⁹ Neither will it affect the application of the GAAR provisions.

¹⁸⁴ 1958 2 All ER 759.

¹⁸⁵ Section 80L of Act 58 of 1962.

¹⁸⁶ Haffejee, Y. (2009) p. 6.

¹⁸⁷ *Meyerowitz v CIR 1963 (3) SA 863 (A)*.

¹⁸⁸ Broomberg, E.B. (2007) p. 21.

¹⁸⁹ Section 80L of Act 58 of 1962.

This is typically situations where parties agree to agree in future on the terms and conditions of the agreement or the so called ‘gentleman’s agreement’.¹⁹⁰ These types of arrangements are usually difficult to prove as they are typically not documented.¹⁹¹

An unenforceable arrangement cannot be executed¹⁹², hence the wonder why this element is included in the definition in the first place. The only logical reason behind this, is the fact that the Commissioner wanted the best possible coverage under these provisions. Thus creating the idea that the GAAR provisions are aggressive, in the sense that it is applicable even in impossible situations.

3.3.1.3 An Arrangement includes all steps or parts thereof

The definition of an arrangement includes all steps of the arrangement or only parts thereof.¹⁹³

The terms ‘parts’ or ‘steps’ are not defined by the Act, however writers have mentioned that it relates to a distinctive transactional element of the whole.¹⁹⁴

By allowing the Commissioner to apply the provisions of the GAAR to parts or steps of the arrangement¹⁹⁵, widens the scope of the GAAR.

Broomberg¹⁹⁶ criticise the GAAR provisions and is of the opinion that the Commissioner can not apply the GAAR to a step or a part of an arrangement where it loses its commercial value due to the fact of it being considered in isolation.

In SARS’s Explanatory Memorandum it explains that this phrase was included to target steps that are tax driven and that lacks commercial substance and which, therefore results in an abuse of the provisions of the Act.¹⁹⁷

The objective of a step or part of an arrangement may differ from the objective of the arrangement as a whole.¹⁹⁸ Thus the inclusion of this phrase in the GAAR prevents

¹⁹⁰ Benn, D.J. (2013) p. 20.

¹⁹¹ *Ibid* n190.

¹⁹² Woods v Watters 1921 AD 303.

¹⁹³ Section 80L of Act 58 of 1962.

¹⁹⁴ Clegg, D. And Stretch, R. (2013) p. 26.

¹⁹⁵ Section 80H of Act 58 of 1962.

¹⁹⁶ Broomberg, E.B. (2007) p. 21.

¹⁹⁷ SARS, Explanatory Memorandum on the Revenue Laws Amendment Bill, (2006), p . 65.

the inclusion of abusive steps to be ‘*camouflaged by a legitimate purpose of the arrangement as a whole*’.¹⁹⁹

Based on the above, I have to admit that I disagree with Broomberg as this requirement is especially useful in regulating BEPS. The movement of profits from high to low tax jurisdictions, are usually sneaked in between a series of transactions, which as a whole could be regarded as a legitimate commercial transaction. This requirement allows the Commissioner to target the specific step that will ultimately result in the tax avoidance, while at the same time allowing the rest of the transaction to proceed.

Therefore the fact that the GAAR can be applied to a step in a transaction helps establish the GAAR as a pre-emptive BEPS measure.

3.3.2 The arrangement must result in a tax benefit and constitutes an avoidance arrangement entered into on or after 2 November 2006

A tax benefit is defined in Section 1 of the Act²⁰⁰ as follow:

“It includes any avoidance, postponement or reduction of any liability for tax.”

The term ‘tax benefit’ was also considered judicially and the Court described a tax benefit as a situation where a taxpayer “*gets out of the way and escapes or prevents an anticipated liability.*”²⁰¹

The word ‘tax’ includes any tax, levy or duty imposed by the Act or any other Act administered by the Commissioner.²⁰² Examples of taxes imposed by other Acts include VAT, estate duty, stamp duty and transfer duty.²⁰³ Thus, an arrangement leading to the avoidance, postponement or reduction of any type of taxes will fall under the scope of the GAAR.

By placing the word ‘any’ directly in front of the word ‘liability’ indicates that ‘liability’ will be interpreted as widely as possible.

¹⁹⁸ Satumba, R. (2012) p. 22.

¹⁹⁹ SARS, Explanatory Memorandum on the Revenue Laws Amendment Bill, (2006), p . 65.

²⁰⁰ Act 58 of 1962.

²⁰¹ *Smith v CIR 1964 (1) SA 324 (A) at 12.*

²⁰² Section 80L of Act 58 of 1962.

²⁰³ Stiglingh, M and Others (2015) p. 807..

The Act does not provide for a formal test to determine whether or not a tax benefit was derived from an arrangement.²⁰⁴ However, the Court in ITC 1625²⁰⁵ established the ‘but for’ test. The test merely states that a taxpayer would be regarded of obtaining a tax benefit if the taxpayer would have be obligated to pay taxes, but for the transaction, he did not.

This test, together with the GAAR provisions, places the onus of proof, on a balance of probabilities, on the Commissioner to proof that the taxpayer did obtain a tax benefit as a direct result of the arrangement.²⁰⁶ The Commissioner must establish a direct link between the tax benefit and the arrangement and what the taxpayer’s position would have been had he not enter into the arrangement.²⁰⁷

This onus of proof on the Commissioner may be difficult to establish in the sense of sophisticated international BEPS activities. As tax benefits can be easily disguised on an international level and as tax legislation differs across jurisdictions this onus may be the reason why BEPS cannot be controlled by the GAAR. What may constitute a tax benefit in one jurisdiction may not be a tax benefit in another jurisdiction.

On a domestic level such an onus is feasible. But on an international level it is my submission that to expect the Commissioner to successfully proof a tax benefit over various jurisdictions and legislations is unrealistic, and requires in depth insight into a taxpayers global financial affairs and various jurisdictions’ tax legislation.

South Africa, being a developing country, do not have the technology, electronically development or skilled man power, allowing us to obtain such financial information.

3.3.3 The sole or main purpose of the arrangement is to obtain a tax benefit

Section 80A determines that an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit.

Section 80G(1) elaborates on Section 80A and establishes a rebuttable presumption. This presumption entails that it is presumed that an avoidance arrangement has been entered into or carried out for the sole or main purpose of obtaining a tax benefit, unless and until the

²⁰⁴ Benn, D.J. (2013) p. 27.

²⁰⁵ 1996 59 SATC 383.

²⁰⁶ Loof, G. (2013) p. 14.

²⁰⁷ *Ibid* n206.

party obtaining a tax benefit proves that, in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.²⁰⁸

3.3.3.1 Sole or main purpose

In the case of *SBI v Lourens Erasmus (Edms) Bpk* the Court explained the meaning of the words ‘solely’ and ‘mainly’.

*“...The word ‘mainly’ establishes a purely quantitative measure of more than 50% and the associated use of the word ‘solely’ or mainly is inserted, ex abundante cautela, to circumvent the possibility that what may be described as being solely of a particular character would not qualify as being ‘mainly’ of that character.”*²⁰⁹

The Court further held that the word ‘solely’ *“does not detract from the interpretation but differs in meaning as is the only purpose.”*

3.3.3.2 Objective Test v Subjective test

The question is whether an objective or subjective test should be used in determining the sole or main purpose of the arrangement.

The Court, in the case of *SIR v Gallagher*²¹⁰ explained the difference between the objective and subjective test.

“By an objective test in this context is evidently meant a test which has regard rather to the effect of the scheme, objectively viewed, as opposed to a subjective test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme.”

An objective test clearly looks at the purpose for which the transaction was entered into,²¹¹ thus the purpose of the arrangement. Whereas a subjective test will consider the purpose of the parties when entering the arrangement.

²⁰⁸ Haffejee, Y. (2009) p. 18.

²⁰⁹ 1996 (4) SA 434 (A).

²¹⁰ *Ibid* n209 at p. 471 B.

²¹¹ *Newton v FCT* 1958 2 ALL ER 759 (PC).

If one considers the wording of section 80A, the reference to the words ‘its sole or main purpose’ indicates that the legislature intended that an objective test should be used.²¹²

The subjective test would require the Commissioner to determine the subjective intention of the taxpayer.²¹³ Thus placing the onus of proof on the Commissioner.²¹⁴ This will probably result in the taxpayer easily escaping liability as the subjective test places an extremely difficult onus on the Commissioner.

The objective test shifts the onus to the taxpayer to prove the contrary: that the sole or main purpose of the arrangement was not to obtain the tax benefit. The rebuttable presumption established in Section 80G also establishes that the onus of proof lies with the taxpayer.²¹⁵

Many scholars have confirmed this view and their opinions are listed below.

De Koker²¹⁶ states that:

“Section 80A refers to the purpose of the arrangement, and not the taxpayer. The purpose as used in section 80A of the Act is used in the sense of the effect (objective enquiry) of the arrangement and not the intention (subjective enquiry) with which the arrangement was entered into by the taxpayer.”

Whereas Louw²¹⁷ advocates that

‘...when applying the purpose requirement, regard must be had to the effect of the arrangement and not the purpose of the taxpayer.’

The use of the objective test also raises the question if an arrangement that accidentally results in a tax benefit will also fall under the GAAR provisions?

Furthermore, this requirement does not take into consideration the feasibility of such onus of proof in an international level. How will the Commissioner be able to discard

²¹² Haffejee, Y. (2009) p. 16.

²¹³ *Ibid* n212 at p. 17.

²¹⁴ Satumba, R. (2012) p. 31.

²¹⁵ *Supra* n212.p. 18.

²¹⁶ De Koker, D.E. (2010) par.19.6

²¹⁷ Louw, I.D.P. (2007) p. 24.

a taxpayer's opinion that an international transaction's main purpose was not to obtain a Tax benefit? This is especially true as an international transaction may result in a tax benefit in one jurisdiction, whereas in the other it does not. Furthermore what if this tax benefit occurs accidentally and not intentionally?

Again, this requirement requires in depth knowledge into a taxpayers financial affairs abroad and foreign tax laws, making it an unrealistic requirement in an international context.

3.3.4 The arrangement must include an abnormality element.

The last requirement that must be met for the GAAR provisions to be applicable, is the avoidance arrangement must include an abnormality element. Section 80A distinguishes between three situations where the abnormality element can be present:

- In a business context;
- In a non-business context;
- In any other context.

3.3.4.1. In a business context

Section 80A(a) reads as follow:

“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.”*

It is clear that Section 80A(a) creates two sub-requirements that must be met:

- A. The arrangement must be entered into or carried out by means or in a manner which would not normally be employed (the business purpose – requirement);

or

B. The arrangement must lack commercial substance.

Before I look at the meaning of these two sub-requirements, it is firstly important to establish what is meant with ‘in a business context’.

The terms ‘business context’ or ‘business’ are not defined in the Act.²¹⁸ However, these terms have been considered judicially and case law has defined ‘business’ as *“anything which occupies the time and attention and labour of a man for the purpose of profit or improvement.”*²¹⁹

There is no specific feature that could indicate a business context. Each case must be determined on its own facts, taking into account its specific circumstances.²²⁰

One way to determine if a ‘business context’ is present, is to analyse the type of activities applicable. Judge Beadle had the following opinion:

*“The sensible approach, I think is to look at the activities concerned as a whole, and then to ask the question: Are these the sort of activities which, in commercial life, would be regarded as carrying on business? The principle features of the activities which might be examined in order to determine this are their nature, their scope and magnitude, the object (whether to make a profit or not), the continuity of the activities concerned, if the acquisition of property is involved, the intention with which the property was acquired. This list of features does not purport to be exhaustive, nor is any one of these features necessarily decisive, nor is it possible to generalise and state which feature should carry most weight in determining the problem. Each case must depend on its own particular circumstance.”*²²¹

²¹⁸ Act 58 of 1962.

²¹⁹ Smith v Anderson (1880) 15 CHD 247.

²²⁰ Modderfontein Deep Levels Ltd v Feinstein 192 TPD 288.

²²¹ Estate G v Commissioner of Taxes 1964 (2) SA 701 SR.

A. Business Purpose – Requirement

The business purpose – requirement requires that an arrangement must have been “*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.*”²²²

This requirement focus solely on the methods used to enter into and to give effect to the arrangement.²²³ The fact that the arrangement had no business purpose (commercial substance) is irrelevant. Hence the feeling that the term ‘business-purpose- requirement’ is misleading.²²⁴

There is a presumption that if this requirement is met, in other words if it is established that the arrangement was entered into or carried out in a manner not normally employed for bona fide business purposes it is presumed, that that the sole or main purpose of the avoidance arrangement was to obtain a tax benefit.²²⁵

The Act does not define the term ‘bona fide’ but writers have described this term as follow:

*“The term relates to the business purpose so that, even if the arrangement is entered into or carried out in a bona fide manner the method employed may nevertheless be found to be abnormal in a business context.”*²²⁶

SARS is of the opinion that this section does not require one to enquiry into whether or not the particular taxpayer entered into the particular transaction for bona fide purposes, but that it requires an enquiry into a hypothetical situation: what method would be used normally for a similar type of arrangement?²²⁷

Therefore an objective comparison must be done between the current transaction in question and another similar type of transaction in order to establish if the methods used are similar.²²⁸

²²² Section 80A(a)(i) of Act 58 of 1962.

²²³ Satumba, R. (2012) p. 37.

²²⁴ Clegg, D. And Stretch, R. (2013) p. 26.

²²⁵ Modderfontein Deep Levels Ltd v Feinstein 192 TPD 288.

²²⁶ De Koker, D.E. (2010) par. 19.

²²⁷ Williams, R.C. (1997) p.24.

²²⁸ Haffejee, Y. (2009) p. 22.

The problem with the abovementioned is, that how do you establish what is regarded as normal business practises?²²⁹ If an ‘abnormal’ business method is widely used it may gain ‘commercial acceptability’ and become the norm.²³⁰ Some business practices may have already been established as normal in certain jurisdictions, but not in other. This will make it difficult for the Commissioner to rely on the GAAR provisions.

Another problem was highlighted in the case of *Hicklin v SIR*²³¹ where it was held that: *“what may be interpreted as normal as a result of the surrounding circumstances of an agreement, may be abnormal in a similar agreement in the absence of such circumstances.”*

It would be unrealistic to expect the Commissioner to satisfy this requirement in an international environment, as each country has, over hundreds of years, developed its own customs, norms and practices. Business practices, in an international context, cannot be applied on a ‘one size fits all’ basis as these practices are influenced in country specific needs. Thus, it seems if this requirement is not feasible in an international context.

B. Commercial Substance –Requirement

a) General Rule

Section 80C provides for a general rule for determining if an avoidance arrangement lacks commercial substance. This general rule entails that:

*“an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party but does not have 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.”*²³²

²²⁹ Loof, G. (2013) p. 21.

²³⁰ SARS (2006) *Revised Proposals on Tax Avoidance and Section 103 of the Income Tax Act, 1962.* p. 22.

²³¹ 1980 (1) SA 481 (A).

²³² Section 80C of Act 58 of 1962.

The Act does not define the term ‘significant’. However it is submitted that the term must be interpreted objectively as this term may mean different things to different people, depending on their circumstances.²³³

One can assume that the term ‘significant’ would imply something material or relevant.²³⁴

SARS stated that a transaction will be lacking commercial substance if there is:

- *“A disproportionate relationship between the actual economic expenditure or loss incurred by a party and the value of the tax benefit that would have been obtained by that party but for the provisions of the GAAR; and*
- *A loss claimed for tax purposes that significantly exceeds a measurable reduction in the party’s net worth.”*²³⁵

The use of the term “cash flows” by the legislature is also worrisome. In terms of the ordinary accounting definition, the term means ‘inflows and outflows of cash or cash equivalents’.²³⁶ The problem with using the term “cash flows” is that one could advocate that this section is only applicable with regards to a taxpayers cash / monetary position.²³⁷ Oliver is of the opinion that a better word should have been ‘funds’ which “includes money and it is worth widening the net to cover all forms of property.”²³⁸

b) List of indicators

Section 80C(2) contains a non-exclusive list of characteristics that serves as indicators of a lack of commercial substance.

The Section reads as follow:

²³³ Stiglingh, M. and Others (2015) p. 808.

²³⁴ Davis et al. (2009) p. 181.

²³⁵ SARS (2010)

²³⁶ *Supra n233* at p. 327.

²³⁷ Satumba, R. (2012) p. 42.

²³⁸ Oliver, L. Davis, D.M. and Uruquhart, G. (2009) p.

“...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;
- (iii) element that have the effect of offsetting or cancelling each other.”

(i) Substance over Form

The South African Common Law principle of *plus valet agitur quam quod simulate concipitur* can be translated to mean “what is actually done is more important than what seems to have been done”.

In terms of this principle, a court will not give effect to the form of an agreement if it does not reflect the true intention of the parties. This is called simulated transactions.²³⁹

In the context of tax planning, parties “simulate” a transaction (in form) to resemble another transaction in order to obtain the tax benefits of that other transaction.²⁴⁰

Despite the common law principle, the Commissioner have been unsuccessful in the past to combat these tax avoidance transactions due to the fact that the underlying transaction is legal and cannot be challenged.²⁴¹

²³⁹ Olivier, L. and Honiball, M. (2008) p. 385.

²⁴⁰ Available at <http://www.saflii.org/za/journals/DEREBUS/2013/25.html>. Accessed 2 April 2016.

²⁴¹ *Supra* n239.

According to section 80C(2)(a), an arrangement lacks commercial substance, and is thus an impermissible avoidance arrangement, if its legal substance is inconsistent with the form of its individual steps.

The legislature clearly inserted this section to allow the common law principle to prevail and to target those transaction where unnecessary steps have been inserted into the arrangement that are specifically designed to camouflage the true substance of the overall form.²⁴²

In the past Courts have used the intention of the parties to determine the legal substance of the transaction. However, in the recent case of *NKW v C SARS*²⁴³ the Supreme Court of Appeal held that a commercial test should rather be used:

“In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: Of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: The charade of performance is generally meant to give credence to their simulation.”

This will ensures that a tax-driven step cannot be “*camouflaged by the legitimate purpose of the arrangement as a whole.*”²⁴⁴

²⁴² Cassidy, J. (2009) p. 771.

²⁴³ 2011(2) SA 67 (SCA)

²⁴⁴ SARS (2006) Explanatory Memorandum on the Revenue Laws Amendment Bill, p. 65.

(ii) Round Trip Financing

Section 80C(2)(b)(i) states that the presence of round trip financing is indicative that an avoidance arrangement lacks commercial substance.

Section 80D defines round trip financing as 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.”*

Section 80D specifically includes cash, cash equivalents or any right or obligation to receive or pay the same, as part of the definition of funds.²⁴⁵

In this practice no money is actually paid from one party to another, it is simple re-routed to a party to the contract to obtain a tax benefit.²⁴⁶

In the case of *Ramsey v IRC*²⁴⁷ the term was described as follows:

“Although sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hands in his pocket.”

The only criticism with regards to the inclusion of this practice in section 80 as an indicator of lack of commercial substance, is that it seems to be a duplicate of the “of-setting or cancellation element”.

²⁴⁵ Section 80D(3) of Act 58 of 1962.

²⁴⁶ Satumba, R. (2012) p. 46.

²⁴⁷ (1982) A.C. 300.

Both these ‘practices’ leads to the of-setting or cancellation of steps and thus camouflages the real effect of the transaction as a whole.²⁴⁸

(iii) Tax indifferent parties

One of the indicators of a lack of commercial substance in a transaction is the inclusion or presence of an accommodating or tax-indifferent party. (The party must therefore be a party to the avoidance arrangement).

A party is an accommodating or tax-indifferent part, in terms of section 80E, 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*

²⁴⁸ Clegg, D. And Stretch, R. (2013) p. 26.

- (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.”*

In order to determine if a party is a tax-indifferent party, the Commissioner may treat parties who are connected persons in relation to each other as one and the same person.²⁴⁹ The effect of this is, that the GAAR provisions will be applicable on any arrangement between connected persons if the arrangement results in a tax benefit. The onus will be on the connected person that the sole or main objective of the arrangement was not to obtain the tax benefit.²⁵⁰

SARS is of the opinion that tax-indifferent parties are often included in arrangements to create the illusion that the arrangement contains commercial substance and thus to circumvent the GAAR provisions.²⁵¹

In order to prevent this section from being too aggressive, a ‘safe-haven’ clause was included in Section 80E(3) which list circumstances when this section will not be applicable.

(iv) elements offsetting or cancelling each other

Section 80C(2)(b)(iii) determines that an arrangement lacks commercial substance, and will thus be regarded as an impermissible avoidance arrangement (if the sole or main purpose of the arrangement was to obtain a tax benefit) if it includes elements that have the effect of offsetting or cancelling each other.

SARS did not explain in its Explanatory Memorandum²⁵² what is meant with the term ‘elements’. It is assumed that this includes steps,

²⁴⁹ Section 80F of Act 58 of 1962.

²⁵⁰ Stiglingh, M. and Others (2015) p. 731.

²⁵¹ SARS (2006) *Explanatory Memorandum on the Revenue Laws Amendment Bill*.

rights, obligations, amounts, other arrangements or any other action which could lead to the offsetting or cancelling of another action.

Such a step will result in neutralizing the tax obligation.

The reason for the inclusion of such a clause has been summarised as follow:

*“The self-neutralising mechanism draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called fiscal nullity doctrine. It is targeted primarily at complex schemes, typically involving complex financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another effectively neutralises the first leg for non-tax purposes.”*²⁵³

It seems as if the Commissioner, when including this section, wanted to target misleading steps and actions in complex schemes.²⁵⁴

The problem comes in if a tax arrangement results in a tax benefit in one year, but the cancelling element occurs in another year.²⁵⁵ In such instances it may be difficult for the Commissioner to apply the GAAR provisions.²⁵⁶

Broomberg has highlighted another problem with this section. He is of the opinion that a situation may exist where two provisions seem to cancel one another if you look at it from a legal perspective.²⁵⁷ Where on the other hand, if you look at it from an economic perspective, this may not be the case. Based on this, Broomberg came to the conclusion that when analysing elements of an arrangement, one should compare

²⁵² SARS (2006) *Explanatory Memorandum on the Revenue Laws Amendment Bill*.

²⁵³ De Koker, D.E. (2010) par.19.7.

²⁵⁴ Haffejee, Y. (2009) p. 34.

²⁵⁵ *Ibid* n254 at p. 35.

²⁵⁶ *Ibid* n254 at p. 35.

²⁵⁷ Broomberg, E.B. (2007) p. 22.

legal elements with legal elements and economic elements with economic elements.²⁵⁸

3.3.4.2 In a non-business context:

Section 80A(b) determines that:

*“an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and, 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 bona fide business purposes, other than obtaining a tax benefit.”*²⁵⁹

This section is identical to Section 80A(a)(i). The only difference between the two is that the one refer to a context of business whereas the other refers to a context other than business. Therefore it seems as if the one excludes the other.

Section 80A(a)(i) was discussed in detail above, and the same facts shall apply in Section 80A(b).

3.3.4.3 In any other context:

Section 80A(c) reads as follow:

“An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and, in any other context:

- (i) it has created rights and 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).”*

²⁵⁸ Broomberg, E.B. (2007) p. 22.

²⁵⁹ Section 80A(b) of Act 58 of 1962.

This section has been described as the heart of the GAAR as it extends the scope of the GAAR to apply to any other situation that is not covered by the previous sections.²⁶⁰

Section 80A(c) is an extremely important section as it brings the South Africa GAAR in line with international best standards,²⁶¹ and it “*reinforces the modern approach to the interpretation of tax legislation in order to find the meaning that harmonises the wording, object, spirit and purpose of the provisions of the Income Tax Act.*”²⁶²

A. Creating Abnormal Rights and Obligations

In order to determine whether or not an arrangement has created abnormal rights and obligations, one should make a factual inquiry into the specific circumstances of the case.²⁶³

The Court, in the case of *SIR v Geustyn Forsyth & Joubert*²⁶⁴ found that in order to establish what is normal in a specific situation, one should consider “*the subjective circumstances surrounding the taxpayer’s operations.*”

Based on the aforesaid judgement, Broomberg²⁶⁵ is of the opinion that it will be most unlikely for the Commissioner to succeed. The reason behind this opinion is the fact that the Commissioner will bear the onus of proof on a balance of probabilities that the arrangement created abnormal rights.

The term ‘dealing at arm’s-length’ has been described in the case of *Hicklin v SIR*²⁶⁶ as a situation where parties to an arrangement seeks to obtain the best possible advantage from the arrangement. Flowing from this is clear that it will usually not involve parties who are regarded as connected persons.

²⁶⁰ Cilliers, C. (2008) p. 85.

²⁶¹ SARS (2006) *Explanatory Memorandum on the Revenue Laws Amendment Bill*, p. 22.

²⁶² *Ibid* n261.

²⁶³ Garg, R. and Mukerjee, K. (2012) p. 47..

²⁶⁴ 1971 (3) SA 567 (A) 33 SATC.

²⁶⁵ Broomberg, E.B. (2007) p. 23.

²⁶⁶ 1980 (1) SA 481 SATC 179.

B. Misuse or Abuse of the Provisions of the Act

One should take note of the positive tone used by the legislator: The GAAR provisions shall be applicable if an impermissible avoidance arrangement results in the misuse or abuse of the provisions of the Act. In the case of *Sayers v Khan*²⁶⁷ the court was of the opinion that the use of negative language has a peremptory connotation and the use of positive language suggest that the relevant statutory provision is directory.

In order to determine if an avoidance arrangement has resulted in the misuse or abuse of the provisions of the Act, one must establish the purpose of that provisions.²⁶⁸ Writers have different opinions as to how legislation in South Africa must be interpreted.²⁶⁹ It is generally accepted that the correct method of interpretation is to use a purposive approach, thus meaning reading the provision in light of the purpose it was drafted, and the intention of the legislator.²⁷⁰

With regards to tax legislation it has been said that one has to “*merely look at what is clearly said. There is no room for intendment. There is no equity about tax, There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.*”²⁷¹

Therefore if a taxpayer engages in an arrangement which is in line with the object, spirit and purpose of the Act, it is most likely not to be regarded as a misuse or abuse of the provisions of the Act.

3.4 Analysing the GAAR as a pre-emptive BEPS measure

In the introduction to this Chapter, it was mentioned that the previous Section 103 was criticised as “*to be an inconsistent and, at times, ineffective deterrent to the increasingly*

²⁶⁷ (2002) 1 ALL SA 57 (C).

²⁶⁸ Broomberg, E.B. (2007) p. 32.

²⁶⁹ Joubert, W. A. And Faris, J. A. (2001) p. 285.

²⁷⁰ *Ibid* n269.

²⁷¹ Cape Brandy Syndicate v CIR (1921) 12 TC 358 1 KB.

*sophisticated forms of impermissible tax avoidance” and “has not kept up with international developments”.*²⁷²

In order to rectify such criticism the Commissioner introduced section 80A-80L. In the above study, the provisions of Sections 80A-80L was critically analysed in order to establish if these sections are indeed an improvement on its predecessor and can thus be regarded as a pre-emptive BEPS measure.

What is interesting to note, is how the legislator intended to broaden the scope of the GAAR in every possible way. Each and every section, sub-section or requirement was placed in the GAAR in order to widen its application.

This have resulted in the new GAAR being criticised as being too complex and too wide, even so to *‘perplex even the most impressive minds’*.²⁷³ It has been suggested that a GAAR that is too broad could *‘start to remove the nature of the GAAR as a broad principle and turn it into a detailed set of rules which could damage its essence.’*²⁷⁴

A more detailed and complex set of rules, can create more avoidance opportunities for a taxpayer.

It was mentioned earlier that avoidance activities that meets all the requirements of the GAAR are considered to be impermissible tax avoidance activities, and therefore the GAAR can be applied to discard any tax benefit generated there from.²⁷⁵

From the face value it is evident that BEPS activities are considered to be impermissible tax avoidance activities. It complies with SARS’ definition as it is conducted through *“artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived loopholes in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament.”*²⁷⁶

²⁷² SARS, Explanatory Memorandum on the Revenue Laws Amendment Bill, (2006), p . 62

²⁷³ Drummond, B. (2006) p. 11.

²⁷⁴ Freedman, J. (2007) p. 21.

²⁷⁵ West, C. And Roeleveld, J (2016) , p.1.

²⁷⁶ SARS (2006) p. 20.

From the discussions in this chapter, it is clear that some of the requirements listed in the GAAR provisions are easy to comply with in an international context. This will include for example, the establishment of an arrangement.

However, most of the requirements are difficult to establish in an international transaction. It seems, as if the legislator, when imposing these requirements, did not keep in mind the feasibility thereof in an international environment. This is for example the requirements which places the onus of proof upon the Commissioner. This onus requires in depth knowledge of the taxpayer's international financial affairs and transactions as well as in depth knowledge into foreign tax laws.

South Africa, being a developing country, do not have the advanced technology or communication systems in order to obtain such information. Needless to say the appropriate skilled man power.

In 2010 the Foreign Account Tax Compliance Act (FATCA) was enacted by the United States of America.²⁷⁷ FACTA basically requires foreign financial institutions to report information regarding financial accounts and transactions, held by US taxpayers, or by foreign entities in which such taxpayers hold a considerable ownership interest, to the American Internal Revenue Service (IRS).²⁷⁸

As a result of the enactment of FACTA, the G20 Finance Ministers, in collaboration with some European countries endorsed 'automatic financial information exchange' as the expected new global standard.²⁷⁹ Based on the Intergovernmental Agreements (IGA) between the US and the G20 countries and some European Countries, their goal is to develop and manage a multilateral tax information exchange system.²⁸⁰

South Africa, being a member of the G20, signed an IGA with the USA on 9 June 2014 which agreement was approved by House of Parliament in terms of section 231(2) of the Constitution and entered into force on 28 October 2014.²⁸¹ Hereby South Africa commits to

²⁷⁷ Available at <https://www.ensafrica.com/news/The-implications-of-FATCA-in-South-Africa?Id=1520&STitle=tax%20ENSight>, accessed 3 May 2016.

²⁷⁸ *Ibid* n277.

²⁷⁹ OECD (2014) p. 5.

²⁸⁰ *Ibid* n279.

²⁸¹ Available at <http://www.sars.gov.za/Media/MediaReleases/Pages/26-March-2015---Update-on-implementation-of-FATCA-in-South-Africa.aspx>, accessed 3 May 2016.

implementing a Common Reporting Standard (CRS) which requires the exchange of information between SARS and the American IRS and other countries with whom such agreement may be concluded, regarding financial accounts and transactions, held by nationals of those countries, and by foreign entities in which such nationals hold a considerable ownership interest.

Despite South Africa's enthusiasm and cooperation in the implementation of a CRS it seems somewhat unrealistic for a developing country to implement such information exchange system.

The South African Banks are of the opinion that the implementation of the system is not feasible as it requires a complete review of all existing and new clients.²⁸² Furthermore, the South African banks receives no guidance whatsoever from SARS on the requirements and process that must be followed. Therefore they are of the opinion that it will take years for South Africa to successfully implement such an automatic information exchange system, and even then there will most probably be major issues to resolve.²⁸³

As every jurisdictions has the right to determine and regulate its own tax regime,²⁸⁴ each jurisdiction will establish its own norms and practices. Therefore a measure which is created, taking only into consideration local norms, cannot be applied to an international transaction. A transaction that may result in a tax benefit in one jurisdiction, may not have the same effects in another.

Therefore it seems as if the legislator only intended for the GAAR provisions to be applicable to domestic avoidance activities.

3.5 Conclusion

The GAAR was analysed in the discussions above as a pre-emptive BEPS measure. It is my submission that when the GAAR was drafted, it was initially not the intention of the legislator to apply the GAAR provisions in an international context. Therefore the GAAR lacks requirements that allows it to be successfully applied in an international arena.

²⁸² Investec (2016) Best Practice Workshop.

²⁸³ *Ibid* n282.

²⁸⁴ In the OECD's report on *Addressing Base Erosion and Profit Shifting* (2013) p. 28, it stated that "*a tax policy is an expression of national sovereignty, and each country is free to devise its tax system in the way it considers most appropriate.*"

Despite this shortfalls, there is, however, nothing stopping the Commissioner from using the GAAR as a pre-emptive BEPS measure Especially as BEPS activities are regarded as impermissible tax avoidance activities. But, it may not be as feasible or effective as one may hope for in an international environment.

Therefore, I would urge the legislator to consider other alternative measures in order to regulate BEPS in South Africa.

An example is to follow Australia's lead in implementing a Multinational Anti-Avoidance law (MAAL). This would be a General Anti-Avoidance rule focused and created specifically to target multinational transactions and arrangements across borders.

In the following chapter, the provisions of the Australian MAAL will be analysed. This will be done in light of the possibility of implementing a similar measure in the South African legislation.

Chapter 4: The Australian Multinational Anti-Avoidance Law

4.1 Introduction

The publication of the OECD's Action Plan on BEPS served as a wakeup call to most countries worldwide, causing them to recognise and identify BEPS as an international dilemma. It called on countries to re-evaluate their current legislation, to determine if it has kept up with international developments, and if it would sufficiently protect a country's tax base in light of these international developments.

Australia, reacting to the OECD's Action Plan on BEPS, recognised the need to combat tax avoidance activities conducted by, specifically, multinational companies operating in Australia.²⁸⁵

As a direct result hereof, the Australian Government announced, as part of its Federal Budget on the 12th of May 2015, a possible implementation of a pre-emptive BEPS measure targeting multinational enterprises. This measure was dubbed the Multinational Anti-Avoidance Law (hereinafter referred to as the MAAL).²⁸⁶

The provisions of the MAAL was introduced to parliament on the 16th of September 2015 in the Tax Law Amendment (Combating Multinational Tax Avoidance) Bill 2015 (hereinafter referred to as the Bill).²⁸⁷ As is evident from the name, the Bill contains and implements various provisions and measures to curb tax avoidance activities by multinational companies, of which the MAAL is one.²⁸⁸

The MAAL was introduced with the aim of *“countering the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.”*²⁸⁹

²⁸⁵ Available at <http://www.pwc.com/us/en/tax-services/publications/insights/australia-introduces-multinational-anti-avoidance-legislation-in.html>, accessed 11 May 2016.

²⁸⁶ Deloitte (2015) p. 2.

²⁸⁷ Available at <http://www.lexology.com/library/detail.aspx?g=e648e115-229d-4894-905e-f8ef6a076d2f>, accessed 10 May 2016.

²⁸⁸ Other measures implemented by the Tax Law Amendment Bill are Country by Country (CbC) reporting to the Australian Taxation Office (ATO); and increased penalties for certain large company transactions.

²⁸⁹ Exposure Draft Explanatory Material (2015) p. 2.

This is hoped to be achieved by targeting foreign multinational companies generating profits through conducting economic activities within Australia, who do not have a permanent establishment.²⁹⁰

On the 3rd of December 2015, the Bill was passed by Parliament and resulted in the MAAL being effective from 1 January 2016,²⁹¹ irrespective of the fact that the scheme in question was entered into or came into operation before the commencement day.²⁹²

The short period that lapsed, since the MAAL was initially introduced, to its implementation (12 May 2015 -3 December 2015), is indicative of the urgency of the implementation of a pre-emptive BEPS measure targeting specifically multinational companies.

The MAAL has been described as a bolt-on extension to the existing GAAR provisions contained in Australia's Income Tax Assessment Act, 1936.²⁹³ Meaning that, despite the MAAL existing in its own right, most of its provisions is dependent on requirements and definitions as set out in the existing GAAR.

4.2 Australia and the OECD BEPS Action Plan

The Draft Explanatory Material issued on the Bill, states that:

*“The Australian Government is committed to the two year G20/OECD BEPS project which aims to restore fairness in the international tax system and ensure that entities pay tax where they earned their profits.”*²⁹⁴

The Australian Government, being a member of the OECD and the G20, has been actively involved in the OECD Action Plan on BEPS since the introduction thereof.²⁹⁵

As Chair of the G20 in 2014, Australia has shown a high level of commitment in assisting the international campaign against BEPS and has proved itself to be a mentor in the BEPS project.²⁹⁶

²⁹⁰ Ernst Young (2015) p. 1.

²⁹¹ Available at <http://www.lexology.com/library/detail.aspx?g=e648e115-229d-4894-905e-f8ef6a076d2f>, accessed 10 May 2016.

²⁹² Drysdale, D. (2015) p. 1

²⁹³ SAICA (2015) p. 1.

²⁹⁴ Exposure Draft Explanatory Material (2015) p. 3.

²⁹⁵ Available at

http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report%20part%201/c04, accessed 11 May 2016.

Sadiq, K. has highlighted Australia as a leader in the international combat against BEPS and emphasised the leadership role that Australia currently has and will continue to have in the development, implementation and assessment of the BEPS Action Plan:

“...it will be a case of sovereign nations adopting the recommendations out of the OECD BEPS project and countries like Australia entering into multilateral convention, altering tax incentives or enacting domestic legislation. This is where Australia must be proactive in adopting OECD BEPS recommendations and has the opportunity to show leadership within the region.”²⁹⁷

In order to maintain its position as a leader and forerunner in the international campaign against BEPS, Australia had to implement a legislative reform in light of the BEPS Action Plan. Hence the introduction of the Multinational Anti-Avoidance Law.

4.3 The reason for the Multinational Anti-Avoidance Law (MAAL)

As already mentioned in the introduction, the MAAL was introduced with the aim of

“countering the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.”²⁹⁸

If one considers the wording of the above statement, read together with the definition of BEPS, as mentioned in Chapter 2,²⁹⁹ it is evident that the MAAL was introduced, mainly to combat BEPS, and thus as a direct result of the OECD’s BEPS Action Plan.

The Australian Government was of the opinion that the GAAR provisions, as it were before the amendment and inclusion of the MAAL, were not able to adequately deal with the sophisticated tax avoidance activities that MNEs engage in on an international level.³⁰⁰

For the GAAR provisions to apply, it required that the sole purpose for entering into an avoidance arrangements must have been to obtain an Australian tax benefit.³⁰¹ To sidestep

²⁹⁶ Available at

http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report%20part%201/c04, accessed 11 May 2016.

²⁹⁷ *Ibid* n296.

²⁹⁸ Exposure Draft Explanatory Material (2015) p. 2.

²⁹⁹ BEPS activities was defined in Chapter Two as follow: *“The use of legal arrangements that make profits disappear for tax purposes or allow profits to be artificially shifted to low or no-tax locations where the business has little or no economic activity.”*

³⁰⁰ Exposure Draft Explanatory Material (2015) p. 4.

such a requirement, MNEs raised the argument that the sole purpose of an arrangement was to obtain a tax benefit in another country, and that the tax benefit occurring in Australia was merely accidental. This was usually the case where the Australian sales of a MNE were only a small part of its total global sales.³⁰²

In order to address this problem the Australian Government introduced the MAAL. MNEs are the main cause of the erosion of the Australian tax base.³⁰³ The MAAL focus on targeting the most egregious tax planning and avoidance activities by MNEs, while at the same time allowing the conducting of legitimate international business activities.³⁰⁴

4.4 A critical analysis of the Australian Multinational Anti-Avoidance Law (MAAL)

As already mentioned, the Australian MAAL was brought about by means of amending and adding to the existing GAAR provisions. It should be noted that this Chapter is not focussed on discussing and analysing the Australian GAAR in its entirety. It will merely consist of a discussion on the newly enacted MAAL provisions.

Furthermore, one should keep in mind that the MAAL is fairly new. Thus, very little literature is available discussing the implications thereof. The bit of literature that has been published, merely consists of the writers' personal opinions and theoretical analysis of the provisions of the MAAL. No statistics are available, measuring and indicating the practical implications and effects thereof.

Therefore, one should note that the following discussions on the MAAL in this Chapter will include an academic analysis of the provisions, and an estimated affect thereof.

4.4.1 Overview of the MAAL provisions

The MAAL provisions are contained in section 177DA of the Income Tax Assessment Act, 1936.

The section reads as follow:

“(a) the MAAL will apply to a scheme if:

³⁰¹ Exposure Draft Explanatory Material (2015) p. 4.

³⁰² *Ibid* n301.

³⁰³ *Ibid* n301.

³⁰⁴ *Ibid* n301.

- (i) *a foreign entity (hereinafter referred to as the principle) makes a supply to an Australian customer of the foreign entity; and*
 - (ii) *activities are undertaken in Australia directly in connection with the supply; and*
 - (iii) *some or all of those activities are undertaken by an Australian entity (hereinafter referred to as the Australian Service Provider) who, or are undertaken at or through an Australian permanent establishment of an entity who, is an associate of or is commercially dependent on the foreign entity (principle); and*
 - (iv) *the foreign entity (principle) derives ordinary income, or statutory income, from the supply; and*
 - (v) *some or all of that income is not attributable to an Australian permanent establishment of the foreign entity (principle); and*
- (b) *it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:*
- (i) *enabling a taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or*
 - (ii) *enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme;*
- whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers;*
- and*
- (c) *the foreign entity (principle) is a significant global entity for a year of income in which the relevant taxpayer, or one or more other taxpayers, would:*
- (i) *obtain a tax benefit; or*
 - (ii) *reduce one or more of their liabilities to tax under a foreign law;*

in connection with the scheme.”³⁰⁵

When considering section 177DA, one can identify three requirements that must be met for the MAAL to apply:

1. The provisions of the MAAL only applies to an entity that meets certain requirements;³⁰⁶ and
2. The scheme in question must have certain characteristics;³⁰⁷ and
3. The scheme must comply with the principle purpose requirement.³⁰⁸

These three requirements are explained hereunder.

4.4.1.1 The provisions of the MAAL only applies to an entity that meets certain requirements

It is clear that section 177AD(c) intends for the MAAL only to apply to the largest multinational entities or groups of companies, being identified as ‘significant global entities’.³⁰⁹

A significant global entity is described as “*an entity with annual global income, or the annual global income of the group in which the entity is a member, is AU \$1 billion or more.*”³¹⁰

The global income of more than AU \$1 billion must be generated in the year in which the entity engage in the specific scheme that will reduce its tax obligations.³¹¹

In order to determine the global entity’s corporate structure, one should rely on and make use of general recognised accounting standards and principles.³¹²

³⁰⁵ Section 177DA of the Income Tax Assessment Act, 1936.

³⁰⁶ Section 177DA(1)(c) of the Income Tax Assessment Act, 1936.

³⁰⁷ Section 177DA(1)(a) of the Income Tax Assessment Act, 1936.

³⁰⁸ Section 177DA(1)(b) and (c) of the Income Tax Assessment Act, 1936.

³⁰⁹ Exposure Draft Explanatory Material (2015) p. 6.

³¹⁰ Australian Government: Australian Taxation Office (2015) p. 2.

³¹¹ *Supra n309.*

³¹² Schedule 1, item 3, of the Income Tax Assessment Act, 1936.

Furthermore section 177AD(c) expressly states that it only targets “*multinational entities that ultimately return a substantial proportion of the profit from Australian sales to no or low tax jurisdictions.*”³¹³

The MAAL provisions will only be applicable if both the ‘significant global entity-requirement’ as well as the ‘low or no tax jurisdiction-requirement’ is met.³¹⁴

The ‘low or no tax jurisdiction-requirement’ will be fulfilled if it can be identified that the significant entity is conducting economic activities in other low or no-tax jurisdictions.³¹⁵

The Draft Explanatory Material, states, with regards to this requirement, that “*if any of the activities of the non-resident (or an entity in their global group) enjoy a zero or low corporate tax rate in a foreign jurisdiction, either under the foreign law or through preferential arrangements with the foreign government, this requirement will be met. This condition is also met where income from activities of the non resident (or entity in the global group) is stateless and not subject to corporate income tax in any country.*”³¹⁶

It should be noted, however, that if the non-resident entity can prove that the economic activities it is conducting in the foreign jurisdictions (where low or no taxes are paid) are unrelated to the supply of goods or services in Australia; or that the economic activity in the foreign jurisdictions (where low or no taxes are paid) constitutes the substantial economic activity in relation to the total global profits generated, this condition will not be met.³¹⁷

Section 177AD(c) imposes an extremely high threshold that must be met before the MAAL can be applied, thus limiting its scope.

The Explanatory Material issued by the Australian Government expressly states that the MAAL “is targeted at 30 large multinational companies”.³¹⁸ This statement,

³¹³ Exposure Draft Explanatory Material (2015) p. 6.

³¹⁴ *Ibid* n313.

³¹⁵ *Ibid* n313.

³¹⁶ *Ibid* n313..

³¹⁷ *Ibid* n313 at p. 7.

³¹⁸ *Ibid* n313 at p. 8.

together with the provisions of section 177AD(c) makes one question the application of the MAAL as a general, broad anti-avoidance rule.

It is clearly the intention of the legislator to target only large entities. The question is, if a MAAL that only focus on a small class of entities, despite the fact that this class will contribute to a substantial part of revenue income, will be effective in protecting the Australian tax base?

If one considers the method of implementation of the MAAL as a bolt-on extension to the existing GAAR, it seems as if the MAAL should have been created as a general broad rule targeting all multinational companies.

Only time will tell if the MAAL, as a target-focussed rule, will successfully protect the Australian tax base.

4.4.1.2 The structure of a Scheme

The wording used in section 177DA(1)(a) is somewhat confusing and difficult to grasp.

In an attempt to simplify this section, the Draft Explanatory Material states that the MAAL will apply to schemes if under or in terms of that scheme:³¹⁹

- A non-resident company generates income by supplying goods or services directly to Australian customers, (thus being Australian residents); and
- An Australian company (thus being an Australian resident and having a permanent establishment in Australia, identified as an Australian service provider), who is affiliated with or financially dependent on the non-resident company, undertakes activities in Australia directly in connection with that specific supply; and
- The income generated by that supply is not attributable to a permanent establishment in Australia, (thereby the non-resident company avoids attribution of the income to its taxable income).

Schedule 1 expressly states that the supply must be made by a non-resident to a resident (Australian customer), and the two may not be associated with one another.³²⁰

³¹⁹ Exposure Draft Explanatory Material (2015) p. 8.

The reason for this is to cover transactions concluded at arm's length and thus excluding intra-group trade from the coverage of the MAAL.³²¹

It is clear that this structure of a scheme, as set out in section 177DA(1)(a), is intended to combat BEPS activities of MNEs. This is specifically evident of the fact that section 177DA(1)(a) requires the participation of three different parties: the non resident supplier (the mother company), the Australian customer and the Australian service provider (the subsidiary). The requirement that an Australian service provider must participate in the transaction, will ensure that an Australian company, who conducts economic activities within Australia, cannot shift its profits under the foreign group / mother company to a low or not tax jurisdiction. Thus ensuring that profits will be taxed where economic value is created.

This requirement (the participation of three different parties) however, places the onus on the Tax Authorities to obtain sufficient information to identify these three parties, i.e. the country of incorporation of all three parties; the place of effective business of all three parties; the transfer of funds between the three parties etc. In order to obtain such information the Australian Tax Authorities requires cooperation from the Companies (and other Entities) Registrar, financial institutions etc. This requirement is quite a stringent requirement to meet. However the fact that the MAAL is only applicable on 'significant global entities' limits the application of the MAAL, which makes a requirement like this more feasible.

I do believe that, from a theoretical, point of view, this section and its requirements for the establishment of a scheme, will be able to combat BEPS. It is, however, another question if it will be possible, in practice, to identify the relationship between these three different entities. Especially as global groups of companies use complex and sophisticated corporate structures, especially for the goal of avoiding tax.

4.4.1.3 The principle purpose requirement

The principle purpose requirement is found in sections 177DA(1)(b) and (c).³²²

³²⁰ Schedule 1, item 3 Of the Income Tax Assessment Act, 1936.

³²¹ Exposure Draft Explanatory Material (2015) p. 12.

³²² Of the Income Tax Assessment Act, 1936.

This requirement consists of two components:

“The first component is satisfied if it would be reasonable to conclude [taking into account certain matters that will be discussed below] that the scheme is designed to avoid the non-resident deriving income from such supplies, that would be attributable to a permanent establishment in Australia.

The second component is satisfied if it would be concluded that there is a principal purpose, or more than one principal purpose that includes a purpose of, obtaining a tax benefit, or both obtaining a tax benefit and reducing certain Australian and/or foreign tax liabilities.”³²³

Both of these components should be tested objectively, thus meaning that one should consider what is actually achieved by the scheme, instead of looking at the legal form.³²⁴

What is significant to note is the fact that the MAAL requires a ‘principle purpose test’ which is a lower threshold than a ‘sole of main purpose test’. The word ‘principle’ is defined in the Oxford English Dictionary as being the “*first in order of importance or main*”. The test therefore allows for more than one principal purposes of the scheme, of which only one has to be to obtain a tax benefit.³²⁵

When assessing the first component of the principle purpose test, section 177DA(2) sets out certain matters which the Commissioner must consider.

The first matter that needs consideration is the extent to which the activities, carried out by the non resident entity, the Australian service provider or any other entities, contribute to the supply of goods or services to the Australian customers.³²⁶ The inclusion of this section ensures that schemes that have been split or divided in such a way as to avoid a ‘permanent establishment’ will be caught.³²⁷ This allows the Commissioner to identify the various entities involved and their capacities to undertake certain activities. Writers are of the opinion that the inclusion of this section

³²³ Exposure Draft Explanatory Material (2015) p. 15.

³²⁴ This confirms the applicability of the substance over form test.

³²⁵ Australian Government: Australian Taxation Office (2015) p. 2.

³²⁶ Section 177DA(2)(b) of the Income Tax Assessment Act, 1936.

³²⁷ Deloitte (2015) p. 3.

establishes a substance over form test: *“the more substance that exist in the principle, the less likely will it be concluded that there was a principle purpose to reduce tax.”*³²⁸

The second matter that needs consideration is *“the result, in relation to the operation of any foreign law relating to taxation, that would be achieved by the scheme.”*³²⁹ The Commissioner needs to consider the amount of foreign taxes paid on the Australian income: the higher the foreign taxes, the less likely that the main objective of the scheme was to obtain a tax benefit.³³⁰

4.4.2 Effects of the MAAL

From the outset, it is important to note that the MAAL is only a couple of months old, and therefore no substantial information exists with regards to its practicality or feasibility. Furthermore, no statistics are available, measuring and indicating the practical implications and effects thereof.

On the academic side, the introduction of the MAAL has lead to Australia being honoured for having some of the strongest tax integrity provisions globally.³³¹

Some have stated that the success of the MAAL lies within section 177DA (6) which determines that the MAAL *‘applies whether or not the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.’*³³² This section broadens the scope of the MAAL and allows it to attack the global multinational tax avoidance and BEPS problem at heart.³³³

On paper the MAAL hopes to ensure that MNEs will not be able shift their profits to foreign, low tax jurisdictions, which profits were generated through a significant sales activity in Australia.³³⁴ Thereby resulting in MNEs not being able to use complex, artificial avoidance schemes or arrangements to escape their tax obligations.

³²⁸ Deloitte (2015) p. 2.

³²⁹ Section 177DA(2)(c) of the Income Tax Assessment Act, 1936.

³³⁰ Deloitte (2015) p. 2.

³³¹ Treasurer of the Commonwealth of Australia (2015) p.2.

³³² *Supra* n330 at p. 3.

³³³ *Supra* n331 at p.2.

³³⁴ Exposure Draft Explanatory Material (2015) p. 4.

Flowing from this it seems as if the introduction of the MAAL is directly in line with the OECD's recommendation: *“to create a measure which ensures and compels MNEs to report their profits in the jurisdiction where its economic activities are carried out and economic value is created.”*³³⁵

By including the MAAL as part of the GAAR, the legislator intended that any avoidance scheme that falls under the ambit of the MAAL, will not be entitled to any protection under Australia's income tax treaties, or Income Tax Assessment Act.³³⁶

It should be taken into account that the introduction of the MAAL was an unilateral action of Australia, which goes directly against the OECD's warning that a unilateral action can lead to establishing oneself as an unattractive investment jurisdiction.³³⁷ The OECD wanted countries to engage in a coordinated approach to address BEPS.

Reading the provisions of the MAAL, in light of the need to establishing oneself as an attractive investment jurisdiction, makes one wonder if this may be the reason why the MAAL only targets 'significant global entities'. Hereby the MAAL allows smaller MNEs to enter the Australian investment jurisdiction, without the fear of being placed on the radar. Thus establishing itself as an investor-friendly jurisdiction for small or medium enterprises.

I also believe that the 'significant global entities'- requirement is the salvation of the MAAL. This requirement limits the scope and application of the MAAL, and hereby making it more feasible. 'Significant global entities,' due to their size and market value, will be easily identified and traced. They will also, most likely be listed entities, thus being obligated to make available certain financial information. This will relieve the Tax Authorities' onus of proof, making it easier to enforce the MAAL.

Some writers have expressed their opinions, that the MAAL was introduced to target specifically *“structures that are designed to avoid the existence of a permanent establishment.”*³³⁸ Hereby complying with the OECD's recommendations as set out in Action Plan 7.³³⁹

³³⁵ OECD/G20 Information brief (2015) p. 3.

³³⁶ Gary, D. (2015) p. 2

³³⁷ Davis Tax Committee Interim Report (2014) p. 27.

³³⁸ Deloitte (2015) p. 1.

³³⁹ *Ibid* n338.

There is some truth in the above statement. However, I am of the opinion that not only is the MAAL a measure implemented in terms of Action Plan 7, but also as a general anti-avoidance rule that ensures profits are taxed in the jurisdiction where economic value is added.

Therefore, the MAAL is a pre-emptive BEPS measure, implemented as a reaction to the entire OECD Action Plan on BEPS.

The question that now needs to be answered is whether or not South Africa should follow Australia's lead in implementing a Multinational Anti-Avoidance Law. This question will be answered in the following Chapter.

Chapter 5: Should South Africa follow Australia's lead?

The question that remains unanswered is whether or not South Africa should follow Australia's lead in implementing a Multinational Anti-Avoidance Law.

In order to answer this, I think it is necessary to firstly provide a short overview of all the chapters.

5.1 Summary of the previous Chapters

In Chapter One it was stated that despite the negative impact tax avoidance activities have on a government's revenue income, and despite the need to address it, courts have recognised that every person is allowed to arrange his financial affairs in such a way to pay the minimum taxes.

In the famous case of *IRC v Duke of Westminster* the Court held:

*“Every man is entitled, if he can, to order his affairs so that tax attaching under the appropriate Act is less than it would otherwise be. If he succeeds in ordering them so as to secure this result, then, however, unappreciative the Commissioners for Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”*³⁴⁰

The current trend of globalisation of economies has led to the increase in foreign direct investments (hereinafter referred to as FDI) and cross border transactions. Hand in hand with these developments comes an increased scope for international tax avoidance activities, on a national and international level.³⁴¹ An example of these international avoidance activities is BEPS.

³⁴⁰ *IRC v Duke of Westminster* (1936) AC 1, p. 19.

The Duke of Westminster- principle has been confirmed by the South African Courts: *CIR v Este Kohler* 1953 2 SA 584 (A) p. 591E-592H; *CIR v King* 1947 2 SA 196 (A) p. 212; *SIR v Hartzenberg* 1966 1 SA 405 (A) p. 408 F-G; *Western Bank Ltd v Registrar of Financial Institutions* 1975 4 SA 37 (T) p. 45A.

³⁴¹ Olivier, L. and Honiball, M. (2008) p. 384.

The OECD define BEPS activities as:

*“The use of legal arrangements that make profits disappear for tax purposes or allow profits to be artificially shifted to low or no-tax locations where the business has little or no economic activity.”*³⁴²

In Chapter Two BEPS activities were identified as an international dilemma, with the OECD estimating the annual global revenue losses, as a result of BEPS activities, to be between USD 100 billion and 240 billion.³⁴³

South Africa is also suffering from the drastic impacts of BEPS activities. Statistics indicate that corporate taxes in South Africa have declined from 7.3% of GDP in 2009 to 4.9% of GDP in 2013.³⁴⁴ This decline of corporate taxes is a major concern for the government, and absolute proof that BEPS activities exist in South Africa.³⁴⁵

In his 2015/2016 budget speech the South African Minister of Finance, Nhlanhla Nene, announced that South Africa has a budget deficit of 3.9 percent of GDP for the financial year.³⁴⁶ Some are of the opinion that the main reason for the budget deficit is the major tax gap³⁴⁷ South Africa is experiencing as a result of BEPS activities.³⁴⁸ If South Africa was able to minimise BEPS activities it would be more than enough to plug the budget deficit.³⁴⁹

This has raised the question as to what extent should the Duke of Westminster-principle be allowed and enforced? And, if a principle that is more than 80 years old, is still relevant in the 21st century?

Unfortunately, no one has ever attempted to disregard the well-known Duke of Westminster-principle. Most countries worldwide allows for and acknowledges legitimate tax planning.³⁵⁰

³⁴² OECD Policy Brief (2015) p.1.

³⁴³ OECD Policy Brief (2015) p.1.

³⁴⁴ National Treasury Budget (2013).

³⁴⁵ Davis Tax Committee Interim Report (2014) p. 20.

³⁴⁶ Available at <http://www.biznews.com/budget/2015/02/25/sa-widens-201516-budget-deficit-forecast-to-3-9/>, accessed 29 October 2015.

³⁴⁷ The United Kingdom’s Her Majesty’s Revenue and Customs (HMRC) defines a tax gap as the “*difference between tax collected and the tax that should be collected if all individuals and companies complied with the letter of the law and the spirit of the law as set out by parliament’s intention of enacting law*”.

³⁴⁸ Available at <http://mg.co.za/article/2014-11-20-clampdown-on-tax-avoidance>, accessed 9 November 2015.

³⁴⁹ *Ibid* n347.

³⁵⁰ Tax planning has been defined as “*The organising of a taxpayer’s affairs (or the structuring of transactions) so that they give rise to the minimum tax liability within the law without resort to the sort of impermissible tax avoidance.*”

Hence the fact that the Duke of Westminster-principle has never been, and probably never will be challenged.

As a result hereof the OECD, in collaboration with the G20 countries, have identified and recognised the need for multilateral efforts to improve and develop tax legislation, with the goal of harmonising it with the developments of the globalised world.³⁵¹ Also creating a system which ensures and compels MNEs to report their profits in the jurisdiction where its economic activities are carried out and economic value is created.³⁵²

In February 2013, the OECD issued a report, titled *Addressing Base Erosion and Profit Shifting* in which it identifies 15 action steps assisting governments in designing and creating their own pre-emptive BEPS measures, which will, when implemented in domestic legislation, help countries regulate, control and prevent BEPS activities.

However, the Davis Tax Committee warns against a unilateral effort from South Africa in amending its domestic legislation in light of global reforms.³⁵³ The Committee notes that such actions could establish South Africa as an investor unfriendly tax environment, and may place South Africa in the back seat when it comes to choosing investment jurisdictions.³⁵⁴

As South Africa is not a member to the OECD, the Davis Tax Committee strongly recommends South Africa to wait with any drastic legislative reforms to give effect to the OECD action plan, and rather make use of and improve measures that is already in place.³⁵⁵

One of the suggestions made by the Committee is to address BEPS by applying South Africa's General Anti-Avoidance Rules and the substance over form principles.³⁵⁶

In Chapter Three the South African GAAR was analysed as a pre-emptive BEPS measure. A GAAR gives Revenue Authorities the right and power to question transactions and financial arrangements and disregard their form, to deny the permitted tax benefit unless the taxpayer can establish the commercial essence and legitimacy of the transaction.³⁵⁷

³⁵¹ OECD/G20 Information brief (2015) p. 3.

³⁵² *Ibid* n350.

³⁵³ Davis Tax Committee Interim Report (2014) p. 27.

³⁵⁴ *Ibid* n352.

³⁵⁵ *Ibid* n352 at p. 29.

³⁵⁶ *Ibid* n352 at p. 37.

³⁵⁷ Garg, R. and Mukerjee, K. (2012) p. 1.

The Chapter consisted of doing a critical analysis of the provisions of the GAAR as set out in section 80A-80L of the Income Tax Act.³⁵⁸ This was done by taking into account the legislator's intention when the provisions were drafted, various court cases and authorities on the interpretation and meaning of certain words and SARS' interpretation notes.

From the discussions in Chapter Three it was identified that most of the requirements, listed in the GAAR provisions, are difficult to establish in an international transaction. It seems, as if the legislator, when imposing these requirements, did not keep in mind the feasibility thereof in an international environment. This is for example the requirements which place the onus of proof upon the Commissioner. This onus requires in depth knowledge of the taxpayer's international financial affairs and transactions as well as in depth knowledge into foreign tax laws.

South Africa, being a developing country, does not have the advanced technology or communication systems in order to obtain such information. Needless to say the appropriate skilled man power.

In light of this I came to the conclusion that the GAAR lacks requirements that allows it to be successfully applied in an international arena. Despite this shortfalls, there is, however, nothing stopping the Commissioner from using the GAAR as a pre-emptive BEPS measure especially as BEPS activities are regarded as impermissible tax avoidance activities. But, it may not be as feasible or effective as one may hope for in an international environment.

Therefore, I suggested that the legislator considers other alternative measures in order to regulate BEPS in South Africa.

Against this background the Australian Multinational Anti-Avoidance law (MAAL) was analysed in Chapter 4 in order to establish if South Africa should follow Australia's lead and implement a similar measure. The MAAL would be a General Anti-Avoidance rule focused and created specifically to target multinational transactions and arrangements across borders.

As the MAAL is relatively new legislation, and only implemented on the 3rd of December 2015, there is very few literature available on this subject. Therefore discussions merely included an academic and theoretical analysis of the provisions of the MAAL.

³⁵⁸ Act 58 of 1962.

The question that remains unanswered in Chapter Four, is whether or not South Africa should follow Australia's lead in implementing a Multinational Anti-Avoidance Law. This question will be answered in the following paragraph.

5.2 Should South Africa follow Australia's lead?

The South Africa GAAR was criticised on the same grounds as the Australian GAAR in the sense that the GAAR provisions are not able to adequately deal with the sophisticated tax avoidance activities that MNEs engage in on an international level.³⁵⁹

In Chapter Two a typical example of BEPS activities occurring in South Africa was given: Investors want to invest in countries that offer the best possible growth opportunities. This will typically be developing and least developing countries (LDCs), such as African countries, as resources and labour are cheap and freely available. However, investors are hesitant to invest in Africa due to the political, financial and economical instability and uncertainty the countries offer. In contrast to the rest of Africa, South Africa is known to have a sound and robust financial sector supported by water-proof business laws, and has, for a number of years, proved to be politically and economically stable (well at least more so than the rest of Africa).³⁶⁰ Furthermore, South Africa is a member to the Southern African Customs Union (SACU) and Southern African Development Community (SADC) which allows tariff-free trade between member countries.³⁶¹ This has resulted in South Africa to be a popular investment jurisdiction, and a gateway into Africa. Investors use South Africa to set up their businesses and companies (usually in the form of a subsidiary to a global group of companies) in a safe(r) environment, developing their products and conducting their economic activities within South Africa, using South African resources. Thus creating value here. They also make use of the advantage of tariff-free trade between member countries to further enhance their profits in other African Countries. However, once profits are made, all profits are moved back to South Africa and then extracted and moved to low or no-tax jurisdictions through the subsidiary set up in South Africa. This could be done by selling the products or services at a loss to the mother company or other subsidiaries of the mother company, or simply transferring the profits to them.

³⁵⁹ Section 80 A of Act 58 of 1962.

³⁶⁰ Marcus, G. (2011) p. 1.

³⁶¹ Mathis, J. (2005) p. 1.

South Africa merely serves as an instrument, where cheap labour and resources can be used to generate profits. Together with the advantage of being a member of SACU and SADC, South Africa is an extremely attractive investment jurisdiction. The problem is, after investors use South African resources to create value and to generate profits, the profits are channelled to low or no-tax jurisdictions. Thus, none of this value or profits are contributed back to South Africa, hereby, obtaining no advantage of the whole transaction.

For the South Africa GAAR to regulate such a transaction, it requires the Commissioner to have in-depth knowledge of the taxpayer's international financial affairs and transactions, the overall effect of the arrangement as well as in depth knowledge into foreign tax laws. The GAAR focuses specifically on targeting the arrangement. In a world where international trade and transactions has boomed, it is almost impossible for the Commissioner to have knowledge of all the transactions or arrangements that is occurring, needless to say investigating them.

In contrast thereto, the MAAL, does not focus on the arrangement. It targets the relationship between a foreign company (mother company), an Australian resident (the subsidiary), and the conducting of activities in Australia (creating value). The MAAL targets the link (between the subsidiary and the mother company) that serves as the instrument to channel profits to low tax jurisdictions.

South Africa does not currently have a general broad rule targeting international transactions between 'connected companies'. Implementing a MAAL will allow the South African Tax Commissioner to regulate the flow of funds between 'connected companies', especially after South Africa was used to generate those funds. The MAAL does not require the Commissioner to have in-depth knowledge into other foreign tax laws, neither does it require him to have knowledge of any other financial affairs of the foreign company.

The MAAL merely requires the Commissioner to identify a relationship between the foreign company (mother company), a South African resident company (the subsidiary) and if economic activities are conducted in South Africa.

Furthermore, the MAAL only requires that one of the purposes of the relationship had to be to obtain a tax benefit, despite any other benefits that might occur from this transaction. This

shift from the 'main or sole purpose' requirement, as set out in the GAAR, makes the MAAL much more feasible than the GAAR.

I do think that South Africa should consider implementing a similar measure into our tax laws. A MAAL will allow the Commissioner to regulate BEPS on an international level. However, certain aspects of the MAAL should, of course, be custom made to consider South Africa's unique circumstances.

Firstly, the requirement of being a 'significant global entity' needs to be re-evaluated in a South African context. Should a South African MAAL only target 'significant global entities', and if so, what should constitute to be a 'significant global entity'? I do think that it is necessary to create a requirement that allows the MAAL only to apply to certain types of entities, (larger entities). This will help balance the need to regulate BEPS, while still be recognised as an attractive investment jurisdiction. Especially for smaller investor companies. However, the South Africa legislator needs to determine how many, and if any large companies (with a significant annual turnover) have subsidiaries and are operating in South Africa. He needs to establish what companies are the major culprits of BEPS, and what their average annual turnover is. This will allow him to establish a 'significant global entity' – threshold. Furthermore, the threshold of establishing a 'significant global entity' must be determined in relation to the percentage tax gap South Africa needs to address, ensuring that the MAAL would contribute to plugging the South African national budget deficit.

Secondly, in order to establish a relationship between a foreign company (mother company), a South African resident (the subsidiary), and the conducting of activities in South Africa (creating value), the Tax Commissioner and Companies and Intellectual Property Commissioner (CIPC Commissioner) of South Africa should work in collaboration. In South Africa, a company can be registered by a click of a button. Therefore the process for registering a South African company should be amended to help the Tax Commissioner address BEPS. A requirement must be incorporated, requiring the person registering the company, to admit and identify if this new company is part of a global group of companies. Should this information not be made available, such actions must be criminalised. This will relieve the onus of the Tax Commissioner and will contribute to the success of a MAAL.

Thirdly, I agree with the requirement that one of the purposes of the transaction must be to obtain a tax benefit. As mentioned above, the shift from the ‘main or sole purpose’ requirement, as set out in the GAAR, is beneficial for the Commissioner. It broadens the scope of the MAAL, and allows the MAAL to apply even if a tax benefit is accidental to a transaction. This tax benefit should include any type of taxes and any type of benefit, being a reduction or postponement.

The legislator should learn from the shortcomings and impediments of the GAAR as it currently stands. As international trade and globalisation are developing at an extreme pace, the MAAL should not contain a requirement that binds the Commissioner to a specific time or custom. It should be drafted as a general broad rule that could be applied to any situation. Furthermore, it should, as far as possible, place any onus of proof on the foreign company. This will contribute to the success of the MAAL and relieving the Commissioner from any unrealistic duties.

5.3 Conclusion and Recommendations

In light of the discussions in this thesis, it is evident that BEPS activities are an international problem that needs to be addressed.³⁶² In South Africa, it is said that BEPS activities are the main reason for South Africa experiencing a tax gap, hence our national budget deficit.³⁶³ South Africa needs to implement measures that could effectively control and regulate BEPS activities in order to close the tax gap.

In this thesis, I conducted a critical analysis of the South African GAAR to determine if the GAAR could be used as a pre-emptive BEPS measure, as recommended by the Davis Tax Committee.

I came to the conclusion that the requirements, listed in the GAAR provisions, are difficult to establish in an international transaction. It seems, as if the legislator, when imposing these requirements, did not keep in mind the feasibility thereof in an international environment. It seems as if the GAAR was drafted in light of a specific time and specific customs. Thus removing from the fact that it should be used as a general broad rule.

³⁶² OECD Policy Brief (2015) p.1.

³⁶³ National Treasury Budget (2013).

The GAAR targets an arrangement, which requires the Commissioner to have in-depth knowledge of the taxpayer's international financial affairs and other foreign tax laws.

South Africa, being a developing country, do not have the advanced technology or communication systems in order to obtain such information. Needless to say the appropriate skilled man power. The GAAR was drafted to specifically target domestic avoidance activities.

Therefore, it is my conclusion that the Davis Tax Committee faulted in suggesting the use of the South Africa GAAR, as an effective pre-emptive BEPS measure.

Against this background the Australian Multinational Anti-Avoidance law (MAAL) was analysed in Chapter Four to establish if South Africa should follow Australia's lead and implement a similar measure.

I do believe that the MAAL is a measure that will effectively regulate BEPS. It is a clever measure drafted and created specifically to target international transactions, which allows it to be applied as a general broad rule.

I would recommend that the legislator and South African Revenue Services consider implementing a similar measure, as there is an urgent need to regulate BEPS in South Africa. Of course the provisions of the MAAL should be drafted, taking into consideration South Africa's unique history and circumstances.

Unfortunately, the Australian MAAL is relatively new, and no statistics are available indicating the practical effect thereof. However, based on my academic analysis of the provisions, I urge the South African legislator to implement a Multinational Anti-Avoidance Law in the South African tax laws in order to regulate BEPS.

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