THE EFFECTIVENESS OF THE GENERAL ANTI-AVOIDANCE PROVISIONS AND THE GLOBAL INITIATIVES CREATED TO PREVENT MULTINATIONALS AVOIDING TAX

by

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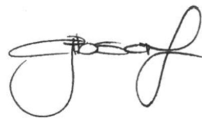
Signature of student: 

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LIST OF ACRONYMS AND ABBREVIATIONS

A	Appellate Division
AD	Appellate Division of the High Court
All ER	All England Law Reports
BEPS	Base Erosion and Profit Shifting
CIR	Commissioner for Inland Revenue (South Africa)
CIR	Commissioner for Inland Revenue (UK)
CPD	Cape Provincial Division
CSARS	Commissioner: South African Revenue Service
DTC	David Tax Committee
Finance Act	Finance Act 2013 (Chapter 29)
GAAR	General Anti-Avoidance Rule (South Africa)
GAAR	General Anti-Abuse Rule (UK)
G20 Countries	Group of Twenty Countries
HMRC	Her Majesty's Revenue and Customs
HL	House of Lords
Income Tax Act	Income Tax Act, 58 of 1962
OECD	Organisation for Economic Cooperation and Development
PwC	PricewaterhouseCoopers
SAAR	Specific Anti-Avoidance Rule
SARS	South African Revenue Service
SATC	South African Tax Court
SCA	Supreme Court of Appeal
TAAR	Targeted Anti-Avoidance Rule
TC	Tax cases (UK)
Treasury Committee	House of Commons Treasury Committee
TSAR	Tydskrif vir die Suid-Afrikaanse Reg (Journal of South African Law)
UK	United Kingdom
UKHL	United Kingdom House of Lords
VAT	Value-Added Tax
VAT Act	Value-Added Tax Act, 89 of 1991
1941 Act	Income Tax Act, 31 of 1941

LIST OF KEY TERMS

Key Terms	Meaning / Function
Action Plans	the BEPS Action Plans as developed by the OECD.
Arm's length principle	refers to the international standard that OECD member countries have agreed should be used when determining transfer prices for tax purposes.[1] Where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[2]
BEPS	refers to the tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.
DTC	refers to the committee that assesses the South African tax policy framework and aims to support the objectives of inclusive growth, employment, development and fiscal sustainability in South Africa.
Domestic law	means the law of a specific country.
Exchequer	refers to a department or office of state in medieval England charged with the collection and management of the royal revenue and judicial determination of all revenue causes.
Fiscus	one of three branches of the public treasury under the Roman Empire that was most under imperial control.[3]
GAAR	in terms of South African legislation, the GAAR refers to the General Anti-Avoidance Rule, whereas in terms of UK legislation, the GAAR refers to the General Anti-Abuse Rules implemented by a country in order to prevent tax avoidance.
G20 Countries	refers to the international forum made up of finance ministers and central bank governors of 19 countries, as well as the European Union. The G20 represents both developed and emerging economies and the role of the G20 is the co-ordination of policies on an international level, and to make globalisation a more harmonious and sustainable process. In addition, the G20 brings together the world's leading industrialised and emerging economies representing approximately 85 percent of the global Gross Domestic Product (GDP). The OECD is an active partner of the G20 and participates in G20 meetings both at a political level, as well as a technical level.
Multinational	refers to a corporation operating in several countries.
The OECD	refers to the unique forum where Governments of various countries work together, as well as with various countries who are not

1 OECD (2017). "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations".
2 Article 9 of the OECD Model Tax Convention.
3 Merriam Webster Online Dictionary. [Accessed on 2017-11-01].

	members of the OECD in order to promote economic growth, prosperity, and sustainable development. The OECD is an international organization that has 30 members and promotes policies that will improve the economic and social well-being of people around the world.
Residence based system of taxation	refers to a system of taxation where residents of South Africa and the UK are taxed on their worldwide income. Non-residents of South Africa and the UK are however only taxed on income received from a source either from within South Africa or the UK respectively.
SAAR	means, the Specific Anti-Avoidance Rules implemented by a country in order to assist with the prevention of tax avoidance.
TAAR	means, the Targeted Anti-Avoidance Rules implemented by the HMRC with the aim of targeting all tax avoidance schemes "generating contrived management expenses or in which a claim to management expenses is involved…".[4] The TAAR is further used as an agent to deter companies from entering into tax avoidance schemes.
Tax haven	refers to countries that create an incentive for Multinationals (or individuals) to transfer their income and profits from countries with a higher tax rate, to counties which have a lower tax rate, resulting in higher profits as a result of less taxes paid in the country in which the Multinational operates.
Tax inadequacies or mismatches	refers to the gaps or loopholes found in the law.
UK Treasury Committee	refers to the committee appointed by the House of Commons to examine expenditure, administration and policy of the HM Treasure, HMRC and associated public bodies.

4 HMRC Internal Manual: Company Taxation Manual. [Accessed on 2017-11-01].

SUMMARY

Tax structuring arrangements resulting in the shifting of profits by Multinationals has become increasingly relevant, with Multinationals such as Starbucks, Amazon, Google and MTN amongst others, coming under scrutiny by tax authorities. Multinationals are being challenged in respect of these tax avoidance strategies adopted in order to pay as little tax as possible.

In the UK for example, the accounts of Starbucks have shown that since 1998, Starbucks has obtained approximately £3 billion from its UK coffee sales, opened seven hundred and thirty-five outlets throughout the UK, but paid only £8.6 million in income taxes. Despite the measures undertaken by Multinationals to avoid paying taxes, or paying limited taxes, these Multinationals have maintained that they have not avoided tax as they have complied with the tax legislation in the countries in which they operate and transact.

The loss of revenue for the *fiscus* as a result of the Multinationals avoiding paying taxes in the countries in which they operate could have serious consequences, and it is the responsibility of the legislators to enact or amend legislation, or to create frameworks to prevent tax avoidance taking place.

This study research is aimed at the analysis of the general anti-avoidance provisions found in South Africa and in the UK in order to ascertain whether these provisions have been an effective deterrent against tax avoidance by Multinationals. In addition, this study will further provide an insight into the BEPS current global framework, which aims to equip governments with the domestic and international instruments required to tackle BEPS in an attempt to prevent Multinationals from shifting their profits to low or no tax jurisdictions. this study is whether the newly established GAAR provisions

TABLE OF CONTENTS

DECLARATION OF ORIGINALITY I
ACKNOWLEDGEMENTS II
LIST OF ACRONYMS AND ABBREVIATIONS III
LIST OF KEY TERMS IV
SUMMARY VI

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND 1
1.2 RATIONALE FOR THE STUDY 3
1.3 SCOPE AND LIMITATIONS OF THE STUDY 3
1.3.1 Scope 3
1.3.2 Limitations 5
1.4 RESEARCH METHODOLOGY AND DESIGN 5
1.4.1 Methodology 5
1.4.2 Design 5
1.4.3 Research question 6
1.5 STRUCTURE 6

CHAPTER 2: THE MEANING OF TAX AVOIDANCE

2.1 INTRODUCTION 8
2.2 THE DISTINGUISHING FACTORS BETWEEN TAX AVOIDANCE AND TAX EVASION 10
2.2.1 Tax Avoidance 11
2.2.2 Tax Evasion 13
2.3 CONCLUSION 14

CHAPTER 3: MULTINATIONALS AVOIDING TAX AND THE GLOBAL ANTI-AVOIDANCE INITIATIVE

3.1 INTRODUCTION 16
3.2 SOUTH AFRICAN MULTINATIONALS 17
3.2.1 Google alleged to have avoided paying South African taxes by taking advantage of the tax mismatches in domestic legislation 17

3.2.2 Lonmin alleged to have avoided paying South African taxes via the payment of sales commissions, management fees and 'non goods payments' 20
3.2.3 The MTN Tax Scandal 22
3.3 UK MULTINATIONALS 23
3.3.1 Starbucks avoids paying UK taxes by paying premiums to divisions in other jurisdictions 24
3.3.2 Google avoids paying UK taxes by claiming that it does not sell in the UK 26
3.3.3 Amazon alleged to avoid the payment of UK taxes by reporting sales to a low tax jurisdiction 28
3.4 THE ANTI-AVOIDANCE SOLUTION – THE GAAR AND BEPS 29
3.4.1 The BEPS Problem 29
3.4.2 The Action Plans 31
3.4.3 Implementation of the Action Plans 32
3.4.4 South Africa's implementation of BEPS: The DTC 33
3.4.5 The UK's implementation of BEPS: The Treasury Committee 34
3.5 CONCLUSION 36

CHAPTER 4: THE SOUTH AFRICAN GAAR

4.1 INTRODUCTION 37
4.2 HISTORICAL OVERVIEW OF THE GAAR IN SOUTH AFRICA 37
4.2.1 The 1941 Act – Section 90 38
4.2.2 The Income Tax Act - Section 103 40
4.2.3 Reasons for the failure of sections 90 and 103 44
4.3 INTRODUCTION OF THE CURRENT GAAR - SECTIONS 80A - 80L 46
4.3.1 The Scope of the GAAR Legal Framework 46
4.4 THE APPLICATION OF THE SOUTH AFRICAN GAAR TO THE TAX AVOIDANCE STRATEGIES ADOPTED BY GOOGLE, LONMIN AND MTN 53
4.4.1 Tax avoidance strategies adopted by the South African Multinationals 54
4.4.2 Application of the GAAR 54
4.5 CONCLUSION 57

CHAPTER 5: THE UK GAAR

5.1 INTRODUCTION 59
5.2 HISTORICAL OVERVIEW OF ANTI-AVOIDANCE PROVISIONS IN THE UK 60
5.2.1 Fundamental anti-avoidance case law in the UK 60

5.2.2 Specific Anti-Avoidance Rules and Targeted Anti-Avoidance Rules 64
5.3 THE IMPLEMENTATION OF THE GAAR IN THE UK (2013) 65
5.3.1 The Scope of the GAAR Legal Framework 66
5.4 THE APPLICATION OF THE UK GAAR TO TAX AVOIDANCE STRATEGIES ADOPTED BY STARBUCKS, GOOGLE AND AMAZON 69
5.4.1 Tax avoidance strategies adopted by UK Multinationals 69
5.4.2 Application of the GAAR 70
5.4.3 Comparison to the South African GAAR 73
5.5 CONCLUSION 74

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1 CONCLUSIONS 77
6.1.1 Tax Avoidance by Multinationals: A Global Concern 77
6.1.2 Permissible or impermissible tax avoidance? 78
6.1.3 Multinationals, tax avoidance strategies and the Action Plans 79
6.1.4 The South African GAAR 80
6.1.5 South African Multinationals avoiding tax. 82
6.1.6 The UK GAAR 82
6.1.7 UK Multinationals avoiding tax. 84
6.1.8 The anti-avoidance solution: BEPS and the GAAR 84
6.2 RECOMMENDATIONS 85
6.2.1 In favour of South Africa 85
6.2.2 In favour of the UK 86

BIBLIOGRAPHY 87

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND 1
1.2 RATIONALE FOR THE STUDY 3
1.3 SCOPE AND LIMITATIONS OF THE STUDY 3
1.4 RESEARCH METHODOLOGY AND DESIGN 5
1.5 STRUCTURE 6

1.1 BACKGROUND

Judge Schultz noted in the matter of *CIR v Sunnyside Centre (Pty) Ltd*:[1]

> "Companies are often used in a variety of ways to avoid taxes. When a scheme works, no tears are shed for the commissioner. That is because the taxpayer is entitled to order his affairs so as to pay the minimum of the tax. When he arranges them so as to attract more than the minimum he has to grin and bear it".

Over the last few years, strategic corporate structuring has resulted in Multinationals avoiding the payment of taxes in the countries in which they operate, and has become particularly topical and relevant. As a result of the increase in this type of behaviour, Multinationals such as Starbucks, MTN and Google to name a few, have been challenged by the *fiscus* in respect of the ways in which they are conducting their financial and business affairs in order to pay as little tax as possible.

In the UK, the accounts of Starbucks for example showed that since 1998 when Starbucks began trading in the UK, until 2012, Starbucks obtained approximately £3 billion from its UK coffee sales, opened seven hundred and thirty-five outlets throughout the UK, but paid only £8.6 million in income taxes.[2]

In response to the allegations made against Starbucks, an unnamed spokesperson from Starbucks stated that:

> "We seek to be good taxpayers and to pay our fair share of taxes ... We don't write

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1 (1997) 1 SA 68 A at 23.

2 Bergin (2012) "How Starbucks avoids UK taxes". Reuters Special Report. Bergin further noted that Starbucks reported no profits and had not paid any income tax in 2009, 2010 and 2011.

this tax code; we are obligated to comply with it. And we do".[3]

Notwithstanding the strategies adopted by Multinationals to avoid paying taxes, or paying limited amounts of taxes, Multinationals have maintained that they have remained within the confines of the law and not evaded tax as they have complied with the tax rules in the countries in which they operate.[4] Due to the complexity of countries domestic tax legislation when entering into cross border transactions, and the lack of a uniform set of global tax legislation, this allows for the identification of tax mismatches in legislation which are used by Multinationals to their advantage in order to reduce their corporate tax liabilities.

Notwithstanding Starbucks alleging that it conducted its affairs within the letter of the law, the tax avoidance allegations made against Starbucks caused a social uproar resulting in UK citizens boycotting Starbucks.[5] UK citizens were of the view that why should they be compelled to pay taxes to the UK Government, when the likes of Starbucks, a multi-billion dollar Multinational gets away with not paying taxes in the UK, or extremely low taxes in comparison to the profits made. For this reason, UK citizens made the decision not to support Starbucks when the allegations of tax avoidance became public knowledge.

Multinationals who are able to prove that they have not evaded tax, but simply structured their financial and business affairs in the most economical manner within the confines of the law, may escape liability despite their financial and business affairs having economic implications for the countries in which the Multinational operates due to a loss of revenue income. This aspect was emphasised in the case of *IRC v Duke of Westminster* ("*Duke of Westminster"*), wherein Lord Tomlin stated that "every man is entitled if he can to order his affairs so that the tax attaching under the appropriate act is less than it otherwise would have been".[6]

In addition to the loss of revenue income for the country in which the Multinational operates, the social impact or reputational damage for the Multinational resulting from tax avoidance can be catastrophic and can outweigh the financial gains derived from the tax avoidance strategies adopted. According to the Neville and Malik, the YouGov BrandIndex[7] indicated that Starbucks

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[3] Bergin (2012) "How Starbucks avoids UK taxes". Reuters Special Report. In addition to the aforementioned, the Chief Financial Officer of Starbucks, Alstead, quoted in the transcripts of calls which Reuters reviewed, that Starbucks "strictly follows international accounting rules and pays the appropriate level of tax in the countries where they operate".

[4] A discussion regarding the tax avoidance strategies adopted by certain Multinationals operating in South Africa and the UK is mentioned in Chapter 3 below.

[5] Campbell (2012). "Starbucks facing boycott over tax: Protest groups threaten to try close branches over revelations it hasn't paid for three years".

[6] 1936 AC 1; 19 TC 490. South African Courts have also expressed this view, as in *CIR v Estate Kohler and others* 1953 (2) SA 584 (A) at 591F – 592H.

[7] YouGov BrandIndex is an authoritative measure of brand perception which measures public perception of thousands of brands and operates at a national and international level and therefore allows the tracking of various brands, as well as brand comparisons across multiple countries. [Accessed on 2017-11-01].

dropped to a record low score of -28.6 following the release of the Reuters Special Report, which in comparison to its score of +3.21 in 2011, is significantly less.[8] It is therefore evident that the accusations caused significant reputational damage for Starbucks at that time and Starbucks therefore made the decision in December 2012 to pay higher tax payments in the UK going forward.[9]

With regards to the loss of revenue for the *fiscus* due to Multinationals avoiding the payment of taxes in the countries in which they operate, it is for the Governments in consultation with the legislators in the countries concerned to enact or amend legislation, or to create frameworks to prevent tax avoidance from taking place. Furthermore, it is the aim of the Governments and legislators to protect the economic interests of the countries in which the legislation has been enacted.

There are instances where legislation will not be sufficient to prevent tax avoidance due to the fact that there are countries which exist who wish to attract foreign investment within their borders, and therefore offer lower tax rates to foreigners. These countries are known as tax haven countries.[10] When a Multinational shifts its profits to a tax haven country, the profits made by the Multinational increase as a direct result of a reduced tax liability. The effect of this is that there is an increase in off-shore investment in the tax haven country, and a loss of investment income in the country in which the Multinational operates.

1.2 RATIONALE FOR THE STUDY

The avoidance of tax creates the need for the enactment or amendment of a countries domestic legislation in order to prevent recurrent tax avoidance from taking place. The enactment or amendment of a countries domestic legislation however causes Multinationals to explore further means to avoid paying taxes, or ways in which to reduce the amount of taxes paid. For this very reason, tax avoidance is an on-going issue for Governments and legislators today.

1.3 SCOPE AND LIMITATIONS OF THE STUDY

1.3.1 Scope

Tax Avoidance Strategies

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8 Neville and Malik (2012) "Starbucks wakes up and smells the stench of tax avoidance and controversy". The Guardian.
9 Houlder, Jopson, Lucas and Pickard (2012). "Starbucks pays up to avoid boycott". Financial Times.
10 Tax haven, as described in the list of key terms on page v above.

This study will consider the tax avoidance strategies adopted by selected Multinationals in South Africa and the UK who have been accused of avoiding the payment of taxes in the countries in which they operate, despite large profits being realised. The following factors were considered when deciding which Multinationals, as well as which countries' GAAR should form part of this study:

- the size and popularity of the Multinationals chosen;
- the significant value of profits made by these Multinationals, as well as the significant value of profits which these Multinationals were allegedly said to have not paid tax in respect thereof;
- the history of the GAAR. South Africa found it necessary to have a GAAR as early as 1941, whereas the UK only introduced its first GAAR in 2013; and
- the fact that both South Africa and the UK follow a residence based system of taxation.[11]

In terms of Multinationals operating in South Africa and the UK, Chapter 3 provides an insight in respect of the tax avoidance strategies adopted by Google, Lonmin PLC ("Lonmin") and MTN (hereinafter referred to as the "South African Multinationals") operating in South Africa, as well as Starbucks, Google and Amazon (hereinafter referred to as the "UK Multinationals") operating in the UK.

The Anti-Avoidance Global Initiative

One of the strategies adopted by Multinationals enabling the avoidance of tax, is by artificially shifting profits made in the country of operation to low or no tax jurisdictions, where there is little or no activity, thus eroding the Multinational's tax base. This concept is known as base erosion and profit shifting ("BEPS")[12] and will be discussed in Chapter 3 below.

This study will further include a discussion of one of the most influential anti-avoidance global initiatives, the implementation of the BEPS Action Plans,[13] which was developed by the OECD[14] and the G20 countries.

The South African and the UK GAAR

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11 Residence based system of taxation as described in the list of key terms on page v above.
12 The OECD Better Policies for Better Lives Database "About BEPS and the inclusive framework". [Accessed on 2016-07-10].
13 Action Plans, as described in the list of key terms on page iv above.
14 On 16 May 2007, the OECD Council adopted a resolution to strengthen co-operation with South Africa and various other countries such as Brazil, China, India and Indonesia. In the aforementioned resolution, the OECD Council invited the Secretary General to strengthen OECD co-operation with South Africa through enhanced engagement programs with the view of possible membership.

In addition, this study will include an historical analysis of the implementation of the GAAR in South Africa and the UK, as well as various anti-avoidance doctrines followed in the UK before the implementation of its first GAAR in 2013. Lastly, the anti-avoidance strategies adopted by the South African Multinationals and the UK Multinationals will be discussed taking into account the provisions of the GAAR in an attempt to ascertain whether the GAAR could potentially act as a deterrent against tax-avoidance should the GAAR be considered by the courts in the future.

1.3.2 Limitations

The current GAAR legal framework in both South Africa and the UK, has not been tested in courts as yet, and therefore this study is limited to the tax avoidance strategies adopted by Multinationals, taking into consideration the implementation of the Action Plans and a hypothetical scenario of the application of the GAAR in order to curb tax avoidance on a global basis. Although this study refers to historical case law regarding individuals and the reasons why the GAAR has failed over the years, the focus of this study is the anti-avoidance strategies adopted by Multinationals operating within South Africa and the UK. The reason for the inclusion of references to individuals in this study is due to the fact that the case law which tested the anti-avoidance provisions throughout the years focused predominantly on individuals, which ultimately has led to the current GAAR legal framework applicable today.

Furthermore, although South African and UK legislation contains additional anti-avoidance legislation such as the SAAR's and the TAAR's, this study will focus on the GAARs, and limited weight will be placed on the SAARs or the TAARs.

1.4 RESEARCH METHODOLOGY AND DESIGN

1.4.1 Methodology

The methodology adopted for this research involved a comparative analysis, which makes use of the critical theory strategy, where an analysis of anti-avoidance legislation, case law and literature in South Africa and the UK is considered. In addition, this research adopts a critical approach when analysing various theories pertaining to anti-avoidance measures.

1.4.2 Design

The design of the research is as follows:

1.4.2.1 the style of thinking in respect of this research is pragmatic;

1.4.2.2 the nature of the research is exploratory;
1.4.2.3 the type of reasoning for the research is deductive;
1.4.2.4 the time horizon is longitudinal;
1.4.2.5 the unit of analysis is Multinationals; and
1.4.2.6 the sources of data used in this research is secondary quantitative data.

1.4.3 Research question

Are the GAARs in South Africa and the UK, as well as the global anti-avoidance initiatives implemented to address the on-going issue of tax avoidance by Multinationals sufficient, in order to effectively prevent tax avoidance by Multinationals?

1.5 STRUCTURE

This study comprises of the following Chapters:

1.5.1 Chapter 1 provides an introduction to the study and the rationale behind the study.

1.5.2 Chapter 2 contains an analysis of the important concepts of tax avoidance and tax evasion.

1.5.3 Chapter 3 identifies the tax avoidance strategies adopted by the South African Multinationals and the UK Multinationals, as well as introduces the implementation of the OECD's BEPS legal framework and its application in South Africa and the UK.

1.5.4 Chapter 4 contains a historical overview of the GAAR in South Africa, and considers whether the GAAR is an effective measure to prevent Multinationals avoiding the payment of tax by making use of the tax avoidance strategies identified in Chapter 3.

1.5.5 Chapter 5 contains a historical overview of the anti-avoidance doctrines used in the UK and the incorporation of the first GAAR into UK legislation in 2013. In addition, Chapter 5 considers whether the GAAR is an effective measure to prevent Multinationals avoiding the payment of tax by making use of the tax avoidance strategies identified in Chapter 3.

1.5.6 Chapter 6 brings the study to conclusion by summarising the findings and

conclusions from the previous 5 Chapters, explains the contribution and limitations of the present study, and makes recommendations in respect of the GAAR in South Africa and the UK.

CHAPTER 2: THE MEANING OF TAX AVOIDANCE

2.1	INTRODUCTION	8
2.2	THE DISTINGUISHING FACTORS BETWEEN TAX AVOIDANCE AND TAX EVASION	10
2.3	CONCLUSION	14

2.1 INTRODUCTION

The structuring of a taxpayer's affairs and the debate surrounding what constitutes tax avoidance, has continued for more than two centuries. Krishna indicated that "[g]overnments of the G20 countries, desperate for tax revenues to support their spending addictions, are at war with taxpayers seeking to maximise returns on their earnings and investments", and that this tug of war is not a new war.[1]

He indicated further that the first income tax was introduced by Pitt, Britain's youngest Prime Minister in 1799, and noted that the introduction of income tax "was necessary to repress those evasions [of excise duty] so disgraceful to the country, so injurious to those who honourably discharge their equal contribution, and above all, so detrimental to the great advantage which it is intended to promote".[2]

In addition to the historical introduction of income tax, Krishna made mention of the BEPS Project Report which he indicated picks up where Pitt left off. In this Report, it was identified that there was a growing perception in terms of the loss of tax revenue for Governments due to the fact that international tax planning was designed to shift profits in ways that erode the tax base, to countries with a more favourable tax treatment.[3] It is therefore evident that the debate regarding tax avoidance has been a longstanding debate which still finds relevance today.

The last two centuries have seen courts handing down judgments where the House of Lords and/or Judges, have been required to interpret the concept of tax avoidance taking into account the specific facts of each case, as well as the interpretation of what falls within the ambit of lawful tax planning, and what does not. A popular dictum regarding the structuring of a taxpayer's affairs is that which Lord Tomlin made in 1936 in the prevalent case of the *Duke of*

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[1] Krishna (2013). "Tax avoidance debate reaches back two centuries". Financial Post. Krishna noted that tax avoidance has been debated by politicians for more than two centuries.

[2] *Ibid.*

[3] The OECD (2013). "Meeting of the OECD Council at Ministerial Level". Paris 29-30 May.

Westminster where he stated that:[4]

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax". [Emphasis added]

The qualification "if he can" is a significant element which depends on the circumstances of each case. In some instances, a taxpayer may attempt to remain outside a certain statutory provision of legislation, and in others he may wish to bring himself within the ambit of a statutory provision with the aim of obtaining a tax benefit, for example, a tax deduction. Should a taxpayer's intention be to remain outside a statutory provision, it may become possible that he unsuccessfully brings himself within that statutory provision, resulting in a tax liability.[5]

Partington v Attorney General ("*Partington*")[6] is often cited to demonstrate the traditional view of the House of Lords with regards to the interpretation of statutes. After consideration of the facts in *Partington*, Lord Cairns upheld the Revenue's right to claim probate duty twice and stated that:[7]

> "If a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the

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4 1936 AC 1; 19 TC 490 at 520. South African Courts have also applied this well-known legal principle, such as in *CIR v Estate Kohler and others* 1953 (2) SA 584 (A) at 592F – 592H, wherein Centlivres CJ in his minority judgment stated that the device which was adopted in this case was specifically intended to as to escape taxation". Centlivres CJ further noted that forcible language was used by Lord Tomlin in the *Duke of Westminster* matter where he stated that when there is a matter dealing with revenue, the courts are permitted to ignore the legal position and take into consideration the substance of the matter instead. Lord Tomlin indicated that the supposed doctrine (upon which the Commissioners apparently acted), "seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable". In addition to Lord Tomlin, in *Duke of Westminster*, Lord Russel stated that the taxpayer is only required to be taxed by the plain words of a statute applicable to the facts and circumstances of the case and not by inference of analogy.

5 De Koker and Williams. (2017). "SILKE on South African Income Tax" at 19 – 7. Reference is made to the matter of *IRC v Burmah Oil Co Ltd* 1982 STC 30, wherein the taxpayer sought to transform a bad debt which was not subject to an allowable loss, into share capital which could be permitted as an allowable loss. In this regard, the taxpayer made a series of book entries backed by a circular series of payments. Lord Diplock indicated that the much quoted dictum by Lord Tomlin "tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straightforward way". In addition, Macdonald and JP expressed disproval of tax avoidance in *COT v Ferera* 1976 (2) SA 653, 38 SATC 66 wherein they stated that they "endorse the opinion expressed that the avoidance or tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making proper contribution to the *fiscus,* but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain advice and set up the necessary tax avoidance machinery, fail to do so".

6 1869 LR 4 HL 100. The judgment in respect of *Partington* was decided on 11 June 1869 by the House of Lords, on appeal from the decision handed down by the Exchequer Chamber. The facts in *Partington* were that two taxpayers died intestate, and the second taxpayer to pass away was the next of kin of the first taxpayer. The Revenue in this case sought to recover probate duty twice. According to the Merriam Webster online dictionary, probate duty has been defined to mean a British tax on the gross value of the personal estate of a deceased testator introduced in 1694 and merged in the estate duty in 1894.

7 *Ibid* at 370.

> letter of the law, the subject is free, however apparently within the law the case might otherwise appear to be. In other words, if there be an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute".

It follows from Lord Cairns interpretation, that regardless of the extent of the adversity to the taxpayer, if a tax is levied and the taxpayer falls within the specific requirements in terms of the legislation wherein he is required to pay tax, the taxpayer is obliged to obey the law and pay the necessary taxes due regardless of any "hardship" which may arise.

Due to the fact that concepts such impermissible tax avoidance (usually referred to as tax avoidance), and permissible tax avoidance (usually referred to as lawful tax planning) are often open to interpretation, in consideration of the rationale for this study, it is necessary to understand the fundamental meanings of these concepts. In addition, the concept of tax evasion is significant as the distinction between tax avoidance and tax evasion is also subject to the opinion of taxpayers, legal advisors, the Commissioner, Judges, House of Lords as well as academic writers, and therefore can often become confused. Kujinga describes tax avoidance as "the concept that polarises opinions between many taxpayers (and those that are conscious of taxpayer's rights) on the one hand, and the revenue authorities (and those who believe that the tax avoiders act immorally) on the other".[8]

There is however an established and fundamental distinction between tax avoidance and tax evasion, and therefore the purpose of this Chapter is to analyse each concept and understand this fundamental distinction.

2.2 THE DISTINGUISHING FACTORS BETWEEN TAX AVOIDANCE AND TAX EVASION

"The distinction between tax avoidance and tax evasion is clear in theory at least: the former is legal and the latter is illegal".[9] The courts are tasked with the duty to determine whether a transaction is legal or illegal and not the taxpayer or even SARS. Therefore each case is decided on its own merits taking into account the specific actions of the taxpayer and the relevant legislation at the time that the taxpayer entered into the transaction in respect of which the dispute arose.[10]

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8 Kujinga (2013). "A comparative analysis of the efficiency of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa*"* at 10.
9 Olivier and Honibal (2011). "International Tax a South African Perspective" at 509.
10 *Ibid.*

In November 2005, SARS published a Discussion Paper about tax avoidance and section 103 of the Income Tax Act (the "2005 Discussion Paper"), which contained the Income Tax Act's draft GAAR provisions.[11] It was noted by SARS in the 2005 Discussion Paper, that any discussions regarding tax avoidance were said to begin with an attempt to define and distinguish the following three concepts:

- Tax evasion;
- Impermissible tax avoidance; and
- Legitimate tax planning (permissible tax avoidance).[12]

Whilst on the one hand, it has been shown that there is general agreement in respect of what constitutes tax evasion, the difference between permissible tax avoidance and impermissible tax avoidance, on the other hand, has proved to be more contentious.[13] SARS further indicated that whilst the exact distinguishing characteristics may not be possible in respect of the aforementioned three concepts, these concepts do assist in identifying the types of behaviours, such as lawful tax planning on the one hand and unlawful tax evasion on the other.[14]

In *CSARS v NWK Ltd,* Lewis JA also made reference to the distinguishing factors of tax avoidance and tax evasion whereas he was in agreement with Lord Tomlin regarding his statement that that there is nothing wrong with arrangements that are tax effective, however there is something wrong with "dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law".[15]

2.2.1 Tax Avoidance

SARS noted in the 2005 SARS Discussion Paper that the definitions of "tax evasion", "impermissible tax avoidance" and "legitimate tax planning" had been obtained from numerous sources, one of which includes publications made by the OECD.[16] With regards to the concept

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[11] GAAR, as described in the list of key terms on page iv above.

[12] 2005 Discussion Paper at 2.

[13] In the matter of *Macniven v Westmoreland Investments Limited* (2001) UKHL6; (2001) 1 All ER 865 at 257, Lord Hoffman indicated that the question whether steps taken by a tax payer are acceptable or unacceptable is the conclusion that is arrived upon by applying the statutory provisions to the facts of the case, however were the statutory provisions do not contain words like avoidance or mitigation, Lord Hoffman indicated further that it is not helpful to introduce such words.

[14] 2005 Discussion Paper at 2.

[15] 2011 (2) SA 67 (SCA) at 77. At paragraph 42, Lewis JA made reference to the case of *Ladysmith (Pty) Ltd and Another v CIR* 1996 (3) SA 942 (A), wherein Hefer JA emphasised the importance between distinguishing between the principle of arranging one's affairs in order to remain outside the provisions of a particular statute and the principle that the courts will not be misled by the form of the transaction. This matter was particularly concerned with the possible simulation of a transaction and the test for simulation taking cognisance of the commercial sense of the transaction taking into consideration its real substance and purpose. In the event that the purpose of a transaction is only to achieve an object that allows for tax evasion of a peremptory law, then the transaction will be regarded as simulated.

[16] 2005 Discussion Paper at 2.

of tax avoidance, the OECD defines “avoidance” as the arrangement of a taxpayer's affairs intended to reduce the taxpayer’s tax liability, and although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law (impermissible tax avoidance).[17] In addition, the OECD further defines “tax planning” as an arrangement of a person's business and/or private affairs in order to minimize tax liability (permissible tax avoidance).[18]

Van Zyl indicated that tax avoidance “usually denotes a situation in which the taxpayer has arranged his affairs in a perfectly legal manner, with the result that he has reduced his income or has no income on which tax is payable”.[19] She further indicated that a taxpayer cannot be stopped from entering into a *bona fide* transaction which results in a taxpayer paying a reduced amount of tax, or alternatively avoiding tax altogether. However, the proviso to this is that there is no provision in the law which is designed to prevent the reduction or avoidance of tax. Once again the words of Lord Tomlin were referenced by Van Zyl to emphasise this principle in respect of a taxpayer’s right to order his affairs in a way in order to pay the least amount of tax necessary.

Brown described tax avoidance in terms of a transaction entered into specifically in order to obtain a tax benefit, such as a tax deduction for example. She further noted that this reduction is one which is unintended by law and is in fact an unacceptable manipulation of the law which is unlike tax mitigation.[20] The definition of “tax avoidance” in the Oxford Dictionary confirms both the interpretation of Van Zyl and Brown and defines tax avoidance as “the arrangement of one’s financial affairs to minimize tax liability within the law”.[21]

In addition to Van Zyl and Brown, authors have described tax avoidance to mean the minimization of tax which may be lawful or unlawful depending on whether it is conducted in accordance with income tax legislation. Whereas, tax evasion has been described as the commission or omission of an act knowingly with the intent to deceive, resulting in the amount of tax paid by the taxpayer to be less than what is payable under the law.[22]

De Koker and Williams have described tax avoidance to connote stratagems which are *prima facie* lawful, unless prohibited by the Income Tax Act, and by contrast, tax evasion connotes inherently unlawful methods.[23]

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17 The OECD Glossary of Tax Terms. [Accessed on 2017-05-15].
18 *Ibid.*
19 Van Zyl (2016). “Silke. South African Income Tax” at 811.
20 Brown (2012). “A Comparative look at regulation of corporate tax avoidance” at 1.
21 According to Oxford’s Online Dictionary. [Accessed on 2017-06-03].
22 Krishna (1990). “Tax Avoidance: The General Anti-Avoidance Rule”.
23 De Koker and Williams (2017). “SILKE on South African Income Tax” at 19 - 3.

It is therefore evident from the above, that tax avoidance is commonly identified as an arrangement of a taxpayer's affairs in order to legally reduce his tax liability or obtain a deduction. An important aspect when considering tax avoidance and the distinction between permissible and impermissible tax avoidance is whether the arrangement entered into by the taxpayer is conducted in accordance with income tax legislation. The intention of the taxpayer is similarly important due to the fact that if the taxpayer knowingly had the intention to deceive the *fiscus*, the taxpayer's actions would no longer be regarded as being in accordance with income tax legislation and therefore no longer fall within the permissible tax avoidance category, and would constitute impermissible tax avoidance, and ultimately could result in tax evasion.

Therefore, it follows that when assessing whether a particular transaction or arrangement constitutes tax avoidance, it is important to firstly ascertain whether the transaction or arrangement was undertaken in accordance with the domestic legislation of the country where the transaction/s took place, as well as the intention of the parties involved in the transaction/s or arrangement. The subjective intention of a taxpayer can create uncertainty and interpretational difficulties when trying to establish whether a taxpayer has legally avoided the payment of tax, or unlawfully evaded the payment of tax.

2.2.2 Tax Evasion

With regards to the concept of tax evasion, the OECD defines "tax evasion" as a term that is difficult to describe but which is generally used to mean illegal arrangements where liability to tax is hidden or ignored.[24]

Van Zyl indicated that tax evasion "refers to illegal activities deliberately undertaken by the taxpayer to free himself from a tax burden".[25] In addition, tax evasion has been defined in the Oxford Dictionary as "the illegal non-payment or underpayment of tax".[26]

Tax evasion has also been described as the "wilful and conscious non-compliance with domestic tax laws, in other words, tax evasion is an action by a taxpayer to escape legal obligations by fraudulent or illegal means".[27] There are numerous ways in which taxpayers can evade tax, such as, failing to report income or reporting fabricating deductions, sophisticated tax structures or providing false information to the relevant tax authorities. It has become apparent from case law that persons or companies have sought to evade paying the correct

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[24] The OECD Glossary of Tax Terms. [Accessed on 2017-05-15]. For example, a taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities.
[25] Van Zyl (2016). "SILKE. South African Income Tax". at 811.
[26] According to Oxford's Online Dictionary. [Accessed on 2017-06-03].
[27] Olivier and Honibal (2011) "International Tax a South African Perspective" at 509.

amount of taxes due by not disclosing certain income which they have received, or exaggerating expenses in order to claim deductions which are in fact not applicable.

As noted above in paragraph 2.2 above, Olivier and Honibal described tax avoidance as legal and tax evasion as illegal.[28] Therefore, the fundamental distinction noted when identifying whether a taxpayer has avoided paying tax (whether permissible or impermissible in nature), or whether a taxpayer has evaded tax, is the concept of legality taking into account the taxpayer's intention at the time.

2.3 CONCLUSION

The significance for Multinationals understanding the concepts of tax avoidance and evasion has also become considerable over the years. Not only are tax authorities focused on the tax affairs of private individuals, tax authorities globally have awakened to the fact that Multinationals are taking advantage of tax mismatches between domestic legislation in the countries in which they operate and in which they transact, as well as making use of tax avoidance strategies via cross border transactions or arrangements in order to erode their tax base.

Differences of opinion exist between taxpayers, legal advisors, the Commissioner, Judges, House of Lords, as well as academic writers regarding the interpretation of what constitutes tax avoidance and the difference between tax evasion. A common factor decided upon time and time again by the courts over the years is that each matter must be decided taking into account its own unique facts and merits. Regardless of these differences of opinion and as evident from the above, the fundamental difference between the two concepts appears to be the issue of legality taking into account the taxpayer's intention at the time of the transaction. Tax avoidance is said to be legal, whereas tax evasion is said to be illegal.

Taking into consideration the various definitions and opinions, it is recognised that tax avoidance is a means of which a taxpayer structures its tax affairs in order to pay as little tax as possible, however by still remaining within the confines of the relevant tax legislation in the country in which they are operating or transacting. The fundamental principle is that the avoidance of tax must be conducted in accordance with tax legislation whereas with regards to tax evasion, the taxpayer is said to enter into certain transactions or structure its affairs deliberately to reduce its tax liability with the intent to deceive the *fiscus.* This type of structure is normally considered to be an illegal arrangement where the taxpayer intentionally does not comply with the relevant

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28 *Ibid.*

tax legislation in the country in which they are operating or transacting.

CHAPTER 3: MULTINATIONALS AVOIDING TAX AND THE GLOBAL ANTI-AVOIDANCE INITIATIVE

3.1	INTRODUCTION	16
3.2	SOUTH AFRICAN MULTINATIONALS	17
3.3	UK MULTINATIONALS	23
3.4	THE ANTI-AVOIDANCE SOLUTION – THE GAAR AND BEPS	29
3.5	CONCLUSION	36

3.1 INTRODUCTION

This Chapter provides an insight in respect of the tax avoidance strategies adopted by the South African Multinationals operating within South Africa, as well as the UK Multinationals operating within the UK. These Multinationals have been accused of avoiding the payment of tax, or paying significantly reduced amounts of tax although large profits have been realised.

Following the allegations and focus on the tax avoidance strategies by Multinationals, the OECD released a report in 2013 titled "Addressing Base Erosion and Profit Shifting" (the "2013 BEPS Report"), which highlighted the fact that BEPS constitutes a "serious risk to tax revenues, tax sovereignty and tax fairness" for OECD member and non-member countries.[1] Although South Africa is not a member of the OECD, the OECD still works with South Africa in addition to its member countries, and was awarded OECD observer status in 2004. In 2007, the OECD Council adopted a resolution that led to South Africa becoming one of the five key partners to the OECD.[2]

The 2013 BEPS Report noted the importance of developing comprehensive Action Plans to address BEPS, which would provide countries with domestic and international instruments to allow for the alignment of rights to tax where the real economic activity of the operation takes place.

This Chapter further includes a discussion regarding the steps taken by South African and UK committees, such as the DTC and the Treasury Committees,[3] who have contributed and

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1 OECD (2013). "Addressing Base Erosion and Profit Shifting" at 5. The 2013 BEPS Report was requested by the G20 countries who welcomed the work which the OECD is undertaking in respect of BEPS.

2 Information on the five key partners is available on the OECD website. [Accessed on 2017-10-30]. The function of the key partners is to contribute to the OECD's work in a "sustained and comprehensive manner". Each of the five key partners participate in the OECD in respect of "Partnerships in the OECD", "Adherence to the OECD instruments" and "Integration into the OECD statistical reporting and information systems".

3 The Treasury Committee is appointed by the House of Commons to examine expenditure, administration and policy of the HM Treasure, HMRC, and associated public bodies. Available from http://bit.ly/2k58z0j. [Accessed on 2017-09-20].

commenced with the implementation of the Action Plans to assist with limiting Multinationals operating within their borders from shifting their profits to low or no income tax jurisdictions as an attempt to avoid the payment of tax.

3.2 SOUTH AFRICAN MULTINATIONALS

Notwithstanding anti-avoidance legislation available in South Africa, tax avoidance is still a prevalent and on-going issue, especially amongst Multinationals. Various online news websites such as Fin24, Mail and Guardian and Reuters have published articles in respect of Multinationals operating in South Africa, as well as other South African companies avoiding the payment of taxes although large profits being realised in South Africa.[4]

During May 2012, the then Commissioner of SARS, Magashula, advised Parliament's Finance Committee that they have detected an increase in the use of cross-border structuring and Transfer Pricing manipulations by businesses who unfairly and illegally reduce their local tax liabilities.[5] Five years later, the former Minister of Finance, Gordhan, made reference in his 2017 Budget Speech that tax avoidance by Multinationals is still an issue which is required to be combatted.[6]

3.2.1 Google alleged to have avoided paying South African taxes by taking advantage of the tax mismatches in domestic legislation

In 2014, Smith published an article on Fin24 wherein she indicated that whilst local digital publishers in South Africa are required to pay tax to SARS on their profits made, Google has avoided paying taxes in South Africa as a result of transacting through an off-shore entity in Ireland. Smith further indicated that Google's estimated revenue is between R800 million and R1 billion, and therefore a loss of taxable revenue in corporate taxes for SARS of approximately R140 million per annum. Google's representatives responded to the tax avoidance allegations made against it insisting that the Multinational had not done anything unlawful and simply made

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4 Examples of these online articles which will be considered for purposes of this Chapter include: "Google 'avoids SA taxes'" (Fin24), "Large companies avoiding tax in South Africa" (Reuters) and "MTN threatens to pull out of South Africa". (Business Tech).

5 Roelf (2012). "Large companies avoiding tax in South Africa". Reuters. In addition, Roelf indicated that South Africa has accused large Multinationals of making use of "complex transactions to illegally reduce local tax payments, costing Africa's largest economy billions of rand", and that SARS raised more than R5 billion through audits and additional assessments in respect of large corporations. The costs involved in order to raise the R5 billion was however not quantified.

6 Gordhan (2017). South African Budget Speech. "Multinational corporations continue to use inconsistencies in global tax rules to their advantage and to avoid tax liabilities. South Africa intends to sign a multilateral instrument this year which will assist in the updating of treaties and will reduce the scope for aggressive tax avoidance activities…" Gordhan reiterated that the automatic exchange of information between tax authorities came into operation in September this year whereas Multinational will be required to file further information with SARS on cross-border activities from the end of the year. Gordhan further indicated that "we will continue to work actively with the international tax community and within Government to modernise customs administration and combat cross-border revenue leakages, money laundering and harmful tax practices".

use of tax mismatches found in the domestic legislation of the different countries which did not take the internet into account at the time.[7]

In addition to Smith, the then Chief Executive Officer of Fin24, Cohen, stated that it is accepted in this digital age that there will be global competition amongst businesses, however it is "clearly wrong that, as we invest in building a tax-paying business employing hundreds of South Africans, we are competitively disadvantaged through aggressive tax planning strategies".[8] It appears that Google has not only managed to escape paying South African local taxes, but also in the UK,[9] Italy,[10] France and Australia.[11]

With regards to the type of taxation in South Africa, non-resident entities are only subject to the payment of tax from income that arises from a source within South Africa. In response to the tax avoidance allegations made, Google's representatives argued that it remained within the confines of the law and Wellstead agreed with this argument.[12] Wellstead noted that if non-resident companies such as Google are able to structure their business affairs in such a way that their revenue streams are not "sourced" within South Africa, and although Google has offices in South Africa, the business which was directed off-shore and not from South Africa, will not be taxable in South Africa.

Following the publicity concerning Google not paying taxes in South Africa, the Electronic Service Regulations[13] (the "ES Regulations") were promulgated under the VAT Act,[14] introducing a 14 percent VAT levy on digital products and services with effect from 1 June 2014.[15]

Following the publication of the ES Regulations, the Department of National Treasury issued a press release on 28 March 2014 addressing concerns made that the ES Regulations were seen

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7 Smith (2014). "Google 'avoids SA taxes'". Fin24.

8 Staff Writer (2014). "Naspers hits out at Google over tax dodge". Business Tech.

9 Google avoiding the payment of taxes in the UK is dealt with in paragraph 3.3.2 below.

10 Staff Writer (2014). "Google tax outburst". Business Tech. 24.com indicated that Google's tax practices have come under severe criticism in addition to South Africa, such as Italy and the United Kingdom. Critics have claimed that Google "abuses" tax and accounting laws in order to pay less tax.

11 Smith (2014). "Google 'avoids SA taxes'". Fin24. Stuart Thomas from a local technology web-site (Memeburn) told Fin24 that France billed Google for years in unpaid taxes around the same time as the article was published. In addition, the Guardian reported that France was seeking €1 billion from Google, and although in Australia an estimate of $1 billion in revenue being made by Google, that only $74,176.00 was paid in Australia tax in 2011.

12 Bronkhorst (2013). "Is Google dodging paying tax in South Africa". Business Tech. Wellstead is an attorney specialising in tax law from international law firm Norton Rose Fullbright.

13 Government Notice Number 221 of 28 March 2014.

14 As referenced in the List of Acronyms and Abbreviations on page iii.

15 Regulation 8 of the ES Regulations in Government Notice Number 221 of 28 March 2014 indicates that the ES Regulations came into operation on 1 June 2014. Before the ES Regulations came into effect, in the 2013 South African Budget Speech regarding tax policy, Gordhan noted that the budget review outlines various measures proposed to protect the tax base by limiting the scope for tax leakage and avoidance. Gordhan proposed that VAT be imposed on foreign businesses who sell e-books, music and other digital goods and services, which is in line with regulations which have been implemented by the European Union, as well as other jurisdictions.

as the imposition of a "new form of tax".[16] The Department of National Treasury responded that the ES Regulations were not a new form of tax and merely changed the tax liability from the importer of the of the service to the foreign supplier. It appears from the press release that the main purpose for the introduction of the ES Regulations was to "level the playing field" between local suppliers of e-services and foreign suppliers.

The ES Regulations apply to the supply of electronic services in the course and furtherance of an enterprise from an export country to any resident in South Africa, or where payment in respect of electronic services is made from a local bank.[17] It is therefore clear that the definition of "electronic services" encapsulates certain services which are provided to South African residents by Multinationals such as Apple, Microsoft, Amazon and Google. The list of electronic services provided is however limited, and does not include all types of electronic services available. It is therefore yet to be seen whether the ES Regulations will be amended in the future in order to widen the scope of their application or whether the regulations will remain as they currently are.

The Department of National Treasury did however note in the 28 March 2014 press release, that a decision was taken to reduce the scope of application of the Regulations by excluding certain electronic services due to the fact that imported services which do not fall within the ambit of the scope of the ES Regulations, will still be subject to VAT in terms of section 14 of the VAT Act.[18]

In a further online article,[19] Vermeulen indicated that Apple, Microsoft and Google, amongst others, responded to their anticipated compliance with the ES Regulations as per the table below:[20]

Company	Store	Comment
Apple	iTunes	Let developers know about the price change. Responded to queries, but could not provide an official statement.

[16] The Department of National Treasury Press Release: Final Electronic Services Regulations published on 28 March 2014. The Regulations published followed a consultation process, taking into account public comments by businesses, groupings, private companies, private individuals, representative organisations and tax advisors. Following the submission of comments, the National Treasury and SARS held a stakeholder workshop where the comments received were discussed.

[17] Regulation 2. The electronic services listed to whom the ES Regulations find application include; electronic services (regulation 3), games and games of chance (regulation 4), internet-based auction services (regulation 5), miscellaneous services (regulation 6) and subscription services (regulation 7).

[18] The Department of National Treasury Press Release: Final Electronic Services Regulations published on 28 March 2014.

[19] Vermeulen (2014). "Google, Apple and Microsoft respond to SA digital tax". Business Tech.

[20] The table represents an extract taken from Vermeulen's article "Google, Apple and Microsoft respond to SA digital tax" as published in Business Tech on 27 June 2014.

Microsoft	Windows marketplaces	Awaiting feedback.
Microsoft	Nokia Store	Will comply. No immediate price increase.
Google	Play Store	Will comply. No comment on effect on pricing.

PwC's De Wet noted that there are numerous suppliers of electronic services who remain outside the scope of the South African tax system.[21] PwC further indicated in March 2016 that the Department of National Treasury must examine taxing foreign suppliers of electronic services more closely in order for South Africa to be able to expand its tax base and tax officials across the globe are increasingly turning their attention to foreign e-services.[22]

Google is able to collect user data in one country and make use of that data to sell targeted advertisements to advertisers in another country. The revenues which are then collected from the selling of targeted advertisements is then shifted through subsidiaries in low tax jurisdictions, i.e. Ireland, and thus avoiding the permanent establishment[23] status in the countries in which the advertisements are collected.[24]

3.2.2 Lonmin alleged to have avoided paying South African taxes via the payment of sales commissions, management fees and 'non goods payments'

The Alternative Information and Development Centre (the "AIDC") made a submission to the DTC in April 2015 addressing the tax avoidance risks involved with Transfer Pricing and the Erosion of the Tax, Wage and Local Investment Base in South Africa (the "2015 AIDC Submission").[25]

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[21] The recent Google decision in the UK and the introduction of the diverted profits tax model by HMRC, seeks to provide guidance regarding the manner in which Multinationals shift profits around the world in order to minimise their tax liability. This model will be considered in further detail in Chapter 5.

[22] Staff Writer - PwC (2016). "SA 'misses' opportunity' to tax foreign e-services". Fin24Tech. PwC listed two examples where South Africa missed the opportunity to tax foreign e-services. The first being the levy of corporate income tax on foreign suppliers of electronic services who do not pay South African income tax, and the second being the failure to introduce VAT on electronic advertising services supplied from offshore.

[23] SARS has described a "permanent establishment" to be a fixed place of business through which the business of the enterprise is wholly or partly carried on. [Accessed on 2017-09-20].

[24] Addressing Base Erosion and Profit Shifting in South Africa: DTC Interim Report: Action 1: Address the tax challenges of the Digital Economy.

[25] AIDC (2015). "Transfer Pricing and the Erosion of Tax, Wage and Local Investment Base in South Africa: Submission to the DTC". In the submission it was noted that Lonmin's South African subsidiary, Western Platinum Ltd (WPL), paid approximately R250 million in sales commissions on an annual basis to fellow companies between the period 2006 until 2012. In addition to the sales commissions paid, it was noted that approximately the same amount was paid annually in management fees. The management fees were paid to Lonmin Management Services (LMS) and the sales commissions first paid to Western Metal Sales in Bermuda (WMS), and thereafter paid to LMS who is Lonmin's external company in South Africa, or its head office branch. The cost of the sales commissions paid annually reduced the amount of profits generated, and therefore corporate taxes paid. In addition, it was noted that in the event that the sales commissions "income" is received by a structure located in a tax haven country, this would also reduce the total tax.

It was further noted in the 2015 AIDC Submission that the director of Lonmin, Seedat, made an admission (under oath) on 16 September 2014 during the Marikana Commission of Inquiry, stating that the reason why metals were sold from Bermuda was specifically for tax purposes.[26] This statement was retracted a few days later where a representative from Lonmin stated that:[27]

> "The WMS structure and fee did not provide a tax benefit as there was a CFC [Controlled Foreign Company / AIDC] relationship between Bermuda and the UK in terms of which Lonmin Plc was required to pay taxes in the UK on the dividends declared by WMS. In terms of the agreement WMS has to declare dividends in terms of a dividend distribution policy acceptable to the UK revenue authorities. Mr Seedat, whilst continuing with his evidence on 29 September, corrected this position and confirmed that the WMS structure and fee did not provide a tax benefit".

In a response made by the Mail and Guardian's McKune, McKune indicated that Lonmin had not paid any UK taxes for the last 14 years and stated that Lonmin's 2000 – 2013 annual reports and accounts were evidence of this.[28]

The first Transfer Pricing transaction by Lonmin was a large payment in the form of a "sales commission", paid from the Group in South Africa to a subsidiary in Bermuda, and a second transaction made by Lonmin was the payment of "management fees" to LMS, which is Lonmin's external company based in South Africa. In this regard, it was further noted from a report published by the AIDC,[29] (the "Bermuda Connection Report"), that senior economist, Forslund, indicated that the report focused on Transfer Pricing schemes and made reference to the DTC's first interim report in respect of cross border 'non-goods' payments.[30] Non-goods payments by the mining sector amounted to R19.7 billion, R16.5 billion of which were payments made to "legal, accounting and management consultancy services".[31] An important question to consider in relation to these non-goods payments, is whether they are in fact fabricated as inter-company

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26 AIDC (2015). "Transfer Pricing and the Erosion of Tax, Wage and Local Investment Base in South Africa: Submission to the DTC" at 16.

27 Lonmin Plc (2014). Questions and Answers held on 10 October at 7.

28 AIDC (2015). "Transfer Pricing and the Erosion of Tax, Wage and Local Investment Base in South Africa: Submission to the DTC" at 16.

29 Forslund. "The Bermuda Connection: Profit shifting, inequality and unaffordability at Lonmin 1999 – 2012". The AIDC.

30 DTC First Interim Report at 21. "…just after the financial crisis in 2008, outflows increased by nearly one quarter. It is a well-known fact that the South African economy did not feel the full brunt of the aftermath of the financial crisis but it seems peculiar that legal, accounting and management consulting services increased by nearly R6.5bn (an increase of 32.6 percent) and engineering and technical services R3.7 billion (an increase of 39.5 percent). Consumption increases during the aftermath of a global financial crisis seem odd in the wake of sluggish economic activity…". It was further indicated that in respect of measuring South Africa's tax gap, South Africa should emulate the UK in respect of the vision statement enlisted in the IMF "United Kingdom": Technical Assistance Report – Assessment of HMRC's Tax Gap Analysis (2013) which was used to assess the loss of tax revenue, support efficiency and support fairness. It was noted that this tax gap analysis is one of the most comprehensive studies of tax gap estimates internationally.

31 *Ibid* at 20.

transfers in order to avoid paying the required amount of tax, or whether they have a valid commercial business purpose and are payments in respect of services rendered by the relevant parties who received the payments.

Furthermore, it was noted from the financial statements of EPL, WPL and Messina Ltd,[32] that intercompany loans were provided by Lonmin's South African subsidiaries, as well as from Lonmin PLC to its South African subsidiaries, as well as from its subsidiaries Southern Platinum Corporation (Cayman Island) and AfriOre (British Virgin Islands). This tax avoidance tactic is often used by Multinationals in order to be able to book the interest from the loan as a tax deductible cost in South Africa, and the income in the country with low or no tax on profits.

Regarding the economic consequences of profit shifting, Forslund made an interesting observation and indicated that not only does the effect of Multinationals avoiding or evading taxes reduce taxation expenditure, but these amounts are "removed from the wage bargaining table in South Africa by evading taxes are in fact much larger than the amount that potentially could be paid to SA Revenue Service".[33]

3.2.3 The MTN Tax Scandal

Following the accusations made by McKune in respect of Lonmin, MTN was found to be involved in a tax scandal in October 2015.[34] McKune further indicated that MTN moved billions earned in African countries to offshore tax havens as "management fees" where MTN employed no staff.[35] MTN maintained that it was not involved in any tax avoidance scheme and had not actively engaged in any unlawful activities however avoided answering the question as to why the management fees were paid to Mauritius and not to South Africa where the people who provided the management services were located.[36]

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32 Forslund. "The Bermuda Connection: Profit shifting, inequality and unaffordability at Lonmin 1999 – 2012" at 9. In 2006, one of Lonmin's South African subsidiaries, bought all the shares in Messina Ltd and the Messina Platinum Mine from Lonmin PLC in a once off transfer of R758 million. Between 2008 and 2012, WPL made a loan to Messina Ltd and thereafter declared the loan impaired in the same financial year assuming that it will never be paid back. The amount of the loan was used to reduce WPL's taxable profit in their books.

33 *Ibid* at 35.

34 Hunter (2015). "Bad Timing: Cyril Ramaphosa is Embroiled in a Massive MTN Tax Scandal". 2Oceans Vibe News. It was alleged that MTN was involved in shifting millions of dollars from its subsidiary companies located in Nigeria, Uganda, Côte d'Ivoire and Ghana to companies in Dubai and Mauritius with the aim of avoiding its tax obligations. As was the case with Lonmin, MTN has been accused of paying management fees to offices for certain services in Dubai and Mauritius, however, the issue raised was whether these are in fact services rendered by real people. Hunter stated that territories like Dubai and Mauritius are often used by Multinationals in order to shift profits to jurisdictions which have a low or sometime zero tax rate tax regime and therefore the Multinationals are able to reduce their costs due to the fact that they pay little, if any tax liabilities in the country in which they are required to do so.

35 McKune (2015). "Ramaphosa and MTN's offshore stash". Mail and Guardian.

36 *Ibid.* Correspondence between MTN and McKune between the period 18 March 2015 and October 2015. On 16 September 2015, when MTN was asked the question where MTN International (MTNI) is effectively managed, MTN responded that MTNI is effectively managed in South Africa. In addition, when asked the question why the management fees were not paid to the South African MTN office, MTN responded that "the South African office of MTN is properly remunerated for services provided. Both MTN Dubai and MTNI pay fees to the South African entity for services rendered". McKune's article "Ramaphosa and MTN's offshore stash" contains a copy of the questions by McKune and MTN's full responses thereto.

Although the profits which were shifted to Dubai and Mauritius were profits made in Nigeria, Uganda, Côte d'Ivoire and Ghana, the allegations made against MTN continues to mimic the tax avoidance strategies adopted by Multinationals by shifting profits to tax haven jurisdictions, and as was the case with Lonmin, by way of so called "management fees", regardless of the place of effective management not being in that jurisdiction.

Following these allegations against MTN, MTN threatened South Africa's Parliament that they would pull out of South Africa and move overseas resulting in job losses in South Africa, if its tax credit was not rescinded.[37] Reference was further made by MTN's representatives in MTN's 2016 Group Tax Report, that MTN in addition to other Multinationals, have been the subjects of news articles about tax issues over the years and once again, MTN indicated that they follow all Transfer Pricing and international tax developments and endeavour to be compliant with all the regulation pertaining to these aspects.[38]

In the MTN 2016 Group Tax Report, it was noted that in MTN's 2015 tax year, MTN contributed R33,7 billion in group tax and further indicated that over the last few years, international tax and Transfer Pricing have become extensive focus areas for tax authorities globally, and the implementation of the Action Plans. The impact of these Action Plans will be dependent on whether the various jurisdictions in which MTN operates (i.e.17 countries), adopt and implement the Action Plans. MTN's representatives made further reference that MTN adheres to key principles underpinning the BEPS framework and ensures that profits are reported where the value is being created.[39]

3.3 UK MULTINATIONALS

Tax avoidance by Multinationals operating in the UK has also been an on-going issue, just as it has been in South Africa for many years. Various online news websites such as Reuters and Bloomberg continue to publish articles in respect of Multinationals and other UK companies avoiding paying taxes in the UK.[40]

In the 2013 Budget, Osborne, who served as the Chancellor of the Exchequer from May 2010

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[37] My Broadband (2015). "MTN threatens to pull out of South Africa". Business Tech.
[38] MTN Group Tax Report 2016 at 5.
[39] *Ibid.*
[40] Examples of these online articles which will be considered for purposes of this Chapter include: "How Starbucks avoids UK taxes" (Reuters), "Google paid USD55 million in UK taxes on USB5.5 billion sales in 2012" (Reuters), "UK issues 14 'Google Tax' charges to Multinational companies" (Bloomberg).

until July 2016,[41] made an oral statement to Parliament whereas he made reference to the UK moving towards low and competitive taxes, and insisting that individuals, as well as businesses must pay the applicable taxes, and not aggressively avoid or evade them.[42]

In the succeeding Budget's by Osborne in 2014, 2015 and 2016, tax avoidance was raised as an on-going battle for the UK. Of particular interest was the 2015 Budget, where Osborne indicated that the UK inherited a system where some Multinationals shifted their profits offshore, as well as the 2016 Budget, wherein other anti-avoidance strategies used by Multinationals were highlighted, such as, Multinationals deliberately over-borrowing in the UK in order to fund activities abroad, and then deducting the interest as a result of the loans from their UK profits, decreasing the profits made in the UK and taxes paid to the revenue authorities.[43]

3.3.1 Starbucks avoids paying UK taxes by paying premiums to divisions in other jurisdictions

As noted earlier,[44] Starbucks began trading in the UK, and up until 2012, earned approximately £3 billion from its UK coffee sales, opened seven hundred and thirty-five outlets throughout the UK, but paid only £8.6 million in income taxes. It was further indicated that Starbucks reported no profit for the years 2009, 2010, and 2011 and had not paid any corporate or income tax on sales amounting to approximately £1.2 billion in the UK.[45]

Bergin noted that the Public Accounts Committee ("PAC"), who was charged with monitoring Government financial affairs, invited companies who wished to provide evidence during the increasing public and political concern in respect of Multinationals avoiding tax.[46] Various publications became available in respect of concerns raised relating to tax avoidance by Multinationals, and in particular Starbucks. In a publication by Henn, he indicated that prominent companies such as Starbucks and Apple pay little or no income taxes on their large international profits, and further indicated that the roles played by tax havens were firmly on the international

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41 Information regarding the Chancellor of the Exchequer is available on the Government of the UK's online web-site. [Accessed on 2017-10-11].

42 2013 Budget. Osborne further introduced the "new rules to stop the abuse of partnership rules, corporate tax losses and offshore employment intermediaries" in the Budget. These rules, referred to as the GAAR, which came into operation effective 17 July 2013. In addition, Osborne advised that they wanted the global rules governing the taxation of Multinational firms to be updated from the 1920's when they were first written and made relevant to the global internet economy which is available in the 21st century, as this would be the right and fair thing to do.

43 2015 and 2016 Budget. Osborne further noted that the UK would start to implement new mismatch rules, in order to prevent the complex structures which were used by some Multinationals in order to avoid paying taxes, as well as to avoid the circumstance where Multinationals deduct the same expenses in more than one country.

44 In paragraph 1.1 of Chapter 1.

45 Bergin (2012) "How Starbucks avoids UK taxes". Reuters Special Report. Bergin obtained this information from the accounts filed by the Starbucks UK subsidiary.

46 Bergin (2012) "Starbucks, Amazon and Google to face UK lawmakers over tax". Reuters. Chairperson of PAC, Hodge, indicated that it is hard for ordinary people to believe that tax avoidance by Multinationals is fair.

policy agenda, such as the G20.[47]

Krishna indicated that Starbucks avoided paying taxes in the UK for three years by making use of complex Transfer Pricing structures amongst its inter-corporate transactions. Furthermore, Starbucks was said to have reported losses in the UK by paying a 4.7 percent premium to its Netherlands divisions where the coffee beans are roasted, as well as a 20 percent premium to Switzerland where it buys the coffee beans.[48]

Throughout the investigations and acquisitions made in terms of Starbucks avoiding the payment of taxes in the UK, Starbucks maintained that they complied with the tax codes and paid their fair share of taxes.[49] Despite Starbucks' persistence of innocence, Starbucks made the decision to volunteer higher tax payments in the UK as a result of its UK customers boycotting the company for not contributing to the Treasury.[50]

The decision was also said to set an odd precedent for a company to pay more tax then what is actually due. Starbucks however noted that the decision to make the volunteer payments for 2013 and 2014 was not an indication that Starbucks has accepted the Transfer Pricing arrangements it used in respect of intercompany payments as being too aggressive, however the voluntary payments made were calculated by rounding up its deductions and applying the relevant tax rate,[51] and reflected the "soul" of Starbucks.[52]

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[47] Henn (2013). "Tax Havens and Taxation of Transnational Corporations". Friedrich Ebert Stiftung. Henn indicted that companies make use of a number of techniques in order to benefit from their cross-border transactions, as well as loopholes and contradictions in the tax legislation within the countries within they operate and transact. Henn's publication focused on the role of tax havens, preferential tax schemes, the abuse of intra-firm Transfer Pricing, as well as the topic of "double non-taxation" as a result of the tax treatment in different counties. Since Henn's publication in 2013, the GAAR was introduced in the UK and the introduction and implementation of the Action Plans which sought to achieve results where tax avoidance is reduced and Multinationals pay the correct (and fair) amount of corporate income taxes within the countries wherein they operate.

[48] Krishna (2015). "Corporate barons vote with their feet". Financial Post. Krishna stated that by making payment of these premiums to the Netherlands and Switzerland that Starbucks accumulated a large amount of foreign earnings which were not subject to taxation until such time that the profits are repatriated. In this regard, it was said that the capital flows to its lowest level of taxation in order to maximise return on equity, however Krishna indicated that the OECD is working on complex solutions to prevent Multinationals shifting their profits. The BEPS Action Plans form a large part of these complex solutions which the OECD has been investigating and implementing since 2013.

[49] Bergin (2013) "Google paid USD55 million in UK taxes on USB5.5 billion sales in 2012". Reuters.

[50] Houlder, Jopson, Lucas and Pickard (2012) "Starbucks pays up to avoid boycott". Financial Times. The decision taken by Starbucks to pay higher taxes in the UK was perceived in a number of ways. UK Uncut, a protest group that targets companies accused of tax dodging, stated that "offering to pay some tax, if and when it suits you, doesn't stop you being a tax dodger". Tax specialists also voiced their opinions at the time and had doubts in respect of the effectiveness of the decision made by Starbucks and how the UK Treasury would receive the voluntary payment as it does not have any clear mechanism to do so.

[51] Houlder, Jopson, Lucas and Pickard (2012) "Starbucks pays up to avoid boycott". Financial Times.

[52] Houlder, Jopson and Lucas (2012). "Starbucks ground down". Financial Times. The managing director of Starbucks, Engskov noted that Starbucks has listened to its customers and is a company that likes to do the right thing by the communities within in which it operates.

3.3.2 Google avoids paying UK taxes by claiming that it does not sell in the UK

In 2012, Google was said to have paid $55 million in UK taxes on its $4.9 billion sales.[53]

As was the case in South Africa,[54] non-resident entities of the UK are only subject to tax from income that arises from a source within the UK. Bronkhorst indicated that whilst Google drew in billions in revenue from UK residents between the period 2006 until 2011, Google only paid £10 million in taxes.[55] In November 2012, Bergin reported that Google's Northern Europe boss at the time, Brittin, explained that the reason for the low payment of tax in the UK was due to the fact that the UK sales were conducted from Ireland, an arrangement which allowed it to pay taxes at a rate of 3.2 percent on non-US profits.[56]

A Special Report was published by Bergin in May 2013 containing the details from Brittin's appearance before the parliamentary committee in November 2012 on the topic of how it was possible for Google to have made billions of revenue in the UK, however paid very little corporate income tax. The issue which arose from Brittin's statement is that although Google had its headquarters in Ireland and claimed to not have a presence in the UK, Google UK Ltd employed 1,300 people at the end of 2011, 720 who were said to be engaged in the provision of marketing services to Google Ireland.[57]

The following evidence was noted from the Special Report that was found to be in contradiction with the information provided by Google UK Ltd ("Google UK"), wherein Google UK claimed not to sell to UK clients:

- Google UK's corporate website indicated that London is home base to "a number of EMEA sales and marketing leaders", as well as that most Google offices outside Ireland focus on engineering or sales, whereas Google UK does both;
- Google UK's corporate website advertised numerous London based sales positions;
- The LinkedIn[58] profiles of around 150 London based Google UK employees indicated that they were involved in formulating sales, strategies, maintaining sales teams, closing deals

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53 Bergin (2013) "Google paid USD55 million in UK taxes on USB5.5 billion sales in 2012". Reuters. Please note that the amount of $5.5 billion was amended to $4.9 billion on 30 November.

54 As indicated in paragraph 3.2.1 above.

55 Bronkhorst (2013). "Is Google dodging paying tax in South Africa". Business Tech.

56 Bergin, (2012). "Starbucks, Amazon and Google to face UK lawmakers over tax". Reuters. Google declined to comment on the article.

57 Bergin, (2013). "How Google UK clouds its tax liabilities". Reuters Special Report. Brittin indicated that Google Inc was not liable for tax on its UK sales because they were all conducted through its headquarters, in Ireland. Brittin maintained that nobody in the UK is selling. Bergin indicated that although there may be a fine line between marketing and sales, the idea that Google does not "sell" in the UK was considered laughable by Johnson from a digital marketing agency who buys a range of services from Google and has meetings with account managers in London.

58 LinkedIn is a global online business networking platform.

or other sales work; and

- A strategic partner of Google UK, Smith, indicated on his LinkedIn profile that his role involved the selling of media platform solutions.

Google maintained that "only staff in Ireland sold to UK clients".[59]

Google UK's accounts show that it does not receive any revenue from sales, however fees from Google Ireland and Google Inc, which are supposed to cover the costs and include a small premium. In addition, Google UK has reported losses from 2006 until 2011, allowing it to build up tax credits to be used to offset future tax bills. Begin further noted that Google Ireland reported sales of €12.5 billion in 2011, however only profits of €24 million due to the fact that it pays most of its sales turnover to an affiliate in Bermuda which does not levy any tax of foreign controlled corporations for the use of computer algorithms.[60]

In January 2016, an unnamed spokesperson from Google announced that there had been a change in Google's policy going forward, whereas Google will "pay tax based on revenue from UK-based advertises, which reflect the size and scope of our UK business". In addition, a deal was entered into between Google and the UK tax authorities, wherein it was agreed that Google would pay £130 million in back taxes to the UK tax authorities.[61]

In December 2014, the UK Treasury published its draft legislation for the new Diverted Profits Tax ("DPT"), with the planned implementation date of 1 April 2015. The DPT has been unofficially described as the "Google Tax" and has resulted from the UK Government's reaction to Multinationals paying very little corporate income tax in the UK although substantial revenues having been realised due to the popularity of the brand from UK customers.[62]

The charge will arise if either of the following two rules apply:

- Rule 1: Where there is a non-resident company and another person (the "Avoided PE"), carries on an activity in the UK in connection with the supplies of goods and services of the

[59] Bergin, (2013). "How Google UK clouds its tax liabilities". Reuters Special Report. Barron, a director of Google, declined to say whether UK employees negotiate terms with clients or why job advertisements advised potential candidates that they would be required to negotiate terms with clients. As noted in paragraph 3.2.1 above, Wellstead agreed with Google in that "if a non-resident company like Google is able to structure its business in such a way that its revenue streams are not "sourced" in the country – like it does in the UK – that revenue will not be subject to tax.

[60] *Ibid.* Googles Chairman, Schmidt indicated that he is very proud of Google's corporate structure and noted it as "capitalistic".

[61] Rawlinson (2016). "Google agrees to pay British authorities £130m back in taxes". The Guardian. A spokesperson from the HMRC indicated that Google will pay the full taxes due in law on profits that belong to the UK, and emphasised that Multinationals must pay the tax that is due as the HMRC will not accept anything less than that.

[62] Ross (2014). "The UK's new Diverted Profits". Lexology. There are two separate charges to DPT, the first being a charge on companies which are non-residents, and the second being a charge on companies that are UK resident or have a UK permanent establishment.

non-resident company. The rule will apply where it is reasonable to assume that any of the activities of the Avoided PE and/or non-resident company is to ensure that the non-resident company is not carrying on a trade within the UK;[63] or

- Rule 2: Where certain arrangements between a UK resident company and another person, whether inside or outside the UK, imposes a material provision by means of a transaction or series of transactions. Rule 2 will find application where both an "effective tax mismatch outcome" occurs and an "insufficient economic substance" condition is met.

Following the publication of the draft legislation, the DPT came into effect on 1 April 2015, whereafter the HMRC published a paper identifying the method used to measure the yield from the DPT, where it was noted that the purpose of the DPT is to encourage large businesses to change their behaviours aimed at minimising their tax liabilities through the use of "contrived arrangements".[64]

The effect since the implementation of the DPT in April 2015 was tabulated by HMRC for the 2015/2016 and 2016/2017 years as follows:[65]

Year:	2015/2016	2016/2017
Total amount collected:	£31 million	£281 million

Stupples noted that the tax authority reported an 89.6 percent increase in additional receipts collected from Multinationals by challenging their transfer pricing arrangements.[66] It is therefore evident that the introduction of the DPT has significantly increased the revenue for the UK Government and has had a positive impact in respect Multinationals making conscious decisions regarding the minimisation of their tax liabilities within the UK.

3.3.3 Amazon alleged to avoid the payment of UK taxes by reporting sales to a low tax jurisdiction

Bergin indicated that according to a filing made by Amazon, Amazon's main UK unit paid less

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63 Staff writers (Undated). "Diverted profits tax: Details released". EY. In order for rule 1 to apply, it must further be reasonable to assume that either the main purpose was to avoid corporate taxes, or there is a mismatch condition.

64 HMRC (2017). "Diverted Profits Tax Yield: Methodical Note". Should companies be found to be making use of contrived arrangements, they will be liable to pay a higher tax rate of 25 percent, as opposed to the 19 percent corporate tax rate that is currently applicable.

65 *Ibid.* The figures reflected in the table include amounts received as a result of DPT charging notices which were issued by the HMRC, as well as corporate taxes from companies which changed their behaviour as a result of the introduction of the DPT into UK legislation. In 2016/2017, an amount of £138 million was as a direct result of issuing DPT charging notices.

66 Stupples (2017). "UK issues 14 'Google Tax' charges to Multinational companies". Bloomberg.

than £1 million in income tax in 2011, even though UK sales were said to be approximately $5.3 - $7.2 billion.[67] In this regard, Amazon was said to avoid the payment of UK taxes by reporting European sales through its Luxembourg based unit which allows it to pay a tax rate of 11 percent on foreign profits.

In 2013, Amazon was able to achieve a tax bill of £4.2 million on sales of £4.3 billion in the UK.[68] Following the tax payment made by Amazon in respect of its 2013 tax year, consumers were urged to boycott Amazon's British business.[69] Garside indicated that the reason why Amazon is able to pay low tax is due to the fact that when UK customers purchase from its local websites, the payment is taken by a subsidiary in Luxembourg, a low tax jurisdiction.

With regards to Amazon's brand perception, and unlike Starbucks who according to YouGov's BrandIndex suffered the deepest damage, by comparison, Google and Amazon's ratings were seemingly unaffected.[70]

3.4 THE ANTI-AVOIDANCE SOLUTION – THE GAAR AND BEPS

Discussions in respect of the introduction of the GAAR in the UK began many years before the OECD's BEPS Acton Plans were commissioned and published. However, due to the fact that the GAAR was introduced in 2013 into the Finance Act around the same time in which the Treasury expressed the UK's support of the Action Plans, the GAAR has come under criticism from politicians, commentators and the press stating that the GAAR does not prevent Multinationals' from shifting profits in order to erode their tax base.[71] Freedman noted that the GAAR cannot solve the "underlying structural issues" of the type of structures at an international level and it was never suggested that it would be able to do so.

3.4.1 The BEPS Problem

The OECD undertook studies with available data found in the public domain in order to analyse

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67 Bergin (2012). "Starbucks, Amazon and Google to face UK lawmakers over tax". Reuters. Bergin noted that Amazon did not respond to any requests made for comments on the article.

68 Chew (2016). "7 corporate giants accused of evading billions in taxes". Fortune.

69 Garside (2014). "Amazon UK boycott urged after retailer pays just £4.2m in tax". The Guardian. Hodge noted that it was an outrage, and Amazon must pay its fair share of tax and that she no longer uses Amazon. Hodge further made reference to the boycotting of Starbucks and the power of the voice of the consumer. As with the case of Starbucks and Google, Amazon stated they "pay all applicable taxes in every jurisdiction that it operates within. Amazon EU serves tens of millions of customers and sellers throughout Europe from multiple consumer websites in a number of languages dispatching products to all 28 countries in the EU. We have a single European headquarters in Luxembourg with hundreds of employees to manage this complex operation".

70 Neville and Malik (2012) "Starbucks wakes up and smells the stench of tax avoidance and controversy". The Guardian.

71 Freedman (2016). "General Anti-Avoidance Rules (GAARs) – A key element of tax systems in the post BEPS tax world?" University of Oxford Legal Research Paper Series. Professor Freedom noted that the GAAR and the implementation of the Action Plans have "tended to become conflated".

the extent of the issues found pertaining to BEPS. It was noted in the 2013 BEPS Report, that although most of the writings on BEPS are inconclusive, there is an abundance of circumstantial evidence that BEPS behaviours are common.

Studies have further indicated that there has been an increased segregation between the location where the actual business activities take place and the location where the profits are reported for tax purposes.[72] This serves as evidence that Multinationals are shifting their profits to jurisdictions with low or potentially no tax implications, although the business activities of the Multinationals are taking place in different jurisdictions. In addition to the shifting of profits, expenses are also shifted to jurisdictions where they are relieved at higher rates in order to further reduce the amount of tax payable.

The OECD made reference to the following BEPS strategies adopted by Multinationals:[73]

- Jurisdiction to tax: An important challenge to note in respect of a different jurisdictions right to tax is that there may be unintended consequences and mismatches between the domestic tax laws of those jurisdictions insofar as cross-border transactions are involved. These mismatches may result in double taxation, or possibly even a situation where double non-taxation exists, which results in a reduction of taxes paid by the parties of the cross-border transaction;
- Transfer Pricing: Transfer Pricing is an important concept for Multinationals and provides the opportunity for a Multinational to optimise the value of a business by effective tax rate and foreign tax credit management. In this regard, corporate structures focus on allocating significant risks and hard-to-value intangibles to low-tax jurisdictions, where their return may benefit from a favourable tax regime. Transfer Pricing takes into account the arm's length principle,[74] and identifies transactions between parties which are unlikely to have taken place between independent parties;
- Leverage: The principle of leverage takes place where companies chose to finance themselves through debt, rather than equity.[75] For example, in the event that a parent company and its subsidiary are based in different jurisdictions, and the parent company provides its subsidiary with equity, and as a result the subsidiary is funded through debt, due to the fact that the parent and the subsidiary are in different jurisdictions, the amount of equity provided by the parent company will affect the total tax burden borne by the group. Leveraging high-tax group companies with intra-group debt makes it possible for the group

[72] The OECD (2013). "Addressing Base Erosion and Profit Shifting" at 15.
[73] *Ibid* at 33.
[74] As described in the List of Key Terms on page iv above.
[75] The OECD (2013). "Addressing Base Erosion and Profit Shifting" at 43.

to save money in respect of taxes paid; and

- Anti-Avoidance: Domestic and treaty based tax avoidance provisions constitute the benchmark against which to decide whether a structure should be challenged or permitted. An example of an anti-avoidance rule is that of thin capitalisation,[76] which may be circumvented by challenging the financing through an independent third party.

3.4.2 The Action Plans

The aim of the Action Plans is to tackle the BEPS structures by comprehensively addressing the causes rather than the mere symptoms. Indicators show that tax planning by Multinationals has become more aggressive over the years, raising serious compliance and fairness issues.[77] In an attempt to circumvent the issues arising from BEPS, the leaders of the international forum, the G20, endorsed the Action Plans in September 2013, which between the period 2013 and 2015, consisted of 13 published reports.[78]

In October 2015, the following BEPS Action Plan Reports (the “Action Plans”) were finalised and published:

- Action 1: Addressing the tax challenges of the digital economy;
- Action 2: Neutralising the effects of hybrid mismatch arrangements;
- Action 3: Designing effective controlled foreign company rules;
- Action 4: Limiting base erosion involving interest deductions and other financial payments;
- Action 5: Countering harmful tax practices more effectively, taking into account transparency and substance;
- Action 6: Preventing the granting of treaty benefits in inappropriate circumstances;
- Action 7: Preventing the artificial avoidance of permanent establishment status;
- Actions 8 - 10: Aligning Transfer Pricing outcomes with value creation;
- Action 11: Measuring and monitoring BEPS;
- Action 12: Mandatory disclosure rules;
- Action 13: Guidance on Transfer Pricing documentation and Country-by-Country Reporting;
- Action 14: Making dispute resolution mechanisms more effective; and
- Action 15: Developing a Multilateral Instrument to modify bilateral tax treaties.

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[76] A company is said to be "thinly capitalised" when its equity capital is small in comparison to its debt capital, as defined in the OECD Glossary of Tax Terms. [Accessed on 2017-05-15].

[77] The OECD (2013). “Addressing Base Erosion and Profit Shifting” at 6.

[78] The OECD (2015) “Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project” at 4. It was estimated that global corporate income tax (CIT) revenue losses could be between 4 percent and 10 percent of the global CIT, i.e. USD100 to USD240 billion annually. These losses were said to result from aggressive tax planning by Multinationals, the interaction of domestic tax law, a lack of transparency and coordination between tax administrations, limited country enforcement resources and harmful practices.

Following publication of the Action Plans, countries who adopted the BEPS framework have laid the foundation in terms of which profits should be taxed where economic activity and value creation occurs.[79] The benefit of an international tax legal framework is its assistance with the exposure of gaps and tax mismatches in domestic tax legislation which allows for the facilitation of Multinationals artificially shifting their profits to low or no tax havens.

3.4.3 Implementation of the Action Plans

The implementation of the Action Plans is dependent on a number of aspects, for example, certain Action Plans are capable of immediate implementation such as the Transfer Pricing Guidelines, whilst other Action Plans require legislative amendments to the participating countries domestic law. A further aspect which is required to be taken into consideration when implementing the Action Plans are potential changes made via tax treaties, such as the development of a multilateral instrument to modify bilateral tax treaties (Action Plan 15).[80]

It is the participating countries obligation to enforce the Action Plans and ensure that the ways in which these Action Plans are enforced do not conflict with their international legal commitments. A holistic approach is necessary in order to be able to address the issues of BEPS, and the participating countries' Governments must be mindful and comprehensively deal with these issues.[81]

The implementation of these Actions Plans are not without challenges, and therefore the OECD and the G20 countries have agreed to work together with regards to the implementation of the Action Plans on a global basis. In addition, the OECD and the G20 countries further have to agree to monitor the implementation of the Action Plans, including performing an assessment of compliance with the minimum standards in the form of reports, documenting the steps undertaken by the participating country in respect of the implementation of the BEPS recommendations.

Once BEPS has been implemented successfully, Multinationals will no longer be able, or at least not easily able to escape taxation by shifting their profits to low or no tax locations via the adoption of various tax avoidance techniques. Multinationals are now faced with the realisation that the days where they were able to arrange their affairs in a way in order to attract as little

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79 The OECD (2015). "Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project" at 9.
80 *Ibid.*
81 The OECD. (2013) "Addressing Base Erosion and Profit Shifting" at 7. The actions which were proposed in the 2013 BEPS Report include, the balance between source and residence taxation, the tax treatment of intra-group financial transactions, the implementation of anti-abuse provisions, including controlled foreign company and Transfer Pricing rules.

tax as possible have gone, and they are now faced with the harsh reality that tax authorities, as well as committees such as the DTC, and the Treasury Committee have awakened to issues regarding tax avoidance, and are actively taking steps to address these very issues.

3.4.4 South Africa's implementation of BEPS: The DTC

As noted in paragraph 3.1 above, although South Africa is not a member of the OECD, the OECD still works with South Africa in addition to its member countries,[82] and for this reason South Africa made the decision to adopt and implement the Action Plans.

From a South African perspective, the DTC has been tasked to assess South Africa's tax policy framework with the aim of supporting the objectives of inclusive growth, employment, development, and fiscal sustainability. In fulfilling its task, the DTC is required to publish an interim report which includes an introduction and background information of the OECD report, the recommendations made by the OECD, a section dealing with the DTC's recommendations when addressing BEPS, and lastly, a section containing annexures providing a summary of the draft discussion document as published by the OECD.

The DTC was formally appointed on 17 July 2013 as a review committee under the chair of Judge Davis, following an announcement made by Gordhan in the 2013 Budget Speech.[83] The DTC submitted its first BEPS interim report to the Minister of Finance on 30 June 2014, whereafter on 23 December 2014 a media statement was released calling for public comments by 31 March 2015 (the "DTC Interim Report").[84] In the DTC Interim Report, concerns were raised regarding media reports where Multinationals were accused of paying little or no corporate tax in the countries in which they operate.[85]

Shortly before the release of the DTC's Interim Report, Steyn indicated that the global initiative has gained traction since July 2013 following the release of the Action Plans by the OECD, and a "global crackdown on tax avoidance has begun and South Africa is forging ahead in a bid to tackle wealthy individuals and corporates who practice this tactic".[86] Steyn further indicated that the global crackdown on tax avoidance was in a better position to succeed in 2014 as opposed to prior years due to the fact that the G20 countries have promised to set up a system of

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82 The OECD has 35 member countries at present. A list of the member countries is available from the OECD's web-site. Available from http://www.oecd.org/about/membersandpartners/list-oecd-member-countries.htm. [Accessed on 2017-10-30].

83 2013 Budget Speech at 19. Gordhan indicated that a "tax review will be initiated this year to assess our tax policy framework and its role in supporting the objectives if inclusive growth, employment, development and fiscal sustainability…".

84 The progress timeline of the DTC is available from http://www.taxcom.org.za/library.html. [Accessed on 2017-10-30].

85 Multinationals revealed to have followed this practice included Google, Amazon and Starbucks, amongst others.

86 Steyn (2014). "Clampdown on tax avoidance". Mail and Guardian. The system of automatic exchange is one of the OECD BEPS Actions Plans (Action Plan 13 – Transfer Pricing Documentation and Country by Country Reporting) and was enforced in South Africa effective 1 September 2017.

automatic exchange of information.

In addition to the role as a review committee, the DTC is further tasked to address concerns about BEPS, and specifically in the context of corporate income tax.[87] As part of the fulfilment of this duty, the DTC has published further interim reports in respect of the following Action Plans:

- Digital Economy (Action 1);
- Hybrid Mismatches (Action 2);
- Harmful Tax Practices (Action 5);
- Treaty Abuse (Action 6);
- Transfer Pricing of Intangibles (Action 8);
- Transfer Pricing Documentation (Action 10);
- Multilateral Instrument (Action 15); and
- Summary of Recommendations for South Africa: OECD September 2014 Deliverables.

The second BEPS report was submitted to the Minister of Finance on 2 September 2016 with a call for written comments by 31 March 2017. The current status of the second BEPS report is "awaiting approval to publish".[88]

The DTC published its Tax Administration Report: September 2017 which was signed off on 12 October 2017 (the "Tax Administration Report"), containing an update in respect of the implementation of BEPS in Chapter 2. The Tax Administration Report notes that the BEPS report was submitted to Gordhan in September 2016, however Gordhan did not release it prior to his departure as the South African Minister of Finance in April 2017. The duty to release the report now rests upon the current Minister of Finance, Gigaba.[89]

3.4.5 The UK's implementation of BEPS: The Treasury Committee

In contrast to South Africa, the UK is a member of the OECD and deposited its instruments of ratification on 2 May 1961.[90] In 2014, the former Exchequer Secretary to the Treasury, Gauke,

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87 DTC (2014). "Addressing Base Erosion and Profit Shifting in South Africa: Davis Tax Committee Interim Report" at 9.

88 The news timeline of the DTC is available from http://www.taxcom.org.za/. [Accessed on 2017-10-30].

89 Tax Administration Report (2017) at 20. The DTC noted that the report has been provided to Treasury for consideration. The DTC further noted that many of the Action Plans have already been implemented in South Africa and therefore Chapter 2 focuses primarily on SARS' capacity to fulfil its mandate in ensuring compliance with the legislation.

90 The term "deposited its instruments of ratification" means a declaration by certain member countries relating to the Convention of the OECD. Available from http://bit.ly/2zukdsb. [Accessed on 2017-10-30]. The then ambassador of the UK made a statement whilst in France to the French Minister of Foreign Affairs that the Convention on Economic Co-operation and Development was signed in Paris on 14 December 1960, and ratified by the UK Government of Great Britain and Northern Ireland on 2 May 1961.

expressed the UK's support for the Action Plans in a speech presented on international tax competitiveness.[91]

The UK has a similar review committee as that of the DTC, the Treasury Committee, which falls under the Commons Select Committee and is required to have a minimum of 11 members in order to decide upon the line of inquiry and gather written and oral evidence. The Treasury Committee is tasked to examine the expenditure, administration and policy of HM Treasury, HMRC, and associated public bodies, including the Bank of England and the Financial Conduct Authority.[92]

On 27 January 2016, the Treasury Committee launched an inquiry into the "shifting sands" of UK tax policy and the tax base. In the inquiry, the Treasury Committee made a call for written submissions, and of particular importance in respect of BEPS, addressing the following:[93]

- the difficulty with the shrinking tax base: Important questions were raised by the Treasury Committee requesting information in respect of the extent that the UK tax base is being eroded in relation to business being increasing undertaken globally, as well as requesting written submissions in respect of the manner in which the UK Government should be reacting to these changes; and
- other mitigations in terms of the shrinking tax base which addressed tax avoidance and non-compliance: Important questions were raised by the Treasury Committee as to whether the GAAR and notifications under the Disclosure of Tax Avoidance Schemes have been effective in tackling tax avoidance, as well as the question as to the extent that the BEPS framework and the common reporting standards have assisted with the collection of tax.[94]

Following the aforementioned inquiry, on 2 December 2016, after receiving considerable responses and information in respect of the corporate tax base, the Treasury Committee issued a further call for written submissions in respect of the following pertinent issues:

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91 Gauke's speech to the Lord Mayor's Taxation Forum (2014). Gauke indicated that the UK Government wants an international system with simple and fair rules which would ensure that all companies pay their share of tax. Gauke further emphasised that in order to achieve such an international system, the UK has taken a lead role through the BEPS Project, and that the UK Government believes in good working relationships between companies and tax officials, and where aggressive tax behaviour is clamped down.

92 The functions of the Treasury Committee have been defined on UK Parliament's web-site available online from http://www.parliament.uk/business/committees/committees-a-z/commons-select/#T. [Accessed on 2017-10-10].

93 UK tax policy and the tax base inquiry launch. [Accessed on 2017-09-20].

94 Former chairman of the Treasury Committee, Tyrie, commented on the UK tax policy and the tax base inquiry launch in January 2016, and stated that the inquiry is an inquiry into how tax policy is made, how taxes are collected and administered, as well as manners in which to address the vulnerability of the tax base. Tyrie referred to taxes in respect of corporates, and indicated that the problem is exacerbated by the globalisation of economic activity and the tax liability that accompanies this global activity. Furthermore, Tyrie indicated that it is the shareholders of a corporation's duty to minimise the amount of tax payable by the corporation, and therefore it should be the responsibility of the persons making tax policy to find "better ways to limit the elasticity".

- The ways in which the UK Government and HMRC have contributed to the change in attitude over the years regarding avoidance, and whether there is a clear distinction of what constitutes avoidance; and
- Possible other threats to the UK tax base.[95]

3.5 CONCLUSION

South African and UK Multinationals have come under scrutiny over the last few years in terms of the manner in which they have conducted their financial and business affairs in order to pay as little tax as possible. The strategies adopted by these Multinationals have involved making use of tax mismatches between domestic tax legislation in the countries wherein the Multinational operates, i.e. Google and Amazon, profits being shifted through subsidiaries in low tax jurisdictions and Transfer Pricing strategies where sales commissions are paid to subsidiaries in different jurisdictions, or where management fees are paid or intercompany loans are made and subsequently declared as "impaired", i.e. Starbucks, Lonmin and MTN.

For this reason, the OECD together with various committees and forums, developed the BEPS framework, a global anti-avoidance initiative which is in the process of being implemented by both OECD member and non-member countries. Both South Africa and the UK are in the process of implementing the Action Plans developed by the OECD as an additional attempt to ensure that BEPS is prevented.

As noted by Freedman in paragraph 3.4 above, the GAAR is unable to solve the underlying structural issues at an international level. Therefore, in order for the South Africa and the UK to be successful in combating tax avoidance, especially in respect of Multinationals who make use of complex cross-border structures to avoid paying taxes in the countries in which they operate, the GAAR is required as the domestic law governing tax avoidance, as well as the implementation of the Action Plans in order to tackle tax avoidance globally.

With the implementation of the Action Plans, Multinationals are now faced with the realisation that tax authorities around the world are working together in order address the issue of tax avoidance by Multinationals, as well as wealthy individuals. The battle against anti-avoidance is far from over, and the effectiveness of the Action Plans, as well as other forms of anti-avoidance measures is yet to be seen once the implementation has been finalised.

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[95] *Ibid.* Tyrie commented that a clear distinction regarding acceptable and unacceptable tax planning and avoidance is needed.

CHAPTER 4: THE SOUTH AFRICAN GAAR

4.1	INTRODUCTION	37
4.2	HISTORICAL OVERVIEW OF THE GAAR IN SOUTH AFRICA	37
4.3	INTRODUCTION OF THE CURRENT GAAR - SECTIONS 80A - 80L	46
4.4	THE APPLICATION OF THE SOUTH AFRICAN GAAR TO THE TAX AVOIDANCE STRATEGIES ADOPTED BY GOOGLE, LONMIN AND MTN	53
4.5	CONCLUSION	57

4.1 INTRODUCTION

In addition to the Action Plans, South Africa has relied upon GAARs[1] since 1941 when the first GAAR was enacted into South African legislation to assist with the prevention of tax avoidance. Further to the GAARs, South African domestic legislation also contains additional anti-avoidance rules, the SAARs,[2] which from an international perspective, include controlled foreign company legislation, thin capitalisation rules and Transfer Pricing rules.[3] The aim of this Chapter is to provide the historical legal framework of the GAARs in South African tax legislation, as well as to provide an insight as to why the GAARs have failed over the years since their incorporation.

Furthermore, and due to the fact that the current GAAR provisions[4] have not been considered and tested in South African courts as yet, this Chapter will include a brief examination of the tax avoidance strategies allegedly adopted by the South African Multinationals as indicated in paragraph 3.2 above, and the application of the GAAR provisions to these tax avoidance strategies in order to assess whether the GAAR may be useful against tax avoidance strategies should these South African Multinationals come before the courts.

4.2 HISTORICAL OVERVIEW OF THE GAAR IN SOUTH AFRICA

In 1941, South Africa introduced section 90, its first anti-avoidance provision in 1941 Act. Approximately 20 years later, section 90 was repealed and replaced by section 103(1) of the Income Tax Act.

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1 GAARs, as indicated in the list of acronyms and abbreviations on page iii above, and as explained in the list of key terms on page iv above.
2 SAARs, as indicated in the list of acronyms and abbreviations on page v above.
3 Olivier and Honibal (2011). "International Tax: A South African Perspective" at 536.
4 Sections 80A – 80L.

On 2 November 2006, section 103(1) was repealed by section 36(1)(a) of the Revenue Laws Amendment Act 2006, and sections 80A - 80L were introduced into the Income Tax Act as the new GAAR provisions. Sections 80A - 80L were said to be the "culminating attempt to arrive at a concept of tax avoidance which would prevent taxpayers from taking undue advantage of the specific provisions of the Act but not prohibit them from taking advantage of these provisions".[5] Sections 80A – 80L are still enforced today.

4.2.1 The 1941 Act – Section 90

The interpretation of the word "accrual" in the definition of gross income by the Appellate Division in *Hiddingh v CIR*,[6] ("*Hiddingh*"), gave rise to the enactment of section 90 in the 1941 Act as the first anti-avoidance provision in South Africa. The effect of the cession from the taxpayer to his relatives was to divest him of the right to receive income before it accrued to him. The Appellate Division held that the taxpayer disposed of the income before it accrued to him and as a result of the interpretation followed by the courts, it was noted that this interpretation could potentially result in the erosion of the tax base should South Africa continue to operate without a GAAR.

In the matter of *CIR v King*[7] ("*King*"), Watermeyer CJ indicated that there are many ways in which a taxpayer may "contrive" a transaction or operation in order to free himself of tax liabilities from money which in reality does fall part of his income and should therefore be subject to tax. Watermeyer CJ further indicated that the enactment of section 90 suggested that it was introduced in order to prevent a taxpayer from avoiding tax liabilities by means of assignments of income as was done in *Hiddingh.*

Section 90 required that there must be a transaction or operation carried out, and the purpose of the transaction or operation must be to avoid or reduce the liability for the payment of any tax imposed by the 1941 Act. Should the aforesaid requirements be met, the Commissioner could

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[5] Editorial (2007). "General Anti-Avoidance Rule" at 41. The Taxpayer Journal. SARS alleged that the enactment of sections 80A - 80L was due to the limiting effects of section 103(1) as construed by the courts in cases which have come before them.

[6] 1941 AD 111. In this matter, the taxpayer divested himself of the right to income before it accrued to him. Dr Hiddingh bequeathed to the taxpayer immovable property which was subject to a *fideicommissum*. In terms of Dr Hiddingh's will, all income from the immovable property should accrue to the taxpayer for the rest of his life, following which the property will be sold by order of court and the proceeds from the sale of the immovable property were transferred to the executor of Dr Hiddingh to invest. In 1943, the taxpayer assigned a portion of his income from the trust to certain relatives, resulting in the Commissioner including the money paid to its relatives in the taxpayer's income. The taxpayer objected on the grounds that the amounts should not have been included in his income due to the fact that the amounts never accrued to him. The issue arising from this matter was whether the amounts had in fact accrued to the taxpayer, or whether the taxpayer had disposed of it before it had accrued to him.

[7] 1947 (2) SA 196 (A) at 212.

have enforced the payment of the tax liability as if the transaction or operation never took place. Section 90 further placed the burden of proof on the taxpayer to prove that the transaction or operation was not entered into in order to avoid or reduce their tax liability. In the event that the taxpayer failed to discharge this onus, the transaction or operation was presumed to have been entered into for the purpose of avoiding or reducing a tax liability.

An analysis of section 90 – CIR v King

Subsequent to the enactment and enforcement of section 90, the Appellate Division in *King*, considered section 90 in detail, and focused comprehensively on the interpretation of the concepts "avoiding liability", "reducing the amount" and "the purpose" in order to ascertain whether the taxpayers had avoided their tax liabilities.

Regarding the concept of "reducing the amount", the Appellate Division interpreted this to mean reducing the amount of tax in a year of assessment, and "avoiding liability" to mean that a person specifically orders their affairs in a manner to escape a tax liability. With regards to the concept of "the purpose", the Appellate Division interpreted this to mean the dominant purpose and not an incidental purpose.[8] In this regard the Appellate Division, referred to the judgment handed down by the CPD wherein Jones stated:

> "In my view 'for the purpose' means the main purpose…The use of the definite article 'the' leads me to think that the Legislature meant the main purpose…The Legislature did not in my opinion mean when it used the words 'for the purpose' that if any one of the purposes was to avoid tax the section came into operation. If it did it would have said so".[9]

Following the interpretation by the courts of "the purpose", the Appellate Division could not prove that the Appellants' dominant purpose in terms of the transaction was to avoid or reduce their tax liability as the court found that there were other business objectives behind the transactions. Watermeyer CJ noted that the Commissioner recognised the absurdity in respect of giving section 90 a construction wide enough to include all transactions and noted that it is absurd to assume that the legislature intended to impose a penalty on a man merely due to the fact that his income tax has been reduced from what it was in the previous years if he earns less income than in the previous years and amounts to a reduction in his tax liability.[10]

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8 *Ibid* at 196.

9 1947 (2) SA 196 (A) at 198 – 199. Fagan J in the CPD further indicated that he does not read the words "for the purpose" with the definite article and agreed with the interpretation of Jones JP with regards to "the purpose" meaning the dominant purpose, and not a subsidiary purpose.

10 *Ibid* at 208 – 209.

The scope of section 90 was considerably wide and did not differentiate between permissible and impermissible tax avoidance which resulted in section 90 applying to permissible tax avoidance transactions. In addition, due to the fact that the provision made reference to for "the purpose" and did not identify the type of purpose meant by the Legislature, i.e. the sole or main purpose, or one of the purposes, this aspect was left open to interpretation.

The Commissioner made use of the powers bestowed under section 90 and refused to recognise the agreements entered into for the purpose of the assessments. In this regard, the Commissioner assessed each taxpayer as if the agreements had not been entered into. The decision of the Commissioner was upheld by the Special Income Tax Court, and thereafter considered by the CPD. The majority of the members of the CPD held that the alienation of the shares did not constitute a transaction or operation within the true meaning of section 90 and therefore did not have the effect of avoiding liability for payment of tax or reducing its amount.

In response to the findings of the CPD, the Appellate Division's Schriener JA, indicated that section 90 should not be read as a penalty section, or as widening the net beyond the general scope of the 1941 Act.[11]

In 1959, section 90 was amended in order to address the inadequacies which were found in the 1941 Act and raised in the *King* matter. Section 90, once amended, specifically identified the purpose as either "the sole or one of the main purposes", and identified impermissible tax avoidance to be an "abnormal" transaction, operation or scheme.

4.2.2 The Income Tax Act - Section 103

The Income Tax Act commenced on 1 July 1962 and replaced the 1941 Act in its entirety and section 103 was introduced as the new GAAR provision at the time. Subsequent to the commencement of the section 103 in 1962, section 103 was amended in 1996 and repealed in 2006.

Section 103(1), although not identical to section 90, contained similarities. Section 103(1)

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[11] *Ibid* at 216. Schreiner JA indicated that section 90 appears to be aimed at a "truer or fairer determination of the liability to the taxes imposed by the Act and their due payment when so determined". In addition, he noted that in his opinion section 90 is intended to deal with cases in which the Commissioner is properly aggrieved by a transaction or operation which has been contrived to enable a part to avoid paying a tax liability. Furthermore, Schreiner JA indicated that in this regard the "Commissioner is not properly aggrieved merely because at a stage before income has accrued to a taxpayer it might have been predicted with confidence, amounting even to certainty, that if the taxpayer took no steps in the matter such income would accrue to him, and because he then takes the avoiding steps". However, he noted that the Commissioner would be properly aggrieved if a transaction or operation was merely entered into in order to prevent the income from accruing to the taxpayer while still leaving him in the position as if the income did normally accrue.

requires that there had to be a transaction which was entered solely or mainly for the purpose of obtaining a tax benefit, however the differentiating factor between section 90 and section 103(1) was evidenced in the detail regarding the circumstances under which the transaction, operation of scheme was carried out.

Before section 103(1) could be applied, the Commissioner had to be satisfied that there was a transaction, which had either been made within the scope of a business or outside the scope of a business. In the event that the transaction was said to fall within the scope of business, the question as to whether the transaction was undertaken in a way which does not reflect a *bona fide* business purpose, or if the transaction was said to fall outside the scope of a business, whether the transaction would not normally be created between persons dealing at arm's length under a similar transaction.

Although numerous cases have come before the courts regarding the application of section 103(1), *SIR v Geustyn, Forsyth and Joubert*[12] (*"Geustyn, Forsyth and Joubert*"), provided important insights regarding the interpretation of section 103(1).

Geustyn, Forsyth and Joubert

In an appeal to the Appellate Division, Thompson C.J noted that all four of the following requirements must coexist in order to be able to justify section 103(1) being invoked:[13]

i. there must be a transaction, operation or scheme which has been entered into;
ii. which must have the effect of avoiding or postponing the liability for tax;
iii. the transaction, operation or scheme must have been (a) entered into or carried out in a manner which would not normally be employed when entering into such a transaction, operation or scheme taking into consideration the specific nature of the transaction, operation or scheme, or (b) has created rights or obligations which would not normally be created between persons dealing at arm's length; and
iv. the avoidance or postponement or the reduction of the amount of the tax liability must have been the sole or one of the main purposes of the transaction, operation or scheme.

Taking the above requirements into consideration, the Appellate Division held that the

[12] 1971 (3) SA 567 (A). In this matter, three taxpayers (Geustyn, Forsyth and Joubert), who were engineers by trade, carried out a partnership which was converted into an unlimited company in respect of which they were the main shareholders and directors. The appellant invoked section 103(1) and allocated the whole of the companies' taxable income to the three shareholders, therefore reflecting that the company had no taxable income. An appeal was lodged by the respondent company and on appeal the Special Income Tax Court held that the circumstances of the matter did not fall within the ambit of section 103 and set the assessment aside.

[13] *Ibid* at 568.

transaction entered into between the three taxpayers was not considered to be abnormal. In addition, the Appellate Division agreed with the finding made by the Special Income Tax Court whereas it was noted that the question of whether tax avoidance had been a factor taken into consideration by the partners in deciding to convert the partnership to an unlimited company is a question of fact. The Appellate Division dismissed the appeal with costs. The findings in favour of the taxpayer caught the attention of the Margo Commission,[14] and later the Katz Commission,[15] who identified certain essential deficiencies with section 103.

The Margo and Katz Commissions

The Margo Commission published a report in 1986[16] wherein significant changes to the South African tax system were recommended, and of particular importance were the findings noted by the Margo Commission in respect of section 103 of the Income Tax Act.[17] Following the concerns raised in section 103, a recommendation was made that the defects be remedied by providing for a arrear interest payment in the event that the Commissioner is successful.

Subsequent to the Margo Commission, the Katz Commission was introduced in 1995 which recommended amendments to the abnormality requirement in the specific context of a business, which is not normally employed for a *bona fide* business purpose. The amendments introduced a business test into section 103(1). Although the term "business" had not been defined, the likelihood of an interpretational issue was considered to be slim due to the fact that the meaning of the word "business" is straightforward. The Katz Commission further made recommendations concerning the amendment of section 103(1).[18] Following the recommendations made, section 103(1) was amended in 1996 by section 29 of the Revenue Laws Amendment Act.[19] Following the amendment, section 103(1)(c) read as follows:[20]

"(a) having regard to the circumstances under which the transaction, operation of scheme was carried out –

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14 The Margo Commission was a Commission of Inquiry developed by the South African Government with the duty to investigate the tax system in South Africa with the objective of renewing it, amongst other duties. Judge Margo was appointed as the chairman of the Margo Commission and tasked to investigate the South African tax system and alleviate the challenges at the time. In this regard, the Margo Commission published a report which made recommendations in respect of South Africa's tax system.

15 The Katz Commission was the first tax commission after the establishment of the African National Congress.

16 Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa Pretoria (1986).

17 Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa Pretoria (1986) at 410. The Margo Commission indicated that section 103 "suffers" from two deficiencies. The first deficiency is that the test of abnormality presents difficulties. In this regard the Commission noted that "if a particular form of transaction is widely used for tax avoidance purposes, it may gain commercial acceptability" as the transaction gains a degree of normality. The second deficiency is that there are no disadvantages for taxpayers making use of tax avoidance schemes due to the fact that in the event that the Commissioner invoked section 103, the taxpayer would in all likelihood be successful.

18 Katz Commission (1995). Third Interim Report of the Commission into certain aspects of the Tax Structure of South Africa.

19 36 of 1996.

20 The amendments to section 103(1) are indicated in bold italic font.

(i) it was entered into or carried out –

(a)(a) ***in the case of a transaction, operation or scheme in the context of business, in a manner which not normally be employed for bona fide business purposes, other than obtaining a tax benefit; and***

(b)(b)

(i) in the case of any other transaction, operation or scheme, **being a transaction, operation or scheme not falling within the provision of item (a)(a)** by means or in a manner by means which would not normally be created between persons dealing at arm's length under a similar transaction, operation or scheme or entering into or carrying out a similar transaction, operation or scheme; or

(ii) had created rights or obligations which would not normally be created between persons dealing at arm's length under a similar transaction, operation or scheme."

Subsequent to the 1996 amendment, SARS alleged that section 103(1) still had limiting effects following the interpretation by the courts in cases which came before them. It would appear that the decision handed down by the courts in the matter of *CIR v Conhage (Pty) Ltd* (Formerly Tycon) [21] ("*Conhage*"), was a cause for SARS no longer making use of section 103(1), which had the effect of encouraging SARS to extend the scope of the GAAR by highlighting the problems noted with regards to section 103(1).[22]

Conhage

In *Conhage*, the SCA noted that "within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner". The SCA upheld the decision of the Special Court concerning the interpretation of section 103, and the fact that although the transaction entered into between Conhage (Pty) Ltd (the "Respondent") did result in a tax benefit, the Respondent required capital from Firstcorp Merchant Bank Ltd, and the agreements would never have been entered into if the Respondent did not genuinely require such capital. The principal that a taxpayer has the right to arrange his affairs in a way to obtain the most effective tax benefit was reaffirmed by the SCA.

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21 1999 (4) SA at 1149. In this matter, the court decided to look at the entire transaction as opposed to reviewing the individual steps taken in order to ascertain whether tax avoidance had taken place.

22 Editorial (2007). "General Anti-Avoidance Rule". The Taxpayer Journal at 41.

Six years after the SCA's interpretation of section 103(1) in the *Conhage* matter, which was said to have "effectively emasculated the legislation," and caused greater concern as to whether a business purpose for an overall scheme could be used to separate all of its steps from the challenge,[23] SARS published a Discussion Paper[24] (the "2005 SARS Discussion Paper"). The 2005 Discussion Paper identified the major issues that arose under section 103 and invited comments in respect thereof.

Following comments and critical suggestions received by SARS after the publication of the 2005 Discussion Paper, SARS published an Interim Response in March 2006,[25] and thereafter supplemented the 2005 Discussion Paper with the publication of the Revised Proposals in September 2006.[26] The Revised Proposals contained the draft GAAR legislation (sections 80A – 80L) as an annexure thereto.

SARS noted that the Revised Proposals took into account the criticism received following the publication of the 2005 SARS Discussion Paper, and indicated that the Revised Proposals would "significantly reduce the original abnormality factors from 11 to 5, refocus the remaining ones on arrangements lacking in commercial substance, and provide additional guidance on their scope". In addition to the aforesaid, SARS indicated that the GAAR provisions would leave the threshold test under the purpose requirement unchanged and introduce explicit procedural safeguards for taxpayers.[27]

4.2.3 Reasons for the failure of sections 90 and 103

SARS noted "problems and weaknesses" with section 103 in the 2005 SARS Discussion Paper,[28] wherein it was indicated that section 103 was found to be ineffective for the following reasons:

- it was not an effective deterrent against tax avoidance schemes, as well as other forms of impermissible tax avoidance;
- the "abnormality requirement" presented two main weaknesses. The first weakness

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23 Liptak, (2008). "Battling Boundaries: The South African GAAR Experience in Freedon (ed) Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management. Further, in the General Anti-Avoidance Rule: The Taxpayer Journal. March 2007. Volume 56, No.3. SARS alleged that the enactment of sections 80A - 80L was due to the limiting effects of section 103(1) as construed by the courts in cases which have come before them and it would appear that *Conhage* was the cause of SARS not making use of section 103(1), resulting in SARS extending the scope of the GAAR.

24 SARS (2005). "Tax Avoidance and Section 103 of the Income Tax Act, 1962 Discussion Paper".

25 SARS (2006). "Tax avoidance and Section 103 of the Income Tax Act, 1962, an Interim Response".

26 SARS (2006). "Tax avoidance and Section 103 of the Income Tax Act, 1962, Revised Proposals".

27 *Ibid* at 1.

28 2005 SARS Discussion Paper at 41 – 44.

identified was that tax is not neatly divided into two types of arrangements, one for *bona fide* business transactions, and the other for impermissible business schemes. The second weakness identified was that due to the fact that impermissible business schemes "hijack techniques that were originally developed for *bona fide* business purposes", taxpayers find it relatively easy to create conceivable business purposes;

- the "purpose requirement" created the effect that in order for the requirement to be met, it must be proved that the taxpayer's sole or main purpose of the transaction was to avoid tax. SARS further noted that the term "main" has generally been interpreted to mean the predominant purpose which limits the application of section 103 substantially;[29] and
- procedural and administrative issues were noted with regards to the scope and application of section 103, particularly with regards to larger transactions and the Commissioner's authority to apply section 103 as an alternative when there is another section in the Income Tax Act which is also in dispute.

The amendment of the GAAR would ultimately create a wider net for SARS in reaching as many forms as impermissible tax avoidance as possible.[30] The proposed amendments specified that the following five changes would be made with the introduction of a new GAAR:[31]

i. the introduction of a non-exclusive set of factors which are to be used when determining the abnormality of a transaction or scheme in the context of business, and the creation of a rebuttable presumption of "abnormality" where certain factors were present;
ii. the purpose requirement would be determined objectively as opposed to subjectively taking into account the relevant circumstances and facts of each case;
iii. clarity would be provided with regards to the application of the GAAR to larger transaction or schemes;
iv. the Commissioner would be authorised to apply the GAAR in the alternative; and
v. the introduction of penalty provisions for taxpayers' who substantially under report their

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29 Brincker (2001). "The purpose requirement of the general anti-avoidance provision in South African fiscal law". TSAR at 160 - 161. Brincker noted that a number of issues are required to be considered in order to determine whether the purpose requirement has been met. The first issue which requires consideration is that the test used is subjective in nature, as opposed to the objective test which is used in respect of the abnormality requirement. Kroon J indicated in *ITC 1636 60 SATC 227* at 334 that the subjective intention of the taxpayer must be taken into consideration at the time when the taxpayer entered into the transaction. The second issue which Brincker noted that requires consideration is that the purpose of the transaction entered into remains a question of fact. In this regard, Brincker made reference to the matter of *Geustyn, Forsyth and Joubert* 1971 3 SA 567 (A), wherein the court concluded that various commercial reasons existed which were not related to the avoidance of tax. The third issue was that although the purpose of the transaction was not contrived to avoid a tax liability, it may become the sole or main purpose of the taxpayer when the transaction is carried out. Lastly, Brincker emphasised that the fact that the transaction may result in a tax benefit, does not imply that the sole or main purpose of the transaction in question was to obtain the tax benefit. An example of Brincker's last point is noted in the *Conhage* matter where the taxpayer obtained a tax benefit, however the tax benefit was overshadowed by the fact that the taxpayer required capital and therefore the tax benefit was not seen as the main purpose for the transaction.

30 Revised Proposals at 2.

31 2005 SARS Discussion Paper at 48.

income.

4.3 INTRODUCTION OF THE CURRENT GAAR - SECTIONS 80A - 80L

In 2006, the Revenue Laws Amendment Act[32] repealed section 103(1) of the Income Tax Act and replaced it with sections 80A - 80L found in Part IIA of Chapter 3 of the Income Tax Act. The GAAR provisions are applicable to any arrangement (or any step therein or parts thereof) entered into on or after 2 November 2006, and contain the provisions used to prevent taxpayers from taking undue advantages of the specific provisions of the Income Tax Act. The GAAR must be read with section 103(2), which applies to companies and trusts, as well as section 103(5) which deals with cessions of rights in order reduce or extinguish a payment of tax.[33]

4.3.1 The Scope of the GAAR Legal Framework

The GAAR applies to "impermissible avoidance arrangements", as defined in section 80A, and although the GAAR has retained the four requirements which were available in section 103(1), the GAAR has further introduced new provisions into its legal framework.[34]

Section 80A – Impermissible tax avoidance arrangements

Section 80A provides guidance as to what constitutes an "impermissible avoidance arrangement", and provides that the following requirements are necessary in order for the GAAR to find application:

i. there must be an "avoidance arrangement" entered into on or after 2 November 2006;[35]
ii. the sole or main purpose of the avoidance arrangement must be to obtain a tax benefit; and
iii. the avoidance arrangement must contain either one of the abnormal elements (also

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32 20 of 2006.
33 De Koker (2017) "SILKE on South African Income Tax". Chapter 19 at 19.33. Section 103(2) assists with the prevention of companies and trusts from entering into any agreement or effecting changes in its shareholding or trustees or beneficiaries with the sole or main purpose of utilizing an assessed loss to avoid liability for the payment of tax. Section 103(5) provides that in the event that a cession of a right to receive an amount has taken place in exchange for the right to receive dividends, and as a result has the effect that the liability for normal tax is reduced or extinguished, the Commissioner is able to determine the liability for normal tax as if the cession had not been effected.
34 Olivier and Honibal (2011). "International Tax a South African Perspective" at 530.
35 Section 80L defines an avoidance arrangement to mean any arrangement, but for the provisions of the GAAR, which results in a tax benefit.

referred to as the "tainted elements"),[36] which have been divided into a business context,[37] a context other than a business context,[38] or in any other context.[39] Section 103(1) also contained the abnormality test, but limited the test to business transactions only, whereas the GAAR has broadened the scope considerably.

The aforementioned requirements are conjunctive, and therefore cannot exist independently from one another, however the tainted elements contained in sections 80A(a) – (c) are the decisive elements determining whether an avoidance arrangement is impermissible or not.

Regarding an avoidance arrangement within the business context, at least one of the following requirements must be met:[40]

- the means or the manner which is not normally employed;[41]
- rights or obligations which are not normally created;[42]
- lack of commercial substance;[43]
- misuse or abuse of provisions of the Income Tax Act.[44]

In the event that the avoidance arrangement is in any other context other than in a business context, one of the following three requirements must be met:[45]

- the means or the manner which is not normally employed;[46]
- rights or obligations which are not normally created;[47]
- misuse or abuse of provisions of the Income Tax Act.[48]

Section 80B – Tax consequences of impermissible tax avoidance

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36 Revised Proposals at 3. SARS noted that the tainted elements would replace the "abnormality" and "non-arm's length rights and obligations" provisions and would introduce two new elements to target avoidance arrangements that lack commercial substance, or would frustrate the purpose of the provisions of the Income Tax Act.

37 Section 80A(a). An avoidance arrangement is said to be an "impermissible avoidance arrangement" in the context of business if it were carried out in a manner which would not normally be employed for a *bona fide* business purpose, other than obtaining a tax benefit, or it lacks commercial substance, in whole or in part. The lack of commercial substance concept is dealt with in detail in section 80C below.

38 Section 80A(b). An avoidance arrangement is said to be an "impermissible avoidance arrangement" in the context other than a business if it were carried out in a manner which would not normally be employed for a *bona fide* business purpose, other than obtaining a tax benefit.

39 Section 80A(c). An avoidance arrangement is said to be an "impermissible avoidance arrangement" in any context if it created rights and obligations which would not normally be created between two people dealing with each other at arm's length, or results in the misuse or abuse of the provisions of the Income Tax Act.

40 Stiglingh, Koekemoer, Wilcocks, de Swardt, van Zyl. (2016). "SILKE: South African Income Tax" at 812.

41 Section 80A(a)(i).

42 Section 80A(c)(i).

43 Section 80A(a)(ii).

44 Section 80A(c)(ii).

45 Stiglingh, Koekemoer, Wilcocks, de Swardt, van Zyl. (2016). "SILKE: South African Income Tax" at 813.

46 Section 80A(a)(i).

47 Section 80A(c)(i).

48 Section 80A(c)(ii).

Section 80B allows the Commissioner to determine the tax consequences of an "impermissible avoidance arrangement", which includes the authority to disregard, combine or re-characterise any steps in or part of an impermissible avoidance arrangement, or reallocate gross income or receipt of accruals of a capital nature, amongst other tax consequences.

Section 80C – Lack of commercial substance

As noted above, section 80A(a) provides that an avoidance arrangement is said to be an "impermissible avoidance arrangement" in a business context, if it were carried out in a manner which would not normally be employed for a *bona fide* business purpose, other than obtaining a tax benefit, or it lacks commercial substance, in whole or in part. Section 80C has therefore been included as an entirely new GAAR provision introducing this important addition to the GAAR.

An avoidance arrangement is said to lack commercial substance in the event that it results in a significant tax benefit for a party, however it does not have a significant impact on their business risks or net cash flows. Therefore, in order for a taxpayer to show that the arrangement does not lack commercial substance and therefore falls outside the ambit of section 80C, the taxpayer must show that the arrangement would have existed even in the event that the taxpayer derived no tax benefit, and further that the arrangement had a significant effect on either the business risks or net cash flow of the taxpayer. The term "significant" used in section 80C could potentially create additional interpretational issues due to the word having a subjective nature to different persons. Any interpretational issues are however yet to be seen as the term has yet to be considered by the courts in the context of section 80C.

A non-exhaustive list of avoidance arrangements has been provided in the GAAR provisions that are said to be indicative of a lack of commercial substance. The list includes the following:[49]

i. the legal substance or effect of the avoidance arrangement as a whole is inconsistent or differs significantly from the legal form of its individual steps; or
ii. any of the following is present:
    - round trip financing;[50]
    - an accommodating or tax indifferent party;[51] or
    - elements which have the effect of offsetting or cancelling each other.

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49 Section 80C(2)(a) – (b).
50 The provisions in respect of round trip financing are dealt with in section 80D below.
51 The provisions in respect of an accommodating or tax indifferent party are dealt with in section 80E below.

With regards to the legal substance as a whole, and the legal form in respect of its individual steps as provided for in section 80C(2)(a), Broomberg noted that it was necessary to obtain clarity in respect of the nature of the test, as it must not be confused with the familiar substance-versus-form issue which was considered in the matter of *Relier (Pty) Ltd v CIR* 60 SATC 1 (SCA),[52] (herein after referred to as "*Relier*").

Broomberg noted that the substance-over-form exercise explained in the *Relier* matter should always be applied in tax cases where there may be potential tax avoidance arrangements. He further noted that the substance-over-form exercise must take place before consideration is given regarding whether the GAARs apply to a specific arrangement.[53] Therefore he is of the opinion that the provisions of the GAAR are to be applied only to the true rights and obligations which have been identified after all substance-over-form issues have been resolved, and therefore, the test contained in section 80C(2)(a) should rather refer to a different comparison.

Accordingly, Broomberg suggests that a comparison be made in respect of the legal substance or effect of the whole of the scheme on the one hand, and the legal form of the individual steps on the other. By making use of the word "legal" when referring to both the "legal substance or effect" and the "legal form", this could create confusion due to the fact that in "judicial parlance" as mentioned by Broomberg, the term "legal" is usually used when making a distinction between the legal effects of the one hand, as opposed to the economic or commercial effect on the other. For this reason, Broomberg suggests that further clarity be provided with regards to the meaning of the legal substance or effect and the legal form.

Section 80D – Round trip financing

In the event that "round trip financing" is found present in an arrangement, this could indicate that the arrangement lacks commercial substance as provided in section 80C(2)(b)(i). Round trip financing involves any avoidance arrangement in which funds[54] are transferred between or amongst parties (round trip amounts), and the funds which are transferred result directly or indirectly in a tax benefit, and significantly reduce, offset or eliminate the business risk incurred by any party in connection with the avoidance relationship.

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[52] Harms JA noted in the judgment handed down by the SCA at 2, that the factual and legal issues raised in the *Relier* matter are similar, or identical to those raised in *Ladysmith*, the facts of which are indicated in footnote 15 of Chapter 2 above. In *Ladysmith*, Hefer JA confirmed that paragraph (h) of the definition of 'gross income' did not deal with the benefit accruing to the first mentioned person who is usually the owner of the land, as an improvement to his property, and only to the right to have improvements effected, which right must accrue in terms of an agreement.

[53] Broomberg (2008). "Then and now." Tax Planning - Corporate & Personal Journal at 1. The substance-over-form rule may well require the stripping away of the form of a sham transaction and exposing its true substance".

[54] For purposes of section 80D, "funds" has been defined in section 80D(3) to include any cash, cash equivalents or any rights of obligation to receive the same.

It is interesting to note that in section 80C(1), an avoidance arrangement is said to lack commercial substance if it results in a significant tax benefit but does not have a significant effect on the business risk of the taxpayer, whereas in section 80D(b)(i) and (ii), round trip financing occurs when funds are transferred resulting in a tax benefit, however in contrast to section 80C, the avoidance arrangement must significantly reduce the business risk of the taxpayer.

Section 80D finds application to the following round trip amounts:[55]

i. whether or not the round trip amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;
ii. the timing or sequence in which round trip amounts are transferred or received; or
iii. the means by or manner in which round trip amounts are transferred or received.

Due to the fact that round trip financing involves any avoidance arrangement in which funds are transferred between or among parties, Broomberg indicated that the requirement that funds are transferred between or among parties is so wide in its application and can hardly serve as a useful purpose. Further, he indicated that almost every single commercial arrangement between two or more parties will involve the transfer of funds, either physically or electronically.[56] This could result in the situation where the Commissioner is required to consider numerous arrangements which may potentially trigger section 80D simply on the basis funds have been transferred between the parties concerned.

Section 80E – Accommodating or tax indifferent parties

A person who is a party to an avoidance arrangement is considered to be an accommodating of tax-indifferent party if:

a. any amount derived by the party in connection with the avoidance arrangement is either:
    1. not subject to normal tax; or
    2. 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:

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55 Section 80D(2)(a) – (c).
56 Broomberg (2008). "Then and now". Tax Planning - Corporate & Personal Journal at 2.

1. as a direct or indirect result of the participation of that party an amount that would have:
   (aa) been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts or accruals of a capital nature of that party; or
   (bb) constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party; or
   (cc) constituted revenue in the hands of another party would be treated as capital by that other party; or
   (dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or
2. the participation of that party directly or indirectly involves a pre-payment by any other party.

In terms of section 80E(2), a person may qualify as an accommodating or tax indifferent party, even in the event that that person was connected to that person before the transaction took place.[57]

In addition, section 80E(3) excludes certain parties from being said to be accommodating or tax indifferent parties, i.e. if a party is subject to income tax in another country other than South Africa which is equal to at least two-thirds of the amount of normal tax which would have been payable in terms of South African income tax. The reason for this exclusion is that tax paid in a country other than South Africa, compared to normal tax levied in terms of the Income Tax Act, will neutralise the tax benefits. The final exclusion is extended to parties who are engaged in substantive active trading in connection with the avoidance arrangement for a period of at least 18 months, provided that the activities are attributable to a "place of business, place, site, agricultural land…" if the party of a controlled foreign company under section 9D of the Income Tax Act.

Section 80F – Treatment of connected persons and accommodating tax indifferent parties

Section 80F contains the provisions relating to the "treatment of connected parties and accommodating and tax indifferent parties" for the purposes of the Commissioner applying section 80C above, with regards to determining whether a tax benefit exists. In terms of section

[57] Kujinga (2013). "A comparative analysis of the efficiency of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa" at 114. Kujinga indicated that it is not a defence to argue that the parties have always been commercially connected.

80F(a) and (b), the Commissioner is authorised to treat parties who are connected persons in relation to each other as one and the same person, or disregard any accommodating or tax indifferent person, or treat any accommodating or tax indifferent party as one and the same person.

Section 80G – Presumption of purpose

Section 80G places the burden of proof on the taxpayer and indicates that an avoidance arrangement is presumed to have been entered into for the sole or main purpose of obtaining a tax benefit, unless the party who received the tax benefit is able to prove otherwise.

Section 80H – Application to steps in or parts of an arrangement and section 80I – Use in the alternative

Section 80H allows the Commissioner to apply the GAAR to a “part of an arrangement” and not the entire transaction, whereas section 80I allows the Commissioner to apply to GAAR as an “alternative” for raising an assessment. The latter is in line with proposed amendments made in the 2005 SARS Discussion Paper, and assists with addressing the procedural and administrative issues raised.[58]

Section 80J – Notice

Section 80J contains the GAAR procedural requirements, and requires that the Commissioner first provide the taxpayer with a notice wherein the Commissioner has set out the reasons why they believe the taxpayer’s arrangement falls within the ambit of the GAAR. The taxpayer receiving the notice is thereafter given 60 days, or such longer period as allowed by the Commissioner, to provide reasons why the Commissioner should not apply the GAAR. This allows for procedurally fair administrative justice and allows the party to respond to the Commissioner before the Commissioner determines a tax liability.

Section 80K – Interest and section 80L - Definitions

Section 80K refers to “interest” and contains the same provisions provided for under section 103(6). In this regard, the Commissioner is not permitted to exercise his discretion in terms of

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[58] As referenced in footnote 31 above, the proposed amendments provided in the 2005 SARS Discussion Paper at 48, indicated that five changes would be made with the introduction of a new GAAR, the fourth change allowing the Commissioner to apply section 103 in the alternative.

section 89quat(3)[59] or (3A)[60] in order to direct that interest is not payable in respect of the portion attributable to the GAAR.

Section 80L contains the definitions of the following terms used throughout the GAAR:

- arrangement;
- avoidance arrangement;
- impermissible avoidance arrangement; and
- tax.

4.4 THE APPLICATION OF THE SOUTH AFRICAN GAAR TO THE TAX AVOIDANCE STRATEGIES ADOPTED BY GOOGLE, LONMIN AND MTN

As noted above in paragraph 4.3.1 above, the GAAR finds application taking into account the concept of an impermissible avoidance arrangement as defined in section 80L of the Income Tax Act.

The GAAR has not been challenged by SARS or by taxpayers and brought before the courts for consideration as yet, and therefore there are no reported cases where the provisions of the GAAR have been interpreted and applied.[61] Although Kujinga may be of the view that the GAAR may be serving its role effectively and for this reason has not been judicially considered to date, De Koker is of the view that as a result of the GAAR not having been considered by the courts, uncertainty has been created with regards to what constitutes permissible or impermissible tax avoidance.[62]

Paragraphs 4.4.1 and 4.4.2 include a brief examination of the tax avoidance strategies allegedly adopted by Google, Lonmin and MTN, and the application of the GAAR in order to access whether the GAAR may be useful against tax avoidance strategies should these South African Multinationals come before the courts.

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59 Where the Commissioner having regard to the circumstances of the case is satisfied that the interest payable in terms of subsection (2) is a result of circumstances beyond the control of the taxpayer, the Commissioner may direct that interest shall not be paid in whole or in part by the taxpayer.

60 Where any natural person has, in respect of the year of assessment during which he for the first time became a provisional taxpayer, became liable for the payment of interest under subsection (2), the Commissioner may, subject to the provisions of section 103 (6), if he is satisfied that the circumstances warrant such action, direct that interest shall not be paid by such person in respect of such year of assessment.

61 Kujinga (2013). “A comparative analysis of the efficiency of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa” at 129. Kujinga noted that the fact that there have been no reported cases in respect of the GAAR is not unusual and that it may be said that the GAAR is serving its role effectively and that perhaps taxpayers are not attempting transactions that could “provoke its invocation”. Kujinga further indicated that perhaps the GAAR is effective as it clearly distinguishes between permissible and impermissible tax avoidance, resulting in there being no cases to litigate.

62 De Koker (2017). “SILKE on South African Income Tax” at 19.33.

4.4.1 Tax avoidance strategies adopted by the South African Multinationals

The main issues raised in respect of the South African Multinationals allegedly avoiding the payment of taxes in South Africa were:

- transactions made through an offshore entity in Ireland (Google). Due to the fact that South Africa follows a residence based system of taxation where South African residents are taxed on their worldwide income, irrespective of whether their income was earned in South Africa or from a foreign source, and by contrast, non-residents are taxed only in South Africa on their income earned from a South African source, by Google transacting through Ireland, Google's representatives maintained that the revenue received from those transactions was not from a source within South Africa as the business was not directed from Google South Africa and therefore not taxable in South Africa;
- Transfer Pricing strategies (Lonmin), where so-called "sales commissions" were paid from Lonmin's South African Group to a subsidiary located in Bermuda, in addition to "management fees" paid to Lonmin's external company which is located in South Africa, and 'non-goods' payments by way of payments made for legal, accounting and management consultancy services; and
- billions in profits earned in African countries being shifted to Mauritius and Dubai (MTN), where no staff were employed by making use of "management fees", similarly to that of Lonmin.

4.4.2 Application of the GAAR

In the event that SARS is of the opinion that a transaction or arrangement undertaken by the South African Multinational constitutes an impermissible tax avoidance arrangement,[63] SARS is authorised to make use of the provisions of the GAAR in an attempt to hold the South African Multinational liable. The first aspect which is required to be proved is that the sole or main purpose of the arrangement was to obtain a tax benefit, and secondly that either the arrangement was carried out in a manner which would be regarded as not normally carried out for a *bona fide* business purpose, or is found to be an arrangement which lacks commercial substance.

When determining whether the sole or main purpose of an arrangement was to avoid the payment of tax, there is a presumption that any avoidance arrangement is presumed to have

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[63] Section 80A, as indicated in paragraph 4.3.1 above.

been entered into for the sole or main purpose of obtaining a tax benefit until proven otherwise. It follows, that the burden of proof is thus placed on the taxpayer (the South African Multinational) to rebut this presumption.[64]

If the South African Multinationals could prove that the sole or main purpose for their transactions was not solely or mainly for the purpose of avoiding the payment of tax, and could further prove that it entered into such arrangements in terms of a *bona fide* business purpose, or that the rationale for entering into the arrangements had commercial substance which did not result in a tax benefit for one party whilst not having a significant effect on the South African Multinationals' business, it could provide difficultly for the court to prove that the arrangements constituted impermissible avoidance arrangements in terms of section 80A of the GAAR.

Google

In addition to Google having to rebut the presumption that the sole or main purpose of the arrangement was to avoid tax, Google must further prove that the arrangement either had a *bona fide* business purpose, or must show that the arrangement whereby Google transacted through Ireland had commercial substance in order not to be regarded as an impermissible tax avoidance arrangement.

It could be argued in Google's favour that due to the fact that Google's head office is based in Ireland and that its sales staff are employed and located in Ireland, that all the sales are in fact made from Ireland as part of Google's business plan and not sourced within South Africa and therefore cannot be regarded as an impermissible tax avoidance arrangement. However, Google will have to prove that that no sales are made through its South African entity and that transacting through Ireland has a *bona fide* business purpose or has commercial substance and not only arranged in that manner to avoid the payment of tax.

In the event that SARS can prove that sales took place from South Africa and not only from Ireland for example, the chances of Google being able to prove that the arrangements were not solely or mainly entered into to avoid the payment of tax and were in fact for a *bona fide* business purpose or had commercial substance becomes slim.

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[64] Section 80G contains the presumption of purpose provision and places the burden of proof on the taxpayer as indicated in paragraph 4.3.1 above.

Lonmin and MTN

In terms of the commissions, fees and payments paid by Lonmin, and the management fees made by MTN (the "payments"), Lonmin and MTN would be required to prove that these payments were genuine payments for services rendered, and not merely payments made in order to avoid the payment of taxes in South Africa and to shift profits abroad in order to reduce its tax base.

In order for Lonmin and MTN to prove that there is a *bona fide* business purpose, or that the cross border payments did not lack commercial substance, they could use the following defences in their favour, for example:

i. for Lonmin:
   - Lonmin has employees employed at its subsidiary located in Bermuda (where the sales commissions are being paid), who are tasked to sell the metals which are mined in South Africa;
   - the management decisions are taking place by Lonmin's external company in South Africa where the management fees are being paid;
   - proof that the 'non-payments' are in respect of genuine consultancy services and not fabricated payments; or
   - if Lonmin could prove that no significant tax benefit arose for a party to the arrangement without a significant effect upon the business risks of the party concerned.

ii. for MTN:
   - the "management fees" transferred to Mauritius and Dubai were in fact *bona fide* payments for management services rendered in Mauritius and Dubai; or
   - if MTN could prove that no significant tax benefit arose for a party to the arrangement without a significant effect upon the business risks of the party concerned.

From the facts provided however, and due to the fact that it was indicated that MTN employed no staff in Mauritius and Dubai where it received the management payments, it could potentially be difficult for MTN to be able to prove that there was a *bona fide* business purpose when making these payments. In addition, when dealing with the concept of commercial substance, it could potentially be difficult for MTN to prove that no significant tax benefit arose which had a significant effect upon the business risks of MTN.

Taking the provisions of the GAAR into consideration in the MTN matter, the facts appears

to point towards the arrangement being regarded as an impermissible tax avoidance arrangement where MTN shifted its profits to lower tax jurisdictions under the disguise of the payment of "management fees". In addition, it would under the circumstances be difficult for MTN to prove that the sole or main purpose of these payments were made for any other reason than the avoidance of tax.

In the event that the South African Multinationals are unable to rebut the presumption that the arrangement was entered into for the sole or main purpose to avoid the payment of tax, and cannot disprove that the arrangement constitutes an impermissible tax avoidance arrangement, the Commissioner may determine the tax consequences in accordance with section 80B.[65]

Although the application of the GAAR is complex and requires a significant amount of information to be provided by the taxpayer in order to support its defence that the arrangement should not be considered to be an impermissible avoidance arrangement, it appears taking the above into consideration, that should a matter come before the courts in respect of a Multinational adopting one of the strategies discussed above, the GAAR will add value to SARS against tax avoidance by Multinationals, however the extent of the value is yet to be seen.

4.5 CONCLUSION

The history behind the anti-avoidance legislation in South Africa has come a significant way since the GAARs first enactment in 1941 following the Appellate Division's decision in *Hiddingh* where it was held that the taxpayer disposed of income before it accrued to him, and therefore did not result in a taxable event.

The interpretations provided by the courts over the years, as well as the various amendments to the GAAR, have paved the way to South Africa's current GAAR which to date has not been brought before a court by SARS or the taxpayer for judicial consideration. The fact that the GAAR has not been judiciary considered can be perceived positively that the GAAR is serving its intended purpose, the prevention of tax avoidance, and therefore there are no cases that require litigation in order to make the fundamental distinction between permissible and impermissible tax avoidance.

Although the GAAR has remained outside the courts, tax avoidance is still an on-going issue, especially when it comes to South African Multinationals entering into cross-border transactions.

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[65] Section 80B, as indicated in paragraph 4.3.1 above.

In this regard, South African Multinationals have made use of tax avoidance strategies in order to shift their profits to low or no income jurisdictions to avoid paying taxes to the South African authorities. For this reason, the OECD, together with various committees and forums, developed the BEPS framework consisting of 15 Action Plans, a global anti-avoidance initiative which is in the process of being implemented in South Africa, and once implemented, will provide a much wider anti-avoidance legal framework specifically targeting Multinationals shifting their profits abroad.

Regardless of the implementation of the Action Plans in South Africa and on a global basis, it is still however important for South Africa's domestic legislation to be structured in a way in order to assist with the prevention of tax avoidance, where applicable.

Taking into account the limited information available in respect of Google, Lonmin and MTN, as well as the assumptions made regarding potential defences in favour of these South African Multinationals, it appears that the GAAR could provide value should it be tested in court when considering the avoidance arrangements undertaken by the South African Multinationals and whether these arrangements constitute "impermissible tax avoidance arrangements". By placing the burden of proof on the taxpayer who is required to rebut the presumption that the arrangement was entered into for the sole or main purpose to avoid the payment of tax, SARS is placed in a favourable position and the taxpayer is required to provide evidence to disprove this presumption. The more evidence the taxpayer provides, the more ammunition SARS has to find potential issues with this evidence.

At this stage, we do not have a true indication of the value of the GAAR in respect of the prevention of tax avoidance by Multinationals, however with the implementation of the Action Plans read in conjunction with South Africa's domestic law, the prevention of tax avoidance by Multinationals appears much more optimistic going forward.

CHAPTER 5: THE UK GAAR

5.1	INTRODUCTION	59
5.2	HISTORICAL OVERVIEW OF ANTI-AVOIDANCE PROVISIONS IN THE UK	60
5.3	THE IMPLEMENTATION OF THE GAAR IN THE UK (2013)	65
5.4	THE APPLICATION OF THE UK GAAR TO TAX AVOIDANCE STRATEGIES ADOPTED BY STARBUCKS, GOOGLE AND AMAZON	69
5.5	CONCLUSION	74

5.1 INTRODUCTION

Until July 2013, the UK did not have a GAAR incorporated into its legislation and relied upon judicial anti-avoidance doctrines in order to curb impermissible tax avoidance. These judicial anti-avoidance doctrines emanated from case law handed down by courts within the UK.

On 17 July 2013, the GAAR[1] received royal assent and was introduced into the UK's Finance Act[2] for the first time. The GAAR comprises of sections 206 – 215 and finds application to tax arrangements entered into or after the day in which the Finance Act came into effect, i.e. 17 July 2013.[3] Amendments made to UK tax legislation, especially concerning tax avoidance schemes, are often announced in advance and are amended yearly in the annual Finance Bill. The enforcement of tax legislation in the UK is governed by HMRC, which is one of the largest Governmental departments within the UK.[4]

The aim of this Chapter is to provide the historical legal framework in respect of anti-avoidance provisions and judicial doctrines available in the UK before the introduction of the GAAR in 2013, as well as to provide an insight as to why the historical anti-avoidance framework failed to prevent recurring tax avoidance. Due to the fact that the current GAAR framework has not come before the HMRC for consideration as yet, this Chapter will include a brief examination of the tax avoidance strategies allegedly adopted by the UK Multinationals as indicated in paragraph 3.3 above, and the application of the GAAR provisions to these tax avoidance strategies in order to assess whether the GAAR may be useful against tax avoidance strategies should these UK Multinationals come before the HMRC.

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1 The General Anti-Abuse Rule (as indicated in Part 5 of the Finance Act).
2 Finance Act 2013, in Chapter 29.
3 *Ibid* section 215.
4 Brown (2012). "A Comparative look at regulation of corporate tax avoidance." Chapter 16. Brown noted that the enforcement of tax laws is governed by HMRC, in particular the laws found in the Taxes Management Act 1970 c.9 and Commissioners of Revenue and Customs Act 2005 c.11.

5.2 HISTORICAL OVERVIEW OF ANTI-AVOIDANCE PROVISIONS IN THE UK

Before the introduction of the GAAR in 2013, the courts traditionally relied on various judicial anti-avoidance doctrines. The approach adopted by the courts during the period 1869 until 1981, was a literalist approach whereby the courts considered the primary meaning of the words contained in the statutory provisions.

A change emanated from approximately 1981, whereby the literalist approach was relaxed, and an increasingly subjective approach gained recognition and acknowledgement by the judiciary. The courts gradually started moving away from the objective literalist view when interpreting the law and precedents, to a view where subjective elements were allowed to be considered. This subjective view was commonly referred to as the "substance doctrine" at the time.

With effect from 17 July 2013, the UK incorporated its first GAAR provisions into the Finance Act, which provisions are still enforced today.

5.2.1 Fundamental anti-avoidance case law in the UK

The approach in the UK prior to the Duke of Westminster case (1869 - 1936)

Prior to the *Duke of Westminster* case being heard by the courts in 1936, where the courts rejected the so-called substance doctrine and followed a literalist approach, the literalist approach was regarded as the acceptable approach followed in the UK at the time. As noted earlier in the case of *Partington*,[5] Lord Cairns was of the view that regardless of any adversity towards a taxpayer, a person is required to be taxed if he comes within the letter of law, and therefore in line with the literalist approach adopted in the UK in the years going forward.

Duke of Westminster (1936)

In 1936, judgment was handed down by the House of Lords in favour of the taxpayer.[6]

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5 *Partington* was judicially considered in the UK in 1869 and a full citation of the case has been provided in Chapter 2, footnote 6.

6 1936 AC 1; 19 TC 490. In this matter, the taxpayer employed servants who received payments for the work undertaken by way of a deed of covenant. A deed of covenant according to the online Oxford Dictionary is defined as "an agreement to pay a regular amount of money, particularly when this enables the recipient (typically a charity) to reclaim any tax paid by the donor on the amount". Available from https://en.oxforddictionaries.com/definition/deed_of_covenant. [Accessed on 2017/10/02]. In terms of the agreement between the taxpayer and his employees, the taxpayer covenanted in respect of the employees past services to pay the employee during their joint lives, or for a period of seven years, a weekly sum. Further, in terms of the agreement, the taxpayer (who executed the deed of covenant) was entitled to a tax deduction, however this deduction was only valid in the event that the employer had not paid any consideration to the employee. In this regard, the taxpayer provided its employees with letters explaining that for as long as the deed of covenant was in effect, the employee would not claim any of the wages that they had become entitled to, which letter was acknowledged by the employees, allowing the taxpayer to claim the aforementioned deductions.

Two important questions arose in this judgment which required consideration by the court at the time. The first question was whether certain payments, which had been made by the Duke of Westminster (the "Appellant") under the deeds of covenant, constituted annual payments which were allowed as deductions,[7] and secondly, whether certain sums which had been paid by the Appellant under the deeds of covenant should have been included in the Appellant's total income.[8]

In terms of the appeal, judgment was made in favour of the Appellant against the judgment handed down by Finlay, J, and comprised of the following views of Lord Tomlin, Lord Russel of Killowen ("Lord Russel"), Lord Macmillan and Lord Wright who were in favour of the judgment of the Appellant, whereas Lord Atkin was of the view that the appeal should have failed:

- Lord Atkin agreed with the Commissioner and Finlay JA that the substance of the transaction was that what was being paid was considered remuneration.[9] With the exception of Mr Blow, an employee of the Appellant, Lord Atkin was of the view that the order of the Commissioner must be restored and the appeal allowed with costs;
- Lord Tomin disagreed with the Commissioner's use of the term "the substance of the matter" doctrine, wherein the Commissioner stated that the substance of the matter is that the annuitant was serving the Appellant for something equal to his former salary or wages, and ignoring the legal position.[10] Lord Tomlin found that he did not agree with Lord Atkin and in his view found that all of the annuities falling part of this appeal, ought to be dismissed with costs;
- Lord Russel stated upfront that he would dismiss the appeal and agreed with Lord Tomlin;[11]
- Lord Macmillan expressed that in his view the proper approach to the problem was to ask the question whether the 38s[12] received by the employee per week, was in the form of an annual payment payable as a personal debt, or resulted from a contract entered into between the parties.[13] Lord Macmillan further agreed with Lord Tomlin and Lord Russel in

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7 *Ibid* at 491.
8 *Ibid* at 497.
9 *Ibid* at 517. Lord Atkin was of the view that the difficulty arose with the wording used by the Commissioner in his finding wherein it was stated that "the payments made under these deeds…were, in substance" payments by way of remuneration, and that the aforementioned phrase would not be justified standing alone. However, reference to the immediately preceding sentence indicated that the Commissioner had taken the letters provided by the Appellant to its employees, as well as their acknowledgments before making such a finding.
10 *Ibid* at 520. Lord Tomlin further indicated that this so-called doctrine of substance appears to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax is not legally sought from him.
11 *Ibid* at 521. Lord Russel summarised the result by stating that if the payment of these sums is the payment of salary or wages within Schedule E from which tax is not deductible by the Appellant, then he is not permitted to exclude these amounts in ascertaining his total income for Sur-tax purposes. In the event that the payment is an annual payment within Schedule D, from which tax is deductible by the Appellant, then he is entitled to exclude the amounts in ascertaining his total income.
12 According to the University of Nottingham, shillings were usually abbreviated to 's'. The 's' stands for 'sesterius' or 'solidos', coins used by the Romans. Available from http://bit.ly/2BtyCCx. [Accessed on 2017-10-28].
13 Lord Macmillan stated that if question one is answered in the affirmative, rule 19(1) of the rules will find application and the Appellant is therefore entitled to deduct tax on making the covenanted payments. If the Appellant is entitled to deduct tax

that the appeal ought to be dismissed; and

- Lord Wright stated that the conflicting opinions from the appeal did cause some doubt in his mind, however noted that after careful consideration of the facts, that he was of the view that the appeal must fail and be dismissed.[14]

As a result, the appeal was subsequently dismissed with costs. The judgment confirmed the approach followed by the judiciary at the time, being a literalist approach evidenced by the strict interpretation of the words of the statute, as opposed to the so-called substance doctrine.

Ramsay and Eilbeck (1981/2)

Following the literalist approach adopted in the *Duke of Westminster* case, the House of Lords was required to consider the conjoined matter of *WT Ramsay v CIR; Eilbeck* (Inspector of Taxes) *v Rawling* ("*Ramsay*").[15] In both *Ramsay* and *Eilbeck,* each of the taxpayers had made substantial gains and purchased a scheme designed to produce capital losses in order to avoid paying taxes on these gains by setting off the capital losses produced.

The House of Lords dismissed both appeals on the ground that both of the taxpayers had not incurred a loss allowable as a deduction against the capital gain within the meaning of the legislation. Lord Wilberforce indicated that for the Commissioner who is required to consider a particular case:

> "… It is a wrong, and an unnecessary self-limitation, to regard themselves as precluded by their own finding that documents or transactions are not 'shams', from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is. They are not, under the Westminster doctrine or any other authority, bound to consider individually each separate step as a composite transaction intended to be carried through as a whole".[16]

Following *Ramsay*, the substance doctrine came under scrutiny in the same year in the matter of *IRC v Burmah Oil Co Ltd* ("*Burmah Oil*"),[17]where the substance doctrine was interpreted in a similar manner to *Ramsay*, where Lord Diplock noted that steps inserted which did not have

from the payments he is also entitled to deduct the amount of these payments in computing his total income for Sur-tax purposes.

[14] *Ibid* at 527. Lord Wright also made reference to the fact that in his opinion there is no room for the phrase "in substance".

[15] 1981 1 All ER 865.

[16] *Ibid* at 325.

[17] 1982 STC 30. The facts are noted in Chapter 2, footnote 5.

any commercial purpose apart from the avoidance of a tax liability, indicated that the transaction as a whole was artificial.[18] The appeal in this matter was allowed in favour of the Commissioner.

Following the cases of *Ramsay* and *Burmah Oil*, uncertainty existed in respect of the circumstances in which the new approach would be applicable, and the circumstances in which the literalist approach would still find application. The view was held that the decision should be restricted to the facts of the case and the approach followed in *Ramsay* and *Burmah Oil* would only be followed where the steps forming part of the scheme were circular or self-cancelling, or where a change in the parties legal position was merely a change in the form, without resulting in any legal consequences.[19]

Barclays Mercantile (2005)

Many years after *Ramsay* and *Burmah Oil*, in the judgment of *Barclays Mercantile Business Finance Ltd v Mawson* (HM Inspector of Taxes) ("BMBF"), the Commissioner appealed to the House of Lords in 2005 from a finding of the court of appeal in favour of BMBF.[20] In this matter, the Commissioner challenged the availability of capital allowances to the lessor arguing that the arrangements prevented BMBF from any entitlement to such allowances. The Special Commissioner dismissed BMBF's appeal by virtue of the fact that the purpose of the expenditure of £91 million had not been the acquisition of plant or machinery, but the obtaining of a capital allowance. On appeal to the High Court, the judgment by the Special Commissioner was upheld.

BMBF thereafter took the matter on appeal, which was granted on the basis that the expenditure which was incurred, was incurred for the purposes of its trade of providing asset-based finance. As a result of the appeal being granted, the Commissioner appealed to the House of Lords who after consideration of the matter, dismissed the Commissioner's appeal on the basis that the House of Lords was of the opinion that the view followed in *Ramsay* (where it was held that the application of any taxing statute, transaction or element of a transaction which had no commercial purpose was to be disregarded), went too far.

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[18] *Burmah Oil*, judgment 1 at 32. Lord Diplock agreed with Lord Fraser who indicated in Judgment 2 that there were two main issues which required consideration. The first question being one of pure construction of the statutory provisions with regards to capital gains tax, whereas the second question deals with the wider interpretation as to whether certain types of transactions on the face of them, according to the taxpayer's submission, resulted in a capital loss, should be regarded as artificial. As in *Ramsay* where Lord Wilberforce indicated that it was admitted that the whole and only purpose of the scheme was the avoidance of tax, the same admission was made in this case and the same adverbs apply.

[19] Olivier and Honibal (2011). "International Tax a South African Perspective" at 522. This interpretation was accepted by Vinelott J in the High Court decision in *Furniss (Inspector of Taxes) v Dawson* 1984 A.C. 474 ("*Furniss*"), as well as other related appeals. In the appeal in *Furniss,* Lord Brightman held that the distinguishing feature between schemes which would be upheld and those which will not be, is not whether any enduring legal consequences exist, but whether the steps which have been inserted into the series of transaction in fact have a commercial purpose, other than the avoidance of tax.

[20] 2005 1 ALL ER 97. BMBF bought a pipeline for £91 million which ran between Scotland and Ireland from BGE, an Irish gas supplier, and then was subsequently leased it back to BGE, where the defeasance was effected through the deposit of cash back with the BMBF.

The House of Lords indicated in its judgment that this matter required a close analysis of what on a purposive construction, the statute actually required. The House of Lords held that the object of granting the allowance was to provide the tax equivalent in respect of a normal accounting deduction from profits for the depreciation of machinery and plant used for the purposes of trade which was in line with the legislation at the time, and therefore dismissed the appeal.[21]

It follows from the above, that the transactions involved in *Ramsay, Burmah Oil* and *Furniss,* were held not to be a sham, but rather genuine. The fact that they were part of a series of transactions made it possible for the courts to look at the scheme of transactions as a whole and ignore the transactions which were found not to have any commercial purpose.[22] This is however not the way in which the substance over form doctrine is applied in the South African context. In South Africa, when agreements between parties reflect their true intention, the courts are not permitted to merely ignore a certain part of a transaction because it is said to lack commercial substance.[23]

5.2.2 Specific Anti-Avoidance Rules and Targeted Anti-Avoidance Rules

Prior to the introduction of the GAAR, the UK made use of SAARs to assist with the prevention of specific instances of tax avoidance, as well as the TAARs, which were used to stop (or target) avoidance within a particular area of law.[24] TAARs are said to be quite complex and have been criticised by practitioners and academics.[25]

In addition, it was noted that the nature and impact of the TAARs represent a middle road between a GAAR (which has been either legislated or judicially created) and the detailed technical measures in order to counter unacceptable tax avoidance transactions.[26]

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21 *Ibid* at 98.

22 Olivier and Honibal (2011). "International Tax a South African Perspective*"* at 524.

23 *Ibid* at 525. It was noted by Olivier and Honibal that the *Ladysmith* case, the facts of which have been provided in footnote 15 above, should not be regarded as authority under the common law for the courts to treat the steps within a series of transactions as one transaction and ignore the part which does not have any commercial benefit, irrespective of the tax benefit derived from that specific step within the transaction. Olivier and Honibal further noted that if the parties to the transaction intended to give effect to each step involved in the transaction, and there is supporting evidence in this regard, then effect should be given to each individual step.

24 Staff Writer (2016). "Recent global developments in general anti-avoidance rules" at 16. PwC. TAARs were first introduced in 2004.

25 Pickup (2008). "In Relation to General Anti-Avoidance Provisions: A Comparative Study of the Legal Framework Used by Different Countries to Protect their Tax Revenues" at 2. Bowler in the Institute for Fiscal Studies, "Countering Tax Avoidance in the UK: Which way forward?" indicated that when considering the TAARs, what is surprising is the amount of TAARs available "which in itself increases the complexity and uncertainty of the legislation". Bowler further questioned the fact as to whether the TAARs perform their anti-avoidance function effectively.

26 Freedman *et al (*2008). "Alternatives to tax risks and tax avoidance: an analysis of a face to face corporate survey" at 16. The TAARs are said to contain "the Purpose Rules" and therefore the TAARs are concerned with the taxpayer's purpose in respect of the implementation of a transaction. The statutory purpose is not the purpose that is considered in terms of the Purpose Rules, however how taxpayers (including large businesses) construe their own purposes when implementing a transaction.

Freedmen further noted that when enacting the GAAR, that eventually some of the TAARs would be removed, however this is unlikely until the GAAR is firmly applied by the courts. Therefore until such time, although the SAARs and TAARs still exist, the GAAR is the overriding legal rule.[27]

5.3 THE IMPLEMENTATION OF THE GAAR IN THE UK (2013)

Although the first GAAR was introduced in the UK on 17 July 2013, in 1997 the chancellor of the Exchequer announced in the pre-budget report that a review would be undertaken in order to address the issues relating to tax avoidance and how anti-avoidance legislation should be able to meet the aim of simplicity, as well as provide revenue protection.[28]

In 1998 the UK Government published a consultative document,[29] wherein the Financial Secretary presented on the prospect of the introduction of a GAAR in the UK to the Treasury on direct taxes.[30] In response to the consultative document, the Tax Review Committee published a response document in February 1999.[31]

Following the publication of the response document, no further steps were taken by Government in respect of the GAAR until 2011 when a study group was appointed following the consideration of the GAAR provisions globally, including the South African GAAR.[32] The study included an illustrative draft GAAR in Appendix I, as well as illustrative guidance notes in respect of the draft

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27 Freedman (2016). "General Anti-Avoidance Rules (GAARs) – A key element of tax systems in the post BEPS tax world?" at 19. University of Oxford Legal Research Paper Series.

28 Bowler (2008). "Tackling Tax Avoidance in the UK" at 2. Oxford University Centre for Business Taxation.

29 Inland Revenue (1998). "A General Anti-Avoidance Rule for Direct Taxes: Consultative Document". Available from http://bit.ly/2kGT9Ps. [Accessed on 2017-10-11]. It was indicated in the introduction of the consultative document, that in the Chancellor of Exchequer's first budget, he asked the Inland Revenue and Customs and Excise to review the possibility of the introduction of a GAAR. The consultative document contains the Inland Revenue's work which was carried out, and notes that a further document from Customs and Excise would be published under separate cover at a later date. The consultative document considered the issues specifically in respect of the corporate sector, where it was said that that is where some of the most "contrived and costly tax avoidance takes place".

30 Bowler "Tackling Tax Avoidance in the UK" at 3. Oxford University Centre for Business Taxation.

31 Tax Law Review Committee (1999). "A General Anti-Avoidance Rule: A Response to the Inland Revenue's Consultative Document". Available from https://www.ifs.org.uk/comms/comm77.pdf]. [Accessed on 2017-10-11]. In the aforementioned response document, the Tax Review Committee rejected the adoption of the GAAR in the form proposed in the consultative document issued by Inland Revenue for three reasons. Firstly, it indicated that the proposed GAAR did not place an adequate burden on the Inland Revenue to justify its use in order to impose tax where it could not otherwise bring the taxpayer within the taxing words of the Act. Secondly, the reservations expressed regarding the administration of the proposed GAAR created doubt in respect of the resources which would be devoted to its administration. Lastly, the proposed GAAR offered no limitation on the similar development of judicial anti-avoidance doctrines and no satisfactory opportunities for legislative simplification.

32 Fichardt (2012). "A General Anti-Avoidance Rule: Finding its feet in the United Kingdom" at 1. The study group published its first report on 11 November 2011 led by Aaronson QC titled, "GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system". The purpose of the study was to consider whether the introduction of a GAAR in the UK would benefit the UK tax system. It was concluded in the study that introducing a broad spectrum GAAR would not be beneficial to the UK as a broad GAAR may have the result of eroding the attractiveness of the UK's tax regime's to business. However, it was indicated that introducing a moderate rule which targets abusive arrangements, and is not applicable to responsible tax planning, would be beneficial for the UK.

GAAR with the view of introducing formal legislation in 2013.[33]

As a result of the General Anti-Abuse Rule consultation process and publication of HMRC's document in June 2012,[34] as well as the General Anti-Abuse Rule summary of responses wherein HM & Treasury considered the responses and proposals made,[35] the GAAR was formally introduced into the Finance Act and became applicable to tax arrangements entered into or after 17 July 2013.

5.3.1 The Scope of the GAAR Legal Framework

The GAAR is found in Part 5 of the Finance Act, and as indicated in paragraph 5.1 above comprises of sections 206 – 215.

Section 206 – General Anti-Abuse Rule

Section 206 provides a list of the taxes to which the GAAR applies, such as income tax, corporation tax, capital gains tax, petroleum revenue tax, inheritance tax, amongst others. In terms of section 206(1), the purpose of the GAAR is to counteract tax advantages arising from tax arrangements that are abusive.

Section 207 – Meaning of the terms "tax arrangements" and "abusive"

Section 207 contains the core elements of the GAAR and provides the reader with an understanding of what would constitutes a "tax arrangement", as well as the meaning of "abusive". Section 207 states as follows:

> "1. Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.
>
> 2. Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all

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33 HMRC (2012). "A General Anti-Abuse Rule. Summary of Responses". This repose document was the response to the consultation document of 12 June 2012 wherein the proposed GAAR was introduced. The Exchequer Secretary, Gauke, indicated that the Government announced in its 2012 Budget that it accepted the recommendations made by the study group led by Graham Aaronson QC and would consult with the view of enacting legislation in the Finance Bill 2013.

34 HMRC (2012). "A General Anti-Abuse Rule Consultation Document".

35 HMRC (2012). "A General Anti-Abuse Rule. Summary of Responses".

the circumstances including –

a. whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,

b. whether the means of achieving those results involves one or more contrived or abnormal steps, and

c. whether the arrangements are intended to exploit any shortcomings in those provisions.

3. Where the tax arrangements form any part of any other arrangements regard must also be had to those other arrangements.

4. Each of the following is an example of something which might indicate that tax arrangements are abusive –

a. the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,

b. the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and

c. the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,

d. but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

5. The fact that tax practices accord with established practice, and HMRC had, at the time of the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive,

6. The examples given in subsections (4) and (5) are not exhaustive".

Therefore, in order for the GAAR to find application to a tax arrangement, a tax advantage must be the main purpose, or one of the main purposes of the arrangement. In addition, a tax arrangement is said to be abusive, if it cannot be regarded as a reasonable course of action in relation to the tax provisions.

Section 208 – Meaning of "tax advantage"

Section 208 provides the meaning of a tax advantage and includes the relief or increased relief

from tax, repayment or increase repayment from tax, avoidance or reduction of a charge to tax, or an assessment to tax and the deferral of payment of tax or advancement of a repayment of tax, amongst others.

Section 209 – Counteracting the tax advantages

Section 209 contains the provisions dealing with the use of adjustments if a tax arrangement is found to be abusive. Adjustments which are permitted to be made include those that impose or increase the liability to tax in any case where there would be no liability or a smaller liability. Section 209 also consists of the following in respect of the use of adjustments:

- Section 209A: Effect of adjustments specified in a provisional counteraction notice;
- Section 209B: Notified adjustments: 12-month period for taking action if appeal made;
- Section 209C: Notified adjustments: case within section 209B(4)(c);
- Section 209D: Notified adjustments: case within section 209B(4)(d);
- Section 209E: Notified adjustments: case within section 209B(4)(e); and
- Section 209F: Notified adjustments: case within section 209B(4)(e).

Section 210 – Consequential relieving adjustments

Section 210 applies where the counteraction of a tax advantage under section 209 is final. In this regard, a taxpayer has 12 months from the date upon which the counteraction was made final, to make a claim for one or more consequential adjustments to be made in respect of any tax to which the GAAR applies.

Section 211 – Proceedings between a court or tribunal

Section 211 contains the procedures in respect of proceedings brought before a court of tribunal and specifically requires that HMRC must prove that the tax arrangement was abusive, and any adjustments made in order to counteract the tax advantage arising from the arrangement is reasonable.

Sections 212 – Relationship between the GAAR and priority rules and 12A - Penalty provisions

Section 212 provides the relationship between a GAAR and the priority rules[36] and section 212A

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[36] A priority rule has been defined in section 212(2) of the Finance Act to mean a rule (however expressed), to the effect that provisions have the effect to the exclusion of, otherwise priority to anything else.

contains the penalty provisions.

Sections 213 – Consequential amendment and 214 - Interpretation of Part 5

Section 213 contains a consequential amendment provision and section 214 contains the definitions of the terms used in respect of the GAAR, such as “abusive”, “designated HMRC officer”, “notified adjustments”, “tax appeal”, “tax enquiry”, amongst others.

Section 215 – Commencement and transitional provisions

Lastly, section 215 contains the commencement and transitional provisions and indicates that the GAAR became applicable to tax arrangements entered into on or after 17 July 2013.

5.4 THE APPLICATION OF THE UK GAAR TO TAX AVOIDANCE STRATEGIES ADOPTED BY STARBUCKS, GOOGLE AND AMAZON

As noted by section 207, a tax arrangement will exist in the event that it is reasonable to conclude that the main, or one of the main purposes of the arrangement is to gain a tax advantage. The use of the word “reasonable” implies that an objective test must be used in order to determine this purpose. Secondly, the tax arrangement must be found to be “abusive”, and in this regard, an arrangement is said to be abusive if it cannot be regarded as reasonable in the course of action in relation to the tax provisions.[37]

Currently, there have been no cases referred to the HMRC for consideration or to the GAAR Advisory Panel.[38]

5.4.1 Tax avoidance strategies adopted by UK Multinationals

The main issues raised in respect of the UK Multinationals allegedly avoiding the payment of taxes in the UK were:

- Transfer Pricing strategies (Starbucks) via inter-corporate transactions by reporting losses by making premium payment to its Netherlands division (where the coffee beans are

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[37] Section 207(2).

[38] Staff Writer – KPMG (2017). “First Opinion on the GAAR Advisory Panel published. 4 August 2017”. The GAAR Advisory Panel is an independent advisory panel whose role is specifically to review the and approve the HMRC’s guidance on any GAAR matters which it is required to consider. The GAAR Advisory Panel is required to provide its opinions in respect of particular matters referred to it by the HMRC, and in particular whether tax arrangements are considered to have occurred in the reasonable course of action.

roasted), as well as paying higher premiums to Switzerland where Starbucks purchases the coffee beans from;

- transactions made through an offshore entity in Ireland (Google). A similar approach was followed by Google UK as was the case with Google South Africa Google maintained that all of the sales were conducted from Ireland, where its head office was based. Google also reported losses over a period of time which has allowed tax credits to build which can be used to set off future tax bills;
- reporting sales through its Luxembourg based unit which allows a lower rate of tax to be charged on foreign profits (Amazon). The strategy used when Amazon's UK customers purchase products from its online local web-site, the payment made by the customer goes to Amazon's subsidiary located in Luxembourg.

5.4.2 Application of the GAAR

Taking sections 206 – 215 of the Finance Act into account, and as noted in paragraph 5.3.1 above, section 207 provides the core elements of the GAAR and provides the reader with an understanding of what would constitutes a tax arrangement, as well as the meaning of abusive.

Should a matter be referred to the HMRC for consideration, the HMRC is required to show that there is a tax arrangement, which is abusive in nature. The burden of proof placed on the HMRC differs from the burden of proof of is placed on the South African Multinational in terms of the South African GAAR.

Following the burden of proof placed on the HMRC, the HMRC is required to show that the main, or one of the main purposes of an arrangement at the time was to obtain a tax advantage[39] in order to constitute a "tax arrangement" in terms of section 207. Furthermore, the HMRC must prove that the tax arrangement is abusive by showing that the tax arrangement cannot be regarded as a reasonable course of action in relation to the tax provisions.[40]

When it comes to determining whether the tax arrangement is reasonable or not, the HMRC must take into consideration, in addition to the facts and circumstances of the matter, the following:

- whether the substantive results of the arrangements are consistent with any

[39] As indicated in paragraph 5.3.1 above, section 208 contains the meaning of a tax advantage and includes the relief or increased relied from tax, repayment or increase repayment from tax, avoidance or reduction of a charge to tax or an assessment to tax and the deferral of payment of tax or advancement of a repayment of tax, amongst others.

[40] Section 207(2).

principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions;

- whether the means of achieving those results involves one or more contrived or abnormal steps, and
- whether the arrangements are intended to exploit any shortcomings in those provisions.

In the event that HMRC can prove that the UK Multinational has entered into an arrangement where the main or one of the main purposes was to obtain a tax advantage, and therefore the arrangement constitutes a tax arrangement, as defined, and in addition is found to be abusive, the HMRC may make an adjustment which either imposes or increases the liability for tax.[41]

Starbucks

From the information which arose at the time in respect of Starbucks' alleged tax avoidance, the strategies adopted by Starbucks appear to involve profits made from coffee sales in the UK being used to pay a premium to two divisions of Starbucks for the purchase and roasting of the coffee beans in Switzerland and the Netherlands (the "Starbucks Divisions").

In order to be able to determine whether the strategies adopted by Starbucks would constitute tax arrangements in the event that the Starbucks matter was brought before the HMRC for consideration, is dependent on the facts provided. In the event that HMRC is able to prove that there is no rationale reason for the premiums paid to the Starbucks Divisions other than for the avoidance of the payment of tax on Starbucks' profits made in the UK, the strategies adopted could be said to constitute tax arrangements due to the fact that the main or one of the main purposes of the arrangements were to obtain tax advantages.

Starbucks could possibly raise a defence against the HMRC's finding that the purchase of the coffee beans from Switzerland at a premium was for the purpose of the avoidance of tax, for example by providing evidence or research undertaken by Starbucks showing that the quality of the coffee beans in Switzerland are superior and the only coffee beans approved for use in terms of Starbucks' overall business plan, however Starbucks would then be required to explain the reason for the premium paid to its Switzerland Division. In terms of the roasting of the coffee beans in the Netherlands, the HMRC could potentially demonstrate that there is no purpose other than for the avoidance of tax to pay a premium for the roasting of the coffee beans taking place in the Netherlands.

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[41] Section 209.

Furthermore, in order for the HMRC to be able to make a tax adjustment, the HMRC must further prove that the tax arrangements are found to be abusive.[42] Taking the factors mentioned above into account, the HMRC must consider whether the premiums paid to the Starbucks Divisions are said to be consistent with the objectives of the provisions upon which they are based, whether the results are reached by way of a contrived or abnormal steps, as well as whether the premiums paid to the Starbucks Divisions were intended to exploit any shortcomings.

Google

As is the case in South Africa,[43] non-resident entities of the UK are only subject to tax from income that arises from a source within the UK. In respect of Google operating in the UK, Google maintained that all of the sales were conducted from Ireland, where its head office was based and not within the UK as was the case with Google operating in South Africa.[44]

The HMRC would once again be required to prove that there is a tax arrangement which is abusive in order to be able to make an adjustment to either levy or increase Google's liability for tax. Taking into account the information which arose in respect of Google's alleged tax avoidance, the HMRC would have to consider the evidence raised against Google as provided in paragraph 3.3.2 above.[45] An important factor in favour of the HMRC is that although Google had its headquarters in Ireland and claimed not to have a presence in the UK, Google employed 1300 employees.

Taking the relevant information into account and in the event that HMRC can prove that Google's main or one of the main reasons for conducting its sales through Ireland was to obtain a tax advantage, and further that the arrangement is found to be abusive, an adjustment could be made in favour of the HMRC.

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[42] *Ibid.*
[43] As indicated in paragraph 3.3.2 above.
[44] As indicated in paragraph 3.2.1 above.
[45] Firstly, Google UK's corporate website indicated that London is home base to "a number of EMEA sales and marketing leaders", as well as that most Google offices outside Ireland focus on engineering or sales, whereas Google UK does both. Secondly, that Google UK's corporate website advertised numerous London based sales positions. Thirdly, that the LinkedIn profiles of around 150 London based Google employees indicated that they were involved in formulating sales, strategies, maintaining sales teams, closing deals or other sales work, and lastly, that a strategic partner of Google in London, Smith, indicated on his LinkedIn profile that his role involved the selling of media platform solutions.

Amazon

From the information which arose in respect of Amazon's alleged tax avoidance by reporting its sales through its Luxembourg subsidiary, as with the case of Starbucks and Google, and taking the GAAR into consideration, due to the fact that the HMRC is required to discharge the burden of proof, the HMRC must show that the main, or one of the main purposes of Amazon reporting its sales through Luxembourg was to obtain tax benefit and therefore constitutes a tax arrangement which is abusive. Taking into account the element of unreasonableness, the HMRC would need to gather evidence that shows that the facilitation of the payment through Luxembourg is abnormal. Only once the HMRC has proven the aforesaid, can the HMRC make an adjustment to Amazon's liability for tax.

In the event that the HMRC is unable to prove that the arrangement constitutes an abusive tax arrangement, the HMRC will not be able to make use of a section 209 adjustment. By placing the burden on the HMRC, the UK GAAR places the taxpayer in a more favourable position than a taxpayer in South Africa who carries this burden, and imposes an additional workload on the HMRC.

Although the application of the GAAR is complex and requires a significant amount of information to be obtained by the HMRC from the taxpayer in order for the HMRC to be able to discharge its burden of proof, it appears taking the above into consideration, that should a matter come before the HMRC in respect of a Multinational adopting one of the strategies discussed above, the GAAR will add value, however the extent of the value is yet to be seen.

5.4.3 Comparison to the South African GAAR

The similarities noted between section 207 of the Finance Act and section 80A of the Income Tax Act are significant. Although certain concepts used in the Finance Act such as "tax arrangement", "abusive" and "which cannot reasonably be regarded as a reasonable course of action" are not found verbatim in the Income Tax Act, concepts such as "avoidance arrangement" and "in a manner which would not normally be employed for *bona fide* business purposes" are used and provide similar meanings and interpretations. In both sections 207 and 80A, the purpose element provides that the sole or main purpose (or one of the main purposes) of the arrangement must be to obtain a tax benefit.

Section 209 and section 80B both contain the steps which may be taken against a taxpayer who is found to have gained a tax advantage in terms of the UK GAAR, or taken part in an impermissible avoidance arrangement in terms of the South African GAAR. From a UK

perspective, a tax adjustment is permitted to be made in order to counteract the tax advantage that the taxpayer derived, and from a South African perspective, the Commissioner is granted the authority to disregard, combine or re-characterise any steps in or part of an impermissible avoidance arrangement, or reallocate gross income or receipt of accruals of a capital nature, amongst other tax consequences.

Despite the similarities, the most obvious difference between the two GAARs, is that in terms of the UK GAAR, the burden of proof has been placed on the HMRC, whereas in South Africa, the burden of proof is placed on the taxpayer to rebut the presumption that the arrangement was entered into for the sole or main purpose to avoid the payment of tax.

In addition, as of 30 September 2017, the UK Criminal Finances Act 2017 (the "CFA") introduced two new corporate offences in respect of the criminal liability for failing to prevent tax evasion (within the UK, as well as cross-border), as part of the UK Government's strategy to strengthen measures relating to tax avoidance and evasion:[46]

i. failure to prevent facilitation of domestic tax evasion offences;[47] and
ii. failure to prevent facilitation of overseas tax evasion offences.[48]

South Africa is yet to implement similar criminal provisions against impermissible tax avoidance or tax evasion as yet.

5.5 CONCLUSION

With the introduction of the first UK GAAR only coming into effect in 2013, substantial reliance was placed on judicial anti-avoidance doctrines in order to curb impermissible tax avoidance. The issue arising in respect of these judicial anti-avoidance doctrines and the fact that they emanate from case law judicially considered, indicate that they are subjective in nature and often led to differences of opinion amongst the judiciary and uncertainties amongst taxpayers.

The years prior to the *Duke of Westminster* case, a literalist approach was followed where it was held in *Partington* that regardless of the hardship placed on a taxpayer, in the event that the taxpayer brought himself within the letter of the law, he would be taxed. This literalist

46 Williams (2017). Criminal liability for failing to prevent tax evasion/ Criminal Finances Act 2017. Lexology. In the years prior to the CFA, in order to prosecute a corporate for the facilitation of tax evasion, it was a requirement to be able to prove that the senior members of the corporation were aware of the tax evasion. Following the promulgation of the CFA, it is now only necessary to prove tax evasion as close to the source as possible.

47 CFA, section 45.

48 *Ibid* section 46.

approach was further confirmed by the House of Lords in the *Duke of Westminster* case, where the substance of the transaction was ignored by four out of the five Lords hearing the matter on appeal.

The literalist approach changed over time with cases such as *Ramsa*y and *Burmah Oil*, where the courts started to recognise the substance of a transaction and noted that where steps were inserted into a transaction which did not have a commercial purpose apart from the avoidance of a tax liability, that this was an indication of the whole transaction being regarded as artificial. The change in approach caused some uncertainty, following which the view was taken that the approach taken in *Ramsay* and *Burmah Oil* would only be followed where the steps forming part of the scheme were circular or self-cancelling, or where a change in the parties' legal position was merely a change in the form, without resulting in any legal consequences.

After years of the UK Government attempting to solve tax avoidance issues, of importance is the implementation of the GAAR in the UK on 17 July 2013. In order for the HMRC to be able to make an adjustment, the HMRC is required to show that there a tax arrangement, and further that the tax arrangement is abusive by showing that the tax arrangement cannot be regarded as a reasonable course of action in relation to the tax provisions. If the HMRC can prove that there that the UK Multinational has entered into an arrangement where the main or one of the main purposes was to obtain a tax advantage and therefore the arrangement constitutes a tax arrangement, as defined, and in addition is found to be abusive, the HMRC may make an adjustment which either imposes or increases the liability for tax.

As is the case with the South African GAAR, the UK GAAR has not come before the HMRC for consideration as yet, however tax avoidance by Multinationals has remained an on-going issue especially when it comes to the UK Multinationals entering into cross-border transactions. In this regard, the UK Multinationals have made use of tax avoidance strategies in order to shift their profits to low or no income jurisdictions to avoid paying taxes to the UK authorities. The UK is for this reason in the process of implementing the Action Plans, and once implemented as noted above with regards to South Africa, will provide a much wider anti-avoidance legal framework specifically targeting Multinationals shifting their profits abroad. Irrespective of the implementation of the Action Plans by the UK, it is still however important for UK's domestic legislation to be structured in a way to assist with the prevention of tax avoidance, where applicable.

Taking into account the limited information available in respect of Starbucks, Google and Amazon, as well as the assumptions made regarding potential defences which may be raised by the taxpayer against allegations made by the HMRC, it appears that the GAAR could provide

value should it come before the HMRC when considering the avoidance arrangements undertaken by the UK Multinationals and whether these arrangements constitute "tax arrangements" that are "abusive".

In comparison to the position followed in South Africa, by placing the burden of proof on the HMRC, the UK taxpayer is in a better position than a South African taxpayer who carries the burden of proof. At this stage, we do not have a true indication of the value of the GAAR in respect of the prevention of tax avoidance by Multinationals, however with the implementation of the Action Plans read in conjunction with the UK's domestic law, the prevention of tax avoidance by Multinationals appears much more optimistic going forward.

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1 CONCLUSIONS 77
6.2 RECOMMENDATIONS 85

6.1 CONCLUSIONS

6.1.1 Tax Avoidance by Multinationals: A Global Concern

Individuals, local companies and Multinationals have developed strategies over the past few centuries in order to reduce the amount of tax paid to the *fiscus*. The manner in which these individuals and entities have managed to achieve the avoidance of the payment of tax, has developed over years, from as early as the days where ancient Rome imposed taxes on the wealthy, to the 21st century where tax avoidance by Multinationals has and continues to remain an on-going problem from a global perspective.

This study was limited to the tax avoidance strategies adopted by Multinationals operating in South Africa and the UK due to the size, popularity and the significant amounts of profits made by these Multinationals, and has shown that Multinationals have, and continue to avoid the payment of taxes. In addition, Multinationals transact with subsidiaries within their group in a manner which is not considered to be transactions at arm's length, resulting in the identification of Transfer Pricing issues.

A shift in focus by tax authorities in South Africa and the UK towards Multinationals avoiding the payment of taxes within the countries in which they operate, has been topical over the last few years, wherein the manner in which Multinationals have conducted their financial and business affairs in order to pay as little tax as possible have been scrutinized. The strategies adopted by these Multinationals involved making use of tax mismatches between domestic tax legislation in the countries in which the Multinational operates, i.e. Google and Amazon, profits being shifted through subsidiaries in jurisdictions who levy lower tax rates, if any tax on profits at all, and Transfer Pricing strategies where sales commissions are paid to subsidiaries in different jurisdictions, or where management fees are paid or intercompany loans are made and subsequently declared as "impaired", i.e. Starbucks, Lonmin and MTN.

Despite the accusations made against these Multinationals, representatives from these Multinationals have insisted that they have remained within the confines of the law in South Africa and the UK, as well as the laws of the countries in which the Multinational entered into

cross border transactions with. In order to determine whether these Multinationals have remained within the confines of these laws and not intentionally avoided or evaded its liability to pay tax, it is important to have an understanding of the concepts of tax avoidance, whether permissible or impermissible, as well as tax evasion.

6.1.2 Permissible or impermissible tax avoidance?

Traditionally, as noted by Lord Tomlin in *Duke of Westminster*, and Lord Cairns in *Partington*, in the event that a taxpayer escapes the liability to be taxed and remains outside the charging provisions of the law, he could not be compelled to pay an increased amount of tax. The same applies to a taxpayer where that taxpayer comes within the letter of law, he cannot escape the tax liability imposed upon him, despite any hardship which may arise as a result of the liability to tax.

Over the years, the courts have had to consider the facts of each case on an individual basis taking into account factors such as the applicable domestic legislation at the time in which a taxpayer was said to have avoided or evaded the payment of tax, the subjective nature of the intention of the taxpayer at that time, as well as additional interpretational issues regarding the facts of each case in order to be able to determine whether the transaction constitutes permissible or impermissible tax avoidance, or potential tax evasion.

The terms tax avoidance and tax evasion have been defined and interpreted by various sources, including publications by SARS, online dictionaries, case law, academic authors, as well as by the OECD, amongst others. In addition, Government institutions and taxpayers have also had to consider these terms in detail in order to ensure that these terms are understood within the correct context, as well as to ensure from a legislator's perspective, that legislation is available which provides statutory rules regarding the fundamental distinction between tax avoidance and tax evasion in order for taxpayers to be able to structure their affairs in a manner that remains within the confines of the law.

The concept of legality appears to be the fundamental distinction underlying the differentiating factors when deciding upon whether a taxpayer has intentionally avoided the payment of tax (impermissible tax avoidance) or made use of tax planning strategies to minimize the tax liability (permissible tax avoidance) on the one hand, or intentionally deceiving the fiscus and evading the payment of tax on the other.
An important aspect when considering tax avoidance and the distinction between permissible and impermissible tax avoidance is whether the arrangement entered into by the taxpayer is conducted in accordance with income tax legislation. In addition, tax avoidance is said to be

legal, whereas tax evasion is said to be illegal. Although this distinction may appear quite evident, in some circumstances the distinction is often not clear and remains open to interpretation, especially insofar as a taxpayer's intention is concerned.

The core element when considering the difference between tax avoidance and tax evasion as indicated in Chapter 2 above, is that tax avoidance usually indicates a situation where a taxpayer arranges its affairs in a legal manner, which it is legally permitted to do, although reducing the amount of tax payable. Whereas, it is said that only when the taxpayer makes use of unlawful methods in order to reduce the payment of tax, that the taxpayer has evaded tax, which is illegal.

6.1.3 Multinationals, tax avoidance strategies and the Action Plans

As noted in Chapter 3 above, South African and UK Multinationals have adopted the following tax avoidance strategies in order to avoid the payment of tax on income within South Africa or the UK:

- Google and Amazon, as non-South African and UK tax residents, have avoided the payment of tax by transacting though an off-shore entity in Ireland as a means to ensure that the sales are not conducted through South Africa or the UK, and therefore not sourced within South Africa or within the UK, and are therefore not taxable;
- Lonmin, Starbucks, MTN, have paid premium payments, sales commissions, managements fees, as well as 'non-goods' payments such as payments for legal, accounting and management consultancy services to subsidiaries located in other jurisdictions. With regards to MTN, profits were shifted by way of so called management fees for services in Dubai and Mauritius, although the management of MTN was said to take place in South Africa and therefore no business rationale for why the fees were paid to Dubai and Mauritius; and
- Lonmin further advanced inter-company loans as a tactic to book the interest from the loan as a deductible cost within South Africa and the income in a country with a low or no taxation on interest tax regime.

The OECD realised that the shifting of profits constituted a serious risk to tax revenues, tax sovereignty and fairness and published the Action Plans for implementation by OECD member and non-member countries. Both South Africa and the UK are in the process of implementing the Action Plans as an additional attempt to ensure that BEPS is prevented going forward.

The Action Plans act as the current global framework with the aim to equip Governments with the domestic and international instruments required in order to be able to tackle the shifting of profits from the country where the profits are ultimately derived from. The enforcement obligation in respect of the Action Plans lies with the participating country. In addition to this obligation, the participating country must further ensure that the enforcement of the Action Plans does not conflict with their international legal commitments and therefore it is important that in order for the Action Plans to add value and to be effective as an anti-avoidance global initiative, that a holistic approach is required to be followed.

The BEPS global framework comprises of 15 Action Plans in total which have been published in the form of 13 reports concerning fundamental anti-avoidance topics. The DTC and the Treasury Committee have been tasked as the committees to review and address concerns in respect of BEPS in South Africa and the UK respectively, which includes regularly monitoring compliance with the minimum standards of the Action Plans.

With the implementation of the Action Plans, Multinationals are faced with the realisation that tax authorities around the world are working together in order address the issue of tax avoidance by Multinationals, as well as wealthy individuals.

6.1.4 The South African GAAR

An important aspect for purposes of this study is whether the South African GAAR provisions are an effective deterrent against tax avoidance by South African Multinationals. Although the GAAR has been around since 1941, and undergone various amendments in order to make it a more effective deterrent against tax avoidance over the years, the answer to this question is not a simple one. The reasons being is that the current GAAR provisions, sections 80A – 80L, have not been considered and tested by the courts as yet, and therefore it is yet to be seen as to whether the GAAR provisions will be effective going forward.

With the enactment of South Africa's first GAAR provision in 1941, following the case of *Hiddingh,* in order for the Commissioner to be able to enforce the payment of tax in terms of section 90, the first requirement was that there had to be a transaction, which had the purpose of avoiding or reducing the liability for payment of tax. Section 90 was analysed in detail in *King,* and in particular the "purpose requirement" wherein the Appellate Division came to the conclusion that the purpose of the avoidance of tax or the reduction of the liability for the payment of tax must be the dominant purpose.

Following the judgment in the *King*, where it could not be proven that a taxpayer's dominant purpose was to avoid or reduce their liability for tax, section 90 would fail, resulting in the erosion of the tax base in South Africa. It was also noted that the scope of section 90 was too wide and applied to both permissible and impermissible tax avoidance transactions. Section 90 was therefore subsequently amended to address this issue to a certain degree, and in particular, the purpose requirement was amended to reflect the sole or one of the main purposes, and further identified impermissible tax avoidance as being "abnormal".

In 1962 section 90 was repealed by section 103 of the Income Tax Act which contained similar provisions to section 90, however not identical. The most important addition to section 103 was the manner in which the transaction was carried out in an attempt to be able to come to the conclude whether a transaction would be regarded as normal or abnormal. Section 103(1) was considered in detail in the case of *Geustyn, Forsyth and Joubert,* and the courts found that the transaction was not abnormal and section 103 failed.

At that time, it was extremely rare that a taxpayer would be found guilty of impermissible tax and this caught the attention of firstly the Margo Commission, and later the Katz Commission who noted certain inherent deficiencies with section 103 in published reports. Section 103(1) was therefore amended in 1996 taking into account the recommendations made, however despite the amendment, SARS was still of the opinion that section 103(1) was limited. Six years after the amendment of section 103(1) in 2006, and after various discussion papers by SARS and the receipt of public comments, sections 80A – 80L were introduced into the Income Tax Act.

The GAAR applies to "impermissible avoidance arrangements", and like its predecessors, also requires that there must be transaction, which has been entered into with the sole or main purpose of reducing the liability for payment of tax. In addition, and as provided in section 103, the avoidance arrangement was also required to contain an abnormal element, however section 103 limited the "abnormality" test to business transactions only. Section 80A broadened the scope considerably.

Furthermore, concepts such as the lack of commercial substance, round trip financing and accommodating and tax indifferent parties have been included in section 80 as additional provisions to prevent tax avoidance. Section 80A – 80L have however not been judicially considered as yet and have remained untested for the past 11 years.

6.1.5 South African Multinationals avoiding tax.

Regardless of the GAAR, tax avoidance remains rife, especially amongst Multinationals who are transacting cross border. As noted above, Google, Lonmin and MTN have come under scrutiny over the past few years regarding the manner in which they have conducted their tax affairs in order to pay as little tax as possible. The strategies used by these Multinationals have involved making use of tax mismatches between domestic tax legislation in the countries where the Multinational operates, resulting in profits being shifted through subsidiaries in low tax jurisdictions, Transfer Pricing strategies where sales commissions are paid to subsidiaries in different jurisdictions, or where management fees are paid or intercompany loans are made and subsequently declared as “impaired”.

6.1.6 The UK GAAR

As noted in paragraph 6.1.4 above, in terms of the GAAR in South Africa, an important aspect for purposes of this study is whether the newly established GAAR provisions have been an effective deterrent against tax avoidance by UK Multinationals. With the first GAAR only coming into effect in the UK in 2013, substantial reliance was placed on the judicial anti-avoidance doctrines in order to curb impermissible tax avoidance. The main issues noted from reliance on these judicial anti-avoidance doctrines (which emanate from the interpretations provided by the courts which are subjective in nature), often led to differences of opinion and uncertainties arising as to what constitutes tax avoidance in the UK.

The main anti-avoidance case law and anti-avoidance provisions in the UK can be divided into the following 5 main time frames:

- the period prior to the *Duke of Westminster* case (1869 – 1936);
- *Duke of Westminster* (1936);
- *Ramsay, Eilbeck and Burmah Oil* (1981/1982);
- *Barclays Mercantile* case (2005); and
- the introduction of the GAAR (2013).

In the years prior to the *Duke of Westminster* case, a literalist approach was followed where a strict interpretation of the words of the law dictated whether a person fell within the taxing provisions of the law or not. The literalist approach was confirmed by the House of Lords in the *Duke of Westminster* case, where the substance of the transaction was ignored by four out of the five Lords hearing the matter on appeal.

With *Ramsay, Eilbeck and Burmah Oil*, the courts took the substance of the transaction into account and noted that where steps were inserted into a transaction which did not have a commercial purpose apart from the avoidance of a tax liability, that this was an indication of the whole transaction being regarded as artificial. This approach created uncertainty, resulting in the view that the substance approach should be restricted to the facts of the case and only permitted if the steps of the transaction were circular or self-cancelling or regarded as only a change in the form, without any legal consequence.

The decision in the *Barclays Mercantile* matter indicated that the view followed in *Ramsay* where the application of the taxing statute, transaction or element of a transaction which was said to have no commercial purpose and therefore was to be disregarded, went too far. The House of Lords looked closely at what the statute actually required. The substance doctrine in the UK differs from the substance over form doctrine found in South Africa. In South Africa, the courts are not permitted to ignore a certain part of a transaction which is said to lack commercial substance, as is the case in the UK where the courts look at the scheme of transactions as a whole.

As a result of the findings by the courts, the UK Government and the Financial Secretary found it necessary that the UK publish a consultative document in 1998 with the aim of implementation the UK's first GAAR. After the publication of the consultative document, no further steps were taken until 2011, with the appointment of the study group who was tasked to consider the GAARs which were being used throughout the world, including South Africa's GAAR. The GAAR in the UK was enacted into the Finance Act and applied to any tax arrangement entered into on or after 17 July 2013.

The GAAR consists of sections 206 – 215 and can be found in Part 5 of the Finance Act. As with the South African GAAR having its core GAAR provision in section 80A, section 207 of the Finance Act contains the UK's core GAAR provisions and is quite similar to the South African GAAR.

Similarly, to South Africa, although to date the GAAR has not been subject to judicial consideration, tax avoidance by Multinationals has remained an issue and led to enactment of additional tax legislation, such as the DPT for example, in an attempt to encourage Multinationals to change their behaviour which have been aimed at minimising their tax liabilities in the past. In addition, penalty provisions have been introduced in the CFA in order to assist with the prevention of tax avoidance and evasion.

6.1.7 UK Multinationals avoiding tax.

As noted above, Starbucks, Google and Amazon have come under scrutiny over the past few years regarding the manner in which they have conducted their business and financial affairs in order to pay as little tax as possible. The strategies adopted by these Multinationals have involved premium payments being paid to subsidiaries in other jurisdictions for the purchase of raw materials, as well as for services rendered and making use of tax mismatches between domestic tax legislation in the countries where the Multinational operates. All of these strategies have resulted in profits being shifted to jurisdictions which levy tax at a lower rate, if any tax at all.

6.1.8 The anti-avoidance solution: BEPS and the GAAR

Taking into account the GAAR in South Africa and the UK, as well as the anti-avoidance global initiatives implemented to address the on-going issue of tax avoidance by Multinationals, the important question and rationale behind this study, is whether these measures are effective to prevent Multinationals avoiding tax.

Following the limited information relating to the South African and UK Multinationals and the manner in which they allegedly avoided the payment of taxes in South Africa and the UK respectively, as well as taking into consideration the GAAR provisions, it does appear that the GAAR will provide value in order to assist with the prevention of tax avoidance by Multinationals, however due to the fact that the GAAR has not been considered by the courts or the HMRC as yet, no true indication regarding the weight of such value can be attributed to the GAAR at this stage.

In addition to the fact that the GAAR has not been judicially considered, the tax avoidance strategies are extremely complex in nature, and thus despite the GAAR in South Africa and the UK's domestic legislation, additional preventative measures have been sought, such as the Action Plans, in order to address the issue of tax avoidance by Multinationals. What is interesting to note that despite the GAAR, the OECD, the DTC and Treasury Committee found the Actions Plans necessary, and decided to implement these plans in addition to the GAAR provisions currently enacted. This in itself could perhaps be seen as indicative that the reliance placed on the GAAR when dealing with tax avoidance by Multinationals is limited and although a countries domestic law is important, when dealing with tax avoidance and cross border transaction, the domestic legislation must not be read in isolation.

Taking into account the Action Plans which have been specifically designed to assist with the prevention of the shifting of profits in order to erode the tax base, as well as both South Africa's and the UK's willingness to implement these Action Plans and the global initiatives taken in respect thereof, it is clear that in addition to the GAAR, or potentially any other anti-avoidance measures available, that the solution for the successful prevention of tax avoidance is not merely one legal framework. The successful solution appears to be a combination of frameworks, inclusive of the GAAR, the Action Plans, as well as other types of anti-avoidance frameworks such as the SAARs or TAARs.

6.2 RECOMMENDATIONS

Taking into account the comparisons noted between the South African and UK GAAR in paragraph 5.4.3 above, the following recommendations have been made in respect of the GAAR in South Africa and the UK respectively.

6.2.1 In favour of South Africa

With the introduction of the CFA where the UK introduced two criminal offences for corporate failure to prevent the administration of tax evasion, South Africa could learn from the UK and monitor the progress that the UK makes following the introduction of the CFA in order to decide whether the implementation of a similar criminal liability provision will be beneficial in South Africa.

The term "tax benefit", which has been used throughout the GAAR provisions, may cause interpretational issues when considered by the courts as this definition was deleted from the Income Tax Act in 2010. It may be beneficial for South Africa to consider an amendment wherein the definition of a "tax benefit" be added back into the GAAR. In this regard, section 208 of the Finance Act provides a thorough definition of a "tax advantage" which may provide assistance when deciding upon what would constitute a tax benefit in terms of South African law.

The use of the word "significant" in Section 80C(1) may also cause potential interpretational issues upon consideration by the courts, as well as by the taxpayer due to the fact that the word is subjective in nature. It may therefore be beneficial to provide guidance as to what is regarded as significant, and what is not.

6.2.2 In favour of the UK

A noticeable distinguishing factor between the South African and the UK GAAR, is that in the UK, the HMRC carries the burden of proving that the arrangement constitutes an abusive tax arrangement, whereas in South Africa, the burden of proof is placed on the taxpayer who is required to rebut the presumption that a transaction was not entered into for the sole or main purpose other than to obtain a tax benefit.

By placing the burden on the HMRC, the GAAR in the UK places the taxpayer in a more favourable position than a taxpayer in South Africa who carries the burden, and imposes additional workload on the HMRC which could potentially cause capacity issues in the future. It may therefore be beneficial for the HMRC to consider whether placing the burden of proof on the taxpayer would be more beneficial for the HMRC, as well as the probability of success in matters in the event that the burden is placed on the taxpayer.

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