

The Scope and Application of the General Anti-Avoidance Provisions in Combatting Aggressive Tax Avoidance Schemes

by

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I dedicate this research to those who are often crippled by imposter syndrome when conducting academic research of this nature.

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ABSTRACT

Taxpayers are often confronted with an avalanche of taxes as a result of the numerous taxes which affect their income. Despite how lucrative a business venture may be, it can be undesirable for taxpayers to pursue such a business because of the tax-laden system supervening these transactions. On the one hand, SARS is mandated to ensure that state revenue is generated, which is used toward ensuring basic services and amenities for citizens. On the other, regardless of the numerous taxes imposed on taxpayers' investments, taxpayers are entitled and empowered to arrange their affairs, to attract less tax liability. In the same vein, laws regulating tax avoidance, including the General Anti-Avoidance Rules (GAAR), as envisioned in section 80A-L of the Income Tax Act, aim to deter taxpayers from aggressively avoiding taxes. Whether these tools are sufficiently effective to combat tax avoidance is questionable as they have not been extensively been used.

Having regard to the conflicting interests of the taxpayer's right to avoid taxes versus SARS's mandate to generate state revenue through the collection of taxes, this research analyses whether the tools used to combat tax avoidance such as the common law doctrine of 'substance over form' as well as the General Anti-Avoidance Rules (GAAR) are effective in attaining the intended purpose. This studies further establishes the reason which negatively affects the GAAR's efficacy.

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CHAPTER 1: INTRODUCTION

1.1. Introduction

Since the inception of the tax system in South Africa, taxpayers have jarred with the South African Revenue Service ('SARS') in respect to paying taxes.¹ Therefore, the conflict rises because numerous taxes encumber and reduce a taxpayer's income.² It lies on the premise that taxpayers engage in arrangements that aim to derive a tax benefit, to maximise their investment as opposed to paying taxes levied on the income accrued from investments.³ Conversely, SARS is mandated to collect state revenue which is collected from taxpayers' income.⁴ Although avoiding paying taxes may not be the taxpayer's intention, it is associated and aligned with the taxpayer's priority to maximise profits.

Moreover, it is trite for taxpayers to arrange their affairs to attract minimal or no tax liability where possible.⁵ Consequently, to limit or absolve tax liability, taxpayers engage in activities aimed at avoiding tax liability. These activities are not always permissible or even legal as taxpayers would resort to conduct which is impermissible.⁶ Accordingly, in addition to the specific anti-avoidance rules which are mainly contained in the Income Tax Act 58 of 1962, legislative rules intended to curb impermissible tax avoidance were adopted in South Africa known as the General Anti-

¹ *Commissioner of Inland Revenue v Conhage (Pty) Ltd* [1999] JOL 5363 (A); see also *CSARS v NWK Ltd* 2010 ZASCA 168; see also *Sasol Oil v CSARS* (2018) ZASCA 153 (A).

² Jones, S. (2012). Avoid multiple-income tax pain: income tax. *Tax Breaks*, (313), 3.

³ *Key Tax Issues at Year-End for Real Estate Investors 2019/2020* <https://www.pwc.com/gx/en/tax/pdf/key-tax-issues-at-year-end-for-re-investors-2019-20.pdf> (accessed: 15 April 2020).

⁴ Section 3 of the South African Revenue Service Act 34 of 1997.

⁵ *IRC v Duke of Westminster* 1936 AC 1.

⁶ Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 232.

Avoidance Rules (GAAR). The common law judicial doctrine of ‘substance over form’ is also invoked in curbing impermissible tax avoidance by taxpayers.⁷

Legwaila points out that it is widely accepted that tax laws are notoriously intricate and intrinsically, tax avoidance schemes are as intricate.⁸ Despite all these tools of combating tax avoidance in place, the issue of tax avoidance continues to subsists.⁹ Furthermore, courts tend to rely on the common law judicial doctrine of ‘substance over form’ notwithstanding that the GAAR was specifically adopted for combating impermissible tax avoidance.¹⁰

This research explores whether the tools aimed at combating impermissible tax avoidance, with particular reference to the General Anti Avoidance Rules (‘the GAAR’), are effective to ensure that state revenue is not lost through impermissible tax avoidance conduct by ingenious taxpayers.

1.2. Research Problem

A prominent United Kingdom case of *IRC v Duke of Westminster* (1936) AC 1 (‘*Duke of Westminster*’) is referred to worldwide and elucidates the principle of permissible tax avoidance. It has been adopted in South Africa in the *Commissioner of Inland Revenue v Conhage (Pty) Ltd* case.¹¹ In the *Duke of Westminster* decision, the court emphasised that:

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

⁷ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 127.

⁸ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 127.

⁹ Kujinga, B. T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

¹⁰ Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

¹¹ *Commissioner of Inland Revenue v Conhage (Pty) Ltd* [1999] JOL 5363 (A).

Notwithstanding the taxpayer's duty to pay taxes, a taxpayer has an inherent right in law to avoid taxes where it is legally permissible.¹² The law that governs avoidance of tax, the GAAR, is inundated with elements of uncertainty which is a definite issue for taxpayers as much as it is for SARS.¹³

1.3. Assumption

By attempting to obtain the utmost tax benefit, taxpayers may tread past the thin line between permissible and impermissible tax avoidance.¹⁴ Therefore, the difference between the two concepts must be distinguished.¹⁵ Consequently, the implementation of the GAAR purports to combat any behaviour that is impermissible with regards to tax avoidance.¹⁶ However, the GAAR is not effective in carrying its object of detecting impermissible tax avoidance as a result of the uncertainty in its application.

1.4. Research question

1.4.1. Are the tools aimed at combating tax avoidance such as the common law doctrine of 'substance over form' and more specifically the GAAR as contained in sections 80A – L sufficiently effective to curb tax avoidance?

1.4.2. Does the application of the GAAR negatively affect the canon of taxation, specifically the taxpayer's right to certainty?

1.4.3. Is SARS negatively impacted by the inefficacy of the GAAR?

¹² *IRC v Duke of Westminster* 1936 AC 1.

¹³ Kujinga, B. T. (2012). Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada. *Comparative and International Law Journal of Southern Africa*, 45(1), 42.

¹⁴ Kujinga, B. T. (2012). Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada. *Comparative and International Law Journal of Southern Africa*, 45(1), 42.

¹⁵ Kujinga, B.T. (2013). A Comparative analysis of the efficacy of the General Anti-Avoidance Rule as measure against impermissible tax avoidance in South Africa. (*LLD Thesis University of Pretoria*).

¹⁶ Section 80 of the Income Tax Act 58 of 1962.

1.5. Research Objectives

The objectives of this research are:

- 1.5.1. to review the tax legislative framework and judicial precedents and other academic commentaries relating to avoidance in South Africa to ascertain the efficacy of the GAAR; and
- 1.5.2. to analyse the tools used to set aside impermissible transactions.

1.6. Approach and Method

In this dissertation, I conduct qualitative research and analyse the provisions of tax laws and academic commentaries regarding the effective application of the GAAR regarding the avoidance of tax transactions. I rely intensively on local and international judicial precedents to explain essential principles relating to the avoidance of taxes.

1.7. Limitation of Research

The current GAAR has not been applied extensively and there is not a sizable number of judicial precedents in South Africa as a sample to establish if the current GAAR lacks efficacy.¹⁷ It is, therefore, necessary to rely on academic commentaries to establish if the South African GAAR lacks efficacy.

1.8. Chapter and content analysis

Below I lay out the pathway, chapter by chapter, which this dissertation takes to answer the research questions as indicated above.

Chapter 1: Introduction

This chapter identifies the problem centred around taxpayers' pursuits in avoiding tax. It sets out the problem around taxpayers' attempts in avoiding taxes and how SARS'

¹⁷ Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

tools of combating impermissible tax avoidance, the GAAR may not be efficient. Furthermore, I lay down the pathway in which the dissertation aims to take.

Chapter 2: Taxpayers' Right to Avoid Taxes

This chapter establishes that a taxpayer is indeed entitled to avoid taxes. It makes a distinction between the various concepts relating to the escaping of taxes, in the legal sense such as tax planning and permissible tax avoidance as opposed to escaping taxes in the illegal sense such as tax evasion and impermissible tax avoidance.

Chapter 3: The 'Substance over Form' Doctrine

In this chapter, I explore the 'substance over form' doctrine as a common law tool to combat the avoidance of tax liability.

Chapter 4: The Development and Application of the GAAR in South Africa.

In this chapter, I trace the historical transition of the GAAR from its inception in South Africa as contained in the Income Tax Act of 1941 to its current state. Through this exposition, I furthermore illustrate the weaknesses encountered in the different GAARs as were amended in their historical development.

Chapter 5: The GAAR's Efficacy and Tax Certainty

In this chapter, I illustrate whether the current GAAR as 3 in section 80A-L has been developed sufficiently to combat impermissible tax avoidance efficiently. I establish whether certainty as one of the canons of taxation is the culprit attributed to the efficacy or inefficacy of the GAAR.

Chapter 6: Conclusion and Recommendation

I finally surmise the core findings of this research as the concluding remarks and provide succinct recommendations in respect to the key issues of concern as highlighted in the research questions/statement.

1.9. Conclusion

This chapter sets out the background and objective for this research. It does so by highlighting the research problems and research objectives. The tug-of-war between the taxpayer and SARS in respect to the avoidance of tax liability has been identified as an issue in that Income Tax Act 58 of 1956 equips SARS with tools to recover taxes from taxpayers – the General Anti-Avoidance Rules. In the same breath, the taxpayer is permitted to avoid taxes. The essence of this research is to determine the efficacy of these provisions. The limitation of this research has also been identified. Finally, the pathway for this research has also been set out. In the next chapter, the fundamental principle of tax avoidance is expanded on.

CHAPTER 2: TAXPAYERS' RIGHT TO AVOID TAXES

2.1. Introduction

The Republic of South Africa generates revenue by mandating the South African Revenue Service to collect taxes from taxpayers such as value-added tax ('VAT'), personal income tax, capital gains tax, amongst others.¹⁸ It is through revenue generated from taxes, that the state can provide essential services to the public.¹⁹ A threat against, or loss of revenue, consequently causes a reduction in the production of essential services by the state.²⁰ It is for this reason that SARS admonishes tax avoidance by taxpayers where it is illegal or prohibited.²¹

As encapsulated in the *Duke of Westminster*, a taxpayer has the right to avoid taxes and where possible, taxpayers will attempt to obtain a tax benefit from the revenue collector.²² Despite SARS's objective to collect taxes to generate state revenue, it is an exercise worth pursuing for a taxpayer to attempt to obtain a tax benefit that may result in paying less or no taxes by the taxpayer insofar as it is legally permissible. The principle which maintains that a taxpayer has the right to arrange his tax affairs to attract less tax liability was expressed in *Duke of Westminster*²³ where the court emphasised that:²⁴

"every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than would otherwise be. [emphasis added] If he succeeds in

¹⁸ Section 3 of the South African Revenue Service Act 34 of 1997; see also *A Breakdown of the Tax Pie* <http://www.statssa.gov.za/?cat=34> (accessed 14 March 2021).

¹⁹ Section 3 of the South African Revenue Service Act 34 of 1997.

²⁰ *What does Government Spend Money On?* <http://www.statssa.gov.za/?cat=34> (accessed 05 March 2021); see also *New or higher Taxes won't Work and could be Unconstitutional* <https://www.bbrief.co.za/2019/12/18/new-or-higher-taxes-wont-work-and-could-be-unconstitutional/> (accessed 05 March 2021).

²¹ Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 238.

²² *IRC v Duke of Westminster* 1936 AC 1.

²³ This position was confirmed in the South African *Commissioner of Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) and *Commissioner of Inland Revenue v Estate Kohler and Others* 1953(2) SA 584(A).

²⁴ *IRC v Duke of Westminster* 1936 AC 1.

ordering them to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax" [emphasis added].

Before establishing whether the tools used to combat tax avoidance are efficient, it is important, for the purpose of this research, to eliminate any ambiguity regarding which conduct can a taxpayer engage in to minimise attracting tax liability.

This chapter establishes the fact that a taxpayer has a common law right to arrange his affairs which enables him to pay the least amount of tax. Such activities are often construed as tax avoidance. I distinguish between ‘tax planning’, ‘tax avoidance’ i.e.: how far a taxpayer can arrange his affairs so that minimal tax is levied in comparison to ‘tax evasion’ i.e.: illicit methods to avoid taxes. These concepts can be elusive to taxpayers as they all attempt to frustrate SARS from effectively collecting taxes from taxpayers.

2.2. Tax avoidance and Tax planning

Concepts relating to escaping tax liability legitimately and legally such as tax planning and tax avoidance must be distinguished from concepts relating to prohibited conduct by a taxpayer such as tax evasion and impermissible tax avoidance. Consequently, a taxpayer who fails to distinguish between these concepts may face unfavourable consequences such as not taking advantage of their right to avoid taxes or even worse, engaging in illicit activities precluded by law.²⁵ The Discussion Paper²⁶ by SARS regarding tax avoidance aims to clarify these concepts.

²⁵ Van Eden, F. (2017). Proper tax planning leads to success. *Stockfarm*, 7(9), 53.

²⁶ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

2.2.1. Tax Avoidance

Tax avoidance relates to the reduction of a taxpayer's tax liabilities in line with the letter and spirit of tax laws.²⁷ The definition of tax avoidance is succinctly described by van Zyl as the situation where the taxpayer arranges their affairs legally and meticulously so that less or no income is taxed.²⁸ Legwaila maintains that despite it being unpopular, it is legal.²⁹ It entails using lawful strategies which are not prohibited by tax laws.³⁰ Avoidance transactions are permissible to the extent that they are congruent with tax laws.³¹ For this reason, a taxpayer has the right to reduce their tax liability within the confines of the law.³² This was further confirmed in *CIR v Conhage (Pty) Ltd* (formerly *Tycon (Pty) Ltd*) ('*Conhage*') where the court held that a taxpayer can arrange his affairs in such a way that they reduce their tax liability within the confines of anti-avoidance regulations. Moreover, the *Duke of Westminster* case is highly potent in situating the principle of permissible tax avoidance.

2.2.1.1. Consequences of Permissible Tax Avoidance

A transaction that constitutes a permissible tax avoidance is illustrated by whether the arrangement entered into by the taxpayer is in accordance with the tax legislation or not.³³ If an avoidance transaction passes the test of permissibility the consequences may include deferring tax, reducing tax or paying no tax at all.³⁴

²⁷ Kujinga, B. T. (2012). Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada. *Comparative and International Law Journal of Southern Africa*, 45(1), 43.

²⁸ Stiglingh, M(ed), Koekemoer, A., Van Zyl, L, Wilcocks, J.S, & De Swardt, R. D. (2016) "Silke: South African Income Tax" Lexisnexis Vol 1 at page 811.

²⁹ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in Commissioner for the South African Revenue Service v NWK Ltd. *SA Mercantile Law Journal*, 28(1), 125.

³⁰ De Koker, A. P, Koekemoer, A & Williams, R.C. (2011) "Silke on South African Income Tax" Lexisnexis Vol 1-4 at paragraph 19.1.

³¹ *IRC v Duke of Westminster* 1936 AC 1.

³² Section 80A of the Income Tax Act 58 of 1962.

³³ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 28 April 2021).

³⁴ Kujinga, B.T. (2013). A Comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible tax avoidance in South Africa.. *LLD Thesis University of Pretoria* at 43. See *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf>

2.2.1.2. Instances of Permissible Tax Avoidance

Simplistically, permissible tax avoidance denotes that a taxpayer has legally avoided tax liability successfully. The case of ITC 1625 (1986) 59 SATC (383) sets out an example where taxpayers successfully arranged their affairs to avoid paying taxes despite the court invoking 'substance over form' doctrine.

ITC 1625 (1986) 59 SATC (383)

i) Facts

A close corporation (CC) acquired property and its member's interest was held in equal shares by three siblings, A, his brother, B, and his sister, C.³⁵ The administration and management of the property and the CC was outsourced to certain experts and the members of the CC obtained the income from the property in the form of salaries.³⁶ The CC had a loan that was secured by a bond with an outstanding amount of R2 139 266,88.³⁷ C and her husband decided to emigrate and wished to take whatever money they could out of the country. If the CC borrowed money and distributed it as a dividend to its members, the interest on the loan would not have been deductible for tax purposes since the purpose would have been to pay a dividend to its members.³⁸

ii) The Arrangement

The members decided to use the increased value of their property. They did this by selling the property to a new company for a price equal to its new market value which was approximately eight million rand.³⁹ The new company would finance the purchase by obtaining a mortgage bond from a financial institution over the property.⁴⁰ The money received by the CC would be distributed to its members as a dividend.⁴¹ The Commissioner disallowed the deduction and invoked the 'form over substance' rule.⁴²

[%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf](#) (accessed 14 May 2021).

³⁵ ITC 1625 (1986) 59 SATC (383) at page 387.
³⁶ ITC 1625 (1986) 59 SATC (383) at page 387.
³⁷ ITC 1625 (1986) 59 SATC (383) at page 388.
³⁸ ITC 1625 (1986) 59 SATC (383) at page 388.
³⁹ ITC 1625 (1986) 59 SATC (383) at page 388.
⁴⁰ ITC 1625 (1986) 59 SATC (383) at page 388.
⁴¹ ITC 1625 (1986) 59 SATC (383) at page 388.
⁴² ITC 1625 (1986) 59 SATC (383) at page 391.

The court was not in favour of this disallowance by the Commissioner as not only did the documents honestly reflect the agreement, but the agreement did achieve what the parties thought they were achieving.⁴³

iii) Court's Decision

The court observed the impracticability of the Commissioner relying on Section 103 yet he argues that there has been no tax avoidance and maintains:⁴⁴

"If he says that the taxpayer is not entitled to a deduction which gives rise to the avoidance of tax because, for example, he contends that expenditure which it is sought to deduct was not incurred in accordance with sections 11(a) and 23(g), he had deprived himself of the jurisdiction for saying that tax was avoided. He therefore cannot rely on section 103(1).[emphasis added]"

Furthermore, the main reason why the Commissioner's argument was unsuccessful was that the court accepted that tax avoidance was not the sole purpose or one of the main purposes of the transaction or scheme.⁴⁵ The court further quoted, the approach of the House of Lords in *IRC v Brebner* [1967] 1 All ER 779 at 784:⁴⁶

"When a genuine commercial transaction is considered and there are two ways of carrying it out, one that involves paying more tax than the other, it is quite wrong to draw the inference, as a necessary consequence, that in adopting the course which involves paying less tax, one of the main objectives is to avoid tax."[my emphasis]

2.2.2. Tax Planning

Tax planning is defined as taxpayer's capacity to arrange their financial activities in a manner so as to bear the minimum liability of taxes.⁴⁷ It refers to the taking of steps

⁴³ ITC 1625 (1986) 59 SATC (383) at page 393.

⁴⁴ ITC 1625 (1986) 59 SATC (383) on page 395.

⁴⁵ ITC 1625 (1986) 59 SATC (383) at page 397.

⁴⁶ ITC 1625 (1986) 59 SATC (383) at page 397.

⁴⁷ Hoffman, W. H. (1961) "The theory of tax planning" *The Accounting Review*, 36(2), 274. See also *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 19 June 2020); see also *CIR v Willoughby* (1997) 4 All ER 65. The OECD defines tax planning as an arrangement of a person's business and or private affairs in order to minimise tax liability.

to attain a more favourable tax outcome, than in other respects would have been the case, within the ambit of the tax laws. In other words, a taxpayer is entitled to choose to pay the least amount of taxes subject to the law.

Tax planning is synonymous with tax mitigation.⁴⁸ As mentioned in paragraph 2.1, the *Duke of Westminster* case (including many other recent cases) has augmented the notion that a taxpayer is entitled to arrange his affairs to attract the least amount of taxes as long as it is within the confines of the law.⁴⁹ Moreover, tax planning involves the use of foresight.⁵⁰ Van Eden maintains that tax planning drives onto contemplating the following two aspects namely, knowing when a taxpayer has to pay tax as well as how much of tax must be paid.⁵¹ Ultimately, it involves planning by a taxpayer in order to use all tax concessions applicable to them.⁵²

2.2.3. Fine Line between Tax Planning and Tax Avoidance

There may seem to be no distinction between legitimate tax planning and tax avoidance. However, the two concepts are not synonymous as they are distinguishable.⁵³ As seen from the definition of tax planning, it involves intelligent planning of reducing the tax liability by claiming eligible deductions, and exemptions permitted in law. Whereas, tax avoidance involves a taxpayer engaging in arrangements that purport to obtain a tax benefit without suffering economic hardships.

⁴⁸ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 19 June 2020).

⁴⁹ Van Eden, F. (2017). Proper tax planning leads to success. *Stockfarm*, 7(9), 53.

⁵⁰ Hoffman, W. H. (1961) The theory of tax planning. *The Accounting Review*, 36(2), 274. See also *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 19 June 2020).

⁵¹ Van Eden, F. (2017). Proper tax planning leads to success. *Stockfarm*, 7(9), 53.

⁵² Hoffman, W. H. (1961). The theory of tax planning. *The Accounting Review*, 36(2), 274. See also *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 19 June 2020).

⁵³ Hoffman, W. H. (1961) "The theory of tax planning". *The Accounting Review*, 36(2), 274.

On the one hand, the objective of tax planning is to decrease taxpayers' tax liability by applying existing provisions of the law. On the other hand, tax avoidance aims to escape paying taxes by taking advantage of loopholes in the law by way of schemes that are impermissible. Kujinga explains how tax avoidance manifests itself and states that tax avoidance is perceived as a 'battle of wits' amongst taxpayers, their advisors, revenue collection authorities and parliamentarians.⁵⁴ Therefore, tax planning involves the use of foresight by considering how much income tax is payable. Once aware of this, a taxpayer may then devise a plan to organise their affairs to enjoy tax concessions. Moreover, tax avoidance is a form of tax planning. However, as discussed below, permissible tax avoidance is predicated by empowering provisions that enable a taxpayer to obtain a tax concession.

2.3. Tax Evasion: Illicit Avoidance of Tax

Up to this juncture, this chapter has indicated permissible conduct of escaping tax liability such as tax avoidance and tax planning. It now lays out conduct that taxpayers engage in which is admonished by SARS such as tax evasion.

Tax evasion refers to illegal activities by a taxpayer to relinquish himself from the tax burden.⁵⁵ The operative word being 'illegal'. It is characterised by fraud on state revenue and exposes a taxpayer to criminal sanction.⁵⁶ It also encompasses features of abnormality, artificiality, and a lack of commercial substance in its definition.⁵⁷ In *CIR v Challenge Corporation Ltd*,⁵⁸ the court described tax evasion as an instance when the Commissioner is not informed of all the relevant details associated with assessing tax liability, however, an evasion that is not done deliberately allows for re-

⁵⁴ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 457.

⁵⁵ Section 80A of the Income Tax Act sets what constitutes impermissible tax avoidance.

⁵⁶ Croome, B.J, Oguttu, A. W., Muller, E., Legwaila, T., Koltitz, M, Williams, R C, & Louw, C (2013) *Tax law: An introduction* (Juta, Claremont) on page 22.

⁵⁷ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020) See also Kujinga, B. T. (2013). *A comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible income tax avoidance in South Africa* (Doctoral dissertation, University of Pretoria) at 42.

⁵⁸ *Commissioner of Inland Revenue v Challenge Corp Ltd* [1986] NZPC 1.

assessment whereas evasion that was done fraudulently leads to criminal prosecution and reassessment. Tax evasion is, therefore, a crime punishable by a penalty or imprisonment.⁵⁹ However, in instances where an innocent taxpayer had no intention of illicitly evading taxes, then a reassessment of income tax payable to SARS can be implemented.⁶⁰ Although tax evasion is often characterised by the element of fraud, Legwaila maintains that it is not limited to, fraudulent practices.⁶¹

An example of tax evasion may include understating the taxes payable to SARS. Fritz and van Zyl elaborate on what an understatement entails and state that it is a result of either failing to submit a return, omitting information from a return or making an incorrect statement in a return.⁶² The *NWK* case, as indicated in chapter 3, suggests that in certain circumstances a transaction might be deemed to be simulated even in the absence of fraud. Therefore, elements such as dishonesty and unlawfulness by a taxpayer in order to reduce tax liability are what often characterises tax evasion.⁶³

2.3.2. Consequences of Tax Evasion

SARS has remedies against the taxpayer who engage in illicit activities to evade tax liability in terms of section 235 of the Tax Administration Act 28 of 2011 ('TAA').⁶⁴ A

⁵⁹ Section 233 of Tax Administration Act 28 of 2011.

⁶⁰ *Commissioner of SARS v NWK Ltd* [2011] 2 All SA 347 (SCA). See also Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 235.

⁶¹ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 125.

⁶² Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 244.

⁶³ Surtees, P., & Millard, S. (2004). Substance, form and tax avoidance. *Accountancy SA*, at page 14.

⁶⁴ Section 235. Evasion of tax and obtaining undue refunds by fraud or theft. —

(1) A person who with intent to evade or to assist another person to evade tax or to obtain an undue refund under a tax Act—

(a) makes or causes or allows to be made any false statement or entry in a return or other document, or signs a statement, return or another document so submitted without reasonable grounds for believing the same to be true;

(b) gives a false answer, whether orally or in writing, to a request for information made under this Act;

(c) prepares, maintains, or authorises the preparation or maintenance of false books of account or other records or falsifies or authorises the falsification of books of account or other records;

taxpayer who is found to be evading taxes is guilty of an offence. Upon conviction, the following punitive measures can be imposed against the taxpayer in the form of a fine⁶⁵ or imprisonment for a period not exceeding five years.⁶⁶

In the 2010 Budget Speech, the erstwhile Minister of Finance Pravin Gordhan highlighted the gravity of tax avoidance.⁶⁷ He stated that vigorous tax avoidance is grievous cancer consuming into the fiscal base of many developing countries.⁶⁸ The most prominent case in this regard is that of *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR*⁶⁹. As highlighted in this case, the principle of tax evasion refers to when a party plans their activities out of the confines of a particular legal provision *vis-a-vis* with attempts to deceive the courts by the nature of the business activities.⁷⁰

2.4. Conclusion

This chapter has established that a taxpayer is entitled to engage in conduct that is permissible to avoid tax liability. Fundamental concepts relating to escaping taxes, whether legitimately or illegitimately, have been elaborated on. The effects of tax avoidance have the effect of reducing the state's revenue. This ultimately means that to the extent that it is within the perimeters of law, a taxpayer may avoid tax liability as long as it is not categorised as tax evasion or impermissible tax avoidance. As a consequence, SARS strongly opposes activities to reduce state revenue. Tax avoidance and tax evasion both have the effect of reducing the fiscus of the state. The

(d) makes use of, or authorises the use of, fraud or contrivance; or

(e) makes any false statement for the purposes of obtaining any refund of or exemption from tax, is guilty of an offence and, upon conviction, is subject to a fine or to imprisonment for a period not exceeding five years.

(2) Any person who makes a statement in the manner referred to in subsection (1) may, unless the person proves that there is a reasonable possibility that he or she was ignorant of the falsity of the statement and that the ignorance was not due to negligence on his or her part, be regarded as being aware of the falsity of the statement.

(3) Only a senior SARS official may lay a complaint with the South African Police Service or the National Prosecuting Authority regarding an offence under this section

⁶⁵ See paragraph 2.2.2.3 below for penalty on tax evasion in accordance with section 233 of Tax Administration Act 28 of 2011.

⁶⁶ section 233 of Tax Administration Act 28 of 2011.

⁶⁷ *Budget Speech 2010* www.treasury.gov.za/documents/2010/speech/speech2010 (accessed on 14 June 2021).

⁶⁸ *Budget Speech 2010* www.treasury.gov.za/documents/2010/speech/speech2010 (accessed on 14 June 2021).

⁶⁹ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229.

⁷⁰ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229 at page 233.

distinguishable feature between tax planning and permissible tax avoidance in contrast to tax evasion and impermissible tax avoidance is that the former is an entitlement a taxpayer whereas, in contrast, tax evasion has adverse effects and may lead to SARS imposing a sanction of either a penalty or imprisonment. Therefore, tax evasion is specifically outright illegal. It is only set aside in accordance with the legislation and not the tool for setting aside tax avoidance transactions.

Despite this chapter indicating that it is possible to avoid taxes, the issues regarding the interpretation of the avoidance transaction tend to pose questions of concern as there seem to be disparities in this regard. In the next chapter, I explore the common law doctrine of 'substance over form' which is a tool invoked by the courts to combat tax avoidance.

CHAPTER 3: THE ‘SUBSTANCE OVER FORM’ DOCTRINE

3.1. Introduction

The previous chapters mention that taxpayers can structure their affairs by entering into a *bona fide* transaction which has the effect of reducing their tax liability. The notion of concealing a transaction by clothing it in another transaction/arrangement is a prominent form of escaping tax liability. As part of taxpayers’ attempts to engage in tax planning, taxpayers may obviously enter into a simulated transaction to obtain benefits of the simulated transaction as opposed to bear the consequences of the actual transaction. Consequently, the common law ‘substance over form’ doctrine is often invoked by courts to give effect to the real transaction as opposed to the transaction that disguises the real transaction. As an example, tax consequences of sales and leases differ and invoking the doctrine ensures that parties are taxed according to the legal consequences of the sale the transaction effects in substance, instead of the lease consequences that the transaction purports to have in its form.

This chapter explores the ‘substance over form’ doctrine as a common law tool to combat tax avoidance. It describes what this doctrine entails. It further examines how the doctrine has been applied in various judicial precedents in South Africa. Finally, it illustrates how the doctrine has been applied in the South African tax landscape.

3.2. What is the ‘Substance over Form’ Doctrine?

The ‘substance over form’ doctrine is a common law principle that refers to the notion of courts exposing the external appearance/label given to a transaction which is either a sham, simulated or disguised, to reveal its true nature.⁷¹ Consequently, it is invoked

⁷¹ Hutchison, A., & Hutchison, D. (2014). Simulated transactions and the *fraus legis* doctrine. *South African Law Journal*, 131(1), 70. See also Legwaila, T. (2012). Modernising the ‘Substance over Form’ Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

in instances where there is an attempt to harbour dishonesty in the form of a transaction to deceive tax authorities.⁷² Such a transaction is known as a simulated transaction and is defined as acts done and documents executed by parties who intend to have third parties believe that legal rights and obligations have been created between contracting parties (a sham transaction) which are not congruent to the actual agreement intended by the contracting parties.⁷³ Courts have maintained that a disguised transaction is a dishonest transaction where the parties do not intend to give effect to the legal effects to the outside world.⁷⁴ Parties hide the fact that the real agreement is subject to taxation or that the real agreement actually falls within the transactions that are prohibited. This is referred to *in fraudem legis* where the court must determine if there is some disguised, unexpressed agreement or tacit understanding for there to be a pretence agreement.⁷⁵ Therefore, the court ought to ascertain the parties' real intention, disregarding the agreement between the parties.⁷⁶

Surtees and Millard posit that the 'substance over form' doctrine is constituted by two principles, namely: the label principle and the simulation principle.⁷⁷ On the one hand, the label principle is characterised by parties, acting in good faith without the intention of deceiving, attach an incorrect label to a transaction either accidentally or negligently.⁷⁸ On the other hand, is the simulation principle which is characterised by parties who enter into a sham transaction or a transaction that is *in fraudem legis*.⁷⁹ In

⁷² Legwaila, T. (2012). Modernising the 'Substance over Form' *Doctrine: Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

⁷³ *Snook v London and West Riding Investments Ltd* 1967 1 All ER.

⁷⁴ *Snook v London and West Riding Investments Ltd* 1967 1 All ER.

⁷⁵ Legwaila, T. (2012). Modernising the 'Substance over Form' *Doctrine: Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

⁷⁶ *Hofmeyer v Gous* 10 SC 115. See also *Zandberg v Van Zyl* (1910) AD 302; *Commissioner for Customs and Excise v Randles Bros & Hudson Ltd* 1941 AD 369; Erf 3183/1 Ladysmith and Another v Commissioner for Inland Revenue 1996 (3) SA 942 (SCA). See also Legwaila, T. (2012). Modernising the 'Substance over Form' *Doctrine: Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

⁷⁷ Surtees, P., & Millard, S. (2004). TAX| Substance, form and tax avoidance. *ACCOUNTANCY SA*, 14-18 at page 15. See also Legwaila, T. (2012). Modernising the 'Substance over Form' *Doctrine: Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

⁷⁸ Surtees, P., & Millard, S. (2004). TAX| Substance, form and tax avoidance. *ACCOUNTANCY SA*, 15.

⁷⁹ Surtees, P., & Millard, S. (2004). TAX| Substance, form and tax avoidance. *ACCOUNTANCY SA*, at page 15.

this regard, there is an element of bad faith conduct or omission by parties to intentionally and dishonestly conceal the true nature of a transaction to avoid the application of tax law.

Legwaila notes that the *NWK* case cannot be the authority for setting aside a transaction as simulated because it is a vehicle for tax evasion. Therefore, a transaction that evades tax is set aside automatically in terms of the law.⁸⁰

3.3. Application of Doctrine in Case Law

Pivotal cases highlighting tax avoidance and the 'substance over form' doctrine are discussed below including the *Erf 3183/1 Ladysmith (Pty) Ltd* case, the *CIR v Conhage (Pty) Ltd* case, the *CSARS v NWK* case, the *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC* case and the *Sasol Oil v CSARS* case.

3.3.5. *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 58 SATC 229*:

i) Facts

The taxpayer company agreed to lease vacant industrial land to the Board of Executor Pension Fund which is a tax-exempt entity ('the lessee').⁸¹ According to the lease agreement, the lessee was entitled to erect buildings and other improvements on the leased property at its expense.⁸²

However, the lessee was not obliged to do so.⁸³ The lessee sub-leased the land to a subsidiary of the taxpayer (sub-lessee). The sublease obliged the sub-lessee to erect a factory on the land. The underlying intention for both the lease and sublease agreements was to generate a tax-free benefit for the taxpayer company in erecting a

⁸⁰ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 126.

⁸¹ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 58 SATC 229* at page 231.

⁸² *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 58 SATC 229* at page 235.

⁸³ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 58 SATC 229* at page 232.

factory on its land.⁸⁴ After assessing the taxpayer company, the Commissioner included the value of the factory in the taxpayer company's gross income⁸⁵

ii) Court's Decision

The court held that the lease agreement entailed elements of simulation. The purpose could have been to conceal the real or complete terms of what the parties truly intended but chose not to express.⁸⁶ The court accordingly dismissed the appeal in that the taxpayer failed to discharge the onus of proving that the agreement reflected the actual intention of the parties and thus failed to show that the right to have improvements effected as envisaged by paragraph (h) of the definition of gross income did not accrue to them.⁸⁷

3.3.44. *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) 1999 (4) SA 1149 (SCA):*

This case is essential for this research as the application of the doctrine of 'substance over form' was applied in light of section 103 GAAR. The facts and rationale of the *Conhage* case decision are highlighted as follows:

i) Facts

The taxpayer had entered into two sets of agreements with Firstcorp. Each set comprised a sale-and-lease-back of some of its manufacturing plant and equipment.⁸⁸ The taxpayer needed capital to expand its business and Firstcorp would make the funds available. Tax benefit to be gained from sale-and-leaseback transactions was apparent. Both parties decided to proceed with the transaction.⁸⁹

The dispute arose when the taxpayer sought to deduct the rental income, from the sale-and-leaseback transaction, as expenditure in the production of income in accordance with section 11(a) of the Income Tax Act.⁹⁰ The Commissioner refused to

⁸⁴ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229 at page 236 – 237.

⁸⁵ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229 at page 232.

⁸⁶ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229 at page 234.

⁸⁷ *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* 58 SATC 229 at page 243.

⁸⁸ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) 1999 (4) SA 1149 (SCA)* at paragraph [2].

⁸⁹ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) 1999 (4) SA 1149 (SCA)* at paragraph [4].

⁹⁰ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) 1999 (4) SA 1149 (SCA)* at paragraph [2].

allow the deduction and had invoked section 103 contending that the agreements were not what they purported to be.⁹¹ Regarding the true nature of the agreements, he contended that despite the form of the agreements, the taxpayer did not sell and lease back its equipment but, in substance, had borrowed the 'purchase price' from Firstcorp.⁹²

ii) Issues

The first issue to be decided was the true nature and substance of the agreements.⁹³ The second issue would be whether the Commissioner had correctly invoked the provisions of section 103.⁹⁴

iii) Decision

The Special Court had found that the onus was on the taxpayer to prove the authenticity of the agreements and that the onus had been discharged.⁹⁵ The court ultimately held that the purpose of the transaction was the need to secure funding rather than the avoiding of tax.⁹⁶ The court argued that the taxpayer can reduce his tax liability by devising his affairs within the limits of anti-avoidance provisions. The court makes an illustration the taxpayer can conduct himself in such a way that he can reduce his tax or not pay tax at all, yet still producing the same commercial effect. However, the court will give effect to the real form of the business activity and will thus not be “deceived” when considering whether the taxpayer has positively managed to reduce or avoid tax.

3.3.33. CSARS v NWK Ltd 2010 ZASCA 168 (NWK case)

This case is essential in the tax arena it provided a suggestion for the alteration of the ‘simulation test’, as seen below.

⁹¹ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [2].

⁹² *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [3].

⁹³ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [3].

⁹⁴ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [2].

⁹⁵ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [7].

⁹⁶ *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) at paragraph [15].

i) Facts

The Commissioner for SARS levied additional assessment for years between 1999 to 2003 against NWK. An additional penalty for making false statements in tax returns and interest was further levied. The reason for the assessment was that NWK concluded a transaction with First National Bank ('FNB') and its subsidiary were simulated. In 1998 NWK borrowed R 96 million from FNB which was to be repaid by delivery of a specified quantity of maize five years after the contract was concluded. NWK paid R96 million and claimed it as a deduction from the income tax as it was contended that it is an expenditure in the production of income. Numerous agreements were entered into to cancel the obligation to deliver maize. The real sum lent was R50 million, while deductions were claimed in respect of interest paid on R96 million.

ii) Tax Court Decision

The Tax Court found that there was no simulation as the parties had intended to perform the contracts on the terms agreed. It considered the performance, by the parties of their respective obligations under the various contracts years later which included the constructive delivery of maize (by exchange of silo certificates in front of a notary) by NWK to FNB and the immediate delivery of the same quantity of maize by FNB to NWK. The Tax Court upheld NWK's appeal against the Commissioner's assessments. It also declined to invoke the former section 103(1) on the basis that it could not be used as an alternative ground to a finding that a transaction was simulated.

iii) Supreme Court of Appeal Decisions

The SCA later held that the loan was simulated and that there had never been an intention to cause the delivery of maize as repayment. Instead of imposing a 200 per cent penalty, the court reduces the penalty to 100 per cent of the amount assessed as additional tax. The SCA held that the test is not whether the contracting party simply fulfilled the contractual obligations but rather enquire into the "commercial sense" of the business activity including its substance and objectives.

Therefore, if the objective of the transaction is to solely evade tax or a peremptory law then it will be considered to be a simulated transaction. Fulfilling the obligations of the

agreement is not an indicator that the transaction was not simulated, since fulfilling the contract can be a pretence to simply conceal the transaction.

Waglay J, in the dissenting judgment, illustrates a disparity regarding the concept of 'tax avoidance' and 'tax evasion' and holds that the *NWK* decision cannot be authority for simulated transaction in the event where a transaction is regarded as tax evasion and not tax avoidance.⁹⁷

3.3.2. *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA) (Roshcon Case)*

Since the *NWK* decision cannot be used as authority for simulated transactions, the *Roshcon* decision purported to bring clarity on this issue.

i) Facts

Roshcon sought to purchase 5 trucks which needed to be modified and fitted with cranes. These trucks were orderd from Toit's Commercial (Pty) Ltd (Toit's). In turn, it ordered these trucks from Nissan Diesel (SA) (Pty) Ltd (Nisan).⁹⁸ Nisan concluded a supply agreement with Wesbank whilst Westbank and Toit's concluded a floor plan agreement.⁹⁹ The trucks were delivered to Toit's.¹⁰⁰

Roschon contended that the supplier agreement and the floor plan agreement were a simulation in that the floor plan agreement was a loan against the security of the trucks without Wesbank taking possession of the truck.¹⁰¹ Consequently, they would be obtaining an advantage that would not, in the ordinary course, be allowed.¹⁰² Wesbank contended that Roshcon had the onus of proof that the transaction is simulated.

⁹⁷ *CSARS v NWK Ltd* 2010 ZASCA 168 at paragraph [7].

⁹⁸ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA)* at paragraph [2]

⁹⁹ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA)* at paragraph [4].

¹⁰⁰ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA)* at paragraph [5].

¹⁰¹ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA)* at paragraph [7].

¹⁰² *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC 2014 (4) SA 319 (SCA)* at paragraph [7].

ii) SCA's Decision

Wallis J maintained that to determine whether a transaction is a simulated transaction, the court must consider the real intention of the parties and contrast that with the intention created by their agreement.¹⁰³ He further emphasised that despite a transaction having the effect of tax avoidance, it is incorrect to suggest that such transaction is a simulated transaction.¹⁰⁴ In *NWK*, if the parties intended the application of the various elements of the contracts, particularly the self-cancelling features, the simulation doctrine would not have been applicable.¹⁰⁵ Furthermore, the court stated that for a transaction to be declared as simulated is primarily dependent on the facts of the particular case. Some factors the court mentioned is the surrounding circumstances, unusual features of the transaction, and the manner in which the parties intend to implement it.¹⁰⁶

3.3.1. *Sasol Oil v CSARS (2018) ZASCA 153 (A) (Sasol case)*

Although this case is relevant in this section of this study, it is appropriately and extensively discussed in paragraph 4.3.3 as it even more relevant in the next section.

3.4. Application of the 'Substance over Form' doctrine

It is a precondition to determine if a transaction is a simulated transaction is whether there is a real intention different from the purported intention as stated in the *Randles Bros & Hudson Ltd*.¹⁰⁷ Therefore, the application of this doctrine denotes that the true intention of a transaction between parties will prevail over the actual terms. This is encapsulated by the maxim "*plus valet quod agitur quam quod simulate concipitur*" ('the *plus valet* rule') which directly translates to "what is actually done is more

¹⁰³ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC* 2014 (4) SA 319 (SCA) at paragraph [15].

¹⁰⁴ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC* 2014 (4) SA 319 (SCA) at paragraph [36].

¹⁰⁵ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC* 2014 (4) SA 319 (SCA) at paragraph [33].

¹⁰⁶ *Roshcon (Pty) Ltd v Anchor Autobody Body Builders CC* 2014 (4) SA 319 (SCA) at paragraph [37].

¹⁰⁷ *Commissioner for Customs and Excise v Randles Bros & Hudson Ltd* 1941 AD 369.

important than that which seems to have been done”.¹⁰⁸ This notion was further supported by the *Duke of Westminster* case where the court held that when there is a matter pertaining to revenue, the courts are permitted to ignore the legal position and rather consider the substance of the matter. Legwaila submits that courts should apply the doctrine in a manner that is appropriate for tax laws as the doctrine is of general application across the legal field in cases dealing with income tax.¹⁰⁹ Therefore, the application of the doctrine ought to be flexible.

In the year 1910, the court in *Zandberg v van Zyl* set the basis of simulation principle for the first time where the issue of contention was regarding whether ownership of the wagon was transferred or the wagon was merely held as security for a debt. The court maintained that it is common for parties to conceal the real character of a transaction by giving it a name or shape to disguise its true nature. In determining any right of such an arrangement, the court is expected to give effect to what the transaction is as opposed to what it purports to be.¹¹⁰

In 1941, the court in *Commissioner for Customs and Excise v Randles Bros & Hudson Ltd* referred to *Zandberg* decision regarding the term ‘real intention’ in contrast to ‘simulated intention’. In this regard the court stated:

“[...] A transaction is not necessarily a disguised one because it is devised for the purposes of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties honestly intend it to have effect according to its tenor, is interpreted by the courts according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax [...].” [my emphasis]

As seen in the cases mentioned in paragraph 3.3., the issue is often to deceive SARS by using dishonest measures to conceal a transaction to mask in order for it to take

¹⁰⁸ *Zandberg v Van Zyl* (1910) AD 302. See also Legwaila, T. (2012). Modernising the 'Substance over Form' Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*: case comment. *SA Mercantile Law Journal*, 24(1), 115.

¹⁰⁹ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 128.

¹¹⁰ *Zandberg v Van Zyl* (1910) AD 302 at paragraph [309].

the form of another transaction. There are instances where there is no dishonesty in a simulated transaction. Parties may legitimately avoid tax liability nonetheless as it would be difficult to render their transaction a simulated transaction.

Legwaila distinguishes between the position regarding the 'substance over form' doctrine before the *NWK* case and a position after. He mentions that before the *NWK* case the application of the 'substance over form' doctrine was focused on the form that the taxpayers projected to be.¹¹¹ Therefore, emphasis was placed on the parties' intentions. However, when the *NWK* case emerged, the emphasis shifted from the parties' intention to the transaction itself despite what the parties intended.¹¹² Legwaila further mentions that where a transaction is structured to achieve a specific objective but is disguised in a different transaction, then the 'substance over form' doctrine will apply to attach the consequences that would have ensued should the transaction have not been disguised.¹¹³

The *NWK* decision extends the application of the 'substance over form' doctrine by setting out a test for tax avoidance. Should the form of a transaction be different to that of its substance, then such a transaction will fail the simulation test. Consequently, following the logic of the *NWK* decision, where a transaction lacks commercial substance, then such a transaction shall be considered to be a sham transaction. If both the substance and the form are congruent, then a further enquiry will be embarked upon of whether the provisions of the General Anti-avoidance Rules as contained in section 103(1) or the new sections 80A to 80L of Income Tax Act have been breached.¹¹⁴

¹¹¹ Legwaila, T. (2012). Modernising the 'Substance over Form' Doctrine: Commissioner for the South African Revenue Service v *NWK* Ltd: case comment. *SA Mercantile Law Journal*, 24(1), 121.

¹¹² Legwaila, T. (2012). Modernising the 'Substance over Form' Doctrine: Commissioner for the South African Revenue Service v *NWK* Ltd: case comment. *SA Mercantile Law Journal*, 24(1), 121.

¹¹³ Legwaila, T. (2012). Modernising the 'Substance over Form' Doctrine: Commissioner for the South African Revenue Service v *NWK* Ltd: case comment. *SA Mercantile Law Journal*, 24(1), 121.

¹¹⁴ Legwaila, T. (2012). Modernising the 'Substance over Form' Doctrine: Commissioner for the South African Revenue Service v *NWK* Ltd: case comment. *SA Mercantile Law Journal*, 24(1), 125.

3.3. Conclusion

This chapter has illustrated that the ‘substance over form’ doctrine in the tax arena is invoked to combat tax avoidance. Where a transaction has either been mistakenly mislabelled by giving it a name that it is not or where a transaction has been clothed with a form which its substance is not, the courts will give effect to the substance of the transaction and ignore the form. There will be adverse consequences for taxpayers where the intention of the parties is dishonest and aim to defraud or deceive SARS.

Some pivotal decisions regarding the ‘substance over form’ doctrine have illustrated instances where the court was required to set aside the alleged simulated transaction. Of particular importance, the *NWK* case laid down how to determine fraud in a transaction by establishing the simulation test. It was found that without the element of dishonesty and while the absence of a sound commercial purpose for a transaction may be a strong indicator of simulation, it could not follow to find a transaction to be fraudulent. Notably, the *NWK* case is of great importance as Legwaila maintains that it attempts to extend to the scope of the ‘substance over form’ doctrine. Contrary to the ITC 1625 (1986) 59 SATC (383) case, as seen in paragraph 2.1.2, where the Commissioner’s case was unsuccessful when the ‘substance over form’ doctrine was invoked, a transaction will often be set aside when the doctrine is invoked by the courts. Transactions that constitute tax evasion cannot be set aside by invoking the ‘substance over form’ doctrine. Rather, legislative tools are used.

In the next chapter, I explore how a transaction is said to be an impermissible tax avoidance transaction. I do this by tracing the historical development of the tools that make a transaction an impermissible tax avoidance transaction. I further consider the application of the GAAR to ascertain its efficacy.

CHAPTER 4: THE DEVELOPMENT AND APPLICATION OF THE GAAR IN SOUTH AFRICA

4.1. Introduction

The different concepts relating to escaping of tax liability such as ‘tax planning’, ‘permissible tax avoidance’, as well as ‘tax evasion’ as explained in the previous chapter all have various legal consequences/impacts. From SARS’ perspective, these concepts reduce the fiscus/revenue of the state.¹¹⁵ From a taxpayer’s perspective, they reduce, postpone or extinguish the taxpayer’s liability. As noted in the previous chapter, a taxpayer is permitted to arrange his tax affairs to the extent it is not disallowed by the tax laws. As mentioned in the previous chapter, the ‘substance over form’ doctrine is a common law tool used to combat tax avoidance. In addition to this, the General Anti-Avoidance Rules (GAAR) were incorporated into legislation as a statutory tool to combat tax avoidance.

This chapter illustrates the development and application of the GAAR leading toward what it is presently. I further expand on an analysis of the current GAAR and deal with how the provisions of the GAAR are interpreted. Although until recently, there has been limited judicial consideration in respect of the current GAAR as contained in sections 80A – L of the Income Tax Act.¹¹⁶ The GAAR continues to be applied with much reluctance by the South African judiciary.¹¹⁷ I further elucidate how essential terms as found in the GAAR such as “impermissible transaction”, “tax benefit” and “a scheme” are interpreted. Furthermore, I establish whether the current GAAR has evolved to such a degree that there is no issue about the taxpayer's right to certainty. The exercise of tracing the preceding GAAR up to the current form is primarily to indicate

¹¹⁵ According to the *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 10 April 2021).

¹¹⁶ Kujinga, B. T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

¹¹⁷ The *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC is one the first cases where the application of the GAAR was interrogated in depth.

its development to provide a clearer understanding of its current application as indicated in the subsequent chapter.

4.2. Historical Background

Since avoidance of tax is an issue of concern all over the world for revenue receivers, most states established legislative rules known as the GAAR to combat tax avoidance.¹¹⁸ A state that levies taxes is most likely to implement the GAAR.¹¹⁹

4.2.1. Income Tax Act 31 of 1941

In South Africa, the initial GAAR was introduced as far back as 1941 in section 90 of the Income Tax Act 31 of 1941. Section 90 provides that if the Commissioner is convinced that a transaction was entered into to avoid being liable to pay tax or to reduce the amount, the Commissioner must determine that amount, enforce payment as if that transaction had never occurred.¹²⁰ From the reading of this provision, Kujinga compartmentalises the elements of the initial GAAR as contained in this provision as:¹²¹

- i. a transaction or operation;
- ii. that had a purpose; and
- iii. the effect of avoiding tax.

Section 90 has demonstrated its weakness in that it had a wide scope of application as it did not have an indicator of impermissible tax avoidance that could draw the line between permissible and impermissible tax avoidance.¹²² The wide application of the

¹¹⁸ *Anti-Avoidance Rules Against International Tax Planning* <https://www.oecd-ilibrary.org/docserver/1a16e9a4-en.pdf?expires=1621418965&id=id&acname=guest&checksum=408C5B1683A0A163B4D5E1B3863B219D> (accessed 15 May 2021).

¹¹⁹ *Anti-Avoidance Rules Against International Tax Planning* <https://www.oecd-ilibrary.org/docserver/1a16e9a4-en.pdf?expires=1621418965&id=id&acname=guest&checksum=408C5B1683A0A163B4D5E1B3863B219D> (accessed 15 May 2021).

¹²⁰ Income Tax Act 31 of 1941.

¹²¹ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), at 435.

¹²² Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), at 434.

GAAR has the effect of creating uncertainty. Consequently, the court in the *Commissioner for Inland Revenue v King* decision alluded that there are many legitimate transactions that a taxpayer can conduct which can reduce his income in comparison to the past, or with the ability to free oneself from being taxed in the future.¹²³ The court illustrates this by using an example of a man who sells his investments which may be subject to tax but make no investments, or spend the proceeds to purchase a house to stay in, or to purchase shares that do not generate an income although they increase in value.¹²⁴ Additionally, an individual can detest paying tax to the extent of selling his investments and survive with his capital and give the balance to the poor. If the individual is a professional, he may opt to reduce his rates or work for free. An individual can thus conduct oneself in a manner that seeks to achieve reducing the amount to pay.¹²⁵

Consequently, any transaction which had an avoidance purpose could be challenged by invoking section 90.¹²⁶ As a result of this section being too wide, Kujinga maintains that it could not be used for permissible tax avoidance transactions.¹²⁷ Furthermore, the 'purpose' requirement was not adequately defined because there was no indication of the degree of the purpose, i.e.: whether the purpose was minor or it was the main.¹²⁸

It is therefore imperative to look at each element of section 90 of the GAAR independently when applying it practically, to avoid the scheme from demonstrating itself as a tax evasion scheme.

¹²³ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at 191.

¹²⁴ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at 191.

¹²⁵ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at 191.

¹²⁶ Kujinga, B.T., (2014). Factors that Limit the Efficacy of General Anti-Avoidance Rules in Income Tax Legislation: Lessons from South Africa, Australia and Canada. *Comparative and International Law Journal of South Africa* 47 (3) at 64.

¹²⁷ Kujinga, B.T., (2014). Factors that Limit the Efficacy of General Anti-Avoidance Rules in Income Tax Legislation: Lessons from South Africa, Australia and Canada.. *Comparative and International Law Journal of South Africa* 47 (3) at 64.

¹²⁸ Kujinga, B.T., (2014). Factors that Limit the Efficacy of General Anti-Avoidance Rules in Income Tax Legislation: Lessons from South Africa, Australia and Canada.. *Comparative and International Law Journal of South Africa* 47 (3) at 64.

4.2.2. Amendment of section 90

As a result of the weaknesses of the GAAR as contained in section 90, the GAAR had to be amended. The *Commissioner for Inland Revenue v King*¹²⁹ is a pivotal case in that it necessitated the amendment of section 90.¹³⁰ The court had to consider and interpret section 90 and held that avoiding tax liability meant that a taxpayer specifically orders his affairs in such a manner that he escapes tax liability on his income and/or capital.¹³¹ The term ‘purpose’ was interpreted to mean a ‘dominant purpose’ as opposed to a mere ‘incidental purpose’.¹³² The court exposed the deficiency of the erstwhile GAAR and proposed a workable meaning, and argued that It is ridiculous to conclude that the legislators objective is to punish an individual who arranges his affairs to decrease the amount he receives and as a result his tax, yet in a broad sense a taxpayer can pay less tax because his income was lesser from the previous year. The court held that both these instances although uncommon they are “ordinary” and “legitimate” business dealings.¹³³

In the light of the weakness as highlighted in the *Commissioner for Inland Revenue v King* decision, in 1959, the GAAR provision as contained in section 90 was subsequently amended to include transactions, actions that are conducted to avoid or postpone being liable to pay tax, duty or levies, or to reduce the amount, in which the Commissioner concludes that the transaction, actions or arrangement was conducted in a manner that is not normally taken in conducting one’s affairs, or in its very nature, or where rights and obligations were created between individuals operating at “arm’s length” under that “transaction” in question.

The Commissioner must be under the impression that avoiding and postponing of tax liability or reducing the amount should have been the only reason or at least one of the main purposes of the transaction, action or arrangement and will thus determine if the

¹²⁹ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A).

¹³⁰ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A).

¹³¹ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at [191].

¹³² *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at [191], [198] & [119].

¹³³ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at [161].

individual is liable for tax or duty and calculate the amount as if the person had never entered the transaction to postpone, avoid and reduce tax liability.¹³⁴

Upon inspection of this provision, the subsequent amended GAAR as found in section 90 became narrow as it identified the impermissible tax avoidance. This means that tax can be avoided by a taxpayer through structuring his affairs by means of transactions, operations or schemes.¹³⁵ The term 'scheme' encompasses a series of combinations of transactions if these transactions are arranged for tax avoidance. Therefore, a transaction, operation or scheme is not limited to a single event as it presented in the old GAAR. The *Commissioner for Inland Revenue v King* decision proposed that the GAAR provision had to be limited as not all instances of avoidance are impermissible and should be challenged by the GAAR.¹³⁶ The *Ferrera* decision maintained that a purposive approach ought to be adopted when interpreting the GAAR.¹³⁷

4.2.3. Section 103 of the Income Tax Act

The current Income Tax Act 58 of 1962 replaced the Income Tax Act 31 of 1941. The GAAR provision as initially contained in section 90 of the former Income Tax Act 31 of 1941 was retained in section 103(1) of the current Income Tax Act, as amended.¹³⁸ Section 103(1) provides for transactions, actions that avoid, postpone tax liability or reduce the amount of tax. There are four essential elements to the section 103 GAAR comprise of:¹³⁹

¹³⁴ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at [168].

¹³⁵ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at [165].

¹³⁶ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), at 452.

¹³⁷ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), at 452

¹³⁸ Steenkamp, L. A., Roeleveld, J., & West, C. (2016). Tapping into a quarter-century's judicial experience with the Canadian General Anti-Avoidance Rule (GAAR): some insights for South Africa. *Comparative and International Law Journal of Southern Africa*, 49(3), at 480.

¹³⁹ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

- i) a transaction, operation or scheme entered into or carried out – the scheme requirement;
- ii) has the effect of avoiding or postponing or reducing the liability for the payment of any tax - the tax effect requirement;
- iii) and was entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit – abnormality requirement/arm’s length test); and
- iv) the transaction must have been entered into solely or mainly to obtain a tax benefit - the purpose requirement.

These elements as enlisted above had to be simultaneously present for the Commissioner to rely on the GAAR.¹⁴⁰

4.2.4. Weakness in the previous GAAR

Upon conducting a review of the GAAR, SARS found that the section 103 GAAR was obsolete and released a Discussion Paper on tax avoidance and section 103(1) in November 2005 as mentioned above.¹⁴¹ In 1995, the Katz Commission¹⁴² noted that section 103 had certain shortcomings. The issue about the “normality test” was that there is ambiguity regarding whether there exists an objective test to be applied regardless of the context of specific circumstances.¹⁴³

¹⁴⁰ *SIR v Geustyn, Forsyth and Joubert* 1971 3 SA 567 (A) at paragraph [571] & [572].

¹⁴¹ *SIR v Geustyn, Forsyth and Joubert* at paragraph [480].

¹⁴² The Katz Commission issued its report 1995 where it recognised that the abnormality requirement presented difficulties in the tax arena and reiterated the Margo Commission. *Third Interim report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* <http://www.treasury.gov.za/publications/other/katz/3.pdf> (accessed 18 June 2021).

¹⁴³ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

Accordingly, section 103(1) was amended in 1996 to address these deficiencies. The abnormality test was considered by the Margo Commission¹⁴⁴ to be a major weakness in that it “is widely used for tax avoidance, it may gain a commercial acceptability to the extent its utilisation becomes normal.”¹⁴⁵ The Discussion paper maintains that the GAAR as contained in section 103 of the current Act had been inconsistent and an ineffective deterrent to the tax.¹⁴⁶ The weaknesses/ inconsistencies identified in the GAAR as found in section 103 are that the Commissioner is entitled to apply the GAAR as an alternative or additional basis for an assessment, the GAAR can be applied to steps or parts of a larger avoidance arrangement and that the objective - rather than subjective test.¹⁴⁷

Most importantly, the legislation was intended to create a more effective deterrent against impermissible avoidance arrangements, particularly aggressive tax shelter arrangements that have little or no commercial substance.¹⁴⁸

4.3. Current GAAR: Section 80A – 80L of the Income Tax Act

As a result of the aforementioned weaknesses, the GAAR needed to be amended further. The current GAAR is contained in sections 80A to 80L and was enacted on 6 November 2006.¹⁴⁹ It purported to eradicate weakness contained in the previous

¹⁴⁴ The Margo Commission issued its report in 1986 where it recognised that the erstwhile section 103 entailed deficiencies. *Report 49 of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (RP 34/1987) <http://www.treasury.gov.za/publications/other/katz/3.pdf> (accessed 14 April 2020).

¹⁴⁵ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

¹⁴⁶ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

¹⁴⁷ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

¹⁴⁸ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 April 2020).

¹⁴⁹ Liptak, Ed. (2016) "Failure, more failure and some success: GAAR ten years on." *Taxtalk* vol 60 at 58-61.

GAAR. Kujinga opines that the current GAAR curbs the tax legislation from being rendered self-defeating by taxpayers who use the very same legislation to avoid tax impermissibly.¹⁵⁰

To recap from the previous chapter, if a transaction fails the substance-over-form test, such a transaction will be set aside as it will be an illegal transaction, it will be categorised as tax evasion.¹⁵¹ If it passes the substance-over-form test, however, a further enquiry will be undertaken whether the transaction is impermissible tax avoidance.¹⁵²

4.3.1. Impermissible Tax Avoidance

Although taxpayers are entitled to arrange their affairs to attract less or no tax liability, as mentioned previously, impermissible tax avoidance has undesirable effects such as short-term revenue loss, increase in disregarding the tax system, unfair distribution of wealth, unjust shifting of the tax burden, and the incapacitation of legislators and National treasury to formulate and implement economic policy.¹⁵³

Tax avoidance is regarded to be impermissible if it is inconsistent with the tax laws that allow taxpayers to avoid tax where there is no commercial substance.¹⁵⁴ In these instances, the only economic justification is to obtain a tax benefit.¹⁵⁵ To establish impermissible tax avoidance the GAAR, as encapsulated in sections 80A – L of the Income Tax Act shall be invoked.

¹⁵⁰ Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

¹⁵¹ Stiglingh, M(ed), Koekemoer, A., Van Schalkwyk, L., Wilcocks, J. S., De Swardt, R. D., & Jordaan, K. (2008). *Silke, South African Income Tax 2009*. LexisNexis on page 773.

¹⁵² Stiglingh, M (ed), Koekemoer, A., Van Schalkwyk, L., Wilcocks, J. S., De Swardt, R. D., & Jordaan, K. (2008). *Silke, South African Income Tax 2009*. LexisNexis on page 773.

¹⁵³ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 04 February 2021).

¹⁵⁴ Kujinga, B.T. (2013). *A Comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible tax avoidance in South Africa LLD Thesis University of Pretoria* at 44.

¹⁵⁵ Kujinga, B.T. (2013). *A Comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible tax avoidance in South Africa LLD Thesis University of Pretoria* at 42- 43.

4.3.2. Scope and Application of the current GAAR

The GAAR is to be applied if an avoidance arrangement is an “impermissible avoidance arrangement”. Kujinga indicates that the application of the GAAR has a dual purpose. On the one hand, it aims to curb impermissible tax avoidance. On the other, it informs taxpayers of the limits of permissible tax avoidance.¹⁵⁶

Section 80A describes what an “impermissible avoidance arrangement” is. This provision is vital as the rest of the GAAR provisions stem from section 80A.¹⁵⁷ Section 80L defines the terms as found in section 80A i.e.: “arrangement”, “avoidance arrangement”, “impermissible avoidance arrangement”, “party” and “tax benefit” which are used for the application of the GAAR:

- a) **“arrangement”** means any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property;¹⁵⁸
- b) **“avoidance arrangement”** means any arrangement that, but for this Part, results in a tax benefit;¹⁵⁹
- c) **“Impermissible avoidance arrangement”** means any avoidance arrangement described in section 80A.

¹⁵⁶ Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

¹⁵⁷ 80A. Impermissible tax avoidance arrangements. —An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and—

(a) in the context of business—

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

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

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

(c) in any context—

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

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

¹⁵⁸ Section 80L of the Income Tax Act 58 of 1962.

¹⁵⁹ Section 1 of the Income Tax Act 58 of 1962.

The rest of the provisions elaborate on the first two provisions. They deal specifically with procedural issues emanating from section 80A. Once all the section 80A requirements for an impermissible tax avoidance arrangement are present read together with section 80L, section 80B empowers the Commissioner to take a certain action. Section 80B(1)(f) provides a remedy for the Commissioner to determine the liability for tax as if the transaction had not been entered into or carried out, or “*in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit*”.¹⁶⁰ The Commissioner also has remedies to combat impermissible tax avoidance arrangements as contained in sections 80B(1)(a) to (e). The Commissioner has three remedies at his disposal:

- i) to ignore or incorporate any steps into the arrangement;
- ii) to recognise different parties as though as they are the same person; or
- iii) to reallocate or reclassify receipts, expenditure, rebates or accruals.¹⁶¹

d) The lack of commercial substance test

A salient characteristic of an abusive avoidance scheme is that if the scheme lacks economic or commercial substances.¹⁶² A general rule for determining whether an avoidance arrangement lacks commercial or economic substance is found in section 80C. The rule states that an avoidance arrangement lacks commercial substance where there is a significant tax benefit for a party but has less or no significant effect on the business risks or the net cash flow of that party.¹⁶³

The indicators that show that a scheme lacks commercial substance are where the situation with legal substance is different from the legal form,¹⁶⁴ or where there is round trip financing.¹⁶⁵ This relates to a transfer of funds between parties that results in a tax

¹⁶⁰ Section 80B(1)(f) of the Income Tax Act 58 of 1962.

¹⁶¹ Section 80F(1) of the Income Tax Act 58 of 1962.

¹⁶² Cassidy, J. (2009). The Holy Grail: The search for the optimal GAAR. *South African Law Journal*, 126(4), 749.

¹⁶³ Cassidy, J. (2009). The Holy Grail: The search for the optimal GAAR. *South African Law Journal*, 126(4), 740-779.

¹⁶⁴ Section 80C (2) of the Income Tax Act 58 of 1962.

¹⁶⁵ Section 80D of the Income Tax Act 58 of 1962.

benefit and a significant reduction, offset or elimination of business risk.¹⁶⁶ Thirdly, a scheme lacks commercial substance, when a tax-indifferent party or accommodating party is a party that receives an amount that has no impact on his tax liability. That amount would have had an impact on the tax liability of another party if the amount was received by that party instead of the tax-different party.¹⁶⁷

It is irrelevant if the parties are connected or not for the party to be a tax-indifferent party in relation to any other party.¹⁶⁸ What is not regarded as a tax-indifferent party or accommodating 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,¹⁶⁹ or if ongoing active business operations of at least eighteen months in connection with the avoidance arrangement are carried out through a substantial business establishment in the Republic or elsewhere.¹⁷⁰ Additionally, elements are present that have the effect of offsetting or cancelling each other. These elements are typically present when one transaction creates a significant tax benefit while another transaction effectively neutralises the undesired consequences of the first transaction.

e) Other provisions relating to the lack of commercial substance

The Commissioner is empowered to treat connected parties as though they are the same person when determining whether an avoidance arrangement lacks commercial substance or whether a tax benefit exists.¹⁷¹ Before determining any liability of a party for tax as envisaged in section 80B, the Commissioner must give notice and set out its reasons of an intention to invoke and apply the GAAR.¹⁷²

Once the taxpayer has received this notice, he may within 60 days reply to the notice but may request an extension to reply.¹⁷³ Once the Commissioner receives a reply or

¹⁶⁶ Cassidy, J. (2009). The Holy Grail: The search for the optimal GAAR. *South African Law Journal*, 126(4), 769.

¹⁶⁷ Section 80E of the Income Tax Act 58 of 1962.

¹⁶⁸ Section 80E (2) of the Income Tax Act 58 of 1962.

¹⁶⁹ Section 80E(3)(a) of the Income Tax Act 58 of 1962.

¹⁷⁰ Section 80E(3)(b) of the Income Tax Act 58 of 1962.

¹⁷¹ Section 80F(1) of the Income Tax Act 58 of 1962.

¹⁷² Section 80J(1) of the Income Tax Act 58 of 1962.

¹⁷³ Section 80J (2) of the Income Tax Act 58 of 1962.

when the reply period has expired the Commissioner has 180 days to raise further queries, withdraw the notice, or invoke the GAAR.¹⁷⁴ If additional information comes to the knowledge of the Commissioner the reasons for invoking the GAAR may be modified or a new notice may be issued if prior notice has been withdrawn.¹⁷⁵

4.3.3. Cases that Applied the GAAR

In November 2018, the judgment concerning the previous GAAR was released: *Sasol Oil v CSARS* (2018) ZASCA 153 (A) (*Sasol* case). It was maintained that the current GAAR was not considered by the court as the transactions occurred before its effective date.¹⁷⁶ The *SASOL* case applied the previous GAAR and did not consider the current prevailing GAAR. Pidduck hypothesises how the current GAAR could be applied and how the outcome would have been.

***Sasol Oil v CSARS* (2018) ZASCA 153 (A)**

i) Facts

The issue in dispute relates to the sale of a between Sasol Oil (Pty) Ltd ('Sasol Oil'), Sasol International Services Ltd (SISL) and Sasol Oil International Ltd (SOIL).¹⁷⁷ In terms of these agreements, SOIL agreed to procure crude oil and deliver it to SISL, in turn, SISL would sell and deliver crude oil to Sasol Oil.¹⁷⁸ In light of this arrangement, SARS viewed these agreements as simulated.¹⁷⁹ Consequently, additional assessments were issued in relation to the 2005 to 2007 years of assessment.¹⁸⁰ The Sasol group has been purchasing oil directly from foreign suppliers in the Middle East and Western Africa from 1991 to 1997. It has established businesses in different locations, including Sasol Trading International Ltd (STI) in the Isle of Man (IOM) and Sasol Trading Services Limited in the United Kingdom (UK) - which changed its name to SISL in 1998.

¹⁷⁴ Section 80J(3) of the Income Tax Act 58 of 1962.

¹⁷⁵ Section 80J (4) of the Income Tax Act 58 of 1962.

¹⁷⁶ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 2.

¹⁷⁷ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [3].

¹⁷⁸ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [3].

¹⁷⁹ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [4].

¹⁸⁰ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [4].

STI and SISL were both wholly-owned subsidiaries of Sasol International Holdings (Pty) Ltd (SIH) incorporated in South Africa.¹⁸¹ Before 2001, the Sasol group had been purchasing crude oil from suppliers subject to an agreement negotiated by STI.¹⁸² The oil was shipped to Sasol Oil in Durban. The procurement was restructured and STI purchased oil from the suppliers, but then sold it to SISL on a 'free on board, which in turn was sold and arranged shipment of the oil to Sasol Oil in Durban on a delivered ex ship basis.¹⁸³ SIH changed its name to Sasol Investment Company (SIC). SOIL was established in the Island of Man as a subsidiary of Sasol Oil.¹⁸⁴ As a consequence, the acquired crude oil remained the responsibility of SOIL, which sold the oil (on a 'free on board' basis) to SISL, who, as before, sold and delivered the oil to Sasol Oil.¹⁸⁵ The Commissioner attributed additional assessment for the sale that took place between SOIL and SISL and then to Sasol Oil in 2005, 2006 and 2007 years of assessment. It contended that the transactions were simulated.¹⁸⁶

The Commissioner contended that the reason for SOIL to sell the oil to SISL and for SISL to sell it back-to-back to Sasol Oil was a scheme designed to achieve avoidance of residence-based tax and that the real intention of the parties was the sale of oil to Sasol Oil by SOIL.¹⁸⁷ The view taken was that SISL was not intended to assume any commercial risk or purpose in the transaction. On this basis, SARS imputed the profits derived by SOIL to Sasol Oil (invoking section 9D of the Act to do so) and additional assessments were raised.¹⁸⁸ In the alternative, SARS stated that the transactions were entered into for purposes of tax avoidance as contemplated by the preceding GAAR (as set out in section 103(1) of the Act at the time).¹⁸⁹ Sasol Oil raised objections that were disallowed. As a consequence, the Court found that the contracts were a sham.

¹⁸¹ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [6].

¹⁸² *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [6].

¹⁸³ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [7].

¹⁸⁴ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [8].

¹⁸⁵ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [31].

¹⁸⁶ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [31].

¹⁸⁷ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [35].

¹⁸⁸ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [91].

¹⁸⁹ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [91].

Furthermore, the CommissionerC found that the real contract was for SOIL to sell the oil directly to Sasol Oil.¹⁹⁰

4.3.4. Hypothetical Application of the GAAR

Pidduck hypothesises how the current GAAR can be applied and does not consider how the common law application of avoidance of tax was applied. She explains each element of the GAAR. However, for this section, I will only lay out how the GAAR could have been applied in the SASOL as suggested by Pidduck.

4.3.4.1. Arrangement requirement

Pidduck posits that the sale of oil between SOIL and SISL and between SISL and Sasol Oil in the three relevant years of assessment does constitute an arrangement as envisaged in section 80L of the Act.¹⁹¹ It must be noted that the Commissioner identified the interposition of SISL between Sasol Oil and SOIL as the specific step of the arrangement to which the current GAAR should be applied.¹⁹²

4.3.4.2. Tax Benefit Requirement

Two arguments were brought that were made regarding a tax benefit in the SASOL case:

- i) The first argument relates to the comparison of oil procurement and management before and after the restructuring.¹⁹³
- ii) The second argument relates to the Commissioner's contention that the oil should have been sold directly to Sasol Oil by SOIL (removing the interposition of SISL).¹⁹⁴

¹⁹⁰ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [125].

¹⁹¹ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 6.

¹⁹² Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 6.

¹⁹³ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 7.

¹⁹⁴ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 8.

Having had the above enquiry, Pidduck is of the view that the avoidance arrangement did lead to a tax benefit.

4.3.4.3. Sole or main purpose requirement

The sole or main purpose of the arrangement in the Sasol case was not to obtain a South African tax benefit. It was however to manage the procurement and shipping of oil functions across two entities, resulting in the ultimate delivery of oil to Sasol Oil in Durban.¹⁹⁵ In determining and quantifying the tax benefit, the reasonability or viability of these transactions had to be considered. This present GAAR will succeed only where the correct scheme and taxpayer are identified by the Commissioner, together with viable alternatives.¹⁹⁶

4.3.4.4. Tainted elements

An avoidance arrangement must contain at least one of the five tainted elements for the current GAAR to be applicable.¹⁹⁷ The onus to prove this lies with the Commissioner. Pidduck posits that in the SASOL case the scheme was intended to achieve a commercial purpose. The following tainted elements were applicable in the SASOL case:

- i) **Abnormality:** The question that ought to be asked is whether there is a difference between a transaction entered into by the taxpayer and a transaction entered into for bona fide business purposes in the absence of a tax consideration? In the Sasol case, it is likely that the alternative arrangement identified by the Commissioner was not a commercially reasonable or viable option.

¹⁹⁵ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 8.

¹⁹⁶ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34 (3) at 8.

¹⁹⁷ Pidduck, T. M. (2020). The Sasol Oil case–Would the present South African GAAR stand up to the rigours of the court? *South African Journal of Accounting Research*, 34(3), at 11.

ii) **Lack of commercial substance:**¹⁹⁸ This element can be divided into a general lack of commercial substance tests and a list of indicators. Although the Commissioner identified that the risks in respect of ownership, delivery, and right of entitlement in relation to Sasol International Services UK (SISL) were hollow, Sasol Oil was able to provide commercial justification for the transaction and reasons for SISL control and management of the risk as owner while the oil was in transit.¹⁹⁹ Pidduck posits that this element would not have been successfully applied.²⁰⁰

iii) **List of Indicators**

- **Substance over form indicator:**²⁰¹ The Commissioner may have greater success in applying the GAAR as opposed to an attack in terms of the common law.²⁰²
- **The round-trip financing indicator:** ²⁰³ Pidduck posits that there may have been reciprocal funding between SISL and SOIL and to SISL and Sasol Oil. For purposes of the Sasol case, the round-trip financing indicator would likely have been met if the tax benefit requirement had also been met.²⁰⁴
- **Tax-indifferent party indicator:**²⁰⁵ It is maintained that since SISL is a tax-indifferent party, as it was incorporated in the IOM a “tax haven”.²⁰⁶ However, in terms of section 80E(3)(b) it is unlikely that it would be considered a tax-indifferent party if a controlled foreign company (that is considered to have a foreign business establishment, like SISL in the

¹⁹⁸ Section 80C (1) and section 80C (2) of the Income Tax Act 58 of 1962.

¹⁹⁹ *Sasol Oil v CSARS* (2018) ZASCA 153 (A), 81 SATC 117 at paragraph [42].

²⁰⁰ Pidduck, T.M. (2020) The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 10.

²⁰¹ Section 80C (1) and section 80C (2) of the Income Tax Act 58 of 1962.

²⁰² Pidduck, T. M. (2020). The Sasol Oil case–Would the present South African GAAR stand up to the rigours of the court? South African Journal of Accounting Research, 34(3), at 11.

²⁰³ Section 80D(1)(b)(i) of the Income Tax Act 58 of 1962.

²⁰⁴ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research* 34(3) at 13.

²⁰⁵ Section 80E of the Income Tax Act 58 of 1962.

²⁰⁶ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 13.

Sasol case) would not be considered a tax-indifferent party.²⁰⁷ Pidduck is of the view that this provision ought to be amended to improve the efficacy of the current GAAR.

- **Offsetting or cancelling indicator:**²⁰⁸ Pidduck mentions that in the Sasol case, there are elements within the transaction that may have the effect of offsetting or cancelling each other, specifically with regard to SISL. This is evident in sales revenues from Sasol Oil and corresponding expenditures of the oil transactions.

- **Creation of Rights or Obligations not at Arm's Length:**²⁰⁹ As a result of SISL not deriving a profit from the oil transactions, this arrangement had the effect of creating rights or obligations that would not have been created between parties dealing at arm's length. Pidduck maintains that it does not seem reasonable that any party to a transaction would have entered into such an arrangement (without reward or incentive) in the absence of the relationships it had with the other companies in the group.

- **Misuse or Abuse:**²¹⁰ Pidduck postulates that section 9D of the Income Act was not applicable,²¹¹ and if this is true then the imposition of SISL was artificial and that the arrangement was employed in a manner that was not intended by the legislator. If the representations by Sasol Oil are considered, it may be argued that the arrangement was not designed to misuse or abuse this section rather the arrangement was designed to manage the procurement and shipping of oil functions across two entities resulting in the ultimate delivery of oil to Sasol Oil in

²⁰⁷ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 13.

²⁰⁸ Section 80C(2)(b)(iii) of the Income Tax Act 58 of 1962.

²⁰⁹ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research*, 34(3) at 13.

²¹⁰ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research* 34(3) at 13.

²¹¹ Section 9 D of the Income Tax Act 58 of 1962.

Durban. Pidduck suggests that there is a strong case to be made that the arrangement may not be considered abusive of the legislation.²¹²

Having subjected the arrangement as contained in the SASOL Case, Pidduck concludes that this transaction may be considered to be an avoidance arrangement as it did result in a tax benefit.²¹³ She further suggests that there are alternative arguments that the tax benefit requirement was not satisfied.

4.5.3. The *ABSA Bank Limited and another v CSARS*

The most recent case of *ABSA v CSARS* is the only case that applied the current GAAR although not extensively. Its primary focus was the section 80J notice. Since it's one of those rare cases where the current GAAR was applied, it is worth mentioning in this research.

i) Facts

The matter relates to ABSA Bank Ltd and its subsidiary Absa Towers (Pty) Ltd who sought to review the decision of the Commissioner. The court had to determine if the “refusal to withdraw a section 80J notice is reviewable” and if it is possible, what jurisprudential grounds are available. Secondly, the court enquired if Absa was a “party” to “an impermissible arrangement” as envisaged under the GAAR. Lastly, if ABSA received a “tax benefit” as provided for under the GAAR.²¹⁴

ii) The transaction alleged to be an “arrangement”

Absa bought shares from PSIC 3 which bought preference shares in PSIC 4.²¹⁵ PSIC 4 invested in an offshore trust in which it received an interest in capital investment. When it received a dividend, which was free of tax, it paid it to PSIC 3 which then was

²¹² Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research* 34(3) at 14.

²¹³ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research* 34(3) at 15.

²¹⁴ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC.

²¹⁵ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [10-12].

paid to Absa.²¹⁶ What triggered SARS to the view that the transaction was a tax avoidance is the investment made by the trust.²¹⁷ Consequently, this led to Absa to be viewed as a “party” as defined in section 80L that received an impermissible tax benefit in the form of a tax-free dividend.²¹⁸ Absa contended that it was not aware of the intermediation between PSIC 4 and the trust. It therefore unknowingly participated in an impermissible tax avoidance arrangement. It further contended that it did neither have a tax avoidance motive in mind nor did it procure a tax benefit to which it was not entitled.²¹⁹

iii) **Was Absa a “Party”**

The section requires a taxpayer to “participate or take part” in an “impermissible arrangement”. Therefore, mere participation is insufficient as volition is required.²²⁰ The arrangement alleged which compromises several distinct transactions is considered to be a scheme. A scheme, therefore, requires unity to tie the several transactions into a deliberate chain.²²¹ A mere series of subsequent events do not constitute a chain. In the absence of any solid basis that Absa was more than an investor in preference shares, then it cannot be said that a scheme was established, even if it extends to some or all of the other entities.²²² The court made a striking remark in this respect and stated that:²²³

"The expectation of receiving dividend income which is free of tax is so banal a transaction that it cannot support a suspicion of pursuing an ulterior motive and thus cannot serve to broaden the compass of the participants in a scheme."

²¹⁶ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] at paragraph [13 – 15].

²¹⁷ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [16].

²¹⁸ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [16].

²¹⁹ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [17].

²²⁰ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [39].

²²¹ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [39].
See also *CIR v Louw* 1983 (3) SA 551 (A) at paragraph [572ff].

²²² *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [40].

²²³ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [41].

iv) Did Absa receive a tax benefit?

To ascertain this, the question to be posed is, but for the purchase of preference shares in PSIC 3, how might an anticipated tax liability be evaded? There is no basis for such a result. Accordingly, the conclusion is irrational.²²⁴

v) The Court held:

The premise of the section 80J notice was that Absa was liable to be taxed in respect of an impermissible arrangement despite its ignorance of the arrangement.²²⁵ That premise was incorrect in law because the factual premise did not establish that Absa was a part of this arrangement nor that it had an intention to escape an anticipated tax liability nor that it received relief from tax liability as a result of acquiring preference shares in PSIC 3.²²⁶ SARS was unsuccessful in its claims. The purpose of section 80J Notice was to ensure that the new GAAR would not be applied lightly or “automatically” by auditors,²²⁷ while at the same time warning taxpayers, at a relatively early stage in the proceedings, that the application of the new GAAR was under consideration.

4.4. Consequences of Impermissible Tax Avoidance

Section 80B of the GAARS imposed consequences that the Commissioner may impose for impermissible tax avoidance. Amongst other remedies, the Commissioner can:²²⁸

- 4.4.1.** recharacterise the arrangement;
- 4.4.2.** assess the taxpayer on the tax in question; or
- 4.4.3.** application of severe penalties in terms of section 223 of the Tax Administration Act Understatement Penalty Table:

²²⁴ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [43].

²²⁵ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC at paragraph [47].

²²⁶ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC paragraph [48].

²²⁷ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 28 July 2021).

²²⁸ Section 80B (a) – (f) of the Income Tax Act 58 of 1962.

<i>Behaviour</i>	<i>Standard case</i>	<i>If obstructive, or if it is a 'repeat case'</i>	<i>Voluntary disclosure after notification of audit or criminal investigation</i>	<i>Voluntary disclosure before notification of audit or criminal investigation</i>
'Substantial understatement'	10%	20%	5%	0%
Reasonable care not taken in completing return	25%	50%	15%	0%
No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
'Impermissible avoidance arrangement'	75%	100%	35%	0%
Gross negligence	100%	125%	50%	5%
Intentional tax evasion	150%	200%	75%	10%

4.5. Conclusion

This chapter has illustrated the development of the South African GAAR through history from its inception to its current state. It has indicated how the previous GAAR had shortfalls and weaknesses which consequently had to be remedied. The initial GAAR as contained in section 90 of the Income Tax Act 31 of 1941 fell short in combating tax avoidance in that it had a wide scope of application as it did not have an indicator of impermissible tax avoidance which creates uncertainty. Consequently, the *Commissioner for Inland Revenue v King* is a pivotal decision that necessitated the amendment of the previous GAAR.

After the previous Income Tax Act was subsequently replaced by the current Income Tax Act 58 of 1962, the subsequent GAAR as contained in section 103 of the Income Tax Act 58 of 1962 was found to be obsolete as it created ambiguity in respect of its objective as it was an inconsistent and ineffective deterrent for tax avoidance. After several commissions that section 103 GAAR was amended and the new GAAR was introduced as contained in section 80A to L of the Income Tax Act 58 of 1962. With its historical development of the GAAR can it be said that the current GAAR effectively deter taxpayers from conduct that is impermissible?

This chapter has further set out how the application of the current GAAR. As mentioned previously, since the current does not enjoy judicial consideration, Pidduck hypothesises the application of the GAAR in respect of the *Saso/ v CSARS* decision to ascertain how the outcome would have been having the current GAAR been applied. Furthermore, the facts and decision of *ABSA v CSARS*²²⁹ were set out as it is one of, if not the only case that a court considered the GAAR. However, the manner the GAAR was applied raises queries as to whether the GAAR, in its current state, is sufficiently effective to combat tax avoidance. The next chapter will address this query and ascertain if the current GAAR is sufficient to effectively combat tax avoidance.

²²⁹ *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC.

CHAPTER 5: THE GAAR'S EFFICACY AND TAX CERTAINTY

5.1. Introduction

Up to this juncture, this research has elaborated with emphasis that a taxpayer has the right to arrange his tax affairs to trigger the least amount of tax payable to the extent that it is within the confines of the tax laws.²³⁰ It has further been noted that a taxpayer does not enjoy free reign to avoid taxes without restriction as SARS is mandated to generate state revenue and will not allow for taxpayers to avoid taxes where it is impermissible.²³¹ The three main anti-avoidance measures which aim to curb impermissible tax avoidance are common law measures, specific anti-avoidance measures and more specifically the general anti-avoidance rules (the GAAR).²³² Over the years the GAAR has been subjected to constant improvement as it displayed features of inadequacy consequently falling short of efficacy.²³³

A good taxation system, as Adam Smith would maintain, is centred around four fundamental principles, ie fairness, certainty, convenience and efficiency. As a result of the deficiencies contained in the previous GAARs, its efficacy has been in question as it poses major issues primarily on one of the canons of taxation, namely the taxpayer's right to certainty. He mentions that this right is predicated by the certainty of the time and manner of paying taxes including the amount to be paid.²³⁴

In this chapter, I explore whether the current GAAR has been developed sufficiently to be functional and efficient to combat tax avoidance arrangements. I do this by examining whether the efficacy of the GAAR poses concerns to the canon of taxation,

²³⁰ Croome, B.J., Oguttu, A. W., Muller, E., Legwaila, T., Kolitz, M., Williams, R. C., & Louw, C. (2013). *Tax law: An introduction* (Juta, Claremont) at 104.

²³¹ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?., *South African Journal of Accounting Research* 34(3) at 5.

²³² Section 3 of the South African Revenue Service Act 34 of 1997.

²³³ Pidduck, T.M. (2020). The Sasol Oil case – Would the present South African GAAR stand up to the rigours of the court?.. *South African Journal of Accounting Research* 34(3) at 5.

²³⁴ Smith, A & McCulloch, J. R.. (1863) *An inquiry into the nature and causes of the wealth of nations*. Edinburgh: Adam and Charles Black at 1043– 1044.

particularly the right to certainty. Furthermore, I further analyse the impact on the taxpayer's right to certainty caused by the GAAR. Since the current GAAR has not enjoyed much judicial consideration, I explore the *Sasol v CSARS* decision which hypothesises how the current GAAR could be applied if it were applied. Finally, I consider the decision of the *ABSA v CSARS* which is one of the rare cases where the current GAAR was applied.

5.2. Criticisms for Efficacy of the GAAR

The current GAAR, as now contained in section 80A – 80L of the Income Tax, has been in operation since 2006. However, there has been limited judicial consideration of its application to date.²³⁵ More often than not courts prefer invoking other provisions of the Income Tax Act as opposed to relying on the specific provision that primarily purports to combat impermissible tax avoidance.²³⁶ Broomberg observes in respect to the uncertainty and application of the GAAR and maintains:²³⁷

“[uncertainty] is now in an even more vulnerable condition. One can therefore anticipate a hostile judicial reaction and this could prove costly to the fiscus [my emphasis].”

Whether the efficacy of the GAAR is a result of the certainty or the lack thereof, as set out below.

5.2.1. Lack of Certainty

One of the reasons the GAAR's efficacy is in question is attributed to and threatened by the concept of certainty. The application of the GAAR appears to lack certainty as it displays features of inefficacy.²³⁸ Accordingly, the right a taxpayer has to arrange his affairs so that less tax liability is triggered is intrinsically intertwined with the taxpayer's right to certainty.

²³⁵ Kujinga, B. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42-47. See also Liptak, E. (2016). Failure, more failure and some success: GAAR ten years on. *Taxtalk*, (60) 60. Until recently in the *ABSA Bank Limited and another v CSARS* (2019-21825 [P]) [2021] ZAGPPHC, the current GAAR has never been extensively applied in South African courts.

²³⁶ Section 103 of the Income Act 58 of 1962.

²³⁷ Broomberg, EB. (2007), *Tax Planning, Then and Now – II*, 21 *Tax Planning*.

²³⁸ Kujinga, B.T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

It has been maintained that canons of taxation are essential to the proper functioning of an effective tax system. In this regard, Adam Smith made salient remarks and stated that the tax which each person ought to pay must be “certain” and rational.²³⁹ He further added that the time and manner of payment must be simple and transparent to the taxpayer including the amount to be paid.²⁴⁰ He further maintains that such information must be unambiguous to the taxpayer or any other person. Uncertainty of taxation breeds “insolence” and “corruption” of “unpopular men”, even instances where they are not insolent or corrupt.²⁴¹

Adam Smith’s remarks suggest that where there is no certainty in the time of payment, manner of payment, the quantity of payment, this can lead to insolence and corruption thus posing a great threat to the proper functioning of an effective tax system, particularly combating tax avoidance. In the same vein, Tredoux and van Zyl state that where it is contemplated that an amendment to legislation would impact negatively on a taxpayer's right to tax certainty, the taxpayer must be allowed to arrange his affairs before the promulgation of such an amendment so as not to be deprived of his rights arbitrarily.²⁴² They further maintain that the amendments to tax legislation cannot be applied retrospectively to collect lost taxes.²⁴³

5.2.2. Uncertainty in the Concept of Impermissible Tax Avoidance

The second argument raised in respect of the efficacy of the is that there is no precise definition of impermissible tax avoidance. Bearing the lack of a precise definition in mind, Wheatcroft argues that no country has managed to distinctly establish how tax

²³⁹ Smith, A. (1937). *The wealth of nations [1776]* (Vol. 11937) 426.

²⁴⁰ Smith, A. (1937). *The wealth of nations [1776]* (Vol. 11937). 426.

²⁴¹ Smith, A. (1937). *The wealth of nations [1776]* (Vol. 11937). 426.

²⁴² Tredoux, L., & Van Zyl, S. P. (2018). Some drastic measures to close a loophole: the case of *Pienaar Brothers (PTY) LTD v Commissioner for the South African Revenue Service* (87760/2014)[2017] ZAGPPHC 231 (29 May 2017) and the targeted retroactive amendment of section 44 of the Income Tax Act 58 of 1962. *PER: Potchefstroomse Elektroniese Regsblad*, 21(1), 24.

²⁴³ Tredoux, L., & Van Zyl, S. P. (2018). Some drastic measures to close a loophole: the case of *Pienaar Brothers (PTY) LTD v Commissioner for the South African Revenue Service* (87760/2014)[2017] ZAGPPHC 231 (29 May 2017) and the targeted retroactive amendment of section 44 of the Income Tax Act 58 of 1962. *PER: Potchefstroomse Elektroniese Regsblad*, 21(1), 26.

is calculated based on the information given.²⁴⁴ As a result of the fact that there are no direct indicators of impermissible tax avoidance, this in effect creates uncertainty to the taxpayer's right to certainty.²⁴⁵ The fact that there is no clarity on the exact elements of impermissible tax avoidance translates to the fact that the GAAR has been drafted without the focus of its target thus posing questions to its efficacy.

Since sections 80B-L of the Income Tax Act elaborates with particularity on the provisions in section 80A, Kujinga opines that this contributes to the GAAR being complex and uncertain.²⁴⁶ The reason he posits regarding the uncertainty is that numerous provisions of the GAAR are derived from a foreign jurisdiction and there are no South African precedents.²⁴⁷ When section L is read with section H it becomes apparent that a single part of a composite avoidance arrangement can be attacked.²⁴⁸ Moreover, Legwaila postulates that the *NWK* case enables SARS to not apply the GAAR but to rely on the 'substance over form' doctrine.²⁴⁹

5.2.3. Judiciary's Role

The third argument in respect to the GAARs efficacy is that the current GAAR does not enjoy judicial consideration as the courts seldomly the GAAR.²⁵⁰ This effectively limits the efficacy of the GAARs as the courts are either reluctant to enhance the provisions of the GAAR and/or they do not engage in the exercise of limiting the scope of the broad and uncertain GAARs.²⁵¹ Kujinga states that the uncertainty created by

²⁴⁴ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

²⁴⁵ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

²⁴⁶ Kujinga, B. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

²⁴⁷ Kujinga, B. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

²⁴⁸ Kujinga, B. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 43.

²⁴⁹ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in Commissioner for the South African Revenue Service v *NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 117.

²⁵⁰ Kujinga, B. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

²⁵¹ Kujinga, B.T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada.. *Comparative and International Law Journal of Southern Africa* 47(3) at 451.

the current GAAR is to be interpreted restrictively by the courts.²⁵² This has a paradoxical effect in making the GAAR effective, their interpretation has to be limited.

5.3. Criticisms against Certainty

Although the GAAR may contain uncertainty in some respects, there are arguments levelled against the fact that uncertainty of the GAAR does not threaten the efficacy of the GAAR. Below are some of those arguments.

5.3.1. Certainty is Immaterial

As stated above, Adam Smith mentions that certainty is deemed important in the field of taxation as it makes up one of the canons of taxation. It is, however, not as material in the case of the applicability of the GAAR. In its Discussion Paper, SARS refers to the *Challenge v CIR*. In this decision, the court was of the view that certainty and predictability are significant concepts in the tax field, although they are not absolute values.²⁵³ It has been argued that the GAAR should not be flawless to be effective.

In support of this view, Kujinga postulates that as a result of the application of the GAAR being uncertain, this can serve as a deterrent to opposing impermissible tax avoidance by restricting tax-avoidance transactions to permissible transactions.²⁵⁴ He further maintains that attaining absolute certainty is virtually impossible as the legislature cannot predict all circumstances that may arise regarding tax avoidance.²⁵⁵ It is conceded that on the one hand, the GAAR will have core situations where there will be no question about their application and on the other hand there will be situations

²⁵² Kujinga, B.T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada.. *Comparative and International Law Journal of Southern Africa*, 47(3) at 453.

²⁵³ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 28 May 2021).

²⁵⁴ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 449.

²⁵⁵ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 449.

where their applicability will be uncertain.²⁵⁶ Such uncertainty ought to be limited because if it is not then it renders the GAAR incapable of reasonably informing taxpayers of the limits of their right to avoid tax.²⁵⁷

5.3.2. Duplicitous

The second criticism cited by Kujinga against uncertainty is that uncertainty can be duplicitous in that it affects both the taxpayer, as they find it difficult to follow the law, and the tax authorities as they are faced with the issue of determining unequivocally what is illegal and what is at the fringe of tax law'.²⁵⁸ Notwithstanding that SARS has "extensive" and "tremendous" powers, it cannot use the GAAR to identify impermissible tax avoidance.²⁵⁹ This is because the conduct of SARS cannot be construed as "law of general application" for the limitation of a taxpayer's rights.²⁶⁰ Instead, SARS conduct can be challenged by relying on section 6 of the Promotion of Administrative Justice Act.

SARS may find itself challenging transactions that are not subject to being challenged which also leads to the GAAR's inefficacy.²⁶¹ As seen in *CIR v Conhage*²⁶² the loss in challenging a legitimate transaction was seen as a weakness of the previous GAAR as contained in section 103 of the Income Tax Act.²⁶³

²⁵⁶ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

²⁵⁷ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

²⁵⁸ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

²⁵⁹ Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 239.

²⁶⁰ Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 239.

²⁶¹ Kujinga, B.T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3) at 450.

²⁶² *Commissioner of Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA).

²⁶³ Kujinga, B.T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3) at 450.

5.4. Conclusion

This chapter establishes whether the current GAAR is effective to combat tax avoidance arrangements. It identifies certainty as a major threat to the efficacy of the GAAR. As a result of this threat, the GAAR in its current state cannot be said to be an effective tool to combat tax avoidance. The concept of impermissible tax avoidance is also not clearly defined thus creating uncertainty. Be that as it may, some arguments are also levelled which maintained that certainty is not or should not be considered as an issue that affects the efficacy of the GAAR.

The issue of the efficacy of the GAAR negatively impacts the taxpayer as a result of its uncertainty. It also negatively affects SARS as it impedes its objective and mandate of collecting taxes to generate state revenue. In this last chapter, I explore some recommendations regarding the efficacy of the GAAR before surmising and concluding the essence of this research.

CHAPTER 6: RECOMMENDATION AND CONCLUSION

6.1. Introduction

The tug-of-war between the taxpayer and revenue receiver ('SARS') in respect to the avoidance of tax liability has been an issue of contention even before the *Duke of Westminster* case, a quintessential case that brought light to taxpayers that they can arrange their affairs to attract minimal tax liability insofar as it is within the confines of the law.

Some taxpayers have opted to engage in illicit activities to attract minimal tax liability where they have been unable or have failed to arrange their affairs accordingly.²⁶⁴ This is regarded as tax evasion and any such taxpayer who engages in such conduct shall be penalised either by a fine or imprisonment. Although permissible tax avoidance and tax evasion both have the effect of reducing state revenue, tax evasion is illegal whereas tax avoidance is permissible. Chapter 2 of this study distinguishes the different concepts relating to escaping taxes. This distinction is particularly important in establishing whether the current GAAR is efficient in combating tax avoidance.

The doctrine of 'substance over form' as a common law tool to combat the avoidance of tax is not efficient as it is broad in its application.²⁶⁵ Consequently, the *NWK* decision drastically impacted this doctrine when the simulation test was abandoned by the SCA. The Court suggested that an examination of the 'commercial sense' or purpose of the transaction was required. It is apparent that the simulation test or the 'substance over form' doctrine falls short of efficacy in combating tax avoidance, and as a result, the court in *NWK* suggested that the test be altered. Despite the shortfall of the 'substance over form' doctrine, Legwaila postulates that on the strength of the *NWK* case, the

²⁶⁴ Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 229.

²⁶⁵ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*. *SA Mercantile Law Journal*, 28(1), 112-131.

NWK case enables SARS to not apply the GAAR but to rely on the ‘substance over form’ doctrine.²⁶⁶

6.2. The Analysis of the GAAR

The GAAR was adopted to combat impermissible tax avoidance and to ensure that SARS is enabled to collect revenue and recover taxes from taxpayers effectively. This study traces the development of the GAAR from its initial state as contained in section 90 of the Income Tax Act 31 of 1941. However, as indicated in chapter 3 of this study, section 90 GAAR had a wide scope in its application as it did not have indicators of impermissible tax avoidance.²⁶⁷ This created uncertainty in its application.

Although the previous Income Tax Act 31 of 1941 and the previous GAAR were replaced by the current Income Tax Act 58 of 1962 and the subsequent GAAR was contained in section 103, it was found to be an ineffective deterrent for tax avoidance, as it still contained elements of uncertainty.²⁶⁸ After several commissions, section 103 GAAR was amended and the new GAAR was introduced as contained in section 80A - L of the Income Tax Act 58 of 1962.²⁶⁹ Similar to both the section 90 GAAR²⁷⁰ and the section 103 GAAR, the current GAAR is also heavily smeared with uncertainty.²⁷¹ It has been the core subject of this study to ascertain if the current GAAR as contained in section 80A-L is sufficiently effective to combat tax avoidance.

²⁶⁶ Legwaila, T. (2016). The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd.* SA *Mercantile Law Journal*, 28(1), 117.

²⁶⁷ *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) at 191.

²⁶⁸ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

²⁶⁹ *Report 49 of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (RP 34/1987) <http://www.treasury.gov.za/publications/other/katz/3.pdf> (accessed 14 April 2020). See also *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

²⁷⁰ As contained in Section 90 of the Income Tax 30 of 1941.

²⁷¹ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

This study has found that, firstly, the implementation of the GAAR is uncertain and therefore poses a threat to a taxpayer's right to certainty.²⁷² Therefore, the right for a taxpayer to arrange his affairs to reduce his tax liability is affected, since such a right is interwoven with the right to certainty.²⁷³ As indicated in chapter 5, the right to certainty means that the tax payable by the taxpayer and collected by SARS ought to be definite and just. If there is a lack of certainty, corruption and insolence will be practised.

Secondly, the GAAR can be perceived as inefficient due to the lack of a distinct definition of impermissible tax avoidance. However, there are arguments that state that lack of certainty does not affect the efficacy of the GAAR as it is not material during the application of the GAAR.²⁷⁴ The application of the GAAR ought not to be perfect for it to be effective. Uncertainty of the GAAR can be a deterrent from opposing impermissible tax avoidance. Secondly, uncertainty affects both the taxpayer who finds it impracticable to abide by the law and tax collectors who are met with the challenge of establishing what is lawful or not.

Lastly, the courts have applied the GAAR with much reluctance as indicated in this research. Since courts have not applied the GAAR intensively/ extensively, this research considered Pidduck's findings, who applied the current GAAR in a hypothetical sense under the *Sasol* case and concluded that the avoidance agreement by SASOL and SOIL did lead to a tax benefit. However, the arrangement was not to solely obtain a tax benefit but was to manage the procurement and shipping of the oil to Durban. The avoidance agreement must include the five tainted elements for the GAAR to apply.

²⁷² *What does Government Spend Money On?* <http://www.statssa.gov.za/?cat=34> (accessed 05 March 2021); see also *New or higher Taxes won't Work and could be Unconstitutional* <https://www.bbrief.co.za/2019/12/18/new-or-higher-taxes-wont-work-and-could-be-unconstitutional/> (accessed 05 March 2021).

²⁷³ Kujinga BT (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

²⁷⁴ *CIR v Challenge Corporation Ltd* [1987] AC 155.

Although seldom, courts have acknowledged that taxpayers are entitled to arrange their affairs when striving to obtain the utmost tax benefit insofar as it does not constitute impermissible tax avoidance.²⁷⁵ In the same vein, it has been made apparent by the courts that SARS is on a mission to combat schemes that aim to compromise its object of collecting taxes as revenue.²⁷⁶

6.2.1. The distinction between Permissible and Impermissible Tax Avoidance

In addressing the issue of whether the current GAAR is sufficiently efficient to combat tax avoidance, this study considered whether the distinction between permissible tax avoidance and impermissible tax avoidance is clear enough to not create uncertainty. It is found that what is considered to be impermissible conduct by a taxpayer to avoid tax liability has not been distinguishable. As a result, Wheatcroft echoed Adam Smith's remarks regarding the fact that certainty is necessary, particularly in defining the concept of impermissible tax avoidance. This study maintains the cause of uncertainty in defining impermissible tax avoidance is a result of the fact that there are no direct indicators of impermissible tax avoidance.

6.2.2. Taxpayers' Right to Certainty

It is noted in this study that the efficacy of the GAAR cannot be established in isolation from the canons of taxation as Adam Smith remarked that these are the pillars of a well-functioning tax system. An effective GAAR poses a huge issue on taxpayers' right to certainty in the time of payment, manner of payment, the quantity of payment, as this may lead to insolence and corruption.²⁷⁷ Some arguments have been brought to the effect that the issue of certainty is immaterial as achieving absolute certainty is practically impossible. However, sufficient certainty to the application of the GAAR must be attained so that taxes recovered from taxpayers are not questionable.

²⁷⁵ *CIR v Conhage (Pty) Ltd* at paragraph [15].

²⁷⁶ Claassen L, *Sars to Crack Down on Tax Avoidance Schemes* <https://www.moneyweb.co.za/news/south-africa/sars-to-crack-down-on-tax-avoidance-schemes/> (accessed 04 November 2020).

²⁷⁷ *Discussion Paper of 2005 in Line with Section 103 of the Income Tax Act* <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf> (accessed 14 July 2021).

6.2.3. SARS and the GAAR's Efficacy

Not only is the taxpayer affected negatively by the inefficacy of the GAAR but also this study has demonstrated that as a result of the inefficacy SARS is also negatively impacted. This is made apparent in the arguments relating to certainty as duplicitous in that it is difficult to determine what is illegal and what is at the fringe of tax law'.²⁷⁸ As a result, it is also mentioned that it would be difficult for SARS to challenge a transaction as a result of the ineffective GAAR.²⁷⁹

6.3. Recommendations

This study has shown that the 'substance over form' doctrine as a common law tool to combat tax avoidance as well as the current GAAR is not sufficiently effective to combat impermissible tax avoidance. This is as a result that not only is the taxpayer's right to certainty affected by the GAAR's inefficacy but also it has a negative bearing on SARS' mandate of collecting taxes.

Below are some suggestions that can be implemented to improve the efficacy of the GAAR:

6.3.1. The Commissioner ought to assess the arrangement or transaction identified properly for the GAAR to be applied effectively.²⁸⁰

6.3.2. Certain provision that poses a threat to the efficacy of the GAAR by creating uncertainty ought to be amended to fine-tune the application of these provisions. An example is that impermissible transactions are defined as transactions which were "entered into or carried out by means or in a manner

²⁷⁸ Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450.

²⁷⁹ *Commissioner of Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA). See also Kujinga, B. T. (2014). Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada. *Comparative and International Law Journal of Southern Africa*, 47(3), 450. See also Fritz, C., & Van Zyl, S. P. (2019). Taxpayer Revolt: Withholding Taxes Due vs the Right of Recourse of SARS against a Defaulting Taxpayer. *THRHR*, 82, 229.

²⁸⁰ Pidduck, T. M. (2020). The Sasol Oil case—Would the present South African GAAR stand up to the rigours of the court? *South African Journal of Accounting Research*, 34(3).

which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit.²⁸¹ What is considered to be normal is not sufficiently defined. It is therefore the court's prerogative to define this term. Kujinga posits that it is through litigation on the provisions of the GAAR that will bring clarity and consequently improving its efficacy.²⁸²

Pidduck suggests that section 80E which contains the definition of a "tax-indifferent party" should be amended to cater for schemes which were controlled foreign companies may be used as vehicles to avoid tax as indicated in the *Sasol* case.²⁸³

6.3.3. As indicated above the current GAAR has not enjoyed ample consideration as a result of its inefficacy. Courts have not interpreted the provisions of the GAAR to establish judicial precedents.²⁸⁴ In this regard, it is advisable that commissions such as the Margo commission and the Katz commission, which led to the production of the Sars Discussion paper of 2005, interpret potentially problematic provisions of the GAAR.

6.4. Conclusion

The current South African GAAR has been developing for over eight decades to date as it fell short of the standard of efficacy, as indicated in this study. Notwithstanding the duration of its development in history, its application still fails to effectively combat tax avoidance. This study indicates that the current GAAR has been in operation since 2005 and yet courts shy away from making use of the GAAR provision. The main reason for courts to not rely specifically on the GAAR is that its application is still encumbered by uncertainty.

²⁸¹ Section 80A(a)(i) of the Income Tax Act 58 of 1962.

²⁸² Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 45.

²⁸³ Section 80E (2) of the Income Tax Act 58 of 1962.

²⁸⁴ Kujinga, B.T. (2017). Thesis theory-searching for certainty. *TAXtalk*, (63), 42.

Across the globe, the GAAR is known to be instrumental in combating impermissible tax avoidance. There is no knowing whether upon effecting changes to the current GAAR, it will be sufficiently effective to combat tax avoidance. However, as seen in this study, each amended version tends to bring the GAAR toward some form of efficacy.

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