Reportable arrangements as an indirect measure against impermissible tax avoidance in South Africa

Dissertation submitted in partial fulfilment of the requirement for a Master of Laws

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Declaration
I, Chevon Celestine Theresa Marupen, hereby declare that the research in this dissertation and the conclusions and recommendations contained herein are the result of my own individual and independent work. Where I have used the words and ideas of others, I have appropriately acknowledged the source of the ideas and words.

Signed:
Date:
Acknowledgements

Firstly, I would like to thank my Heavenly Father for carrying and leading me throughout this dissertation. I would like to thank him for his complete devotion and for giving me the qualities I required to start and complete this study. As Proverbs 2 verse 6 states, the Lord gives wisdom and from His mouth come knowledge and understanding.

Secondly, my supervisor Dr Benjamin Kujinga, under whose leadership I have improved as a writer and legal researcher. Thank you for your sound advice and expertise.

Lastly my family, for their continued support and encouragement. Your prayers and well-wishes do not go unnoticed.
Abstract
Paying tax is considered a pain for most citizens. These citizens will therefore as far as possible try to avoid tax. Tax avoidance is where a taxpayer's tax liability is reduced through legal means by using the provisions of the fiscal legislation to his/her advantage.

With tax avoidance and tax planning in mind, taxpayers and their advisors frequently come up with clever arrangements that cause transactions to be more tax efficient. However, a number of these arrangements may venture very close to being impermissible tax avoidance schemes. Impermissible tax avoidance is a term said to be difficult to define because of its unpredictability and characteristic to always change. The problem that arises with curbing it is therefore the fact that there is no universally accepted or accurate definition of it.

Nevertheless, in an attempt to curb or control it, revenue authorities have various mechanisms at their disposal. These mechanisms include direct legislation in the form of specific anti avoidance rules that are targeted at specific situations and the general anti-avoidance rule (GAAR) that is generally used against any type of tax avoidance. Indirect measures such as the regulation of tax practitioners and the requirement to report transactions that might lead to the avoidance of tax are also at the authority’s disposal.

As of October 2012, reportable arrangements are regulated in s 34 to 39 of the Tax Administration Act 28 of 2011 (the TAA). Arrangements are reportable if they either fall into the specifically defined categories of reportable transactions or if they have certain suspicious characteristics or elements. The provisions in the TAA compel taxpayers who have entered into reportable arrangements to report details of these transactions to the South African Revenue Services (SARS).

This research analyses the efficacy of the current South African reportable arrangement system in section 34-39 of the TAA. In this analysis, extensive reference is made to section 35 of the TAA, the provision specifically setting out the reportable transactions. A large part of the study also analyses the reportable arrangement
system applicable in the United Kingdom, the Disclosure of Tax Avoidance Schemes (DOTAS) regime.

Whether the South African reportable arrangement system is in fact an effective measure to indirectly limit impermissible tax avoidance arrangements is a point to ponder. The legislature enacted five types of arrangements that would become reportable in terms of section 35(1) of the TAA. The questions that can be drawn from this is why the legislature only enacted five specific types of reportable arrangements? Does this mean that impermissible tax avoidance is only targeted by reportable arrangements through five different arrangements? Is tax is only avoided impermissibly in five ways? Finally, is this substantial?

The analysis of the South African reportable arrangement system in this study demonstrates that the efficacy of the system against impermissible tax avoidance, and in informing taxpayers of the limits of the right to avoid tax is limited to a certain extent. In support of this assertion, it is argued that all the reportable arrangement regime has served to do is to identify a limited number of targeted areas of suspected avoidance and that negativities are incorporated into the effectiveness of the reportable arrangement system against impermissible tax avoidance.

On the other hand, most of the reportable arrangement provisions target transactions that lack commercial substance. The argument that transactions that lack commercial substance is a strong indicator of impermissible tax avoidance is thus also made. The focus on transactions that lack commercial substance was possibly mainly due to the fact that these are the arrangements that are actionable. Commercial substance is also primarily focused on in other reportable arrangement regimes like the United States and the insertion of other aspects of impermissible tax avoidance into the reportable arrangement provisions, such as the elements of ‘misuse and abuse’ and ‘abnormality’, seem to create loopholes and it would be difficult for SARS to take legal action on them.

Consequently, the ultimate contention that the reportable arrangement provisions which are primarily based on transactions that lack of commercial substance, is effective in indirectly cubing impermissible tax avoidance, hence a lack of commercial
substance being a strong indicator of impermissible tax avoidance, is therefore made.
The reportable arrangement system is therefore a strong mechanism in identifying
impermissible tax avoidance transactions whereby SARS can employ the GAAR or the
specific anti-avoidance rules. The inclusion of all the hallmarks of impermissible tax
avoidance in the reportable arrangement provisions would place an administrative
burden on SARS which could possibly weaken the system through the added
loopholes an inability of SARS to take legal action on them.
List of Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIR</td>
<td>Commissioner of Inland Revenue</td>
</tr>
<tr>
<td>COT</td>
<td>Commissioner of Taxes</td>
</tr>
<tr>
<td>CSARS</td>
<td>Commissioner for the South African Revenue Services</td>
</tr>
<tr>
<td>GAAR</td>
<td>General Anti-Avoidance Rule</td>
</tr>
<tr>
<td>HMRC</td>
<td>Her Majesty’s Revenue and Customs</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
</tr>
<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
</tr>
<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>ITA</td>
<td>Income Tax Act 58 of 1962</td>
</tr>
<tr>
<td>S</td>
<td>Section</td>
</tr>
<tr>
<td>SA</td>
<td>South Africa</td>
</tr>
<tr>
<td>SARS</td>
<td>South African Revenue Services</td>
</tr>
<tr>
<td>SIR</td>
<td>Secretary for Inland Revenue</td>
</tr>
<tr>
<td>TAA</td>
<td>Tax Administration Act 28 of 2011</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
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</tbody>
</table>

Glossary

‘Arrangement’ means any transaction, operation, scheme, agreement or understanding (whether enforceable or not).

‘Financial benefit’ means a reduction in the cost of finance, including interest, finance charges, costs, fees and discounts on a redemption amount.

‘Financial reporting standards’ means, in the case of a company required to submit financial statements in terms of the Companies Act, 2008 (Act No. 71 of 2008), financial reporting standards prescribed by that Act, or, in any other case, the Generally Accepted Accounting Practice or appropriate financial reporting standards that provide a fair presentation of the financial results and position of the taxpayer.

‘Participant’, in relation to an ‘arrangement’, means—
(a) a ‘promoter’; or

(b) a company or trust which directly or indirectly derives or assumes that it derives a ‘tax benefit’ or ‘financial benefit’ by virtue of an ‘arrangement’.

‘Pre-tax profit’, in relation to an ‘arrangement’, means the profit of a ‘participant’ resulting from that ‘arrangement’ before deducting normal tax, which profit must be determined in accordance with ‘financial reporting standards’ after taking into account all costs and expenditure incurred by the ‘participant’ in connection with the ‘arrangement’ and after deducting any foreign tax paid or payable by the ‘participant’ in connection with the ‘arrangement’.

‘Promoter’, in relation to an ‘arrangement’, means a person who is principally responsible for organising, designing, selling, financing or managing the reportable arrangement.

‘Tax benefit’ includes avoidance, postponement or reduction of a liability for tax.
# Table of Contents

Declaration.........................................................................................................................i  
Acknowledgments...............................................................................................................ii  
Abstract...............................................................................................................................iii  
List of Acronyms and Abbreviations....................................................................................vi  

## Chapter 1: Introduction  
1. Background......................................................................................................................2  
2. Rationale of the study........................................................................................................4  
3. Scope and limitations of the study....................................................................................4  
4. Methodology....................................................................................................................5  
5. Research questions..........................................................................................................5  
6. Structure..........................................................................................................................5  

## Chapter 2: Background- Tax evasion, Tax avoidance and Tax planning  
1. Introduction......................................................................................................................7  
2. Tax evasion.......................................................................................................................7  
3. Tax avoidance...................................................................................................................8  
   3.1. Permissible Tax Avoidance.......................................................................................9  
4. Impermissible tax avoidance..........................................................................................10  
   4.1. The legislative anti-avoidance rules.......................................................................12  
      4.1.1. General anti-avoidance rules..........................................................................12  
      4.1.2. Specific anti-avoidance rules.........................................................................13  
5. Conclusion.......................................................................................................................14  

## Chapter 3: The South African Perspective- Reportable arrangements as an indirect measure  
1. Introduction......................................................................................................................17  
2. Overview of the current reportable arrangement system as contained in section 34 to 39 of the TAA  
   2.1. Interpretation.............................................................................................................17  
   2.2. Basic principles  
      2.2.1. Defining Reportable Arrangements.................................................................18  
      2.2.2. Analysis and interpretation of section 35(1).....................................................19
Chapter 4: The position in the UK
1. Introduction...........................................................................................................40
2. Overview of the disclosure regime in the UK
   2.1. Background..................................................................................................40
   2.2. Basic principles
      2.2.1. Scope and summary of the rules of disclosure.................................41
      2.2.2. Income Tax, Corporation Tax and Capital Gains Tax.....................42
         I. Determining a hallmarked scheme – the tests......................................43
         II. The hallmarks.........................................................................................44
3. Comparison between the UK and SA disclosure regimes..................................53
   3.1. Similarities..................................................................................................53
   3.2. Differences..................................................................................................54
4. Conclusion............................................................................................................59

Chapter 5: Conclusion
1. Conclusions.........................................................................................................63
   1.1. The Efficacy of the reportable arrangement system.................................65
   1.2. Comparison between the South African and United Kingdom reportable arrangement systems.................................................................66
2. Recommendations................................................................................................67

Bibliography...........................................................................................................69

Tables
Table 1.....................................................................................................................56
Chapter 1
Introduction

Table of contents

1. Background ................................................................. 2
2. Rationale of the study .................................................. 4
3. Scope and limitations of the study ............................... 4
4. Methodology .............................................................. 5
5. Research questions ..................................................... 5
6. Structure ................................................................. 5
Chapter 1
Introduction

1. Background

Many, if not most, taxpayers dislike paying taxes.¹ These taxpayers will therefore as far as possible try to avoid tax. Tax avoidance is where a taxpayer’s tax liability is reduced through legal means by using the provisions of the fiscal legislation to his/her advantage.²

Because tax avoidance is legal, taxpayers are entitled to enter into legal arrangements that result in the reduction of their tax liability. The right of taxpayers to avoid tax is supported by the courts in South Africa and other countries.³ The court in the case of *IRC v Duke of Westminster*⁴ stated:

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

With tax avoidance and tax planning in mind, taxpayers and their advisors frequently come up with clever arrangements that cause transactions to be more tax efficient. However, a number of these arrangements may venture very close to being impermissible tax avoidance schemes.⁵ Impermissible tax avoidance is a term said to be difficult to define because of its unpredictability and characteristic to always

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³ Croome (2013) 488.
⁴ 1936 AC 1 19. The court in *Levene v IRC* 1928 AC 217 227 stated that “taxpayers are free, if they can, to make their own arrangements so that their cases may fall outside the scope of taxing Acts. They incur no legal penalties and strictly speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them.” These principles are generally accepted in South Africa, as recognised by the court in *ITC 1636 (1998)* 60 SATC 267 302 where it was stated that “the recognised legal principle that any person is entitled, if he can, so to order his affairs that the tax attached under the relevant legislation is less than it otherwise would be.”
Nevertheless, learned authors have gone on to define it to broadly consist of the avoidance of tax that is inconsistent with the spirit of tax laws as well as including elements such as abnormality, artificiality and lack of commercial substance. Impermissible tax avoidance schemes are also avoidance arrangements that have tax avoidance as their objective sole or main purpose.

Impermissible tax avoidance has an adverse effect on revenue collection. In an attempt to curb or control it, revenue authorities have various mechanisms at their disposal. These mechanisms include direct legislation which creates anti-avoidance rules and indirect measures such as the regulation of tax practitioners and the requirement to report transactions that might lead to the avoidance of tax.

In South Africa, direct legislation used to limit impermissible tax avoidance arrangements entails specific anti avoidance rules that are targeted at specific situations and the general anti-avoidance rule that is generally used against any type of tax avoidance. The general anti-avoidance rule (GAAR) was enacted in s 90 of the Income Tax Act 31 of 1941, which was replaced by s 103(1) of the Income Tax Act, which was itself replaced by s 80A to 80L of the ITA.

Apart from GAARs and specific anti-avoidance rules, there exists an indirect mechanism to curb impermissible tax avoidance in the form of reportable arrangements.

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7 Ibid.
9 Croome (2013) 488.
10 58 of 1962 (the ITA). The first GAAR appeared in s 90 of the ITA. See BT Kujinga “Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia and Canada” (2014) 47 CILSA 431, for a brief discussion of the historical GAAR in s 90.
As of October 2012, reportable arrangements are regulated in s 34 to 39 of the Tax Administration Act.\textsuperscript{12} Similar provisions were previously provided for by s 80M to 80T of the ITA.\textsuperscript{13}

Reportable arrangements, which will be discussed in detail in the latter chapters of this dissertation, help curb impermissible tax avoidance by effectively giving the Commissioner an early warning of potentially impermissible tax avoidance arrangements and enabling him/her to employ specific anti-avoidance provisions or the GAAR in s 80A to 80L.\textsuperscript{14}

Whether reportable arrangements are in fact an effective measure to indirectly limit impermissible tax avoidance arrangements is the subject of this dissertation. This paper seeks to address this exact point by analysing the concept of reportable arrangements. It attempts to ascertain whether the system currently in place is effective by identifying the factors that contribute to its efficacy as well as those that limit its efficacy.

2. Rationale of the study
Reportable arrangements are new to South Africa. As with all new laws, it is important to know and determine whether such laws are effective. This study is thus conducted to investigate the potential efficacy of reportable arrangements from a South African perspective, considering the important role these laws play in curbing impermissible tax avoidance.

3. Scope and limitations of the study
The analysis will start off with a definition of tax avoidance and tax planning, and contrast it with tax evasion. This study will also discuss the general anti-avoidance rule to the extent that it deals with commercial substance. The analysis will then go on to discuss reportable arrangements which is the core of this study. The analysis will end

\textsuperscript{12} 28 of 2011 (the TAA).
\textsuperscript{14} Croome (2013) 502.
off with exploring similar indirect measures against impermissible tax avoidance in the United Kingdom.

4. Methodology
This study will be based on qualitative research with justification in terms of a theoretical approach. A comparative analysis will be done where the reportable arrangements regime in the UK is investigated and compared to that of South Africa.

5. Research questions
The questions that this research study will attempt to answer include:
   a) What is the scope of the reportable arrangements provisions in South Africa?
   b) What is the scope of the reportable arrangements provisions in the UK?
   c) What is the potential efficacy of the system in South Africa?
   d) What recommendations can be made to improve the efficacy of reportable arrangements as an indirect measure against impermissible tax avoidance in South Africa?

6. Structure
The chapter breakdown of this study will include:
   a) Chapter 2- This chapter will explain the differences between tax evasion and tax avoidance, as well as tax avoidance and tax planning.
   b) Chapter 3- This chapter will explore the scope of reportable arrangements in South Africa.
   c) Chapter 4- This chapter will explore the scope of reportable arrangements in the United Kingdom.
   d) Chapter 5- This chapter will provide concluding remarks as well as possible recommendations to improve the efficacy of the reportable arrangement system in South Africa.
Chapter 2
Background:
Tax evasion, Tax avoidance and Tax Planning

Table of contents
1. Introduction........................................................................................................7
2. Tax evasion........................................................................................................7
3. Tax avoidance....................................................................................................8
   3.1. Permissible Tax Avoidance........................................................................9
4. Impermissible Tax Avoidance..........................................................................10
   4.1. The legislative anti-avoidance rules.......................................................12
      4.1.1. General anti-avoidance rules.........................................................12
      4.1.2. Specific anti-avoidance rules.........................................................13
5. Conclusion........................................................................................................14
Chapter 2
Background:
Tax evasion, Tax avoidance and Tax Planning

1. Introduction
In order to determine whether reportable arrangements are an effective indirect measure against impermissible tax avoidance, one needs to understand what impermissible tax avoidance is. However, before impermissible tax avoidance can be understood, it is important to define and give meaning to the broad concepts of tax evasion and tax avoidance.

This chapter will go on to explore tax avoidance as a concept, contrast it with tax evasion and tax planning and look at what impermissible tax avoidance entails. A brief overview of the anti-avoidance provisions used to combat impermissible tax avoidance will also be provided.

2. Tax Evasion
Tax evasion is the unlawful means of escaping tax liabilities whereby taxpayer's deliberately misrepresent or conceal the true state of their affairs to revenue authorities.\(^{15}\) It sometimes reflects “any illegal methods” used by taxpayer’s on their activities which in turn leads them to have no tax liability.\(^{16}\)

The use of deceit is usually involved with tax evasion as a taxpayer’s tax liability is reduced through non-disclosure of income and the exaggeration of expenditure claimed as deductions.\(^{17}\)

Examples of tax evasion as provided by the SARS Draft Comprehensive guide to anti-avoidance provisions\(^{18}\) include but are not limited to:

- The falsifying of financial statements;

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✓ Non-disclosure or misrepresenting relevant information in a tax return;
✓ The deliberate failure to disclose correct amounts of revenue received by a business receiving cash.

Tax evasion is a problem that infiltrates many societies as it involves the intentional disguise of income by a taxpayer which is due to him and taxable as such.\(^\text{19}\) It has however been stated that tax evasion can either be innocent or fraudulent.\(^\text{20}\) If it is innocent (not involving intent), the evasion could lead to re-assessment, but if fraudulent (involving intent), it could lead to criminal prosecution and re-assessment with hefty fines.

3. Tax Avoidance

In contrast to tax evasion, the term tax avoidance refers to a situation where a taxpayer’s tax liability is significantly reduced by using provisions of fiscal legislation to his or her advantage in a lawful manner.\(^\text{21}\) It involves lawful ways of obtaining tax advantages by exploiting legislative loopholes.\(^\text{22}\)

Examples of tax avoidance involve, but are not limited to:
✓ Using tax deductions;
✓ Changing of a business structure through incorporation;
✓ Establishing an offshore company in a tax haven\(^\text{23}\).

The difference between tax avoidance and tax evasion is therefore clear. As stated in the judgment by Gleeson CJ in *R v Mears*\(^\text{24}\):

The difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using illegal means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful.

\(^{21}\) Croome (2013) 487.
\(^{24}\) (1997) 37 ATR 321.
A key distinction between tax avoidance and tax evasion was made by Watermeyer CJ in *CIR v King*:

There [is] a real distinction between the case of one who so [orders] his affairs that he had no income which would expose him to liability for income tax, and that of one who [orders] his affairs in such a way that he escaped from liability for taxation which he ought to pay upon the income which in reality [is] his.

From this it is clear that tax avoidance and tax evasion can be distinguished. As Denis Healey a former British chancellor once put it, “the difference between tax avoidance and tax evasion is the thickness of a prison wall.”

As referred to in chapter 1 above, the courts agree that individuals and businesses are entitled to take all steps necessary and lawful to minimise their taxes. One could thus reason that tax avoidance is a form of tax planning.

### 3.1. Permissible Tax Avoidance

It is contended that tax planning and tax mitigation are synonyms for permissible tax avoidance. As explained by Kujinga, tax avoidance is a continuum that stretches from permissible tax avoidance to impermissible tax avoidance. On one end, permissible tax avoidance involves the avoidance of tax in a manner that is consistent with statutory purpose and the limits imposed by a general anti-avoidance rule (GAAR). On the other end there is impermissible tax avoidance which involves avoiding tax in a manner that is inconsistent with statutory purposes and the limits imposed by a GAAR.

Impermissible tax avoidance is therefore a problem for revenue authorities and needs to be curtailed. It is for this exact reason that courts have expressed their...
disagreement in relation to tax avoidance. Lord Normand in Lord Vestey’s Executors and Another v IRC said:

“Tax avoidance is an evil, but it would be the beginning of much greater evil if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.”

People who engage in tax avoidance therefore deprive a state from the revenue it needs to discharge its responsibility to people. Similarly, the very integrity of the tax system, which is necessary for its long-term sustainability, is attacked by tax avoidance.

4. Impermissible Tax Avoidance

Many taxpayers try to find ways to arrange their affairs in an optimal and desirable manner so as to postpone or reduce or escape their tax liability. Some of them enter into arrangements, transactions or schemes, which venture very close to impermissible tax avoidance.

As pointed out previously, impermissible tax avoidance is difficult to define. This is because the concept is ever-changing and unpredictable. As mentioned, learned authors have gone on to define it to broadly consist of the avoidance of tax that is inconsistent with the spirit of tax laws as well as including elements such as abnormality, artificiality and lack of commercial substance.

Impermissible tax avoidance sets out to achieve one or all of four basic goals in practice namely:

- Deferment of a tax liability;
- Permanently eliminating a tax liability;
- Converting the character of an item;

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33 See Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (A) and the recent decision of CIR v Ocean Manufacturing Ltd 1990 (3) SA 610 (A) where tax avoidance was referred to as a mischief that needs to be suppressed. Also Croome (2013) 488.
35 Kanamugire supra at 352.
37 Kanamugire supra at 351.
38 Kujinga (2012) 45 CILSA 42.
39 Ibid.
The shifting of income.\textsuperscript{40}

The characteristics of impermissible avoidance activity was identified and set out by SARS in its discussion paper\textsuperscript{41} as including any or all of the following:

\begin{itemize}
  \item The lack of economic substance (usually resulting from pre-arranged circular or self-cancelling arrangements), the true nature of the scheme disguised in an overlay complex scheme or transaction;
  \item The use of tax-indifferent accommodating parties or special purpose entities;
  \item Unnecessary steps and complexity;
  \item Inconsistent treatment for tax and financial accounting purposes;
  \item High transaction costs;
  \item Fee variation clauses or contingent fee provisions;
  \item The use of new and complex derivatives, hybrid and synthetic financial instruments, that make it possible for promoters to mimic traditional financial instruments like shares and debt, without having to incur the accompanying tax consequences;
  \item The use of tax havens.\textsuperscript{42}
\end{itemize}

Due to the harmful effects of impermissible tax avoidance, it is necessary to curtail it.\textsuperscript{43} To do this, anti-avoidance provisions that can be used by revenue authorities to counter tax avoidance exist in tax legislation.\textsuperscript{44} In South Africa, the direct means of controlling impermissible tax avoidance comes in the form of GAARs and specific anti-avoidance rules. A GAAR is a broad enough rule that can be used against all forms of impermissible tax avoidance whereas specific anti-avoidance rules target specific forms of impermissible tax avoidance.\textsuperscript{45}

\textsuperscript{42} Ibid., 19.
\textsuperscript{43} Cassidy (2009) 126 SALJ 740.
\textsuperscript{44} Croome (2013) 488. See also Cassidy supra.
\textsuperscript{45} Ibid.
4.1. The legislative anti-avoidance rules

The term anti-avoidance can be described as the prevention of impermissible tax avoidance which has adverse effects on the economy and the society as a whole.\footnote{A Likhovski ‘The Duke and the Lady: Helvering v Gregory and the History of Tax Avoidance Adjudication’ (2008) 70 Tel Aviv University Law Faculty Papers 22. Available at http://law.bepress.com/taulwps/art70 (accessed 17 May 2016). See Salome op cit note 21 at 12.} The presence of impermissible tax avoidance necessitates anti-avoidance rules.

4.1.1. General anti-avoidance rules

As previously mentioned, general anti-avoidance provisions can be used against any type of tax avoidance. A GAAR has been used in South Africa to curb impermissible tax avoidance since 1941.\footnote{Previous GAARs included s 90 of the Income Tax Act 31 of 1941 and s 103(1) of the current Income Tax Act. See Kujinga (2015) 27 SA Merc LJ 219.} At present, the current GAAR is contained in sections 80A-80L of the Act and applies to any arrangement entered into on or after 2 November 2006.

Section 80A of the Act contains the basic statutory structure of the GAAR\footnote{Kujinga (2012) 45 CILSA 44.} and defines an impermissible tax avoidance arrangement as follows:

‘An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and—

(a) in the context of business—

(i) it is entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or

(ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

(b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or

(c) in any context—

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

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

Before the Commissioner can apply the new GAAR, four requirements have to be met and these are.\footnote{Van Schaikwyk & Geldenhuys (2010) 35 Journal for Juridical Sciences 72.}
1) an avoidance arrangement as defined in s 80L entered into or carried out;\textsuperscript{50}
2) a tax benefit as defined in s 80L;\textsuperscript{51}
3) the sole or main purpose of entering into an avoidance arrangement must be to obtain a tax benefit;\textsuperscript{52} and
4) The arrangement must include a tainted element.\textsuperscript{53} These include tainted elements applicable in the context of business, in a context other than business and in any context.

As s 80A only contains the basic statutory structure of the GAAR, the elements expressed therein are defined in more detail in the other sections making up the GAAR.\textsuperscript{54} As mentioned above, apart from the general anti-avoidance rules that can be used against any type of tax avoidance, specific anti-avoidance rules also exist that are primarily aimed at targeting specific types of tax avoidance.

\textbf{4.1.2. Specific anti-avoidance rules}

Anti-avoidance rules can also be aimed at regulating specific types of tax avoidance.\textsuperscript{55} These specific anti-avoidance rules co-exist with general anti-avoidance rules and are contained in different provisions of tax legislation.

In addition, when engaging in impermissible tax avoidance transactions, schemes or arrangements, taxpayers sometimes use simulated transactions to disguise a transaction used to escape tax provisions. Courts will however in such an instance use the common law substance over form doctrine to set aside such disguised transactions instead of the anti-avoidance provisions provided for by statute.\textsuperscript{56} A

\textsuperscript{50} Preamble to s 80A.
\textsuperscript{51} Ibid.
\textsuperscript{52} Ibid.
\textsuperscript{53} S 80A (a)-(c).
\textsuperscript{54} Kujinga (2012) 45 CILSA 45.
\textsuperscript{55} Croome (2013) 488.
\textsuperscript{56} For a detailed analysis of the substance over form doctrine see RH Christie \textit{The Law of Contract} 4 ed (2001) 396 and H Struwig ‘Simulated transactions: The requirement of “commercial substance” to determine simulation as enunciated in the NWK case- The established substance over form doctrine renovated or a mere indicator of a concealed transaction?’ (LLM Thesis, University of Pretoria, 2013) 18. For further insight see the cases of Snook v London & West Riding Investments Ltd [1967] 2 QB 786; Dadoo Ltd and Others v Krugersdorp Municipal Council 1920 AD 530; Kilburn v Estate Kilburn 1931 AD 501; Zandberg v Van Zyl 1910 AD 302; CSARS v NWK Limited 2011 (2) SA 67 (SCA); 73 SATC 55; Michau v Maize Board 2003 (6) SA 459 (SCA).
detailed analysis of this common law mechanism is however beyond the scope of this paper.

5. Conclusion
It has been established from the above discussion that tax avoidance includes a taxpayer doing everything possible within the confines of the law, to reduce his or her tax bill. On the other hand tax evasion can be summed up as a taxpayer paying less than what he or she is legally obliged to. Tax evasion is therefore illegal whilst tax avoidance is allowed by the law in some respects.

A taxpayer is entitled to order his or her affairs in a manner that is most desirable to achieve minimised tax liability. Legitimate tax planning is thus synonymous with permissible tax avoidance that involves the avoidance of tax in a manner consistent with statutory purposes and the limits imposed by a GAAR.

It should however be noted that although tax avoidance is considered legal, engaging in such conduct is often seen as unacceptable behaviour. Learned authors, writers and case law, is of the opinion that it is an “evil” because if reduces the flow of tax revenue to the fiscus. To this end, anti-avoidance provisions in the form of GAARs and specific anti avoidance rules have been put in place to combat such tax avoidance. What these rules specifically aim to combat is impermissible tax avoidance. Impermissible tax avoidance involves the avoidance of tax in a manner that is inconsistent with statutory purposes and the limits imposed by a GAAR. The statutory rules used to limit impermissible tax avoidance is therefore a direct measure used by tax authorities to curtail such tax avoidance.

It is also of importance to look into the common law doctrine of substance over form when tax avoidance transactions, schemes or arrangements are examined. The doctrine, if applied to simulated transactions, would enable a court to disregard the form of the transaction and to give effect to its true nature and substance.

Apart from direct measures used to curtail impermissible tax avoidance, indirect measures such as the regulation of tax practitioners and the requirement to report certain arrangements also exist. Of these two indirect measures, reportable
arrangements are relatively new to South African law. As with all new terms and legislation, there is always a degree of complexity involved especially with unfamiliar terms. The chapter to follow will provide a detailed analysis on reportable arrangements and its efficacy as an indirect measure against impermissible tax avoidance.
# Chapter 3
The South African Perspective:
Reportable arrangements as an indirect measure

## Table of contents

1. Introduction ........................................................................................................................................ 17
2. Overview of the current reportable arrangement system as contained in section 34 to 39 of the TAA
   2.1. Interpretation .............................................................................................................................. 17
   2.2. Basic principles
       2.2.1. Defining Reportable Arrangements .................................................................................. 18
       2.2.2. Analysis and interpretation of section 35(1) .................................................................. 19
       2.2.3. Disclosure obligation: who discloses? ............................................................................. 31
       2.2.4. Information to be submitted .............................................................................................. 31
       2.2.5. Penalties for non-disclosure .............................................................................................. 32
3. Efficacy of reportable arrangement system ...................................................................................... 32
4. Conclusion ......................................................................................................................................... 36
Chapter 3
The South African Perspective:
Reportable arrangements as an indirect measure against impermissible tax avoidance

1. Introduction
The previous chapter dealt with direct legislative measures aimed at curbing impermissible tax avoidance. These provisions serve as a deterrent and where taxpayers challenge their scope, the provisions can be used to counteract the transactions that the taxpayers enter into. This shows that these provisions do not necessarily give SARS the opportunity to know in advance what taxpayers are up to in devising ways to avoid tax.

SARS has a mechanism at its disposal which has been in the ITA and more recently the TAA, which requires of taxpayers to report certain transactions as reportable arrangements.57 Section 34 to 39 of the TAA58 contain the provisions that enable the Commissioner to be given an early warning of transactions that have the objective of obtaining a tax benefit in an undue manner against which he could possibly apply the general anti-avoidance rule in s 80A-L of the ITA or any of the specific anti-avoidance provisions.59 This chapter will provide a brief overview and analysis of the reportable arrangement system.

2. Overview of the current reportable arrangement system as contained in section 34 to 39 of the TAA

2.1. Interpretation
The TAA came into effect on 1 October 2012. It was enacted to incorporate all administrative provisions (save for customs and excise) which are generic to all tax Acts and previously duplicated across different tax Acts, into one Act. The TAA

therefore provides SARS with substantial powers with regards to important administrative aspects of tax, including amongst others the collection of information and the imposition and recovery of tax.\textsuperscript{60}

\section*{2.2. Basic principles}

\subsection*{2.2.1. Defining Reportable Arrangements}

Section 35 of the TAA sets out the general requirements for an arrangement to qualify as a reportable arrangement.\textsuperscript{61} An arrangement could possibly be reportable for two reasons:\textsuperscript{62}

i. If it is listed publically by the Commissioner in terms of s 35(2);\textsuperscript{63} and

ii. If it contains certain generic requirements listed in s 35(1).

Section 35(1) provides as follows:

An ‘arrangement’ is a reportable arrangement if it is listed in terms of subsection (2) or if a ‘tax benefit’ is or will be derived or is assumed to be derived by any ‘participant’ ‘by virtue of the ‘arrangement’ and the ‘arrangement’—

\begin{itemize}
  \item[(a)] contains provisions in terms of which the calculation of ‘interest’ as defined in section 24J of the Income Tax Act, finance costs, fees or any other charges is wholly or partly dependent on the assumptions relating to the tax treatment of that ‘arrangement’ (otherwise than by reason of any change in the provisions of a tax Act);
  \item[(b)] has any of the characteristics contemplated in section 80C (2) (b) of the Income Tax Act, or substantially similar characteristics;
  \item[(c)] gives rise to an amount that is or will be disclosed by any ‘participant’ in any year of assessment or over the term of the ‘arrangement’ as—
    \begin{itemize}
      \item[(i)] a deduction for purposes of the Income Tax Act but not as an expense for purposes of ‘financial reporting standards’; or
    \end{itemize}
\end{itemize}


\textsuperscript{61} The provisions of section 35 do not apply to certain excluded arrangements as referred to in section 36 of the TAA. An arrangement that qualifies as an excluded arrangement is not reportable to SARS. See section 36 of the TAA for these excluded arrangements.


\textsuperscript{63} At the time of writing, the most recent list can be found at: \texttt{http://www.sars.gov.za/AllDocs/LegalDocLib/SecLegis/LAPD-LSec-TAdm-PN-2016-02\%20-%20Notice\%20140\%20GG\%2039650\%203\%20February\%202016.pdf}.
(ii) revenue for purposes of ‘financial reporting standards’ but not as gross income for purposes of the Income Tax Act;

(d) does not result in a reasonable expectation of a ‘pre-tax profit’ for any ‘participant’;

or

(e) results in a reasonable expectation of a ‘pre-tax profit’ for any ‘participant’ that is less than the value of that ‘tax benefit’ to that ‘participant’ if both are discounted to a present value at the end of the first year of assessment when that ‘tax benefit’ is or will be derived or is assumed to be derived, using consistent assumptions and a reasonable discount rate for that ‘participant’.

If an arrangement meets any of the characteristics listed in the above scenarios, then it qualifies as a reportable arrangement and will have to be reported to the Commissioner within 45 business days by way of the disclosure obligation in terms of section 37 of the TAA.

With the definition of a reportable arrangement mentioned, the paragraph that follows will dissect the definition and provide an analysis of its wording.

2.2.2. Analysis and interpretation of section 35(1)

From the above definition of a reportable arrangement, an arrangement is reportable if it is listed by the Commissioner as a reportable arrangement by public notice, or if the arrangement will lead to a tax benefit as well as any of the characteristics contained in s 35(1)(a)-35(1)(e).

A reportable arrangement listed by the Commissioner by public notice is pretty straightforward. The generic requirements listed in s 35(1) do however require some analysis.

It should however be noted that the introductory requirement in section 35(1), ‘a tax benefit is or will be derived from the arrangement’, must first be met before the additional requirements in section 35(1)(a)-(e) can be considered.
Section 35(1) provides that five specific types of arrangements constitutes reportable arrangements: 64

a) Section 35(1)(a)

In terms of section 35(1)(a) of the TAA, an arrangement will constitute a reportable arrangement if the arrangement leads to a tax benefit being obtained and contains provisions in terms of which the calculation of interest as defined in s 24J of the ITA, finance cost, fees or any other charges is wholly or partly dependent on the assumptions relating to the tax treatment of that arrangement. Therefore if the following requirements are met, the arrangement is reportable in terms of section 35(1)(a):

1. An ‘arrangement’, as defined, 65 is entered into.
2. A ‘tax benefit’, as defined, 66 is or will be derived or is assumed to be derived.
3. By any ‘participant’, as defined, by virtue of the arrangement; and
4. The arrangement contains provisions in terms of which the calculation of interest as defined in s 24J of the ITA, finance cost, fees or any other charges is wholly or partly dependent on the assumptions relating to the tax treatment of that arrangement.

In analysing section 24J and the wording of section 35(1)(a), it can be assumed that interest is a deduction to a person that makes a payment in terms of a transaction. If we assume that the interest is not market related, the higher the interest paid on a transaction, the higher the tax deduction obtained. When entering into arrangements, taxpayers often determine the amount of tax they want to pay in terms of that arrangement by taking all possible deductions into account. The aim at the end of the day is to pay the least amount of tax possible. In doing this, they sometimes adjust and arrange the calculation of interest, finance cost, fees or any other charges, in a way that will enable them to pay the least amount of tax on the specific transaction and thereby secure the particular tax benefit that they are after. Taxpayers therefore tweak arrangements in a manner that is most favourable to them. This is exactly what the legislature wanted to avoid. The aim of section 35(1)(a) is thus, if an arrangement is structured in such a way that the interest, finance cost, fees

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64 This excludes the arrangements listed by the Commissioner by public notice.
65 See the abbreviations and glossary section for the definition of arrangement.
66 See the abbreviation and glossary section for the definition of tax benefit.
or any other charges payable is dependent on the assumptions related to the tax treatment of that arrangement, then the arrangement becomes reportable and the Commissioner has an early warning on possible impermissible tax avoidance.

**b) Section 35(1)(b)**

In terms of section 35(1)(b) of the TAA, an arrangement is reportable if a tax benefit is derived from the arrangement and the arrangement has any of the characteristics contemplated in section 80C(2)(b) of the ITA, or substantially similar characteristics. Therefore, if the following requirements are met, the arrangement is reportable in terms of section 35(1)(b):

1. An ‘arrangement’, as defined, is entered into.
2. A ‘tax benefit’, as defined, is or will be derived or is assumed to be derived.
3. By any ‘participant’, as defined, by virtue of that arrangement; and
4. The arrangement has any of the characteristics contemplated in section 80C(2)(b) of the ITA, or substantially similar characteristics.

Section 80C of the ITA describes arrangements that lack commercial substance. Section 80C is part of the GAAR discussed previously, used to attack impermissible tax avoidance arrangements. Broomberg and De Koker are both of the opinion that section 80C can be described as the heart of the GAAR. Section 80C contains both a presumptive test and indicative test to determine whether commercial substance exists. The presumptive test is contained in section 80C(1) which establishes a general rule for determining whether an avoidance arrangement lacks commercial substance, while section 80C(2) contains a non-exclusive set of characteristics that serve as indicators of lack of commercial substance. Before one can look at the characteristics that indicate lack of commercial substance, which is the core to the reportable arrangement in section 35(1)(b) of the TAA, one first needs to establish what lack of commercial substance means.

In terms of the presumptive test to establish whether an arrangement lacks commercial substance, the general rule is that an avoidance arrangement lacks

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67 One of the indicators of an impermissible tax avoidance transaction is a transaction that lacks commercial substance.
69 Ibid.
commercial substance if it results in a significant tax benefit for a party but does not have a significant effect upon either the business risk or the net cash flow of that party.\(^{70}\) Therefore, if a transaction is justifiable or only makes sense by the tax benefits it secures, then it is deemed to lack commercial substance.\(^{71}\)

An in-depth analysis of section 80C(1) of the ITA is beyond the scope of this paper as section 35(1)(b) of the TAA makes specific reference to section 80C(2)(b) of the ITA.

Section 80C(2) of the ITA contains the indicative test to determine whether commercial substance exists. It provides for the purpose of Part IIA of the Act as it provides for characteristics that are indicative of lack of commercial substance, which are however not exhaustive. The legislature has stipulated these indicative characteristics that if present, the courts should have due regard.\(^{72}\) However, a court can still find that an arrangement has commercial substance despite the indicative characteristics, as the indicative characteristics are not an alternative for the presence or lack of commercial substance.\(^{73}\)

In terms of section 80C(2)(b):

- Characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to the inclusion or presence of-
  - (i) round trip financing as described in section 80D; or
  - (ii) an accommodating or tax indifferent party as described in section 80E; or
  - (iii) elements that have the effect of offsetting or cancelling each other.

Section 80C(2)(b) should therefore be read together with section 80D and section 80E of the ITA.

**i. Round trip financing**

Section 80D of the ITA provides a non-exclusive description of round trip financing. Round trip financing relates basically to a transfer of funds between parties which

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\(^{70}\) S 80C(1) of the Act.

\(^{71}\) Kujinga (2015) 27 SA Merc LJ 221.


\(^{73}\) Ibid.
ultimately will result in a tax benefit and a significant reduction, elimination or offset of business risk. As stated in the SARS Revised Proposal document:

'In general, the description (round trip financing) would encompass any avoidance arrangement in which funds are transferred between or among the parties ('round tripped amounts') and those round tripped amounts would both (1) result, directly or indirectly in a tax benefit (but for the provisions of the GAAR), and (2) significantly reduce, offset or eliminate any credit or economic risk incurred by any party in connection with the avoidance arrangements. The provisions are not subject to any 'tracing' requirement and apply regardless of the timing or sequence in which the funds are transferred or received or the means by or manner in which the round tripped amounts are transferred.'

This means that in order for there to be round trip financing as described in section 80D, there firstly has to be an avoidance arrangement which results in a tax benefit as defined in section 80L. Thereafter, secondly, it is required that funds, defined in section 80D(3), be transferred between or among the parties whereby such transfer would directly or indirectly result in a tax benefit and significantly reduce, offset or eliminate any business risk incurred by any party in relation to the avoidance arrangement. The second requirement does however become autologous as the first requirement, an avoidance arrangement, is by definition an arrangement that results in a tax benefit.

If all requirements mentioned are met in a particular scenario, the GAAR can certainly be applied as the arrangement will amount to an impermissible avoidance arrangement lacking commercial substance.

ii. An accommodating or tax indifferent party

Section 80E of the ITA provides a brief description of accommodating and tax indifferent parties. In terms of the SARS Revised Proposals, section 80E will apply in the following respects:

The section would only apply to a party if that party's involvement would have a significant impact on the tax liability of one or more other parties to the arrangement. Accommodating and tax-indifferent parties are typically used in impermissible avoidance arrangements, inter alia, to shift items of gross income from one party to another, to convert the character of amounts from revenue to capital, and non-deductible to deductible, or taxable to exempt, or to absorb a pre-payment or an accelerated payment of expenditure. Section 80E(1) incorporates this functional analysis and limits its scope to parties that are used to achieve any one or more of these ends.\(^7\)

This means that a tax indifferent party is accommodated when a party receives an amount that has no impact on his tax liability\(^7\) and that amount would have had an impact on the tax liability of another party if the amount was received by that party.\(^8\)

In terms of section 80E(2), a person may be an accommodating or tax indifferent party whether or not that person is a connected person in relation to any party. The presence of a party to a transaction will however not be considered as accommodating a tax indifferent party if the tax paid in other jurisdictions amounts to more than two-thirds of the income tax that would have been paid in the Republic\(^8\) or if ongoing active business operations of at least 18 months, in connection with the avoidance arrangement, are carried out through a substantial business establishment in the Republic or elsewhere.\(^8\)

If the presence of a party to an arrangement amount to an accommodating or tax indifferent party, the arrangement will become reportable as it is an impermissible tax avoidance arrangement that lacks commercial substance to which application of the GAAR becomes necessary.

iii. Elements that have the effect of offsetting or cancelling each other

Unlike ‘round trip financing’ and ‘accommodating or tax indifferent parties’, the provision of ‘elements that have the effect of offsetting or cancelling each other’ is not

\(^7\)The party is for example not subject to tax or the receipt is offset by either expenditure, loss or assessed loss that he would incur. See Jordaan ‘General anti-avoidance rule (GAAR)’.
\(^8\)This can for example occur if the second party would have been subject to tax on the amount if he received it or the amount would have been a non-deductible item for tax purposes. See Jordaan supra.
\(^8\)S 80E(3)(a) of the Act.
\(^8\)S 80E(3)(b) of the Act. S 80E(3) therefore provides for a tax haven. See Jordaan supra.
specifically described in any other provision of the Act. The phrase can however be interpreted through explaining specific words:

✓ ‘the effect of’ - the effect need not necessarily be a legal effect. It would in this respect include a commercial or economic effect.\(^\text{83}\)

✓ ‘offsetting or cancelling’ - these words don’t only cover legal offsetting or cancelling, being mergers, confusion and offsetting. It also includes commercial or economic offsetting or cancelling.\(^\text{84}\)

The elements mentioned would normally be present when a significant tax benefit is created by one transaction while the undesired consequences of this transaction is effectively neutralised by another transaction.\(^\text{85}\)

If an arrangement was to create this effect, the arrangement would become reportable as it is an impermissible avoidance arrangement that lacks commercial substance and which is inconsistent with the provisions of the GAAR.

c) Section 35(1)(c)

In terms of s 35(1)(c) of the TAA, an arrangement becomes reportable if a tax benefit will be derived from the arrangement and the arrangement gives rise to an amount that is or will be disclosed by any ‘participant in any year of assessment or over the term of the arrangement as 1) a deduction for purposes of the Income Tax Act but not as an expense for purposes of ‘financial reporting standards’; or 2) revenue for purposes of ‘financial reporting standards’ but not as gross income for purposes of the Income Tax Act. Therefore if the following requirements are met, the arrangement is reportable in terms of section 35(1)(c):

1. An ‘arrangement’, as defined, is entered into.
2. A ‘tax benefit’, as defined, is or will be derived or is assumed to be arrived.
3. By any ‘participant’, as defined, by virtue of the arrangement; and
4. the arrangement gives rise to an amount that is or will be disclosed by any ‘participant in any year of assessment or over the term of the arrangement as:
   4.1. a deduction for purposes of the Income Tax Act but not as an expense for purposes of ‘financial reporting standards’; or


\(^{84}\) This for example could be a loan between A and B which is cancelled and replaced by a similar loan from A to B. See Davis et al ‘South African Income Tax: Legislation and Commentary’ (2015) Juta.

\(^{85}\) Jordaan ‘General anti-avoidance rule (GAAR)’.
4.2. revenue for purposes of ‘financial reporting standards’ but not as gross income for purposes of the Income Tax Act.

The legislature’s intention with section 35(1)(c) was to target instances of inconsistent treatment of tax and financial reporting standards. To elaborate on this, the SARS Discussion Paper on Tax Avoidance recognises inconsistent treatment of tax and financial reporting standards as a hallmark of abusive avoidance schemes.\(^{86}\) If an arrangement, as in section 35(1)(c), gives rise to an amount that is recognised as a deduction in terms of the ITA, thus reducing taxable income, but not as an expense for purposes of financial reporting standards or recognises revenue for financial reporting standards but not gross income in terms of the ITA, the participant is engaging in abusive/impermissible tax avoidance by treating the tax and financial reporting standards inconsistently. It is also known that a transaction that treats tax and financial reporting standards inconsistently is a transaction that lacks commercial substance.

d) Section 35(1)(d)

In terms of s 35(1)(d) of the TAA, an arrangement is reportable if a tax benefit is or will be derived from the arrangement and if the arrangement does not result in a reasonable expectation of a ‘pre-tax profit’ for any ‘participant’. Therefore, if the following requirements are met, the arrangement is reportable in terms of section 35(1)(d):

1. An ‘arrangement’, as defined, is entered into.
2. A ‘tax benefit’, as defined, is or will be derived or is assumed to be arrived.
3. By any ‘participant’, as defined, by virtue of the arrangement; and
4. The arrangement does not result in a reasonable expectation of a ‘pre-tax profit’, as defined,\(^ {87}\) for any participant.

When interpreting the phrase ‘reasonable expectation of a pre-tax profit’, it is useful to define and give meaning to each of the words in the phrase in order to give meaning to what the legislature intended.


\(^{87}\) See the abbreviation and glossary section for the definition of pre-tax profit.
i. Reasonable
Firstly, the Oxford Dictionary defines the word ‘reasonable’ as having sound judgement, being fair, sensible, logical and moderate.\textsuperscript{88} The TAA itself does not define the term ‘reasonable’. The common law however, gives guidance on the definition of ‘reasonable person’ which is a legal fiction representing an objective standard against which an individual’s conduct is measured.\textsuperscript{89} When applying the common law principles, it is suggested that one can assume that a ‘reasonable expectation’ is analogous to a ‘reasonable person’s expectation’.\textsuperscript{90}

ii. Expectation
Secondly, the word ‘expectation’ is defined by the Oxford Dictionary as having a strong belief that something will happen or be the case. Therefore expecting a pre-tax profit is not synonymous with being certain that a profit will be generated.\textsuperscript{91} An expectation must therefore be objectively determined.

iii. Pre-tax profit
Thirdly, the term ‘pre-tax profit’ is defined in the TAA as:

\textit{‘pre-tax profit’}, in relation to an ‘arrangement’, means the profit of a ‘participant’ resulting from that ‘arrangement’ before deducting normal tax, which profit must be determined in accordance with ‘financial reporting standards’ after taking into account all costs and expenditure incurred by the ‘participant’ in connection with the ‘arrangement’ and after deducting any foreign tax paid or payable by the ‘participant’ in connection with the ‘arrangement’.\textsuperscript{92}

As the TAA makes reference to ‘financial reporting standards’, the accounting definition of profit also becomes applicable. The \textit{IAS 1- Presentation of Financial Statements} defines ‘profit and loss’ as:

Profit or loss is defined as "the total of income less expenses, excluding the components of other comprehensive income". Other comprehensive income is defined as comprising "items of

\textsuperscript{88} Oxford Dictionaries Online 2016. Available at \url{www.oxforddictionaries.com} (accessed 18 June 2016).
\textsuperscript{90} In terms of Jones v Santam Bpk 1965 (2) All SA 354 (A), the reasonable person criterion embodies an objective standard that varies with regards to the demands that arise under particular circumstances. According to Midgley & Van der Walt, the reasonable person is a personification of the ideal standard to which everyone is required to conform. See JR Midgley & JC Van der Walt \textit{Delict. Law of South Africa} (2005) 8(1) para 121. See further Steenkamp \textit{supra} at 75.
\textsuperscript{91} Steenkamp \textit{supra}.
\textsuperscript{92} Section 34 of the TAA.
income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs.93

iv. Result
Lastly, the word ‘result’ is defined by the Oxford Dictionary as a thing caused or produced by something else, thus a consequence or outcome.

If the provision of section 35(1)(d) is therefore considered as a whole, an arrangement is reportable if the reasonably expected outcome or consequence of the arrangement is not profit before normal tax is deducted. However, when tax considerations are factored into the arrangement, the arrangement becomes beneficial to the individual or company because of the tax benefit that will be received by the company or individual. This means that the transaction is only profitable after the tax considerations have been factored in. So the value of the transaction is only realised after tax has been levied.

e) Section 35(1)(e)
The interpretation of the provisions of section 35(1)(e) can be read together with the discussion and interpretation of section 35(1)(d) with exception that a pre-tax profit in this case is the result of an arrangement. The interpretation of the meaning of words mentioned under the interpretation of section 35(1)(d) can therefore be inserted here.

In terms of section 35(1)(e), an arrangement becomes reportable if the pre-tax profit received by a participant falls in a category of value below the value of the tax benefit received by the participant. This is taking into consideration that both the pre-tax profit and tax benefit is reduced to a current existing value at the end of the first year of tax assessment when the tax benefit is or will be obtained or is supposed to be obtained, by using consistent assumptions and a reasonable discount rate for that participant. Therefore if the following requirements are met, the arrangement becomes reportable in terms of section 35(1)(e):

1. An ‘arrangement’, as defined, is entered into.
2. A ‘tax benefit’, as defined, is or will be derived or is assumed to be arrived.

3. By any ‘participant’, as defined, by virtue of the arrangement; and
4. the arrangement results in a reasonable expectation of a ‘pre-tax profit’ for any
   ‘participant’ that is less than the value of that ‘tax benefit’ to that ‘participant’ if
   both are discounted to a present value at the end of the first year of
   assessment when that ‘tax benefit’ is or will be derived or is assumed to be
   derived, using consistent assumptions and a reasonable discount rate for that
   ‘participant’

In interpreting section 35(1)(e), taking the interpretation of section 35(1)(d) into
account:

i. **Less than the value**

   The words less than is defined in the Oxford Dictionary as a smaller amount of, not as
   much or of a lower rank. Therefore the value, defined in the Oxford Dictionary as ‘the
   material or monetary worth of something’, of the pre-tax profit expected to logically
   flow from an arrangement is smaller or not as much as the tax benefit the participant
   will receive.

   Section 35(1)(e) does however contain a proviso stating that both the reasonable
   expectation of a pre-tax profit and the value of the tax benefit that will be received by
   the participant has to be discounted to a present value at the end of the first year of
   assessment when that ‘tax benefit’ is or will be derived or is assumed to be derived,
   using consistent assumptions and a reasonable discount rate for that ‘participant’.

ii. **Discounted to a present value**

   The phrase ‘discounted to a present value’ can be interpreted to mean that both the
   expectation of the pre-tax profit and the tax benefit received has to be reduced to a
   present value, present indicating a value existing at the end of the first year of
   assessment when the tax benefit is, will or is assumed to be derived because a future
   expectation is involved. The amounts received have to be reduced to a present value
   because an expectation is involved and the amount might not have incurred yet or is
   reasonably expected to incur in future.
iii. End of first year of assessment

The first year of assessment is the year in which the amount of tax due by the participant will be calculated or estimated for the first time.\(^{94}\) Therefore the end of the first year of assessment when the tax benefit is, will or is assumed to be derived means the end of the year in which the tax benefit is, will or is assumed to be obtained when tax due by the participant is calculated or estimated for the first time.

iv. Is or will be derived or is assumed to be derived

When this phrase is broken up, the word ‘is’ denotes the present tense. Thus the tax benefit is obtained in that year of assessment. The word ‘will’ expresses the future tense. Therefore the tax benefit has not been obtained yet but will be obtained in that year of assessment. The word ‘assumed’ means if something is supposed to be the case without proof.\(^{95}\) Thus if a tax benefit is assumed to be obtained, it could mean the tax benefit is supposed to be obtained without providing proof that it should be obtained. Lastly the word ‘derive’ is to obtain something from something else.\(^{96}\) Therefore to derive a tax benefit means to get, acquire or secure the tax benefit.

v. Consistent assumptions and a reasonable discount rate

The consistent assumptions and reasonable discount rate referred to will depend on the particular scenario and the circumstances at hand.

Section 35(1)(e) differs from section 35(1)(d) in the fact that a reasonable expectation of a pre-tax profit does exist in this case. Therefore in contrast to the example mentioned under section 35(1)(d), if for example a company or individual expects to receive a profit of R200m but enters into arrangements that will result in a R300m deduction, they will end up with a loss. As deductions decrease a company or individual’s taxable income, the individual or company receives a tax benefit from those deductions. Therefore, a reasonable expectation of a pre-tax profit does exist but due to the arrangements (resulting in deductions) entered into the profit received is less than the tax benefit that will be received. The arrangements will lack commercial

\(^{94}\) Section 1 of the TAA defines assessment as the determination of the amount of a tax liability or refund, by way of self-assessment by the taxpayer or assessment by SARS.

\(^{95}\) Oxford Dictionaries.

\(^{96}\) Oxford Dictionaries.
substance and will be susceptible to application of the GAAR as it amount to impermissible tax avoidance.

2.2.3. Disclosure obligation: who discloses?
As stated in s 37, a promoter of an arrangement must disclose the information referred to in s 38 in respect of a reportable arrangement.

A promoter is defined in s 34 as a person who is principally responsible for organising, designing, selling, financing or managing the arrangement.\(^97\) If there is no promoter to an arrangement or if a promoter is not resident to South Africa then all other participants must disclose the information required in s 38.\(^98\)

S 34 defines a participant to an arrangement as a promoter; a person who directly or indirectly will derive or assumes that the person will derive a tax benefit or financial benefit by virtue of an arrangement; or any other person who is party to an 'arrangement' listed in a public notice referred to in s 35 (2). The participant does not have to disclose the information if he or she has obtained a written statement from the promoter or any other participant that the arrangement has been disclosed.\(^99\)

2.2.4. Information to be submitted
The information required to be disclosed to SARS in relation to a reportable arrangement in the prescribed form and manner and by the date specified as indicated in s 38 involve:

- A detailed description of all its steps and key features, including, in the case of an arrangement that is a step or part of a larger arrangement, all the steps and key features of the larger arrangement;
- A detailed description of the assumed tax benefits for all participants, including, but not limited to, tax deductions and deferred income;

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\(^{97}\) An advisor who assists a client in structuring an arrangement will fall within this category.
\(^{98}\) Croome (2013) 504.
\(^{99}\) Section 37(3). Before SARS is notified of an arrangement that at face value is reportable, the parties to the arrangement should firstly determine whether there is actually an obligation on any of them to report the arrangement. See N Musviba ‘Who is obliged to report a reportable arrangement?’ (2015) South African Tax Guide. Available at http://www.sataxguide.co.za/who-is-obliged-to-report-a-reportable-arrangement/ (accessed 28 June 2016).
the names, registration numbers, and registered addresses of all participants; a list of all its agreements; and any financial model that embodies its projected tax treatment.

The arrangements has to be disclosed to SARS within 45 business days after an amount is first received by or accrued to a participant or is first paid or actually incurred by a participant in terms of the arrangement. The revenue authority (SARS) can also grant an extension for the disclosure for a further 45 business days if reasonable grounds for the extension exist.

2.2.5. Penalties for non-disclosure

Failure by a participant to disclose the information in respect of a reportable arrangement as required, shall be liable to a penalty for each month that the failure continues, up to 12 months, in the amount of R50 000 for a participant other than the promoter or R100 000 in the case of the promoter. The amount of the penalty as described is doubled if the amount of the anticipated tax benefit for the participant by reason of the arrangement (within the meaning of section 35) exceeds R5 000 000, and is tripled if the benefit exceeds R10 000 000.

3. Efficacy of the reportable arrangement system

From the analysis of reportable arrangements, it is clear that the reportable arrangement system was legislated to serve the purpose of placing a mechanism at SARS' disposal that would give them an early warning of possible impermissible tax avoidance. This early warning would entitle SARS to employ the GAAR or if applicable, the specific anti-avoidance rules, against such impermissible tax avoidance. As stated previously, there are five types of arrangements that are reportable in terms of section 35(1) of the TAA. The question is whether this is comprehensive given the complexity of impermissible tax avoidance.

In terms of section 35(1), the arrangements that are specifically targeted include arrangements relating to interest, finance costs and the tax treatment of those

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100 Section 37(4).
101 Section 37(5).
102 Section 212(1).
103 Section 212(2)
arrangements (section 35(1)(a)). Section 35(1)(b) specifically targets arrangements that lack commercial substance as described in section 80C(2)(b) of the ITA, while section 35(1)(c)-(e) are just expansions of arrangements that lack commercial substance.

It seems to be that SARS wanted to target transactions that lack commercial substance. These are arrangements that do not make sense when you look at the commercial substance of the transactions. They do not make sense economically. They only make sense by reference to their tax benefit.

It can also be argued that SARS focused mainly on transactions that lack commercial substance when formulating the reportable arrangement provisions, because these are the arrangements that are ‘actionable’. When looking at the ordinary meaning of the word ‘actionable’, the Oxford Dictionary defines it as an adjective that “gives sufficient reason to take legal action”; or something that is “able to be done or acted on; having practical value.” Therefore, because the GAAR is a weapon used by SARS against impermissible tax avoidance, it is only relevant that they formulate reportable arrangement provisions based on the elements of impermissible tax avoidance arrangements that give them sufficient reason to take legal action.

When we look at the definition of an impermissible tax avoidance arrangement in the GAAR, section 80A of the ITA provides that an impermissible tax avoidance arrangement is entered into if the sole or main purpose of entering into the arrangement was to obtain a tax benefit as well as the presence of any four of the tainted elements. The tainted elements involve abnormality (abnormality where bona fide business purposes are concerned and the creation of abnormal rights and obligations), lack of commercial substance and misuse and abuse. The current reportable arrangement provisions already make provision for arrangements that are entered into with the main purpose of obtaining a tax benefit, as well as arrangements that lack commercial substance. So why is it that SARS only catered for transactions that lack commercial substance and not the other aspects of impermissible avoidance arrangement as stated in the GAAR?

To answer this question, we would have to look at how the other aspects of impermissible tax avoidance can be integrated into the current reportable arrangement provisions.
Firstly if the element of misuse and abuse was to be incorporated, the provision would have to provide for something along the lines of ‘an arrangement that is based on a potentially abusive interpretation of the Act.’ The problem with such a provision would be what “potentially abusive” would be defined as. A person might not think a transaction is potentially abusive and therefore not feel the need to report it. It would thus be difficult to incorporate a provision along those lines as the provision might be susceptible to creating loopholes.

Secondly if element of abnormality was to be incorporated, the provision would have to provide for arrangements that create abnormal rights and obligations. The problem that this type of arrangement poses is what would be abnormal rights and obligations? What are normal rights and obligations? The taxpayer could yet again argue that under the circumstances of the arrangement, the rights and obligations created are normal to that arrangement.

It is thus submitted that these elements are not actionable, as it would be difficult for SARS to take legal action on them and because they have no practical value.

However, it is argued that if the legislature was to insert a provision that would provide for ‘an arrangement that creates rights and obligations that are not normally created in an arrangement of the same nature’, such a provision would be actionable. This is because the provision would have practical value as SARS would be able to ascertain what rights and obligations would normally be created in an arrangement of the same nature and therefore giving them sufficient reason to take legal action.

Apart from the reason that SARS focuses mainly on transactions that lack commercial substance in the reportable arrangement provisions because they are actionable, a possible reason for such fixation on lack of commercial substance is because a transaction that lacks commercial substance is on its own a strong indicator of impermissible tax avoidance. This is evident in a country like the United States (the US) where reliance is mainly placed on the judicial doctrine of economic substance to combat impermissible tax avoidance. The economic substance doctrine in the US is similar to the commercial substance indicator contained in the GAAR in South
Africa. In terms of the economic substance doctrine, courts will disregard a transaction for lack of economic substance if the transaction gives rise to a tax benefit, but has no other economic value other than the value attributable to the tax benefits obtained.

Based on the reliance by the US on the economic substance doctrine to curb impermissible tax avoidance, the reliance of SARS on the lack of commercial substance to primarily formulate the reportable arrangement provisions which indirectly curb impermissible tax avoidance, is therefore justified. The justification lies in the fact that the economic substance doctrine and the commercial substance indicator are closely related, if not identical and hence they are both strong indicators of what impermissible tax avoidance is.

Another advantage of SARS limiting their focus on commercial substance to primarily formulate the reportable arrangement provisions is that that the focus on commercial substance is narrower than the GAAR and it allows the reportable arrangement system to be less complex and cluttered. This limit can however also be disadvantageous in that a taxpayer may enter into a transaction that potentially abuses the tax law without having to report it. This similarly applies to abnormal transactions which do not need to be reported.

Nevertheless, it is contended that the reportable arrangement provisions which are primarily based on transactions that lack of commercial substance, is effective in indirectly curbing impermissible tax avoidance due to a lack of commercial substance being such a strong indicator of impermissible tax avoidance. It is clear that tax is not just avoided through the five arrangements contained in section 35(1) of the TAA and

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by the arrangements listed by the Commissioner in section 35(2). However, based on the contention that transactions that lack commercial substance is a strong indicator of impermissible tax avoidance, the reportable arrangement system is therefore a strong mechanism in identifying impermissible tax avoidance transactions whereby SARS can employ the GAAR or the specific anti-avoidance rules. The inclusion of all the hallmarks of impermissible tax avoidance in the reportable arrangement provisions would thus place an administrative burden on SARS which could possibly weaken the system through the added loopholes mentioned previously.

4. Conclusion
The reportable arrangement system has been used by SARS as a mechanism to indirectly combat such impermissible tax avoidance. This regime has been in place for just over a decade considering that the first reportable arrangement system was introduced by SARS in 2005 in form of section 76A of the ITA.

With the aid of the current reportable arrangement system, SARS is given an early warning of transactions that have the objective of obtaining a tax benefit in an undue manner. As seen from the analysis and interpretation of the reportable arrangement provisions, an arrangement becomes reportable if firstly, it is listed by the Commissioner by public notice in terms of section 35(2) of the TAA. It is thus not required that the arrangements listed by public notice result in a tax benefit. The arrangement qualifies as being reportable by just merely being listed. Secondly, an arrangement becomes reportable if it contains any of the generic requirements listed in section 35(1). The generic requirements include inter alia that a tax benefit be derived; the calculation interest, finance costs, fees or other charges are dependent on the tax treatment of the arrangement; the arrangement lacks commercial substance; there’s a mismatch of accounting and tax treatment; there’s no reasonable expectation of a pre-tax profit and when the tax benefit of a transaction exceeds the pre-tax profit if both are discounted to a present value.

From the analysis and interpretation of the reportable arrangement provisions, it was discovered that SARS focused mainly on the element of transactions that lack commercial substance when formulating the reportable arrangement provisions. A lack of commercial substance seemed to be the most important determining factor considering that four out of five of the reportable arrangement provisions relate to
commercial substance. It was argued that the revenue authority’s fixation on transactions that lack commercial substance could be seen as a weakness considering that section 35(1) only provides for five ways in which tax is possibly avoided, therefore implying that SARS only identified a limited number of targeted areas of suspected avoidance and a taxpayer may thus enter into a transaction that potentially abuses the law without having to report it. However, through the analysis of the other tainted elements that relate to impermissible tax avoidance, it was established that the element of a lack of commercial substance was the only element that was actionable. Possible arrangements that relate to the other tainted elements, all resulted in possible loopholes for the Act. Therefore, with justification in terms of the economic substance doctrine used by the United States to primarily curb impermissible tax avoidance, it was submitted that the commercial substance indicator is on its own a strong indicator of impermissible tax avoidance. The revenue authority’s fixation on commercial substance can therefore be seen as strength because it makes the system less complex and cluttered and the incorporation of all the hallmarks of impermissible tax avoidance into the reportable arrangement provisions would place an administrative burden on SARS and thereto also create loopholes for the reportable arrangement system.

With this said, the reportable arrangement system which is primarily based on transactions that lack commercial substance is therefore a strong and effective measure to indirectly curb impermissible tax avoidance transactions, hence the lack of commercial substance being such a strong indicator. It should however be noted that even though the reportable arrangement system notify SARS of possible impermissible tax avoidance, the obligation to report an arrangement to SARS does not mean that the arrangement is automatically deemed to be impermissible tax avoidance, nor does it have any effect on the substantive consideration of normal tax liability for SARS. It is important to realise that transactions that fall under section 35, or that could possibly fall under section 35, are not taboo under all circumstances. It does however mean that taxpayers need to consider the commerciality of the transactions and their tax positions with extreme caution.
Through the reportable arrangement mechanism, SARS is thus able to collect the information it requires effectively by simultaneously curbing impermissible tax avoidance indirectly and being able to recover the tax it is entitled to.
Chapter 4
Comparative Study: The position in the UK

Table of contents
1. Introduction..............................................................................................................40
2. Overview of the disclosure regime in the UK
   2.1. Background......................................................................................................40
   2.2. Basic principles
       2.2.1. Scope and summary of the rules of disclosure.................................41
       2.2.2. Income Tax, Corporation Tax and Capital Gains Tax......................42
           I. Determining a hallmarked scheme – the tests.................................43
           II. The Hallmarks.........................................................................................44
3. Comparison between the UK and SA disclosure regimes..............................53
   3.1. Similarities......................................................................................................53
   3.2. Differences.....................................................................................................54
4. Conclusion..............................................................................................................59
Chapter 4
Comparative Study: The position in the UK

1. Introduction
The international position regarding tax disclosure requirements is referred to by SARS in their *Reportable arrangements Guide*. One of the countries specifically mentioned in this guide is that of the UK as it has comprehensive reportable transaction legislation which came into effect on 1 August 2004.

The Disclosure of Tax Avoidance Schemes (DOTAS) is used in the UK to fulfil the objective of obtaining early information about tax arrangements and how they work. The purpose that this disclosure regime serves is similar to the reportable arrangement provisions used in South Africa which provide the revenue authority with a mechanism to detect impermissible tax avoidance at an early stage. Although similar in purpose, the UK approach is far more extensive and complex and very different to the approach used in South Africa.

As such, it is pertinent to consider whether the court cases and legislation in the UK, which has been in existence for quite some time, can be used to improve the disclosure requirements in South Africa which were enacted quite recently.

2. Overview of the disclosure regime in the UK
   2.1. Background
The majority of the people in the UK pay the taxes due to the revenue authority without bending or breaking the rules in an attempt to avoid tax. However, a small minority of people are tempted by tax avoidance schemes that promise big tax savings for little cost or effort.

The traditional approach in the UK that served to counter tax avoidance was to introduce legislation to prevent individual tax-planning schemes exploiting loopholes in

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the law once their operation has come to light.\textsuperscript{108} However, in the 2004 Budget the then Chancellor Gordon Brown announced that it was not his intention to “introduce a general anti-avoidance rule … at this stage” but alongside the legislation that tackles a number of individual avoidance schemes,\textsuperscript{109} the Government would introduce disclosure requirements on those marketing avoidance schemes and the taxpayers using them.\textsuperscript{110}

The disclosure regime took effect on 1 August 2004 and a statement regarding its success followed very soon in the Pre-Budget Report later that year, wherein Government stated that they were “already achieving their purpose of allowing earlier and more targeted action against avoidance schemes.”\textsuperscript{111} The paragraphs to follow will expand on the principles of the regime as it currently stands.

\textbf{2.2. Basic principles}

\textbf{2.2.1. Scope and summary of the rules of disclosure}

The disclosure rules of the DOTAS regime, covers certain tax arrangements. These tax arrangements relate mainly to:

- Income tax, Corporation Tax and Capital Gains Tax;
- National Insurance Contributions (NICs);
- Stamp Duty Land Tax (SDLT);
- Annual Tax on Enveloped Dwellings (ATED); and
- Inheritance Tax (IHT).

The tax arrangements that relate to these specific taxes all have their own tests and rules that apply for disclosure. The HMRC’s Guidance on DOTAS provides an in-depth analysis on these specific taxes as well as the disclosure rules that apply to them. An in-depth analysis is beyond the scope of this paper. The paragraphs to follow will


\textsuperscript{109} Relevance was also placed on judicially created doctrines to tackle impermissible tax avoidance.

\textsuperscript{110} Seely \textit{supra} at 17.

\textsuperscript{111} Cm 6408 December 2004 para 5.88.
therefore just provide a summary of the disclosure rules applicable to these specific
taxes to provide an understanding of the DOTAS regime.

2.2.2 Income Tax, Corporation Tax and Capital Gains Tax
Income Tax (IT) is a personal tax you pay on your income,\textsuperscript{112} while corporation tax
(CT) is a corporate tax that is levied on the profits made by companies (a limited
liability company, a foreign company with a branch or office in the UK and a club, co-
operative or other unincorporated association).\textsuperscript{113} On the other hand, capital gains tax
(CGT) is a personal and business tax on the profit when you sell or ‘dispose of’ an
‘asset' that has increased in value.\textsuperscript{114} It is the gain that you make that is taxed and not
the amount of money that you receive.
A tax arrangement entered into that relates to any of these taxes should be disclosed
where:
\begin{itemize}
  \item it will, might be, or is expected to enable any person to obtain a tax advantage;
  \item the tax advantage is, or might be expected to be the main benefit or one of the
        main benefits of the arrangement ;
  \item it is a hallmarked scheme by being a tax arrangement that falls within any
        description prescribed in the relevant regulations.\textsuperscript{115}
\end{itemize}
Therefore, if an arrangement is entered into that results in a tax advantage, with the
tax advantage being the main benefit or one of the main benefits and the arrangement
falls within the description of a hallmarked scheme set out in the regulations then the
arrangement becomes disclosable to HMRC.

With this said, it becomes relevant to briefly discuss the tests involved in determining a
hallmarked scheme as well as providing description of what these hallmarks are.

I. Determining a hallmarked scheme – the tests
The HMRC’S Guidance on DOTAS suggests that six tests are involved in determining
a hallmarked scheme:

\begin{itemize}
\end{itemize}
\textsuperscript{113} HMRC (2016) Corporation Tax Guide. Available at https://www.gov.uk/corporation-tax (accessed 1 August
2016).
\textsuperscript{114} HMRC (2016) Capital Gains Tax Guide. Available at https://www.gov.uk/capital-gains-tax (accessed 1 August
2016).
a. **Test 1**: Are there arrangements that enable an IT, CT or CGT tax advantage to be obtained?\(^{116}\)

b. **Test 2**: Is the advantage a main benefit of the arrangements?\(^{117}\)

c. **Test 3**: Is there a promoter of the arrangements?\(^{118}\)

d. **Test 4**: The hallmarks for arrangements where there is a promoter

Following the reason for the differentiation between ‘in-house’ and promoted schemes under test 3, an arrangement with a promoter is regarded as a hallmarked scheme if any of the following hallmarks apply:

- Hallmark 1(a)- Confidentiality from other promoters
- Hallmark 1(b)- Confidentiality from HMRC
- Hallmark 3- Premium fee
- Hallmark 4- the off market terms hallmark has been omitted by The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2010 (SI 2010/2834)
- Hallmark 5- Standardised tax products
- Hallmark 6- Loss schemes
- Hallmark 7- Leasing arrangements
- Hallmark 8- the pensions hallmark ceased to have effect on 6 April 2011
- Hallmark 9- Employment Income

e. **Test 5**: The hallmarks for ‘in-house’ arrangements

Similar to test 4, an arrangement that is designed ‘in-house’ is regarded as a hallmarked scheme if any of the following hallmarks apply:

- Hallmark 1(b)- Confidentiality from HMRC
- Hallmark 3- Premium fee
- Hallmark 7- Leasing arrangements
- Hallmark 9- Employment Income

The first three hallmarks are not applicable if the business that receives the tax advantage is a small or medium enterprise.

f. **Test 6**: Is the person intended to obtain the advantage a large business?\(^{119}\)

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\(^{116}\) Section 306(1)(a) and (b) of the Finance Act 2004.

\(^{117}\) Section 306(1)(c) of the Finance Act 2004.

With the tests for determining a hallmarked scheme now discussed, it is vital that the hallmarks itself are now mentioned.

II. The hallmarks (not applicable to SDLT, ATED or IHT)

a. About the hallmarks

Certain descriptions of arrangements which are referred to as ‘hallmarks’, are set out in the legislation that regulates the disclosure regime in the UK. These hallmarks were designed on the one hand to specifically capture areas of concern and on the other, to capture new and innovative arrangements. An arrangement is a hallmarked scheme or a hallmarked NI contribution scheme if it fits the description of one or more of the hallmarks. The hallmarks are therefore not mutually exclusive.

The hallmarks are not set in stone and are of course expected to change overtime as changes occur in the avoidance market place or as the effectiveness of the counter-avoidance measure is challenged. What follows is a brief discussion of the individual hallmarks.

b. Hallmarks 1(a) and (b): Confidentiality where promoter involved

   i. Hallmark 1(a): Confidentiality from competitors
   ii. Hallmark 1(b): Confidentiality from HMRC
   iii. Hallmark 1(b): ‘Any element’ of the arrangement
   iv. Hallmark 1(b): Confidential ‘at any time’
   v. Hallmark 1(b): Repeated and continued use of the element

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119 Consequent to the fact that certain hallmarks do not apply to small and medium enterprises, it has to be established if the tax advantage is obtained by a large business. See Regulation 3 and 4 of the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).


121 Ibid.

122 The hallmarks are prescribed by regulation 6 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543) as amended by the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) (Amendment) Regulations 2013 (2013 No. 2595). The 2013 regulations commenced and came into force on 4 November 2013 and do not have effect where the relevant date under section 308 (1) for the promoter to provide the prescribed information in respect of a notifiable proposal is before 4 November 2013; the date under section 308 (3) on which the promoter first becomes aware of any transaction that is part of notifiable arrangements is before 4 November 2013. The regulations therefore apply where the promoter has a duty to provide prescribed information on a notifiable proposal or becomes aware of a transaction forming part of notifiable arrangements on or after 4 November 2013. See Annexure G for a description of these hallmarks.
c. Hallmark 2: confidentiality where no promoter involved\textsuperscript{123}

i. Confidentiality from HMRC

ii. The timing rule

This rule serves an indication of the date when the arrangement is put in place, thus the day that it is implemented. Its existence relates to the issue of whether the details of an arrangement want to be kept confidential after the date of this rule. As such, the question of whether the details of the arrangement would be disclosed on return therefore becomes irrelevant.\textsuperscript{124}

d. Hallmark 3: premium fee\textsuperscript{125}

i. Applying the hallmark

Since hallmark 1 and 2 respectively addresses cases where a promoter is and is not involved, thus in-house schemes, this hallmark is applicable to both promoted and in-house schemes. As for in-house schemes, this hallmark will as in hallmark 2, not be applicable where the user that intends to obtain a tax advantage is a business that is a small or medium sized enterprise.

A hypothetical test is involved where this hallmark is concerned. The test examines whether a premium fee could be obtained in absence of the DOTAS regime. The test is therefore not dependent on whether a premium fee is actually received, but on whether the premium fee could be obtained. The term ‘fees’ is drawn very widely in this case and would take amounts paid directly and indirectly to a promoter into account. The fact that a promoter does not charge a fee would not be irrefutable proof that the hallmark does not apply. The fact that the promoter does however charge a premium fee would however result in the test of this hallmark being met. The question to test therefore becomes whether it can reasonably be expected that a promoter could charge a premium if he so wishes.\textsuperscript{126}

\textsuperscript{123} Hallmark 2 is prescribed by regulation 7 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

\textsuperscript{124} Regulation 7 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

\textsuperscript{125} Hallmark 3 is prescribed by regulation 8 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

Another facet to the test is that it has to be applied from the perspective of a client who has experience in the receipt of tax advice or other services of the type being provided. HMRC assumes that clients would be prepared to pay a premium for advice they consider valuable and not commonly available. Similarly, these clients would be unwilling to pay more than a normal fee for similar advice that is available somewhere else. A client will not only choose a particular accounting or law firm based on the size of the fee charged, so this particular hallmark serves as a broad attempt for HMRC to identify tax advice that is innovative and valuable and which the promoter can use to charge premium fees from clients who are experienced in the receipt of such advice.

ii. Is the fee significantly attributable to, or contingent on, the advantage?

It has to be understood that almost any fee acquired in relation to tax planning can somewhat be said to be attributable to the attainment of a tax advantage. Consequently, a premium fee is a fee that can thus for this purpose be significantly attributable to the tax advantage, or it is contingent on a tax advantage being obtained as a matter of law.

e. Hallmark 5: Standardised tax products

i. About the hallmark

This specific hallmark is only applicable to arrangements where a promoter is involved and apart from the exceptions that restrict its application, its intended purpose is to capture what is referred to as ‘mass marketed schemes.’

The schemes applicable in this case have been described as ‘plug and play’ or shrink-wrapped’ schemes as they contain the characteristic to be easily replicated. The number of clients and potential clients that it attracts, as well as the ways in which it

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127 Ibid.
128 Ibid.
129 A fee is not a premium fee merely due to the factors that follow: the adviser’s location; the urgency of the advice; the size of the transaction; the skill or reputation of the adviser; the scarcity of appropriately skilled staff; the number of users who sign up for a scheme. See HMRC (2015) Disclosure on Tax Avoidance Schemes Guidance at 55.
130 Hallmark 5 is prescribed by regulations 10 and 11 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI2006/1543).
can be marketed, differs immensely. All that the client will basically purchase is a prepared tax product that does not necessitate a great deal of modification to fit his or her circumstances. The schemes implementation would also not involve a substantial amount of additional professional advice or services.

A scheme will fall under this hallmark if it does not fall within any of the exceptions and the five tests below are met.

ii. Test 1 – are the arrangements a product?
iii. Test 2 – is the product a tax product?
iv. Test 3 – is the tax product made available generally?
v. Test 4 – was the tax arrangement first made available on or after 1 August 2006?
vi. Test 5 – is the tax product not within an exception?
vii. Packaged solutions

f. Hallmark 6: loss schemes

i. About the hallmark

Hallmark 6 is applicable to arrangements involving a promoter and was put in place to serve the purpose of capturing loss creation schemes that is normally used by wealthy individuals. Generally these schemes are designed in a manner that will generate trading losses which wealthy individuals can use to offset against income tax and capital gains tax liabilities or as a means to generate a repayment. The hallmark is met if the questions to both tests below are answered in the affirmative.

ii. Test 1 – is more than one individual expected to implement the tax arrangements?
iii. Test 2 – is the main benefit of the arrangements an expected loss for use against IT or CGT liabilities?

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132 A ‘solutions register’ that allows accountants and other promoters of tax arrangements to offer equivalent or comparable solutions to multiple clients is often maintained by such accountants and promoters. Whether the schemes of these registers fall within this hallmark is a matter of scale and degree.
133 Hallmark 6 is prescribed by regulation 12 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).
g. Hallmark 7: leasing arrangements

i. About the hallmark

This hallmark is applicable to in-house and promoted arrangements. If an in-house scheme is however under consideration, then the hallmark will not apply if a small or medium enterprise is the person intending to obtain the tax advantage.

An arrangement will fall within this hallmark if:

- Tests 1 to 3 below are met; and
- any one of the three additional conditions are met.

ii. Test 1 – does the arrangement include a plant or machinery lease?

iii. Test 2 – is the lease of high value?

iv. Test 3 – is the lease a long lease?

v. Additional condition 1 – does the lease involve a party outside the charge to corporation tax?

vi. Additional condition 2 – does the arrangement involve the removal of risk from the lessor?

vii. Additional condition 3 – does the arrangement involve a finance leaseback?

h. Hallmark 8: employment income

i. About the hallmark

Unlike the other hallmarks discussed above, hallmark 8 is relatively new to the DOTAS regime as it came into force on 4 November 2013. This new employment income hallmark will not have effect where:

5. the relevant date under section 308(1) of the Finance Act 2004 for the promoter to provide the prescribed information in respect of a notifiable proposal is before 4 November 2013;

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135 Hallmark 7 is prescribed by regulations 13 to 17 to the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

136 Regulation 13(2)(b).

137 Hallmark 8 is prescribed by regulation 18 of the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

6. the date under section 308(3) of that Act on which the promoter first becomes aware of any transaction that is part of notifiable arrangements is before 4 November 2013.\textsuperscript{139}

The hallmark is therefore only applicable if the promoter has a duty to make the prescribed information on a notifiable proposal available on or after 4 November 2013, or when they become aware of a transaction that forms part of the notifiable arrangements on that date. Additionally, the hallmark is applicable to both promoters and in-house designed schemes, and in contrast to the other hallmarks that apply to in-house schemes, this hallmark is applicable to all sizes of business.\textsuperscript{140}

Arrangements that fall within this hallmark are notifiable if the scenarios that follow are met.

\textbf{ii. The two scenarios}

The regulation that prescribes this hallmark, regulation 18, set out two scenarios in which arrangements become notifiable to HMRC. The scenarios are specifically defined by way of Conditions 1 to 5 which are set out in regulation 18(2) to 18(6).

The definition of the first scenario in which arrangements are notifiable if the statutory conditions are met, is contained in regulation 18(1)(a). Briefly, it is that:

- the arrangements are intended to circumvent Part 7A,\textsuperscript{141}
- none of the Part 7A exclusions is in point.\textsuperscript{142}

With this said, the first scenario is applicable if Conditions 1 and 2 are met and Condition 3 is not met.\textsuperscript{143}

The second scenario is applicable if Conditions 1, 2 and 3 are met and at least one of Conditions 4 and 5 is met.\textsuperscript{144}

\textbf{iii. Condition 1- the ‘step’ condition}

The definition of Condition 1 as contained in the regulations, specify three possible steps by making use of the terminology of Part 7A.\textsuperscript{145} If an arrangement does not

\begin{itemize}
  \item \textsuperscript{139} HMRC (2015) Disclosure on Tax Avoidance Schemes Guidance at 69.
  \item \textsuperscript{140} \textit{Ibid.}
  \item \textsuperscript{141} Part 7A (Sections 554A-554Z21) of The Income Tax (Earnings and Pensions) Act 2003. See regulation 18(7).
  \item \textsuperscript{142} HMRC (2015) Disclosure on Tax Avoidance Schemes Guidance at 69.
  \item \textsuperscript{143} Regulation 18(1)(a).
  \item \textsuperscript{144} Regulation 18(1)(b).
\end{itemize}
involve any of the steps being taken, then Condition 1 is not satisfied as value does not arise to benefit ‘A’ which is broadly speaking the employee.

If it is assumed that ‘B’ is the employer, and B designates a sum of money or asset, this will also not satisfy Condition 1 except if B is taking a step under section 554Z18. The Condition is likewise not met if B gives security within section 554Z19.

However, If B was to take a step in terms of section 554C or 554D, Condition 1 will be satisfied despite the fact that Chapter 2 of Part 7A will not apply because of this step.

The time when the relevant step is taken, will make no difference to Condition 1.

iv. Condition 2- the ‘main benefit’ condition
As seen from the discussion above, Condition 1 is broadly defined. Although necessary, the Condition is not sufficient to warrant application of hallmark 8 to an arrangement. This means that Condition 2, which is more narrowly defined, also needs to be satisfied in order for hallmark 8 to apply to an arrangement.

In terms of the definition that defines Condition 2, the Condition is met if the main benefit, or one of the main benefits of the arrangements, is that an amount that would otherwise count as employment income under section 554Z2(1) is reduced or eliminated. If Part 7A applies, an amount counting as employment income under section 554Z2(1) is present. Arrangements that do not eliminate or reduce such income will thus not satisfy Condition 2.

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146 Regulation 18(2).
148 See Regulation 18(2)(c).
152 Regulation 18(3).
Moreover, arrangements will not satisfy Condition 2 if the arrangements were to include a benefit that reduces or eliminates Part 7A income, but this benefit is incidental and the main benefit or main benefits of the arrangements do not include a tax advantage or NIC\textsuperscript{153} advantage.\textsuperscript{154} However, if the situation arises that an arrangement has more than one main benefit and one of those main benefits has the effect of reducing or eliminating an amount counting as employment income under section 554Z2(1), Condition 2 is satisfied irrespective of what the other main benefit or benefits may be.\textsuperscript{155}

v. Condition 3- the ‘exclusion’ condition

This Condition, as defined in the regulations, suggests that Part 7A does not apply and that one of the exclusions relevant to Part 7A is applicable.\textsuperscript{156}

If arrangements are designed to avoid Part 7A, they generally satisfy Conditions 1 and 2, and not Condition 3. This means that the arrangements fall within regulation 18(1)(a) and hallmark 8 is thus applicable to them. Conversely, tax planning that takes advantage of the Part 7A exclusions as intended and defined by Parliament could mean that Condition 1 and 2 is satisfied and that Condition 3 is also satisfied. An arrangement of this nature will thus fall outside regulation 18(1)(a). If the arrangement does however take advantage of a Part 7A exclusion in a manner that was not intended by Parliament, the arrangement will satisfy Condition 1, 2 and 3. This means that the arrangement falls outside regulation 18(1)(a) and regulation 18(1)(b) becomes applicable. Regulation 18(1)(b) sets out the second scenario of disclosable arrangements under hallmark 8 and applies if Conditions 1, 2 and 3 are met as well as at least one of Conditions 4 or 5.\textsuperscript{157}

vi. Condition 4- the ‘contrived or abnormal step’ condition

The definition of Condition 4 states that the condition is met if the arrangements involve one or more contrived or abnormal steps without which the main benefit in

\textsuperscript{153} A discussion on what NIC’s entail and which hallmarks are applicable to them will be set out below.
\textsuperscript{155} See the DOTAS guidance for examples that illustrate when Condition 2 is met.
\textsuperscript{156} Regulation 18(4).
\textsuperscript{157} See the DOTAS guidance for an example that explains condition 3.
regulation 18(3) would not be obtained. The words ‘contrived’ and ‘abnormal’ are equivalent in meaning to that contained in section 207 of the Finance Act 2013, the general anti-abuse rule: definition of ‘abusive’ tax arrangements.

The fact that the definition of Condition 4 makes reference to ‘the main benefit in paragraph [18(3)]’ does not infer that Condition 4 is only satisfied if there is only one main benefit.

It should also be noted that a detailed and complex arrangement will not necessarily mean that the arrangement is contrived and abnormal.

vii. Condition 5- the ‘deliberate fall-back charge’ condition

The definition of Condition 5 states that the Condition is met if the arrangements involve:

- a relevant step being treated as taking place; and
- Chapter 2 of Part 7A applying as a consequence.

Certain exclusions mentioned in Part 7A are protected by what is often referred to as a ‘fall-back’ charge. Part 7A will apply to arrangements that first come within the exclusions described, but fail to meet the statutory conditions later on. Even so, if the relevant step did not give rise to Part 7A income because of the exclusion then the relevant step will still not give rise to Part 7A income, meaning that the past is thus not disturbed. A deemed relevant step will instead come into play at the time when the statutory conditions are contravened and a ‘fall-back’ charge will therefore arise. The conditional fall-back charges can consequently be seen as safeguards as opposed to primary charging provisions. We can accordingly assume that Condition 5 captures those arrangements that attempts to defer tax by way of excluding an upfront charge for the price of a later fall-back charge.

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158 Regulation 18(5).
160 Regulation 18(6)(a).
161 Regulation 18(6)(b).
The hallmarks described in the paragraphs above are consequently essential for the effective application of the DOTAS regime where income tax, corporation tax, and capital gains tax arrangements are concerned.

As previously mentioned, the regime is also applicable to National Insurance Contributions (NICs), Stamp Duty Land Tax (SDLT), Annual Tax on Enveloped Dwellings (ATED) and Inheritance tax. The tests applicable to determining schemes relating to these taxes are similar to the tests under the Income tax and Corporate tax discussions. Due to the fact that these taxes are not similar in nature, they obviously have other specific tests applicable to them. An in-depth discussion of these taxes and their specific tests is however beyond the scope of this dissertation as the intention was mainly to focus on income and corporate tax.

3. Comparison between the UK and SA disclosure regimes

From the discussion of the DOTAS disclosure regime, it is clear that the revenue authority went on to set out the disclosure regime in detail. The rules are detailed in the sense that specific tests and conditions are set out to target different areas where tax avoidance can take place. Although the South African disclosure regime sets out most of the disclosure rules as in the UK, the South African regime is set out in broader terms. The regimes therefore have several similarities and a vast number of differences.

3.1 Similarities

The similarities include *inter alia*:

- The UK regime, as in South Africa serves the purpose of providing the revenue authority with a mechanism to detect impermissible tax avoidance at an early stage. Both regimes are therefore set out to attain the same objective.
- Both regimes provide for the fact that disclosure will not affect the tax position of the taxpayer/person.
- Disclosure in both regimes is required if a tax arrangement enables a person to obtain a tax advantage and the tax advantage is, might be, or is expected to be the main benefit or one of the main benefits.
- Both regimes provide for a meaning of ‘arrangement’, ‘tax advantage’ and who a ‘promoter’ is.
Both regimes make provision for the fact that the absence of an arrangement requiring disclosure should not be an indication that the arrangement not caught will constitute practices that are acceptable to the revenue authorities. In addition, the regimes also provide that arrangement that qualify as disclosable is also not an indication that the arrangement is regarded as an unacceptable practice to the revenue authorities. A person would thus have to let the authority know if a scheme is not considered to be tax avoidance.

Both regimes provide details on who has to disclose, what has to be disclosed and the information to be submitted.

Both regimes have an information penalty regime in place.

3.2 Differences

The differences involve the following:

Both regimes regulate arrangements that relate to specific taxes. However, the DOTAS (UK) regime specifically sets out different detailed rules, tests and conditions that relate to these specific taxes.

The DOTAS regime provides specific tests to determine hallmarked schemes (description of arrangements). The South African regime also has specific hallmarks that are seen as impermissible tax avoidance, but the reportable arrangement provisions focus mainly on ‘a lack of commercial substance’ as an indication of what arrangements are reportable. The DOTAS regime therefore focuses on a variety of hallmarks that the South African regime can greatly benefit from including when arrangements are kept confidential thus specifically targeting arrangements that are kept confidential; premium fees; standardised tax products to capture mass marketed schemes; loss schemes used by wealthy individuals; leasing arrangements and arrangements that reduce or eliminate employment income. An inclusion of these in the South African regime would thus mean that the reportable arrangement regime would expand to different areas of tax avoidance.

The DOTAS regime makes a distinction between in-house schemes and schemes designed by promoters.

The DOTAS regime distinguishes between small, medium and large enterprises. Therefore allowing small and medium enterprises to thrive and grow through certain hallmarks not being applicable to them. As South Africa
has a substantial number of small and medium enterprises, such a distinction could thus improve and aid the growth of these enterprises.

✓ The DOTAS regime provides for disclosure of arrangements that relate to National Insurance Contributions, Stamp Duty Land Tax, Inheritance Tax and Annual Tax on Enveloped Dwellings. Arrangements that relate to these taxes all have tests and conditions that are applicable to them. An inclusion of these taxes into the South African reportable arrangement regime would not contribute to the efficacy of the South African regime as the reportable arrangement regime includes several other taxes in its scope. In addition, South Africa provides for Estate Duty instead of Inheritance Tax and Transfer Duty instead of Stamp Duty Land Tax.

✓ The DOTAS regime provides for a penalty regime that is divided into three categories: a disclosure penalty, information penalty and user penalty. The South African regime only provides for an information penalty and can therefore benefit by also introducing a disclosure and user penalty as this would expand their penalty regime into areas that will result in non-disclosure being more severe and the penalty regime being stricter.

The UK and SA disclosure regimes can be explained by way of the following tabulated comparison.
Table 1: A comparison between the UK and SA disclosure regimes

<table>
<thead>
<tr>
<th></th>
<th>United Kingdom</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td>• Income Tax</td>
<td>• Income tax</td>
</tr>
<tr>
<td></td>
<td>• Corporation Tax</td>
<td>• Donations tax</td>
</tr>
<tr>
<td></td>
<td>• Capital Gains Tax</td>
<td>• Capital Gains Tax</td>
</tr>
<tr>
<td></td>
<td>• National Insurance Contributions</td>
<td>• VAT</td>
</tr>
<tr>
<td></td>
<td>• Stamp Duty Land Tax</td>
<td>and any other tax under a tax Act administered by the Commissioner.</td>
</tr>
<tr>
<td></td>
<td>• Inheritance Tax (for Trust arrangements)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Annual Tax on Enveloped Dwellings</td>
<td></td>
</tr>
<tr>
<td><strong>Who discloses</strong></td>
<td><strong>Promoter or User</strong></td>
<td><strong>Promoter or User</strong></td>
</tr>
<tr>
<td></td>
<td>User must disclose where the scheme is devised in-house, the promoter is offshore</td>
<td>The obligation to disclose scheme details is imposed on the promoter. If there is no promoter then the taxpayers must disclose the information.</td>
</tr>
<tr>
<td></td>
<td>or legal professional privilege applies.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>A “promoter” is defined as a person, in the course of a relevant business, who</td>
<td>A “promoter” is defined as a person who is principally responsible for organising, designing, selling, financing or managing the reportable arrangement.</td>
</tr>
<tr>
<td></td>
<td>is responsible for the design, marketing, organisation or management of a scheme</td>
<td></td>
</tr>
<tr>
<td></td>
<td>or who makes a scheme available for implementation by another person</td>
<td></td>
</tr>
<tr>
<td><strong>What is disclosed</strong></td>
<td>Arrangements falling within <strong>certain descriptions</strong> (known as Hallmarks)</td>
<td>Reportable arrangements are classified into two groups namely ‘<strong>specifically defined and listed categories</strong>’ and ‘<strong>transactions with certain characteristics</strong>’ which are expected to provide tax benefits.</td>
</tr>
<tr>
<td></td>
<td>(known as Hallmarks) which are expected to provide a <strong>tax advantage</strong> as a</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>main benefit</strong></td>
<td></td>
</tr>
</tbody>
</table>
Current Hallmarks

- **Three Generic hallmarks** to capture features indicative of avoidance
  i. confidentiality
  ii. premium fee
  iii. standardised tax product;

- **Four specific hallmarks** to target known risks e.g. losses, leasing, employment income and Annual tax on Enveloped Dwellings.

- There are separate descriptions to capture Stamp Duty Land Tax and Inheritance Tax schemes.

- **Specifically defined categories listed by the Commissioner:**
  i. an arrangement that would have qualified as a ‘hybrid equity instrument’ if the prescribed period had been ten years;
  ii. an arrangement that would have qualified as a ‘hybrid debt instrument’ if the prescribed period had been ten years; or
  iii. any arrangement that has been listed in a public notice.

- **Reportable arrangements with certain characteristics:**
  i. the calculation of any interest, finance costs, fees of other charges are wholly or partially dependent on the tax benefits derived by the arrangement;
  ii. the transaction results in round tripping of funds, involving an accommodating or tax indifferent party or contains elements that have the effect of offsetting/cancelling each other or has substantially similar characteristics;
  iii. the transaction gives rise to an amount that is:
    a. a deduction for income tax purposes but not an expense for purposes of
| Disclosure of schemes details | Users: required to disclose the scheme by reporting a Scheme Reference Number (SRN) on a return.  
Promoters: required to disclose the scheme.  
• Users are not, as a general rule, required to provide details of the scheme to the UK tax administration. | The obligation to disclose scheme details is imposed on the promoter and the participants.  
Users: Users are not, as a general rule, required to provide details of the scheme to SARS. However they are required to include the reportable transaction tax reference number in their annual tax returns.  
Promoters: required to disclose the scheme. |
|---|---|---|
| Process | • Promoter discloses scheme to the UK tax administration, usually within **five days** of scheme being made available to clients;  
• The UK tax administration issues a SRN to the Promoter;  
• Promoter must pass the SRN to | • The reportable arrangement must be disclosed within **45 days** after an amount has first been received by or accrued to a tax payer or is first paid or actually incurred by a tax payer.  
• SARS issues a reportable arrangement reference number. |
clients who implement the scheme;
- Promoter provides quarterly report to the UK tax administration of clients who have implemented the scheme.
- Clients must report the SRN on a return affected by the use of the scheme.
- Taxpayers must disclose that they entered into a reportable transaction and include the reportable transaction tax reference number in their annual tax return.

<table>
<thead>
<tr>
<th>Enforcement</th>
<th>Failure to disclose doesn't affect the efficacy of scheme. [penalty regime]</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Penalties for non-disclosure are up to £1 million</td>
</tr>
<tr>
<td></td>
<td>- Penalties if a user fails to report the use of a scheme on a return are £100 for first failure, £500 for second failure; £1 000 for subsequent failures (apply to each scheme to which the failure relates).</td>
</tr>
<tr>
<td></td>
<td>- Penalty for failure to provide a client list of up to £5 000 per client omitted.</td>
</tr>
<tr>
<td></td>
<td>Failure to disclose does not affect the efficacy of scheme. [penalty regime]</td>
</tr>
<tr>
<td></td>
<td>- A monthly penalty for non-disclosure of R50 000 in the case of a participant and R100 000 in the case of a promoter (up to 12 months) is imposed and the penalty is doubled if the amount of anticipated tax benefit exceeds R5 million and tripled if the anticipated tax benefit exceeds R10 million.</td>
</tr>
</tbody>
</table>


**4 Conclusion**

It is evident that the UK has reportable transaction legislation that is well developed and thoroughly integrated. This chapter clearly shows how HMRC goes about to obtain information that could possibly amount to impermissible tax avoidance under the DOTAS regime.
The regime is currently set out to cover tax arrangements that relate mainly to income tax, corporation tax, capital gains tax, national insurance contributions, stamp duty on land tax, annual tax on enveloped dwellings and inheritance tax. Part of the main reasons why these specific tax arrangements are disclosable under the regime is because the arrangements allow the user to obtain a tax advantage which is considered to be the main or one of the main benefits of the arrangement. The arrangement is therefore only entered into to obtain the tax advantage.

In addition to a tax advantage being obtained, the arrangements also become disclosable if they can be regarded as a hallmarked scheme, which are specific descriptions of arrangements prescribed by regulation. The disclosable hallmarked schemes do however only relate to income tax, corporation tax and capital gains tax.

Furthermore, an arrangement would have to comply with the specific tests relating to each specific tax mentioned in order to become disclosable to HMRC. These tests include inter alia whether a tax advantage is being obtained, when a tax advantage will be regarded as a main benefit of the arrangements and whether arrangements are exempt from disclosure.

A notifiable scheme has to be disclosed in the specific form and manner by a promoter, or user under specific circumstances, within 5 days of one of the trigger events mentioned and is subject to strenuous penalties in the event of non-disclosure.

The comparison of the South African and UK disclosure regimes revealed that a vast number of similarities and differences exist between the systems. The similarities between the approach used in South African and that of the UK confirmed that South is on par with international standards where reportable arrangements are concerned. The differences however showed that a few lessons can be learnt if South Africa takes more cognisance of the very detailed UK approach.

Whether the revenue authority in South Africa is ready to take on a more detailed approach is a point which can be addressed and discussed extensively. Such an extensive discussion is beyond the scope of this dissertation. It is however submitted that a more detailed approach to reporting arrangements in South Africa would lead to
a very extensive and complex system even though a detailed approach would improve the efficacy in the reportable arrangement system curbing impermissible tax avoidance. Therefore, while South Africa could learn a few lessons from the UK system and could potentially introduce a few of the elements which make the UK disclosure regime so effective, it is submitted that the revenue authority should steer clear of an approach that is too detailed as it would lead to a system that is cluttered, complicated and would add an administrative burden on SARS.

Nonetheless, this does not detract from the fact that the DOTAS regime is set out to try and cover every angle relating to impermissible tax avoidance schemes. The fact that it has been in existence for over a decade is part of the main reasons why it is so effective and the UK revenue authority continually tries to find ways to improve it. The regime is of course not without flaws, but its detailed composition forms an ideal backdrop to what an effective disclosure regime should be based on.
Chapter 5
Conclusions and Recommendations

1. Conclusions.....................................................................................................................63
   1.1. The Efficacy of the reportable arrangement system..............................65
   1.2. Comparison between the South African and United Kingdom disclosure
       regimes ..........................................................................................................................66
2. Recommendations............................................................................................................67
1. Conclusions

The research in this study has shown that tax avoidance is a challenge faced by revenue authorities across the globe. The concept involves a taxpayer doing everything possible within the confines of the law, to reduce his or her tax bill. A taxpayer is thus entitled to order his or her affairs in a manner that is most desirable to achieve minimised tax liability.\textsuperscript{163}

Chapter 2 of this study discussed the contrast between tax avoidance, tax planning and tax evasion. It firstly went on to discuss tax evasion, which is considered to be outright illegal and followed with a discussion of tax avoidance, which is considered to be legal is some respects. The chapter furthermore went on to address legitimate tax planning which is synonymous with permissible tax avoidance that involves the avoidance of tax in a manner consistent with statutory purposes and the limits imposed by a GAAR.\textsuperscript{164} Therefore, although legal in some respects, tax avoidance is heavily criticised because if it is successful it reduces the flow of tax revenues to the fiscus. Impermissible tax avoidance on the other hand, involves the avoidance of tax in a manner that is inconsistent with statutory purposes and the limits imposed by a GAAR.\textsuperscript{165} Anti-avoidance provisions in the form of GAARs and specific anti avoidance rules have thus been put in place to specifically combat impermissible tax avoidance. These statutory rules are seen as direct measures to curtail tax avoidance.

In addition to the direct measures used to curtail impermissible tax avoidance, indirect measures such as the regulation of tax practitioners and the requirement to report certain arrangements also exist. Of these two indirect measures, reportable arrangements are relatively new to South African law. As with all new terms and legislation, there is always a degree of complexity involved. This is especially the case with unfamiliar terms.

Chapter 3 of this study, which forms the core of this study, thus went on to discuss reportable arrangements as an indirect measure against impermissible tax avoidance. The chapter addressed the background of this regime by looking at the first reportable

\textsuperscript{163} ITC 1636 (1998) 60 SATC 267 302.  
\textsuperscript{165} Kujinga (2014) 47 CILSA 430.
arrangement provisions in section 76A of the ITA which proved to be ineffective as it resulted in a disappointing number of transactions that were reported to SARS and due to the technical points raised by taxpayers to avoid reporting or the restructuring of transactions to avoid triggers of reporting. SARS therefore took the opportunity to revise their reportable arrangement legislation when they adopted the new GAAR in 2006. Section 76A was therefore repealed and replaced with the second reportable arrangement regime, sections 80M to 80T of the ITA. This reportable arrangement system was successful as it served the purpose for which it was enacted. However, due to the fact that administrative provisions which are generic to all tax Acts (including the reportable arrangement system), was scattered across different tax Acts, the revenue authority decided to enact one piece of legislation that would incorporate all these administrative provisions.\(^\text{166}\) The Tax Administration Act 28 of 2011 which came into effect on 1 October 2012 was therefore enacted. The then reportable arrangement system in section 80M-T was transferred verbatim to what is now known as the current reportable arrangement system in section 34-39 of the TAA.

Chapter 3 then went on provide an in-depth analysis of the current reportable arrangement regime. With the aid of the current reportable arrangement system, SARS is given an early warning of transactions that have the objective of obtaining a tax benefit in an undue manner.\(^\text{167}\) The analysis and interpretation of the reportable arrangement provisions revealed that an arrangement becomes reportable if firstly, it is listed by the Commissioner by public notice in terms of section 35(2) of the TAA, and secondly, if it contains any of the generic requirements listed in section 35(1). The generic requirements include inter alia that a tax benefit be derived; the calculation interest, finance costs, fees or other charges are dependent on the tax treatment of the arrangement;\(^\text{168}\) the arrangement lacks commercial substance;\(^\text{169}\) there’s a mismatch of accounting and tax treatment;\(^\text{170}\) there’s no reasonable expectation of a

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\(^{166}\) C Rogers ‘Interpretation of the Tax Administration Act in the context of SARS’ powers to recover tax’ (2014).

\(^{167}\) Croome (2013) 502.

\(^{168}\) S 35(1)(a) of the TAA.

\(^{169}\) S 35(1)(b).

\(^{170}\) S 35(1)(c).
pre-tax profit\textsuperscript{171} and when the tax benefit of a transaction exceeds the pre-tax profit if both are discounted to a present value.\textsuperscript{172}

This paper was however not aimed at addressing how practical it is to comply with the requirements of the reportable arrangement section. This paper was based on an anti-avoidance perspective which meant that the efficacy of the reportable arrangement system as an indirect measure against impermissible tax avoidance was therefore a crucial point to consider.

1.1. Efficacy of reportable arrangement regime

Based on the discussion in this research, chapter 3 concluded that the reportable arrangement regime is effective in indirectly curbing impermissible tax avoidance. This was evident in that the analysis and interpretation of the reportable arrangement provisions revealed that SARS focused mainly on the element of a lack commercial substance when formulating the reportable arrangement provisions. A lack of commercial substance seemed to be an important determining factor when formulating these provisions considering that four out of five of the reportable arrangement provisions relate to commercial substance. It was argued that the revenue authority’s fixation on transactions that lack commercial substance could be seen as a weakness considering that section 35(1) only provides for five ways in which tax is possibly avoided, therefore implying that SARS only identified a limited number of targeted areas of suspected avoidance.

However through analysis of the other tainted elements that relate to impermissible tax avoidance, it was established that the element of a lack of commercial substance was the only element that was actionable. Possible arrangements that relate to the other tainted elements, all resulted in possible loopholes for the Act. Therefore, with justification in terms of the economic substance doctrine used by the United States to primarily curb impermissible tax avoidance, it was submitted that the commercial substance indicator is on its own a strong indicator of impermissible tax avoidance. The revenue authority’s fixation on commercial substance can therefore be seen as strength because the incorporation of all the hallmarks of impermissible tax avoidance

\textsuperscript{171} S 35(1)(d).
\textsuperscript{172} S 35(1)(e).
into the reportable arrangement provisions would place an administrative burden on SARS as well as create loopholes for the reportable arrangement system. The reportable arrangement system which is primarily based on transactions that lack commercial substance is therefore a strong and effective measure to indirectly curb impermissible tax avoidance transactions, hence the lack of commercial substance being such a strong indicator.

This paper also suggested that a comparative analysis between the South African reportable arrangement regime and a disclosable regime that has been in place for quite some time would add value to the analysis of the South African reportable arrangement regime. An analysis of the United Kingdom’s Disclosure of Tax avoidance Schemes (DOTAS) was therefore conducted.

1.2. Comparison between the South African and United Kingdom disclosure regimes

The comparative analysis in chapter 4 brought to light how detailed the DOTAS regime is. It was therefore evident that the UK has reportable transaction legislation that is well developed and thoroughly integrated.

The analysis revealed that several similarities and a vast number of differences exist between the South African and UK disclosure regimes. The similarities contribute to South Africa being on par with international standards, considering that the UK DOTAS regime is seen as one of the most successful and effective disclosure regimes. However, the differences showed that a few lessons can be learnt by South Africa consciously taking note of the detailed DOTAS regime. It was therefore argued on the one hand that South Africa could benefit from introducing a more detailed disclosure regime as this would subsequently also contribute to the efficacy of its current regime. It was however submitted on the other hand that the introduction of an approach that is too detailed would lead to a very extensive and complex system even though a detailed approach would improve the efficacy in the reportable arrangement system curbing impermissible tax avoidance.

This being said, it was contended that while South Africa could learn a few lessons and introduce a few elements from the UK system to improve the efficacy of its
approach to curbing impermissible tax avoidance, it was submitted that the revenue authority should steer clear of an approach that is too detailed as it would lead to a system that is cluttered, complicated and would add an administrative burden on SARS.

2. Recommendations

Disclosure regimes should be clear and easy to understand.\(^{173}\) They should be set out to balance additional compliance costs to taxpayers with the benefits obtained by the tax administration.\(^{174}\) They should be effective in achieving their objectives and should accurately identify the schemes to be disclosed.\(^{175}\) They have to be flexible and dynamic enough to allow the tax administration to adjust the system to respond to new risks and should ensure that information collected is used effectively.\(^{176}\)

It was argued that the South African reportable arrangement regime was designed to identify tax planning schemes that have the effect of exploiting vulnerabilities in the tax system, while simultaneously providing tax administrations with the flexibility to choose thresholds, hallmarks and filters to target transactions of particular interest and perceived areas of risk.\(^{177}\)

The reportable arrangement provisions contain all the elements for a successful disclosure regime namely: who discloses, what information to disclose, when the information has to be disclosed, and the consequences of non-disclosure.\(^{178}\) The regime is however not without flaws and the efficacy of the regime can be enhanced.

In light of the above, in order to improve the efficacy of the South African reportable arrangement regime, a number of recommendations can be made:

1. As seen from the UK DOTAS regime, South Africa can benefit from revising its disclosure regime and introducing a more detailed regime. This includes

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\(^{174}\) Ibid.

\(^{175}\) Ibid., 15.

\(^{176}\) Ibid.

\(^{177}\) Ibid., 16.

\(^{178}\) Ibid., 7.
providing additional tests and conditions that would result in more arrangements becoming disclosable.

2. South Africa can benefit by including a mixture of specific and generic hallmarks in its current disclosure regime as it currently mainly focuses on one hallmark of impermissible tax avoidance. The existence of each of the hallmarks would also have to trigger a requirement for disclosure. The generic hallmarks, as seen from the UK DOTAS regime, would target features that are common to promoted schemes. Therefore, the requirement for confidentiality or the payment of a premium fee. The specific hallmarks would target particular areas of concern in South Africa.

3. South African can also benefit by revising the penalty regime for its disclosure regime. This could be by introducing, as seen in the UK DOTAS regime, a disclosure and user penalty as this would expand their penalty regime into areas that will result in non-disclosure being more severe and the penalty regime becoming stricter.

4. It should however be noted that introducing a more detailed regime as in the UK, could create and possibly lead to uncertainty. In order to avoid and limit this possible uncertainty, it is recommended that the South African reportable arrangement regime is based on the UK approach of making efforts to strike a balance between curbing impermissible tax avoidance and respecting the right to avoid tax. This would be by revising and creating a disclosure regime that is balanced between the two extremes of on the one hand being too detailed that it creates an administrative burden for the revenue authority and being uncertain; and on the other hand a disclosure regime that does not provide sufficient detail to the extent that taxpayers are able to impermissibly avoid tax easily. The right balance between over and under-inclusiveness would thus have to be established.

It is submitted that these recommendations would add to the standing efficacy of the South African reportable arrangement regime as it would include all the key design features of a disclosure regime that is effective in all areas.
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