AN ANALYSIS OF THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE: LESSONS FROM NEW ZEALAND CASE LAW

by

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ABSTRACT

Tax is a major source of revenue for most countries worldwide and non-compliance by taxpayers in the form of tax avoidance causes a significant loss of tax revenue. South Africa has legislated a GAAR into its tax legislation in an attempt to combat tax avoidance. However, the effectiveness of the South African GAAR has been criticised since it was first introduced. This criticism continues even after its most recent amendment and is compounded by the fact that there is limited guidance on its interpretation and application, as there has only been one reported case in which the GAAR has been applied since its amendment in 2006.

This study followed a qualitative research approach known as 'structured pre-emptive analysis' to use lessons from the New Zealand GAAR to propose reform to the South African GAAR to improve its efficacy. The structured pre-emptive approach combined both doctrinal and reform-oriented research and allowed for a triangulation of the findings to improve quality and rigour of the research.

The findings of this study revealed the following notable areas of improvement for the South African GAAR. Firstly, a different interpretation is required when determining whether a taxpayer may be considered party to an arrangement where motive and volition should not inform whether or not a taxpayer is party to an arrangement. Secondly, the inquiry into the purpose of an arrangement should be amended from the current sole or main purpose requirement to requiring a purpose that is more than merely incidental to the arrangement. This requirement should be further improved by interpreting it as solely objective, thus disregarding the taxpayer's stated intention. Thirdly, the current fourth requirement of the South African GAAR (the tainted elements) should inform the tax benefit requirement, which would result in the South African GAAR containing three instead of four requirements, making it less onerous to apply. Lastly, further guidance should be provided regarding the interpretation and application of the South African GAAR by defining undefined terms in areas where uncertainties could give rise to a level of subjectivity and inconsistent judicial interpretation.

Keywords: Taxation, general anti-avoidance rule, tax avoidance, impermissible avoidance arrangement, structured pre-emptive analysis

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LIST OF ABBREVIATIONS AND ACRONYMS

Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
GAAR	General anti-avoidance rule
Income Tax Act	Income Tax Act No. 58 of 1962
Income Tax Act 2007	Income Tax Act No. 97 of 2007
OECD	The Organisation for Economic Co-operation and Development
SARS	South African Revenue Service

CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION AND BACKGROUND

Tax is a major source of public revenue for most countries including South Africa (Dare, Du Plessis & Jansen, 2019:328). However, governments worldwide have been experiencing significant losses of tax revenue due to non-compliance by taxpayers (Dare *et al.*, 2019:1). The amount of tax revenue lost globally due to non-compliance in the form of tax avoidance has been conservatively estimated at around 100 to 200 billion dollars annually (OECD, 2020:1). In order to protect this important source of fiscal revenue, tax authorities worldwide are engaged in a constant struggle to ensure taxpayer compliance while fighting against tax avoidance (Pidduck, 2017:1). Discussions of tax avoidance usually begin with an attempt to define and distinguish the concepts of 'tax avoidance' and 'tax evasion' (SARS, 2005:2). Tax avoidance encompasses all actions that are not illegal but have the effect of reducing, eliminating or deferring a tax liability (Tretola, 2017:2). Conversely, the Organisation for Economic Co-operation and Development (OECD) has defined tax evasion as illegal arrangements where liability to tax is hidden or ignored (OECD, 2021:1). Despite the distinction between tax avoidance and tax evasion, there is still a fine line between the legality of transactions to reduce tax liability, which is often referred to as tax planning, and impermissible tax avoidance (Pidduck, 2017:1; SARS, 2005:2). Tax planning is a legitimate process whereby a taxpayer protects their property from unnecessary erosion by tax, while impermissible tax avoidance has been described as the use of artificial arrangements designed to exploit loopholes in tax legislation in order to achieve results contrary to those intended by parliament (de Koker & Williams, 2021:par.19.4; SARS, 2005:4). Impermissible tax avoidance is therefore illegal as it involves the abuse of tax legislation.

In addition to the losses of tax revenue, other harmful consequences of impermissible tax avoidance include a growing disrespect of the tax system, increasingly complex tax legislation and an unfair shifting of the tax burden (OECD, 2020:1; SARS, 2005:9-13). Governments worldwide have responded to impermissible tax avoidance through common law doctrines, Specific Anti-avoidance Rules as well as General Anti-avoidance Rules (GAARs). Many countries use GAARs to curb impermissible tax avoidance despite the fact that GAARs have been the subject of criticism and have even been described as a "blunt instrument in income tax legislation"(Prebble & McIntosh, 2015:1011). South African income

tax legislation includes both Specific Anti-avoidance Rules and a GAAR because the flexibility of transactions entered into by taxpayers to minimise their tax liability makes it difficult to combat tax avoidance with Specific Anti-avoidance Rules on their own (SARS, 2005:1). The focus of this study will be on analysing the efficacy of the current South African GAAR in combating impermissible tax avoidance.

The current South Africa GAAR is included in Sections 80A to 80L of the Income Tax Act No. 58 of 1962 (the Income Tax Act) and is a third generation GAAR (Kujinga, 2013:3). The GAAR was initially introduced in 1941 as Section 90 of the Income Tax Act No. 31 of 1941 and has since been amended several times, with the most recent and significant amendments being in 1996 and 2006 (Calvert, 2011:3; SARS, 2005:38). These amendments were necessitated by the everchanging economic environments and the increasingly complex and sophisticated methods that taxpayers were using to engage in impermissible tax avoidance (Calvert, 2011:4; SARS, 2005:1). The 1996 amendment resulted in Section 103(1) of the Income Tax Act (referred to as the previous GAAR).

The previous GAAR was briefly summarised in a document issued by the South African Revenue Services (SARS) entitled 'Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962' (Discussion Paper). Under the previous GAAR, before an arrangement could be seen as an impermissible avoidance arrangement, four key elements were required to be present (de Koker & Williams, 2021:par.19.14; SARS, 2005:38). Those elements are summarised as follows:

1. There must be a transaction, operation or scheme (the Scheme Requirement);
2. The transaction must result in the avoidance, reduction or postponement of a tax (the Tax Effect Requirement);
3. The transaction must have been entered into or carried out in a manner not normally employed for business purposes other than obtaining a tax benefit having regard to the circumstances (the Abnormality Requirement); and
4. The transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the Purpose Requirement) (SARS, 2005:38).

Since its inclusion into the Income Tax Act, the previous GAAR had been the subject of criticism and had even been labelled an ineffective deterrent against impermissible tax

avoidance schemes (Pidduck, 2020:256; SARS, 2005:41). Other weaknesses were identified in the Discussion Paper and have also been the subject of several studies (Calvert, 2011; Kujinga, 2013; Pidduck, 2020). The weaknesses are summarised as follows:

The abnormality requirement - The first issue with this requirement is the assumption that the tax world consists of only two types of transactions; those that are *bona fide* business transactions and those that are designed for impermissible tax avoidance (SARS, 2005:42). The second issue lies in the fact that transactions cease to be abnormal if they became commercially acceptable, which makes it difficult for SARS to prove their abnormality (de Koker & Williams, 2021:par.19.4).

The purpose requirement - The weakness created by this requirement was mainly due to the fact that it was considered a subjective test that required SARS to look at the intention of the taxpayer for entering into a transaction (SARS, 2005:44). The problem created by this requirement was also identified in a document issued by SARS entitled 'Draft Comprehensive Guide to the GAAR' which acknowledged the need for a more objective standard (SARS, 2010).

Procedural and administrative issues - The above weaknesses were compounded by the uncertainties surrounding the scope of application of the section and the powers conferred to SARS in applying the GAAR (SARS, 2005:44).

Following the critical commentary about its efficacy, the previous GAAR was repealed and replaced with Sections 80A-80L of the Income Tax Act (the current GAAR) in 2006 (Kujinga, 2013:103). The 2006 amendments were instituted by Section 34(1) of the Revenue Laws Amendment Act No. 20 of 2006 and apply to transactions entered into on or after 2 November 2006. Nevertheless, criticism of the efficacy of the current GAAR is still evident. According to Liptak (2017:1), the current GAAR has failed in its primary mission of being a more effective deterrent against impermissible tax avoidance because it is a long and complex piece of legislation. The current GAAR has also been the subject of criticism because it has borrowed some of its terms from the previous GAAR (de Koker & Williams, 2021:par.19.4). For instance, both the abnormality and purpose requirements have been retained despite having been identified as key weaknesses of the previous GAAR (Katz, 1996:par.11.2.2; Margo, 1988:par.27.28). It is therefore possible for the current GAAR to

have inherited some of the weaknesses of its predecessor despite the 2006 amendments. The doubts about the efficacy of the current GAAR are exacerbated by SARS' reluctance to invoke the GAAR as a weapon in cases dealing with tax avoidance (Liptak, 2017:1). The current GAAR, as contained in Section 80A of the Income Tax Act No.58 of 1962 is summarised below:

1. There must be a transaction, operation or scheme;
2. The transaction operation or scheme must result in a tax benefit;
3. The sole or main purpose of the transaction must be to obtain a tax benefit;
4. One of the following tainted elements must be present:
    a. The transaction must be abnormal; or
    b. The transaction lacks commercial substance; or
    c. It was carried out in a manner not normally employed for *bona fide* business purposes; or
    d. It amounts to abuse or misuse of the provisions of the tax legislation (Pidduck, 2017).

A comparison of the current GAAR to the previous GAAR reveals that the fundamental principles of the previous GAAR have remained unchanged, whilst additional indicators have been included in the current GAAR (Calvert, 2011:5; Pidduck, 2017:5). Notwithstanding these amendments, it remains unproven whether the legislation was sufficiently amended in order to address the weaknesses identified (Pidduck, 2017:5). This is because the only reported case brought before the courts under the current GAAR only considered certain requirements of the GAAR (*ABSA and Another v Commissioner for South African Revenue Service* (2019/21825) [2021] ZAGPPHC 127 (*ABSA* case)). In this case the court had to determine whether the taxpayer was "party" to an "arrangement" as contemplated in Section 80L of the Income Tax Act. The court therefore had to decide whether the taxpayer had participated in an arrangement and if that participation had led to the "tax benefit". There was no consideration of the sole or main purpose or the tainted elements requirements. Consequently, there remains uncertainty about the efficacy of the GAAR, as the court did not consider application of the GAAR in its entirety.

1.2. RATIONALE FOR THE STUDY

Considering that the GAAR has only been subjected to judicial consideration to a limited extent in one reported precedent setting case since its amendment in 2006, there remains limited guidance and understanding of the application of its provisions by the court and its effectiveness. This thus remains a critical area for research. In the Explanatory Memorandum to the Revenue Laws Amendment Bill of 2006, one of the reasons for the most recent amendments was the need to align South Africa's GAAR with international developments (National Treasury, 2006:62). Furthermore, the Discussion Paper referred to a number of international jurisdictions when the need for a stronger GAAR was tabled. Subsequently, numerous studies have been conducted where the theoretical principles of the current GAAR were analysed and compared to the GAAR provisions in other jurisdictions (Bauer, 2018; Kujinga, 2013; Pidduck, 2017). Calvert (2011) applied the current GAAR to the facts of previous South African court cases where the previous GAAR failed to determine the effectiveness of the 2006 amendments. This study revealed that the Commissioner would have failed to successfully apply the current GAAR to these cases if they were brought to the courts on the same grounds (Calvert, 2011:135). The outcome of this study indicates that there are still fundamental weaknesses in the South African GAAR.

Following this, Pidduck (2017) analysed and compared the South African GAAR in an international context to its Canadian and Australian counterparts, using a structured pre-emptive analysis as the methodological approach, in order to identify weaknesses in the South African GAAR and propose amendments to improve its efficacy. Similarly, this study revealed that weaknesses still exist in the current South African GAAR. Therefore, this study will contribute to this existing body of research by comparing the theoretical principles of the current South African GAAR to the New Zealand GAAR. A structured pre-emptive analysis will also be followed to apply the current South African GAAR to the facts of a court case where the GAAR of New Zealand was successful, in order to identify existing weaknesses in the current South African GAAR and propose amendments to improve its efficacy.

1.3. RESEARCH PROBLEM

After more than a decade since its inclusion into the Income Tax Act, the South African GAAR remains untested in court (Bauer, 2018:2; Liptak, 2017:1; Pidduck, 2017:5). It

therefore remains unknown as to whether the GAAR would serve its intended purpose when applied to the facts of a court case, and thus whether it is effective in combatting impermissible tax avoidance. While research has been conducted to test the efficacy of the South African GAAR, no research has been conducted on the efficacy of the GAAR when compared to that of the New Zealand GAAR. Therefore, the research problem of this study is to identify what amendments can be made to the South African GAAR to improve its efficacy based on lessons from New Zealand case law.

1.4. RESEARCH QUESTIONS

The following research questions will be relevant to this study:

1. What are the primary weaknesses of the South African GAAR that may render it an ineffective deterrent to impermissible avoidance arrangements?
2. What amendments should be implemented, using lessons from New Zealand, to address the identified weaknesses and improve the efficacy of the South African GAAR?

1.5. RESEARCH OBJECTIVES

The goal of this research is to analyse and compare the current South African GAAR to the New Zealand GAAR in order to identify existing weaknesses in the current South African GAAR and how the identified weaknesses can be addressed. Therefore, in order to address the research questions, the following research objectives were pursued:

1. To identify weaknesses in the current South African GAAR;
2. To compare the theoretical principles of the current South African GAAR to the principles of the GAAR of New Zealand;
3. To apply the South African GAAR to the facts of a case from New Zealand where the GAAR of New Zealand was successful, in order to determine whether the South African GAAR would have been successful and thereby identify elements of the South African GAAR that need improvement; and
4. To suggest improvements to the South African GAAR to address the identified weaknesses.

1.6. RESEARCH DESIGN AND METHODOLOGY

This study will follow a qualitative research methodology known as ‘structured pre-emptive analysis’ (Pidduck, 2019:205). Qualitative research is described as a type of research whereby the researcher undertakes to obtain an understanding of the meaning and interpretation of concepts (Hennink, Hutter & Bailey, 2020:10). Contrary to quantitative research, the data collected and analysed in qualitative research is primarily non-quantitative as it consists of textual material and documents (Saldaña, 2011:4). Hennink *et al.* (2020) further describe qualitative research as ‘interpretive’ in nature. A qualitative research methodology is therefore consistent with the purpose of this study as it aims to gain an understanding of the South African GAAR which is interpretative in nature. Moreover, the data to be used in this study consists of words, sentences and paragraphs and thus justifies the use of a qualitative research methodology (Pidduck, 2017:43).

A structured pre-emptive analysis is a unique variant of the qualitative traditional doctrinal and reform-oriented research methodologies and is appropriate when the legislation in question has never been the subject of judicial enquiry (Pidduck, 2019:205). This methodology is therefore justified for this study as there are parts of the South African GAAR that have never been the subject of judicial enquiry (Bauer, 2018:2; Liptak, 2017:1; Pidduck, 2017:5). Doctrinal and reform-oriented research are discussed individually below.

Doctrinal research

Doctrinal research can be defined as research into the law and legal concepts (Duncan & Hutchinson, 2012:85). Knight and Ruddock (2008:29) describe doctrinal research as the formulation of legal doctrines through analysis of legal rules. This research methodology is appropriate where the goal of the research is to critically analyse legal doctrines in order to formulate conclusions and propose changes to legislation (Pidduck, 2017:9).

The legal doctrine that will be analysed includes legal concepts and principles in the form of case law, statutes and rules (Duncan & Hutchinson, 2012:84). Critical and conceptual analysis of the legal concepts and principles is an essential feature of doctrinal research, as it requires the researcher to obtain an understanding of the interpretation and application of the relevant doctrines and statutes through examining a broad range of literature (Pidduck, 2019:210). Undertaking doctrinal research is therefore justified for purposes of this study as

the GAAR that is included in the South African tax legislation will be analysed in order to obtain an understanding of its interpretation and practical application. The judicial precedent set by the courts in interpreting the words and terms in the GAAR will aid in obtaining an understanding of how the GAAR should be applied.

Reform-oriented research

A reform-oriented approach is said to be appropriate when the research is directed towards proposing amendments to existing legislation, as it questions the appropriateness of the underlying doctrines (Coetsee & Buys, 2018; Pidduck, 2019). Duncan and Hutchinson (2012:101) have described reform-oriented research as an intensive evaluation of the adequacy of existing rules in order to recommend changes where the rules are found to be inadequate. It is therefore evident that a reform-oriented approach is consistent with the objectives of this study as it seeks to identify weaknesses in the current South African GAAR in order to suggest improvements to address the identified weaknesses. The combination of both doctrinal and reform-oriented approaches as a structured pre-emptive analysis is discussed below.

Structured pre-emptive analysis

A structured pre-emptive analysis employs a combination of two methodological approaches, namely doctrinal and reform-oriented approaches (Pidduck, 2019:205). Pidduck (2017:43-44) provides guidelines on how this mixed method can be applied and these guidelines have been used for the purposes of this study as follows:

- **Doctrinal research** – this approach will be followed in Chapters 2 and 3 where existing literature will be analysed in order to obtain an understanding of how the GAARs in South Africa and New Zealand should be interpreted and applied. As part of the doctrinal research undertaken, a framework was developed in order to ensure consistent application of the South African GAAR to the facts of the selected case (Pidduck, 2017:45). A framework developed by Pidduck (2017) will therefore be used as a starting point to facilitate consistent application of the South African GAAR to the facts of the selected case in Chapter 4 and amended accordingly. The use of this structured framework allows other researchers to reach comparable findings and thus

improves the external validity and comparability of this study (Pidduck, 2019:211-214). Furthermore, using the structured framework that has already been developed and applied to multiple cases enables triangulation and improves the credibility of the findings of this study (Creswell, 2014:251; Pidduck, 2019:213).

- **Reform-oriented research** – The final step of structured pre-emptive analysis involves the proposal of amendments to the doctrine in question (Pidduck, 2019:217). This approach will be followed in Chapter 4 where the efficacy of the South African GAAR will be evaluated by applying it to the facts of the selected court case.
- Once the doctrinal analysis has been performed and the South African GAAR has been applied to the facts of the selected case in Chapters 2, 3 and 4 respectively, a comparison of the findings of these chapters will be performed in Chapter 5 in order to triangulate and thus validate the findings of the research (Pidduck, 2019:216).

Measures taken to ensure the validity and reliability of the research are discussed below.

1.6.1. VALIDITY AND RELIABILITY

The following measures were taken to maintain the validity, reliability and objectivity of this study:

- Subjectivity or bias in interpreting legislation may impact upon the results of application of the South African GAAR to the selected case (Pidduck, 2017:55). The correct interpretation of the legislation is therefore critical in order to successfully apply the legal doctrine to the facts of the case (Pidduck, 2019:211). Therefore, critical and comprehensive analysis of authoritative texts such as case law, legislation, books and journal articles will be undertaken in order to analyse and interpret the South African GAAR (Pidduck, 2017:55). The approach followed in interpreting the South African GAAR is discussed in Paragraph 1.6.2 below.
- A standard framework developed by Pidduck (2017) is used in order to prevent bias and inconsistencies in applying the South African GAAR to the facts of the selected case in Chapter 4 of this study. However, this framework will be amended to include subsequent literature in the field as necessary.
- The subjective selection of case law is another area where subjectivity or unnecessary bias could impact on the results of the study (Pidduck, 2017:56; Pidduck, 2019:213).

In this regard, selection of case law is done using purposeful maximal sampling together with the objective criteria set out in Paragraph 1.6.4.

- The final area of concern results from the risk of using unreliable sources to obtain the case law (Pidduck, 2017:56). In order to ensure that the full facts and details of the judgment are used in the application of the South African GAAR, the case law is selected from a reliable and impartial source, namely Judicial Decisions Online Database (New Zealand Government, 2021).

1.6.2. INTERPRETATION OF THE SOUTH AFRICAN GAAR

The method used for interpreting the legislation is a crucial part of achieving the objectives of this study (Pidduck, 2017:51). Therefore, a standardised method known as the purposive approach will be used in order to prevent bias and errors in interpreting the South African GAAR (Goldswain, 2008:109). The purposive approach is a method of interpreting legislation in a manner that gives effect to the true intention or purpose of the legislature (de Koker & Williams, 2021:par.19.1B; Goldswain, 2008:109). This is consistent with the approach followed in *Natal Joint Municipality Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA) and *Glen Anil Development v Secretary for Inland Revenue* (1975) (4) SA 715 (A). The following steps will be taken to interpret the legislation:

- Words that are not specifically defined will be interpreted in the context of their ordinary grammatical meaning together with the purpose of the legislation (de Koker & Williams, 2021:par.19.1A). This approach attempts to establish how the courts would have interpreted the words or terms in question (*Natal Joint Municipality Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA)).
- In instances where following the above approach creates an absurdity or an anomaly, the ordinary grammatical meaning of the words will be disregarded in order to give effect to the true intention of the legislature (Goldswain, 2008:111). This approach was followed in *Glen Anil Development v Secretary for Inland Revenue* (1975) (4) SA 715 (A) where it was held that the overriding principle in interpreting all legislation is the intention of the legislature (Goldswain, 2008:109).
- Where a word, sentence or piece of legislation has already been interpreted by the courts using a purposive approach, the interpretation used by the courts will be followed (Pidduck, 2017:53).

- An additional consideration in the case of interpreting the GAAR is the need for a wide interpretation in order to "suppress mischief" and provide remedy to the Commissioner without stretching the meaning of the words beyond what language permits *(Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)).

1.6.3. SELECTION OF JURISDICTION FOR COMPARISON

Under structured pre-emptive analysis, jurisdictions are selected to maintain a manageable scope and to focus the research activities (Pidduck, 2017:7; Pidduck, 2019:209). The primary jurisdiction will be South Africa while the jurisdiction selected for comparison is New Zealand. New Zealand was selected for comparison as the GAAR of New Zealand was referred to in the Discussion Paper issued by SARS in which proposals for amendments to the previous GAAR were made (SARS, 2005). It can therefore be concluded that the GAAR of New Zealand influenced some of the amendments that were made to the GAAR in 2006.

New Zealand and South Africa may also be considered comparative jurisdictions, given their similar historical backgrounds. English law is still a dominant factor in New Zealand's common law. Similarly, South Africa's legal system was influenced by European legal principles (Dutch and English), so similarities in interpretation of legal principles can therefore be expected (Rishworth, 2016:139). This therefore justifies the selection of New Zealand as a comparative jurisdiction for the purposes of this study.

1.6.4. SELECTION OF COURT CASE

Similar to the selection of jurisdictions, the selection of a court case aids in focusing the research activities (Pidduck, 2019). However, Pidduck (2017:56) notes that the selection of case law may lead to subjectivity and bias which would negatively affect the outcome of the study. This threat is reduced by using objective and predefined criteria to select the court case. Another way to reduce the potential bias and subjectivity is by using impartial primary sources for selection of the case. In this case, the court case was selected from Judicial Decisions Online Database (New Zealand Government, 2021).

The method used for selecting the court case is known as purposeful maximal sampling and is intended to select a case that is directed towards achieving the objectives of this study

(Creswell & Creswell, 2018; Pidduck, 2019). Yin (2009:47) explains that the selection of a case is also justified if such a case represents a critical case in the study. This study will therefore use a combination of purposeful maximal sampling and cases that are considered critical to select the case law (Pidduck, 2017:56). The following criteria will be used for selecting the court case:

- Only cases decided on by the Supreme Court of New Zealand will be included, as this is the highest court in which a case was brought on the grounds of the GAAR (New Zealand Government, 2021). Furthermore, the decisions of the Supreme Court are binding on lower courts.
- Only cases in which the court applied the GAAR successfully will be included. This is consistent with purposeful maximal sampling as it will aid in achieving the research objective of whether the South African GAAR would have also been successful (Creswell & Creswell, 2018:75).
- Preference will be given to case law brought before the Supreme Court of New Zealand for the avoidance of income tax and not any other tax.

The cases that meet the above selection criteria are *Ben Nevis Forestry Ventures Ltd v Commissioner for Inland Revenue* (2008) NZSC 115 (*Ben Nevis* case) and *Ian David Penny and Gary John Hooper v Commissioner of Inland Revenue* (2011) NZSC 95 (*Penny* case). The *Ben Nevis* case was selected as this was the first case on tax avoidance to come before the Supreme Court since it was established (Prebble & McIntosh, 2015:1011). In addition, this case is considered seminal as the Supreme Court applied a two-step inquiry process for the first time, which was sharply contrasted from previous views on how the GAAR should be applied, and which is now the leading authority on how the GAAR should be applied (Littlewood, 2011:18; Tretola, 2017:8).

1.7. SCOPE LIMITATION

The selected research design and methodology involves the use of a case. According to Yin (2009:38), it is often difficult to generalise the outcome of a study that uses a case. However, Gomm, Hammersley and Foster (2000:99) are of the view that studies involving the use of a case still contain general relevance because the case investigated is representative of what occurs within a larger system or society. Although this study does not aim to address all possible cases on tax avoidance that may be brought before the courts, it will provide an

understanding of the general interpretation of the South African GAAR (Pidduck, 2017:54). In addition, this study is specific to the jurisdictions of South Africa and New Zealand as well as the selected court case. The findings of this study must therefore be interpreted in the context of the GAAR provisions in the selected jurisdictions and the facts of the selected case when evaluating whether they may be applied to different circumstances (Pidduck, 2017:54).

Pidduck (2017:328) notes that the interpretation of statutes creates a level of subjectivity which is inherent to the interpretation of any legislation and therefore introduces an additional limitation to this study. The measures taken to limit this subjectivity are discussed in Paragraphs 1.6.1 and 1.6.2.

1.8. STRUCTURE OF THE MINI-DISSERTATION

The structure of this study will be as follows:

Chapter 1: Introduction

Chapter 1 provides the broad background to the research topic, the rationale for the study and an outline of the research methodology followed. This chapter also provides a description of the research problem, the research questions, as well as the objectives that are relevant to this study.

Chapter 2: The South African GAAR

An analysis of the South African GAAR is undertaken in this chapter, and the analysis follows a doctrinal approach. Existing weaknesses in the South African GAAR are identified. The analysis done in this chapter aids the application of the South African GAAR to the facts of the selected court case in Chapter 4.

Chapter 3: New Zealand GAAR

An analysis of the GAAR of New Zealand is undertaken in this chapter following a doctrinal approach. This chapter compares and contrasts the South African GAAR to the GAAR of New Zealand for the purposes of identifying weaknesses in the South African GAAR. Where the GAAR of New Zealand is found to be more effective, suggested improvements to the South African GAAR are presented.

Chapter 4: Application of the South African GAAR to the selected case

This chapter provides a brief summary of the facts of the selected case. The South African GAAR is applied to the facts of the case to determine whether the same conclusion would have been reached had the South African GAAR been applicable. Where the South African GAAR is not successful in its application (in part or in whole), suggestions for improvements are made based on lessons from New Zealand.

Chapter 5: Conclusion

This chapter provides a conclusion to the study and summarises the findings of the research. Future areas for research are discussed in this chapter.

CHAPTER 2:THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE

2.1 INTRODUCTION

The objective of this study is to analyse the South African GAAR in order to identify existing weaknesses and to suggest amendments to improve its efficacy. Chapter 1 provided an introduction to the South African GAAR, the research questions and objectives of this study, as well as the methodological approach to be followed in achieving the research objectives. The aim of this chapter is to analyse and interpret the South African GAAR using existing literature and case law. This chapter also aims to identify existing weaknesses in the South African GAAR.

2.2. THE PREVIOUS SOUTH AFRICAN GAAR

The first South African GAAR was introduced as Section 90 of the Income Tax Act No. 31 of 1941. Following the amendments in 1996, the South African GAAR was found in Section 103(1) of the Income Tax Act (the previous GAAR), and further amendments in 2006 resulted in the current GAAR as contained in Sections 80A to 80L of the Income Tax Act. According to de Koker and Williams (2021:par.19.4), the previous GAAR and the extensive body of case law on the interpretation of its terms are still relevant as similar terms are contained in the current GAAR. It is therefore expected that the courts may follow the existing case law principles when interpreting the current GAAR (de Koker & Williams, 2021:par.19.14). The previous GAAR read as follows:

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

bb) in the case of a transaction, operation or scheme being a transaction, operation or scheme not falling within the provisions of item (aa), by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question

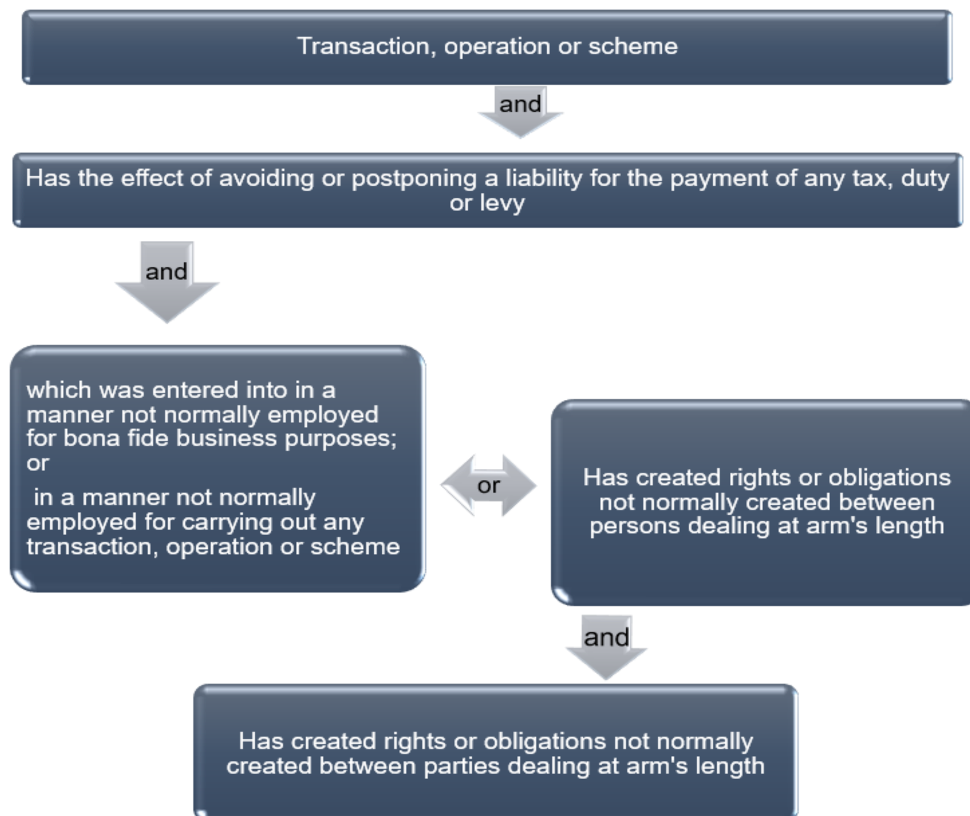
(ii). has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and

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

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

The requirements of the previous GAAR after the1996 amendments may be illustrated by Figure 1 as follows:

Figure 1: The previous South African GAAR



Source: Own design

Under the previous GAAR, the Commissioner had to be satisfied that all four requirements were met before determining the tax liability as if the transaction had not been entered into or carried out (de Koker & Williams, 2021:par.19.14; Pidduck, 2017:68). Furthermore, the Commissioner was entitled to assume that the transaction was entered into solely or mainly for the purpose of obtaining a tax benefit (de Koker & Williams, 2021:par.19.14). It was however left to the courts to determine the standards and norms to establish whether a transaction was normal, as this was not defined in the Income Tax Act (Calvert, 2011:16; Pidduck, 2017:67-68). Critical commentary regarding the efficacy of the previous GAAR continued even after the 1996 amendments, as taxpayers continued to market and enter into aggressive and sophisticated tax avoidance schemes (SARS, 2005:41-42). Following this, SARS issued a Discussion Paper on the previous GAAR highlighting some of the weaknesses identified around its efficacy (SARS, 2005:39-44). The weaknesses were briefly summarised in the background and are discussed in detail below:

- **Not an effective deterrent to tax avoidance:** The previous GAAR was labelled an inconsistent and ineffective deterrent to abusive tax avoidance schemes (SARS, 2005:41). While SARS acknowledged that it had improved its ability to detect and combat these schemes on audit, this required a significant commitment of time and resources which proved to be costly for both government and taxpayers (SARS, 2005:42). A further reason why the previous GAAR was perceived to be ineffective is that it resulted in lengthy battles over the nature of transactions and this had a negative impact upon the relationship between SARS and taxpayers (SARS, 2005:42).
- **The abnormality requirement**: The weakness created by this requirement was that taxpayers utilised transactions and techniques that were originally intended for *bona fide* business purposes to engage in impermissible tax avoidance (SARS, 2005:42). De Koker and Williams (2021:par.19.14) state that if a transaction became widely used for tax avoidance, it would gain commercial acceptability and would therefore cease to be abnormal. The difficulties presented by this requirement were also recognised by the Katz Commission in its report where it was suggested that the abnormality requirement be substituted with a *bona fide* business purpose test (Katz, 1996:par.11.2.2). The effect of the proposed amendment would be that even if a transaction became widely used, it would not pass the abnormality test if the taxpayer did not have a legitimate business reason for entering into that transaction.

- **The purpose requirement**: Under the previous GAAR, it was a requirement that the sole or main purpose of a transaction be to obtain a tax benefit before SARS could invoke the GAAR against that transaction (de Koker & Williams, 2021:par.19.4). This requirement was also the subject of criticism as a transaction would only fall foul of the GAAR if the sole or main purpose was to obtain a tax benefit (SARS, 2005:43). The implication of this requirement was that if a transaction had a tax and a commercial purpose, the purpose requirement would only be met if the tax purpose was proved to be the main purpose (SARS, 2005:43). This was illustrated in *Commissioner for Inland Revenue v Conhage (Pty) Ltd* (1999) (4) SA 1149 (SCA) where it was held that if a taxpayer had genuine commercial cause for entering into a transaction, they were entitled to undertake the transaction in a manner that would maximise the related tax benefits. The difficulties presented by this requirement were exacerbated by the fact that this was a subjective test that essentially required the courts to look into the mind of the taxpayer in order to determine what the sole or main purpose of a certain transaction was (de Koker & Williams, 2021:43:par.19.4; SARS, 2005).
- **The abnormality and purpose requirements together:** The weaknesses created by the abnormality and purpose requirements were exacerbated by the fact that they both had to be met before the GAAR could be applied (SARS, 2005:43). Due to the difficulty involved in proving their presence, the need for both the abnormality and purpose requirements to be met placed taxpayers in a powerful position of being able to avoid application of the GAAR (Pidduck, 2017:72; SARS, 2005:42-44).
- **Procedural and administrative issues:** The last weakness identified in the Discussion Paper was the procedural and administrative uncertainties created by application of the GAAR (SARS, 2005:44). There were uncertainties about the extent to which the GAAR could be applied to steps within a larger transaction or scheme, and whether SARS had the authority to apply the GAAR "in the alternative" (SARS, 2005:44). Both of these uncertainties have been addressed by the inclusion of Sections 80H and 80I of the Income Tax Act respectively.

In order to address the weaknesses identified above, the previous GAAR was amended in 2006 and the provisions of the current South African GAAR are discussed below.

2.3. THE CURRENT SOUTH AFRICAN GAAR

Section 80A defines an 'impermissible avoidance arrangement' and it reads as follows:

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

(a) in the context of business-

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

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

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

(c) in any context–

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

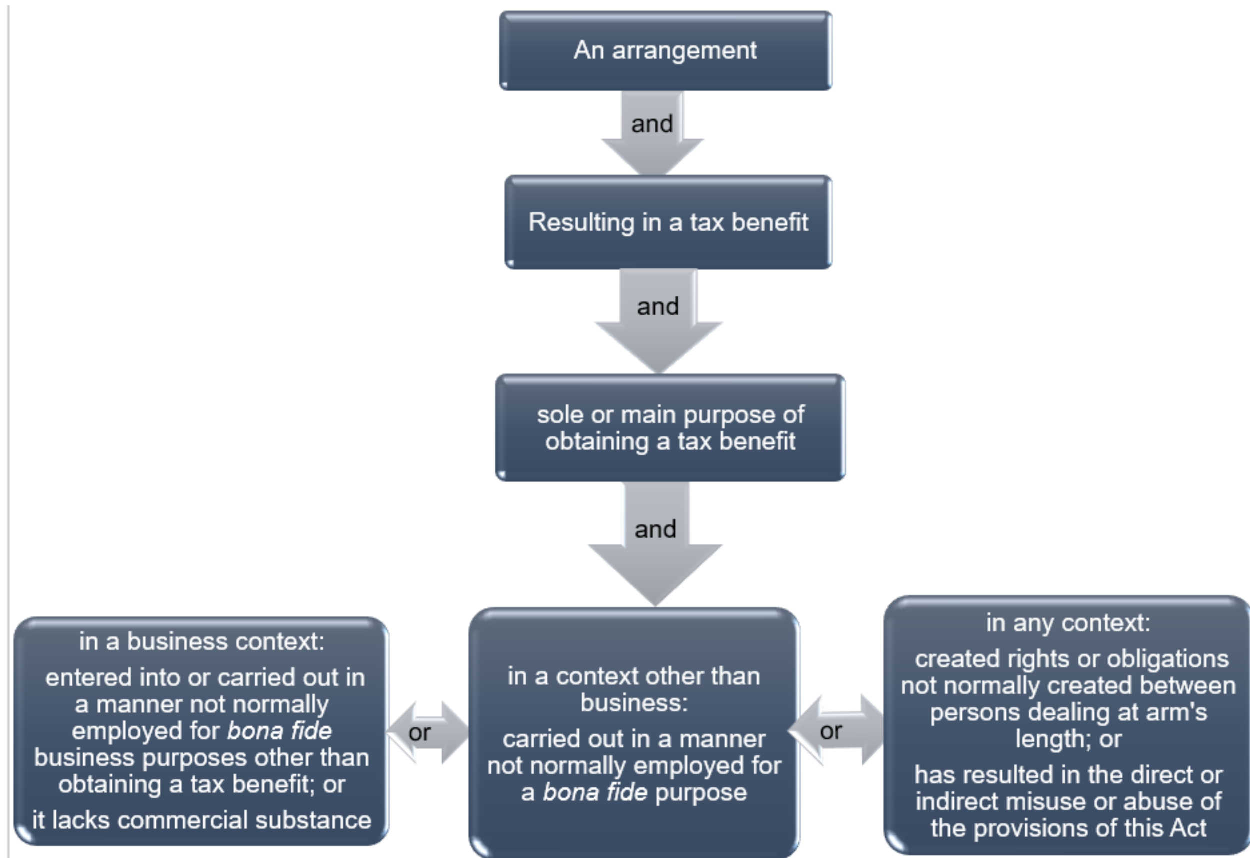
 (ii). It would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this part)."

Pidduck (2017:76) provides a brief summary of the main requirements of the GAAR as follows:

- A transaction, operation or scheme must be present
- The transaction, operation or scheme must result in a tax benefit
- The sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit
- The arrangement must be abnormal, lacking in commercial substance, carried out in a manner not normally employed for *bona fide* business purposes, create rights or obligations not normally arising between parties dealing at arm's length, or be abusive of the provisions of the Income Tax Act

The current GAAR is illustrated by Figure 2 below:

Figure 2: The current South African GAAR



Source: Own design

Each requirement of the GAAR will be analysed individually in order to obtain an understanding of its judicial interpretation.

2.3.1. ARRANGEMENT

The presence of an arrangement is the first element required for the GAAR to be applicable. The word 'arrangement' is defined in Section 80L of the Income Tax Act as:

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

The words "transaction, operation or scheme" are not defined in the Income Tax Act but have been widely interpreted by the courts under the previous GAAR. This is evidenced by the judgment in *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A) (*Meyerowitz* case). In this case, Beyers JA (at 300) held that "[t]he word scheme is a wide term and I think it is sufficiently wide to cover a series of transactions." According to Kujinga

(2013:69), the judgment in the *Meyerowitz* case indicates that the words ‘transaction, operation or scheme’ can be extended to cover multiple transactions that have a common purpose of avoiding tax. The wide interpretation given to these words is consistent with the purpose of the GAAR, as it is aimed at any possible transaction or scheme to avoid tax (Calvert, 2011:22; Pidduck, 2017:78). More recently, in the *ABSA* case it was held that in order to be party to an arrangement, a taxpayer has to willingly engage in or participate in the arrangement and such conduct requires volition. This implies that prior knowledge of a tax avoidance motive and scheme or series of transactions by a taxpayer is required before they can be regarded as a party to an arrangement for purposes of applying the GAAR. The judgment in this case indicates a weakness in the GAAR as taxpayers may attempt to use the lack of prior knowledge or “ignorance” as a defence against the GAAR, even though it can be reasonably expected that they had prior knowledge or even the intention to avoid tax.

One of the weaknesses identified in the previous GAAR was the uncertainty regarding the Commissioner’s ability to apply the GAAR to steps within a larger arrangement (SARS, 2005:44). The definition of arrangement now includes steps within a larger arrangement, and this is specifically provided for in Section 80H of the Income Tax Act. The court illustrated this in *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301(A) where parts of a larger transaction were isolated when applying the GAAR. A different approach was followed in the latter case of *Commissioner for Inland Revenue v Conhage* (1999) (4) SA 1149 (SCA), as the court held that the GAAR was applicable to the larger transaction rather than the steps within the transaction. Regardless of the inclusion of Section 80H of the Income Tax Act, the inconsistent approaches followed by the courts and the lack of guidance on how the GAAR may be applied to steps within a larger arrangement without the arrangement losing its commercial substance creates uncertainties about the application of the GAAR (Pidduck, 2017:292).

For purposes of determining whether an ‘arrangement’ has been entered into using the framework in Paragraph 2.5, the word ‘arrangement’ will be given a wide interpretation that is consistent with the above discussion on case law. In light of the *ABSA* case, once it has been established that there is an arrangement, it will also be considered whether the taxpayer participated in the arrangement with volition, rather than being merely present.

2.3.2. TAX BENEFIT

The second requirement before the Commissioner may invoke the GAAR is that the arrangement in question must be an avoidance arrangement (de Koker & Williams, 2021:par. 19.37). An avoidance arrangement is defined in Section 80L of the Income Tax Act as any arrangement that would result in a tax benefit in the absence of the GAAR, and Pidduck (2017:79) notes that the presence of a tax benefit derived from an arrangement is a critical requirement regardless of the amount of the tax benefit.

The meaning of 'tax benefit' is provided in Section 1 of the Income Tax Act as the "avoidance, postponement or reduction of any liability for tax", while Section 80L defines 'tax' as "any tax, levy or duty that is imposed… by the Income Tax Act or any other law administered by the Commissioner." The term "tax" therefore includes all taxes, levies or duties administered by SARS and this includes taxes imposed by the Value-added Tax Act and the Estate Duty Act (de Koker & Williams, 2021:par.19.37; Pidduck, 2017:80).

The concept of 'tax benefit' has therefore been widely defined and can include any transaction undertaken by a taxpayer that has the effect of reducing a tax liability. The concept of tax benefit has been interpreted by the courts as follows:

- In the case of *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) it was determined that the word 'liability' as contemplated in the definition of tax benefit must be regarded as an anticipated liability, rather than an accrued or existing liability. It was further held in *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) that avoiding a tax liability in the context of the GAAR means 'to get out of the way of, escape or prevent an anticipated liability'. De Koker and Williams (2021:par.19.37) are of the view that an anticipated liability can range from an imminent, certain liability on the one hand to a vague and remote possibility on the other. The courts are yet to determine where the line should be drawn in order to limit the wide interpretation of this concept (de Koker & Williams, 2021:par.19.37).
- The courts have developed a 'but for' test to assist in determining whether a tax benefit was derived by the taxpayer. This test determines the existence of a tax benefit by asking: Would the taxpayer have suffered tax but for this transaction? (*Smith v*

Commissioner for Inland Revenue (1964) 26 SATC 1 (A); *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113(A)).

The above interpretation of 'tax benefit' was confirmed in the *ABSA* case as the court applied the "but for" test to an anticipated liability in determining whether the taxpayer had received a tax benefit.

In order to apply Section 80A, it is a pre-requisite that the Commissioner must show that a tax benefit was derived from the arrangement in question (de Koker & Williams, 2021). In carrying out this burden of proof, the Commissioner is required to illustrate what arrangement would otherwise have been entered into to produce the same commercial result and the related tax consequences of the alternative arrangement which may be a difficult task for the Commissioner given the time and resource constraints required in order to identify an alternative arrangement (de Koker & Williams, 2021:par.19.37; Pidduck, 2017:294).

For purposes of determining the existence of a tax benefit, two questions will be asked. Firstly, whether the taxpayer escaped an anticipated liability and secondly, whether the taxpayer would have suffered a tax but for the transaction. Both of these tests are consistent with the framework included in Paragraph 2.5

2.3.3. SOLE OR MAIN PURPOSE

The third requirement of the GAAR is that the sole or main purpose of the transaction in question must be to obtain a tax benefit. This is a crucial requirement of an impermissible avoidance arrangement as the absence of such a purpose will result in failure to apply the GAAR, even if a tax benefit has been derived (de Koker & Williams, 2021:par.19.38; Kujinga, 2013:110). Except for the provisions of Section 80G of the Income Tax Act, issues around the interpretation of this requirement are common to both the previous GAAR and the current GAAR as a similar requirement was contained in the now-repealed predecessor (de Koker & Williams, 2021:par.19.38; Pidduck, 2017:82). The judicial precedent set under the previous GAAR can therefore be extended to the current GAAR in order to understand the 'sole or main purpose' requirement in the context of the current GAAR (Pidduck, 2017:82). Section 80G of the Income Tax Act contains the following provisions:

> An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining the tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

Section 80G makes a rebuttable presumption of a sole or main purpose to avoid tax and further places the onus of proof on the taxpayer (Kujinga, 2013:110). According to de Koker and Williams (2021:par.19.38), in order to discharge this onus, the taxpayer is required to produce affirmative and conclusive evidence that the sole or main purpose of the arrangement was not to avoid tax. The authors further note that the taxpayer's assertion is irrelevant as the testimony provided must be supported by objective facts.

Notwithstanding the above, the courts have held that the determination of the sole or main purpose should be a subjective test (de Koker & Williams, 2021:par.19.38). This was illustrated in the case of *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A) where the court rejected the Commissioner's argument that an objective test rather than a subjective test be used (de Koker & Williams, 2021:par. 19.38). The court therefore applied a subjective test by taking cognisance of the taxpayer's intention. The same interpretation was followed in two prior court cases, namely *Secretary for Inland Revenue v Geustyn Forsyth and Joubert* (1971) 3 ALL SA 540 (A) and *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A). According to Pidduck (2017:83), applying the sole or main purpose test objectively requires that the courts look at the effect of the transaction rather than the taxpayer's stated intention.

De Koker and Williams (2021:par.19.38) are of the opinion that determining the sole or main purpose subjectively results in a major weakness in the application of the GAAR. In support of their view, the authors contend that two taxpayers could enter into the same type of transaction with exactly the same consequences, and the Commissioner would only be able successfully apply the GAAR in respect of the taxpayer who had a tax avoidance motive. However, the wording in Section 80G of the Income Tax Act appears

to support a subjective test, as it states that the facts and circumstances of the transaction will be considered.

In light of the above opposing views and the uncertainty regarding the application of this test, both a subjective and an objective test will be followed when applying the framework in Paragraph 2.5. Therefore, it will be considered whether it was the stated intention of the taxpayer to enter into an arrangement with the sole or main purpose of obtaining a tax benefit and whether the actual outcome of the arrangement is consistent with the stated intention.

2.3.4. TAINTED ELEMENTS

The presence of the tainted elements is the fourth requirement that must be met before the GAAR can be successfully applied to an avoidance arrangement. Under this requirement, the Commissioner must prove that the arrangement is characterised by at least one of the four tainted elements when considered in one of three contexts, namely arrangements concluded in the context of business, in a context other than business as well as arrangements entered into in any context (de Koker & Williams, 2021:par.19.40; Kujinga, 2013:111). In order to discharge the onus of proof in this regard, the Commissioner may rely on the non-exhaustive guidelines and definitions contained in Sections 80C to 80E of the Income Tax Act (Kujinga, 2013:111). Calvert (2011:28-29) provides a summary of the tainted elements as follows:

- The abnormality element
- The lack of commercial substance element
- The creation of rights and obligations not at arm’s length element
- The misuse or abuse of the Act element

A comparison with the previous GAAR reveals that these tainted elements represent a revised version of the abnormality test in the previous GAAR as two tests have been added, namely a lack of commercial substance test and a misuse or abuse of the Act test (Pidduck, 2017:84). Due to the similarities in the other tainted elements, case law relating to the previous GAAR may be referred to in order to understand how the elements should be interpreted (Pidduck, 2017:85). Each of the four tainted elements will be discussed individually below.

2.3.4.1. THE ABNORMALITY ELEMENT

The abnormality requirement is the first tainted element contemplated in the current GAAR and it applies to transactions concluded in the context of business as well as transactions in a context other than business. This requirement is one of the instances where the wording of the previous GAAR has been retained in the current GAAR despite receiving criticism under the previous GAAR (Bauer, 2018:45; SARS, 2005:42-43). Similar use of the word "normal" in the current GAAR could therefore mean that the current GAAR has inherited some of the weaknesses of the previous GAAR. This also means that the judicial precedent set under the previous GAAR is still relevant in interpreting the abnormality requirement in the context of the current GAAR (Bauer, 2018:45; Langenhoven, 2016:39; Pidduck, 2017:85). It is submitted by de Koker and Williams (2021:par.19.39) that the test for abnormality under the current GAAR is intended to be objective rather than subjective, as was the case with the previous GAAR. This view is supported by the omission of the words "having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out" from the current GAAR (SARS, 2005:55-56). The change from a subjective to an objective test indicates the legislature's attempt to address the problems under the previous GAAR, however, there is still a lack of guidance on normality which creates uncertainties in applying the GAAR.

The test for abnormality in the context of business (Section 80A(a)(i) of the Income Tax Act) was considered in *Income Tax Case No. 1712* (2000) 63 SATC 499 where it was held that the test requires a comparison between a normal transaction entered into by a taxpayer and a transaction carried out for a *bona fide* business purpose without considering any tax benefit. While there has also been no guidance on what constitutes a 'normal' transaction in a context other than business, it is submitted by Louw (2007:27) that this is a test for the manner in which the transaction is carried out rather than the nature of the arrangement. It is evident that the lack of guidance in the Income Tax Act on what constitutes a normal transaction may lead to judicial decisions and standards that undermine the efficacy of the GAAR (Kujinga, 2013:112).

The test for abnormality using the framework in Paragraph 2.5 will be applied by comparing the transaction entered into by the taxpayer with a transaction entered into for a *bona fide* business purpose without considering the tax benefit.

2.3.4.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element in the context of business relates to transactions that lack commercial substance. The general meaning of 'lack of commercial substance' is set out in Section 80C(1) of the Income Tax Act while Section 80C(2) provides a non-exhaustive list of factors that indicate a lack of commercial substance (de Koker & Williams, 2021:par.19.39). The provisions of Section 80C of the Income Tax Act are as follows:

> (1). For the purpose of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be derived but for the provisions of this Part.
>
> (2). For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to
>
> (a) The legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from the legal form of its individual steps; or
>
> (b) The inclusion or presence of –
>
> (i) Round trip financing as described in Section 80D; or
>
> (ii) An accommodating or tax indifferent party as described in Section 80E; or
>
> (iii) Elements that have the effect of offsetting or cancelling each other."

The test for lack of commercial substance under Section 80C(1) of the Income Tax Act is a 'presumptive test' as it provides a general rule for establishing whether transactions lack commercial substance by considering whether the transaction results in significant tax benefit while having no significant impact on the business risks of the parties involved (de Koker & Williams, 2021:par.19.39; SARS, 2010:25). The Income Tax Act does not provide a meaning for the concepts of 'significant tax benefit' and 'significant effect upon business risks.' Consequently, a level of subjectivity may arise in attempting to define these concepts which could lead to lack of clarity about the application of this tainted element (Pidduck, 2017:88). Using the framework in Paragraph 2.5, this element will be applied by considering whether the arrangement resulted in a significant effect upon the business risks of the parties involved.

The list of indicators in Section 80C(2) of the Income Tax Act is non-exhaustive and is intended to provide guidelines for determining a lack of commercial substance. It

therefore does not limit the meaning of lack of commercial substance. Consequently, for the purpose of applying the GAAR to the selected court case, the general test and the list of indicators are applied separately (Pidduck, 2017:89). The indicators listed in Section 80C(2) are discussed separately below.

Substance over form indicator

The substance over form indicator is the first indicator for a transaction that lacks commercial substance. The income Tax Act does not provide any guidance for determining whether the legal substance of an arrangement differs from its legal form. According to the Explanatory Memorandum issued by National Treasury (Explanatory Memorandum), even though the substance over form indicator is derived from the common law substance over form doctrine, it is intended to be wider in the context of the GAAR (National Treasury, 2006:64). This indicator is further intended to empower the Commissioner to invoke the GAAR against transactions whose legal form create the impression that economic risk was incurred while in substance, the taxpayer remains insulated from all economic risk (SARS, 2005:20).

Under common law, the substance over form test determines whether the legal form of a transaction is consistent with the true intentions of the parties to that transaction and whether the risks and rewards are consistent with those that can be expected from the arrangement (de Koker & Williams, 2021:par.19.13). Such transactions are known as simulated transactions and are regulated under common law (*Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A); *Relier v Commissioner for Inland Revenue* (1997) 60 SATC 1 (A)). The common law doctrine is also relevant in the context of the GAAR, as it was held in *Commissioner for South African Revenue Service v NWK Ltd* (2011) 2 All SA 347 (SCA) that the GAAR can be invoked as an alternative weapon against simulated transactions. The more recent case of *Sasol Oil v Commissioner for South African Revenue Service* (2018) ZASCA 153 (A) (the *Sasol Oil* case) provides further guidance on the common law substance over form test, as the judgment in this case indicates that determining whether the substance of a transaction differs from its legal form is subjective. This is illustrated by the conflicting judgments by the South African courts in applying the common law substance over form doctrine in the *Sasol Oil* case, as it was held by the Tax Court in *Income Tax Case No.*

1910 (2018) 80 SATC 353 that the transactions were simulated, while the Supreme Court of Appeal found in favour of the taxpayer, concluding that the transactions were not simulated. The subjectivity involved in applying this doctrine is further illustrated by the dissenting opinions expressed in the judgment by the Supreme Court of Appeal, as some judges still held the contrary view that the transactions were simulated. Pidduck (2020:265) notes that similar differences in opinions may exist when applying the substance over form indicator in the context of the current GAAR, as different people may be expected to have different views in determining whether a transaction lacks commercial substance.

For purposes of applying the framework in Paragraph 2.5, it will be considered whether the arrangement reflects the true intentions of the parties and whether the risks and the rewards resulting from the transaction are those that can be expected from such a transaction.

The round trip financing indicator

The use of round trip financing is the second indication of a transaction that lacks commercial substance. Round trip financing is defined in Section 80D of the Income Tax Act as follows:

> " (1) Round trip financing includes any avoidance arrangement in which –
>
> (a) funds are transferred between or among the parties (round tripped amounts); and
>
> (b) the transfer of funds would
>
> (i) Result, directly or indirectly, in a tax benefit but for the provisions of this Part; and
>
> (ii) Significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.
>
> (2).This section applies to any round tripped amounts without regard to-
>
> (a) Whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;
>
> (b) The timing or sequence in which round tripped amounts are transferred or received; or
>
> (c) The means by or manner in which round tripped amounts are transferred or received
>
> (3). For the purpose of this section, the term 'funds' includes any cash, cash equivalent or any right or obligation to receive or pay the same."

Kujinga (2013:113) explains round trip financing as the deceptive use of funds in a circular manner between parties to an arrangement, while Pidduck (2017:93) notes

that in round trip financing, funds are essentially transferred in a reciprocal fashion between parties. The presence of the word “circular” and “reciprocal” in both these views indicates that the real net cash flows of the parties involved are not affected. According to de Koker and Williams (2021:par.19.39), the parties involved are essentially left in the same financial position except for the tax benefit created and the amounts paid to intermediaries.

An arrangement is required to satisfy both the requirements of Sections 80D(1)(a) and 80D(1)(b) of the Income Tax Act before it is tainted by the presence of round trip financing. The words “among” or “between” as contained in the first requirement have not been defined in the Income Tax Act or interpreted by the courts. However, Pidduck (2017:93) notes that the words allude to the presence of some sort of circular action. The second requirement is that the funds transferred must result in a tax benefit whilst significantly reducing, offsetting or eliminating any business risk incurred due to the arrangement. Similarly, these words (“significant”, “reducing”, “offsetting”, “eliminating” and “business risk”) have neither been defined in the Income Tax Act nor interpreted by the courts and this could give rise to uncertainty regarding the correct interpretation and application of these words (Pidduck, 2017:93).

The test for the existence of round trip financing using the framework in Paragraph 2.5 will consider whether funding was transferred between parties in a circular manner and whether that transfer created a tax benefit.

Accommodating or tax-indifferent parties indicator

The third element that may indicate that a transaction lacks commercial substance is the use of accommodating or tax indifferent parties within an arrangement. According to Section 80E (1) of the Income Tax Act, a party to an avoidance arrangement is an accommodating or tax -indifferent party if:

(a) Any amount derived by the party in connection with the avoidance arrangement is either

- (i) not subject to normal tax; or
- (ii) significantly offset by an expenditure or loss incurred by the party in connection with that avoidance arrangement or any assessed loss of that party; and

(b) either-

(i) as a direct or indirect result of the participation of that party an amount that would have -

(aa) been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts or accruals of a capital nature of that party; or

(bb) constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party; or

(cc) constituted revenue in the hands of another party would be treated as capital by that other party; or

(dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax ;or

(ii) the participation of that party directly or indirectly involves a prepayment by another party.

According to the Discussion Paper issued by SARS, tax indifferent parties are used in avoidance arrangements to defeat the balance between tax deductibility in the hands of one party and taxable income in the hands of another (SARS, 2005:21). Therefore, the inclusion of a provision relating to tax-indifferent parties in the GAAR reflects the legislator's intention to prevent the use of these parties in tax avoidance schemes (Pidduck, 2017:95).

When considering the meaning of an 'accommodating or tax indifferent party' in Section 80E(1) of the Income Tax Act, it is also important to note the provisions of Section 80E(3) of the Income Tax Act, as it provides certain exclusions to the definition contained in Section 80E(1). The provisions of Section 80E(3) of the Income Tax Act read as follows:

"The provisions of this section do not apply if either

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

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

Pidduck (2020:266) notes that the exclusion in Section 80E(3)(b) of the Income Tax Act relating to controlled foreign companies indicates a weakness in the current GAAR in the context of multinational enterprises, as a controlled foreign company within a group of companies may be used as an accommodating or tax indifferent party without the arrangement in place falling foul of the GAAR. The author further explains that this exclusion may incentivise multinational enterprises to use the provisions of Section 9D of the Income Tax Act in a manner that is contrary to the intention of the legislature and thus undermine the purpose of the GAAR.
When applying the framework in Paragraph 2.5 this indicator will be tested for by considering whether there is a party that transferred a tax advantage to other parties.

Offsetting or cancelling indicator

In terms of Section 80C(2)(b)(iii), the presence or inclusion of elements that have the effect of offsetting or cancelling each other is the fourth indicator that a transaction lacks commercial substance .Offsetting or cancelling is often characterised by a lack of fiscal consequence and the existence of transactions that are deliberately created (de Koker & Williams, 2021:par.19.39; Pidduck, 2017:97). Kujinga (2013:115) explains that such arrangements usually involve the use of derivatives that create a gain which is later offset by a loss in order to neutralise the tax effect. The Income Tax Act does not provide any guidance on how the meaning of elements that offset or cancel each other should be determined. However, Pidduck (2017:97) explains that the use of these words in the GAAR is unambiguous and the ordinary meaning thereof should be applied.

In applying the framework in Paragraph 2.5, it will be considered whether there are elements that have the effect of cancelling or offsetting each other and thus indicating that the transaction was artificially created to obtain a tax benefit.

2.3.4.3. RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH

Section 80A(c)(i) of the Income Tax Act provides a third tainted element that must be considered in any context. This section provides that an avoidance arrangement would be tainted if it has created rights and obligations not normally created between parties dealing at arm's length. Sections 80A to 80L of the Income Tax Act do not provide any guidance on how the concept of 'arm's length' should be interpreted in the context of the GAAR. Bauer

(2018:51) notes that this element was retained from the previous GAAR, therefore the judicial precedent set under the previous GAAR remains applicable.

In the case of *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A), the meaning of 'arm's length' was determined by considering what unconnected persons would have agreed upon in the same situation. In a latter court case, this principle was reiterated by considering what independent parties would have agreed upon had they entered into the same transaction (Hicklin v Secretary for Inland Revenue (1980) 1 All SA 301 (A)).

For purposes of applying this element using the framework in Paragraph 2.5, it will be considered what unconnected persons would have agreed to in the same situation.

2.3.4.4. MISUSE OR ABUSE OF THE ACT

The fourth tainted element is contained in Section 80A(c)(ii) of the Income Tax Act and must also be considered in any context. In terms of this section, an avoidance arrangement would be tainted if it results in an abuse or misuse of the provisions of the Income Tax Act as a whole. This element is new in the context of the South African GAAR as it was not contained in any of the previous GAARs (Kujinga, 2013:116). The Income Tax Act does not provide guidance on what constitutes a 'misuse' or 'abuse' as used in the current GAAR. However, the Explanatory Memorandum to the Revenue Laws Amendment Bill (Explanatory Memorandum) explains that it was introduced to align the South African GAAR with international practices and that reliance was placed upon a Canadian precedent in introducing the misuse or abuse of the Act element (Langenhoven, 2016:46; National Treasury, 2006:63). Pidduck (2017:101) notes that given the lack of case law regarding this element in South Africa, a limited interpretation may be obtained from Canadian case law due to the similarities in the wording of this element.

In the Canadian case of *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, the words "misuse or abuse" were interpreted as using the provisions of the legislation to achieve a result that is contrary to what the legislator intended when the legislation was

drafted. This test therefore complies with the intention of the legislator and will be tested for using the framework in Paragraph 2.5 by considering whether the arrangement exploits or manipulates any of the provisions of the Income Tax Act (Pidduck, 2017:101).

2.4. WEAKNESSES IDENTIFIED IN THE CURRENT GAAR

The following weaknesses were identified from analysing the South African GAAR:

- The requirement for taxpayers to have prior knowledge and a tax avoidance motive and scheme or series of transactions when entering into an arrangement puts them in a powerful position of being able to avoid application of the GAAR by claiming to be an unwitting participant of the arrangement. Therefore, taxpayers may use ignorance as a defence against attack under the GAAR, even though they could possibly have been expected to know of such impermissible tax avoidance motives within the scheme undertaken (*ABSA* case).
- Section 80H currently gives the Commissioner authority to apply the GAAR to steps within a larger arrangement, even though there is no guidance on how this may be done without causing the entire arrangement to lose its commercial substance (Pidduck, 2017:159).
- Requiring the Commissioner to prove the existence of a tax benefit by illustrating an alternative arrangement that produces the same commercial effect makes it more difficult for the Commissioner to apply the GAAR successfully due to time and resource constraints (Pidduck, 2017:293).
- The opposing views on whether the sole or main purpose requirement should be a subjective or an objective test have been identified as a weakness, as this indicates that there is currently uncertainty regarding the correct interpretation and application of this test (Pidduck, 2017:83).
- The lack of guidance on what constitutes a normal transaction and whether the abnormality requirement should be a subjective or an objective test may lead to inconsistent judicial decisions and uncertainties in application of the GAAR (Kujinga, 2013:112).
- The weakness identified in the previous GAAR requiring the transaction to meet both the sole or main purpose and the abnormality requirement may have been retained in the current GAAR, as the transaction in question is still required to meet the sole or main

purpose and contains at least one of the tainted elements (Pidduck, 2017:72; SARS, 2005:43-44).

- There is currently limited guidance on the interpretation and application of the indicators of lack of commercial substance, as many of the terms used under this element have neither been defined nor considered by the courts (Pidduck, 2017:322). This therefore creates uncertainty about how the GAAR would be applied to transactions tainted by lack of commercial substance.
- Since the judgment in the *Sasol Oil* case indicates that the test for substance over form in a common law context is subjective, there is uncertainty regarding the application of the substance over form indicator in the context of the GAAR (Pidduck, 2020:265).
- The exclusion of controlled foreign companies from the definition of 'accommodating of tax indifferent parties'(Section 80E(3)(b) of the Income Tax Act) puts multinational enterprises in a position of avoiding application of the GAAR by using controlled foreign companies within a group of companies as tax accommodating or tax indifferent parties (Pidduck, 2020:266).
- There is currently uncertainty and lack of guidance regarding the application of the misuse or abuse element which may limit the efficacy of the GAAR (Pidduck, 2017:162).
- The GAAR contains many undefined terms in its wording which leaves these terms open to different interpretations (Bauer, 2018:69). Terms that have been left undefined include 'normal', 'transaction, operation or scheme', 'significant effect' 'business risk', 'offsetting', 'reducing' and 'eliminating'.

2.5. FRAMEWORK

The framework developed by Pidduck (2017:102-104) will be used to apply the South African GAAR to the facts of the selected court case in Chapter 4 of this study. This framework has been amended for recent developments in the GAAR from the *ABSA case* with reference to the arrangement requirement. This additional consideration involves an inquiry into whether the taxpayer was 'party' to an arrangement and acted with volition as discussed under Paragraph 2.3.1. The table is included in Table 2 below.

Table 2: Framework for South African GAAR

Table 2: Framework for applying Sections 80A – 80L to the facts of previous case law
1 - Is there an arrangement? • Is there a transaction, operation or scheme that has been entered into by the taxpayer? This will be widely interpreted in terms of Section 80L of the Act and the *Meyerowitz* case. • Was the taxpayer 'party' to the arrangement? This will be determined by considering whether there was participation by the taxpayer acting with volition rather than mere presence in the arrangement (*ABSA* case).
2 - Does the transaction, operation, scheme result in a tax benefit? The definition of tax in Section 80L is applied to the cases. • Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability? (Smith case; King case) • Would a tax liability have existed but for this transaction (but for test)? (*Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case and *Louw* case).
3 - Is the sole or main purpose to obtain such tax benefit? In applying the sole or main purpose requirement of the GAAR to the facts and circumstances of the case studies, the following factors are considered: • Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (*Gallagher* case) • Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (Meyerowitz, 2008:19-12; De Koker and Williams, 2015:par19.38) (*Ovenstone* case). In applying the objective and subjective tests the following principles may be considered: • If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (*Conhage* case) or • If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which did not attract tax or attracts less tax, this does not indicate that obtaining a tax benefit was not the sole or main purpose of the arrangement (*Conhage* case) or • If the dominant subjective purpose of the avoidance arrangement was to achieve some

non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (i.e. determine what was in the mind of the taxpayer who entered into the transaction).

4 - Tainted elements requirement

- One of the following with regard to business transactions:

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

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

Does the transaction lack commercial substance?

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

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

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

- ***Has the arrangement been entered into in a manner not normal for bona fide purposes?***

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

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

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

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

  - Each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves? (*Hicklin* case)
  - Would unconnected persons have done the same in this situation? (*Hicklin* case).

  Is there misuse or abuse of provisions of the Act?

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

Adapted: (Pidduck, 2017:102-104)

2.6. CONCLUSION

Chapter 2 provided a discussion of both the previous and the current South African GAAR as well as an analysis of each of the requirements of the current South African GAAR. Principles from case law as well as existing literature were used in performing this analysis which indicated that some of the requirements of the previous GAAR have been retained in the current GAAR, consequently indicating that the current GAAR may have inherited some of the weaknesses of its predecessor. The analysis performed also revealed further weaknesses such as the guidance provided by the court in determining whether a taxpayer was party to an arrangement and the exclusion of controlled foreign companies from the definition of accommodating and tax indifferent parties. This chapter revealed that the current South African GAAR still contains weaknesses, which limits its efficacy against impermissible avoidance arrangements. Given the weaknesses identified, the following chapter will provide an analysis of the New Zealand GAAR while comparing it to the South African GAAR in order

to identify areas where the South African GAAR could be improved using lessons from the New Zealand GAAR.

CHAPTER 3:THE NEW ZEALAND GAAR

3.1. INTRODUCTION

The objective of this study is to analyse and compare the current South African GAAR to the New Zealand GAAR in order to identify weaknesses in the South African GAAR and suggest ways to overcome those weaknesses. In Chapter 2, the individual components of the South African GAAR were analysed using case law and existing literature with the aim of interpreting and analysing its requirements and identifying the existing weaknesses. This chapter will provide a critical analysis of the New Zealand GAAR while comparing it to the South African GAAR, to identify areas that may be used to improve the efficacy of the South African GAAR.

3.2. THE NEW ZEALAND GAAR

New Zealand is one of the countries that use a statutory GAAR in income tax legislation (Atkinson, 2012:7). The country enacted the first GAAR in the world as Section 62 of the Land Tax Act 1878 and subsequently as Section 29 of the New Zealand Property Assessment Act 1879, which was carried forward into Section 40 of the Land and Income Assessment Act 1891 and later became Section 108 of the Land and Income Tax Act 1954 (Section 108) (Elliffe, 2014:148; Tretola, 2017:3). The provisions of Section 108 were amended into Section 99 of the Income Tax Act 1976 which was later carried forward in the same form into Sections BG 1 and GB 1 of the Income Tax Act 1994 (Prebble & McIntosh, 2015:1029). The provisions of Sections BG 1 and GB 1 retained the same wording when carried forward into Sections BG 1, GA 1 and YA 1 of the Income Tax Act No 97 of 2007 (Income Tax Act 2007) as what is now the current New Zealand GAAR (Prebble & McIntosh, 2015:1029). The focus of this study will be on the current New Zealand GAAR.

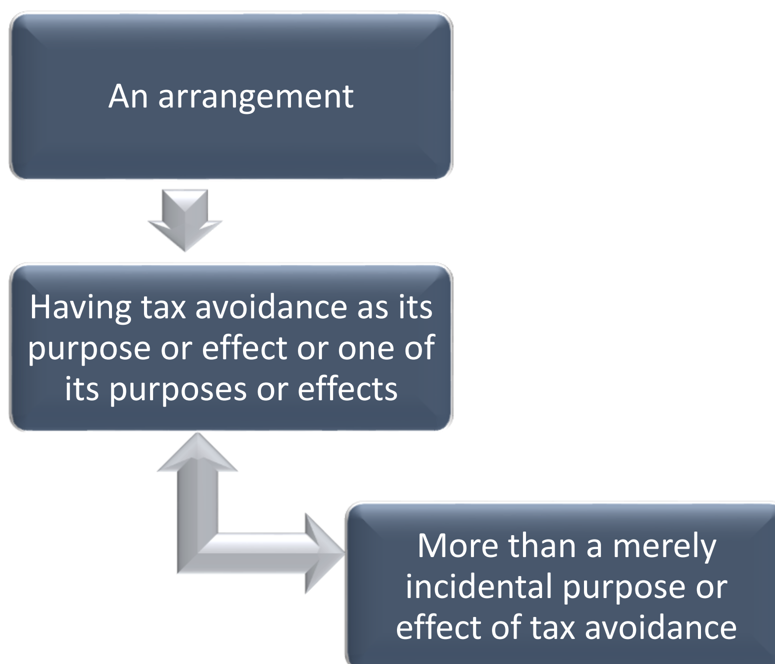
Section BG 1 of the Income Tax Act 2007 renders avoidance arrangements void, while Sections YA 1 and GA 1 provide definitions and interpretations of the some of the wording used in Section BG 1 and the consequences of having an avoidance arrangement declared void respectively (Tretola, 2017:3).

While the South African GAAR applies to an ‘impermissible avoidance arrangement’, the New Zealand GAAR is applicable to a ‘tax avoidance arrangement’ which is defined in Section YA 1 of the Income Tax Act 2007 as follows:

> “Tax avoidance arrangement means an arrangement, whether entered into by the person affected by the arrangement or any other person, that directly or indirectly:
> (a) has tax avoidance as its purpose or effect; or
> (b) has tax avoidance as its purpose or effect or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.”

The components of the New Zealand GAAR are illustrated in Figure 3 below

Figure 3: The New Zealand GAAR



Source: Own design

The effect of the definition of ‘tax avoidance arrangement’ is that two types of transactions would fall foul of the New Zealand GAAR, namely transactions that have tax avoidance as their only purpose and transactions that have tax avoidance as one of their purposes if the transaction has several purposes (Littlewood, 2013:525). Furthermore, Littlewood (2019:3) and Tretola (2017:4) note that the above provisions are wide and that it has been left to the New Zealand courts to determine what constitutes a ‘tax avoidance arrangement” and restricts application of the

GAAR. New Zealand's Supreme Court was established in 2004 after the Privy Council served as the country's highest court and the cases that have been brought before the court since then indicate that the courts are developing their own jurisprudence on tax avoidance, therefore confirming that it was the intention of parliament to leave the determination of what constitutes tax avoidance to the courts (Cassidy, 2012:8; Littlewood, 2011:1-2). The first case on tax avoidance to be heard by the Supreme Court was the *Ben Nevis* case, in which the Supreme Court clarified that a different approach should be adopted when interpreting the provisions of Section BG1 than what was formerly applied and is now considered to be the leading authority in interpreting the New Zealand GAAR (Littlewood, 2013:530; Tretola, 2017:8). Consequently, the principles established in this case as well as subsequent cases will be applied when analysing the New Zealand GAAR. Each of the components of the New Zealand GAAR are individually discussed below in order to obtain an understanding of its judicial interpretation when compared to the South African GAAR.

3.2.1. ARRANGEMENT

The existence of an arrangement is the first step in determining whether the New Zealand GAAR is applicable. The term arrangement is defined in Section YA 1 of the Income Tax Act 2007 as follows:

> "… any contract, agreement, plan or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect."

The inclusion of the term 'arrangement' allows for a wide interpretation of the GAAR so as to include all forms of conduct entered into by taxpayers (Atkinson, 2012:18; Littlewood, 2013:525). The interpretation of this requirement was considered in *Commissioner of Inland Revenue v BNZ Investments Ltd* (2002) 1 NZLR 450 (CA) where it was held that the term 'arrangement' is sufficiently wide to include all actions that may be undertaken to achieve a specific purpose or effect.' This is consistent with the meaning of arrangement in the context of the South African GAAR as established in the *Meyerowitz* case. Furthermore, in *Peterson v Commissioner of Inland Revenue* (2006) 3 NZLR 433 (the *Peterson* case), the Privy Council did not spend time defining an arrangement, but rather focused on determining whether the taxpayers were parties to the arrangement. The Privy Council noted that:

> "Their Lordships do not consider that the arrangement requires a consensus or meeting of minds; the taxpayer need not be a party to the arrangement and in their view he need not be privy to its details either."

The principle established in the *Peterson* case may be compared to the judgment in the *ABSA* case relating to the South African GAAR, as it was held by Sutherland ADJP (at 39) that:

> "The section requires a taxpayer to participate or take part. Such conduct requires volition. A taxpayer has to be, not merely present, but *participating* in the arrangement."

A comparison of the principles of these two cases reveals a weakness in the South African GAAR because, although it may be possible for taxpayers to successfully defend themselves against application of the South African GAAR by claiming "ignorance" and lack of prior knowledge, such defence is not possible against the New Zealand GAAR. It is submitted that an approach similar to that followed in the *Peterson* case should be followed when applying the South African GAAR by disregarding the fact that the taxpayer did not have prior knowledge of a tax avoidance motive or that the taxpayer was not 'party' to the arrangement.

Notwithstanding the difference identified above, a comparison of the two GAARs reveals further similarities as the application of the New Zealand GAAR in the *Ben Nevis* case indicated that the term, 'arrangement should be defined to include all elements that led to a tax benefit, whether individually or in combination. This interpretation is therefore considered similar to Section 80H of the Income Tax Act as it empowers the Commissioner to apply the South African GAAR to steps within an arrangement.

3.2.2. TAX AVOIDANCE

The second step in applying the New Zealand GAAR involves considering whether the arrangement has tax avoidance as its purpose or effect, or as one of its purposes of effects (Tretola, 2017:4). The term 'tax avoidance' is defined in Section YA 1 and it includes any arrangement that:

> "(a) directly or indirectly alters the incidence of any income tax;
>
> (b) directly or indirectly relieves a person from a liability to pay income tax or from the potential or prospective liability to pay any future income tax

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

The statutory definition of tax avoidance has been criticised for using broad terms that virtually include every possible transaction that reduces tax (Littlewood, 2011:269; Tretola, 2020:46). Ruddell (2013:499-500) notes that the word "alters" in Paragraph (a) of the definition potentially refers to both increasing and decreasing a tax liability which might be contrary to what parliament intended with the definition. Furthermore, Paragraphs (a) and (b) refer to altering the incidence of any income tax and relieving a person from a liability to pay income tax, respectively, which is said to introduce ambiguity as words could be referring to a potential or an accrued liability (Ruddell, 2013:499). It is submitted by Littlewood (2011:269) that the phrases are intended to refer to a potential liability, as it is not possible for taxpayers to alter the incidence of a liability that has already accrued. The problems created by the breadth of this definition were noted by Woodhouse J (at 688) in *Elmiger v Commissioner of Inland Revenue* (1966) NZLR 683 (SC) when he stated "[t]hat nearly all dispositions of property and income alter the incidence of income tax."

A comparison of the two GAARs reveals that the South African GAAR refers to a 'tax benefit' while the New Zealand GAAR refers to 'tax avoidance' and that the statutory definitions of these terms contain similar wording. The definition of 'tax avoidance' in the New Zealand GAAR refers to altering the incidence of income tax, relieving a person from liability to pay income tax as well as reducing or postponing any liability to income tax or future income tax. Therefore, the New Zealand GAAR only applies to income tax while the South African GAAR applies to any "tax" as contemplated in Section 80L of the Income Tax Act which is defined to include any tax, levy or duty imposed by the Income Tax Act, or any other Act administered by the Commissioner. In addition to income tax, examples of other taxes administered by the Commissioner include estate duty, value-added tax and transfer duty. Furthermore, the definition of tax avoidance in New Zealand refers to a 'potential or prospective liability to pay any future income tax' and is similar to the interpretation of the tax benefit with reference to an anticipated liability in the South African GAAR (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184).

Given that it was not the intention of New Zealand's parliament to provide an exhaustive definition of tax avoidance and that an extensive analysis of this concept need not be

undertaken in applying the GAAR, the courts have introduced judicial doctrines to limit the scope of the GAAR (Cassidy, 2012:10; Inland Revenue, 2013:34). This was done in the *Ben Nevis* case where the court merely referred to the statutory definition of tax avoidance and focused on developing a parliamentary contemplation test to assist when applying the GAAR (Elliffe, 2014:154-155; Hwong & Li, 2020:554). The parliamentary contemplation test is a two-step process that is adopted in determining the existence of tax avoidance as follows (Tretola, 2017:4):

- The first step considers the taxpayer's use of the specific provisions of the legislation and whether those provisions have been used in a manner that is consistent with parliament's intended scope (Elliffe, 2014:155).
- The second step considers the specific provision when viewed in the context of the arrangement as a whole and whether it is apparent that it was used in a manner which could not have been within parliament's contemplation and purpose when it enacted that provision (Elliffe & Cameron, 2010:449; Tretola, 2017:4).

This test was summarised by the court in the *Ben Nevis* case (at 109) as follows:

> "The ultimate question is whether the impugned arrangement, when viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with parliament's purpose."

In applying the parliamentary contemplation test in the *Ben Nevis* case, the court explained that notwithstanding the taxpayers' freedom to structure transactions in a manner that maximises the tax benefits, the use of the specific provisions must be within the context and purpose of the legislation. This interpretation by the courts reveals that considering whether the use of a specific provision is consistent with the purpose of the legislation is comparable to the tainted element of misuse or abuse of legislation in the South African GAAR. However, the fact that the misuse or abuse tainted element is not specifically linked to the tax benefit requirement indicates a weakness in the South African GAAR. It is therefore submitted that the South African GAAR may be improved by including the misuse or abuse of legislation as part of the tax benefit requirement, instead of considering it as part of the tainted elements requirement.

In addition to the parliamentary contemplation test, the court held in the *Ben Nevis* case that the economic and commercial reality of transactions may also be significant in the test for tax avoidance and thus considered a list of factors that may be relevant in determining the commercial reality of an arrangement and whether the arrangement is ‘artificial’ or ‘contrived’ (Cassidy, 2012:24; Tretola, 2017:6). These factors include:

- the manner in which the arrangement was carried out;
- the role of all the relevant parties and their relationships;
- the economic and commercial effect of documents and transactions;
- the duration of the arrangement;
- the nature and extent of the financial consequences for the taxpayer.

Elliffe and Cameron (2010:450) note that the list of factors adopted in the *Ben Nevis* case is not intended to be exhaustive, but rather serves as a guideline for taxpayers as to what will be considered by the courts. Consequently, other factors normally indicative of artificiality and contrivance have been identified in studies of the New Zealand GAAR and include the following:

- lack of business purpose;
- circularity of cash flows;
- the existence of offsetting or self-cancelling obligations;
- Transactions where the investor incurs no risk;
- A divergence between the economic and legal effects of transactions;
- Transactions between tax asymmetrical parties at uncommercial prices and dealings between non-arm’s length parties (Elliffe, 2014:450; Tretola, 2017:6).

A comparison of the two GAARs indicates that the factors considered in conjunction with the parliamentary contemplation test when applying the New Zealand GAAR are comparable to some of the tainted elements contained in the South African GAAR, as well as indicators of lack of commercial substance in Sections 80C to 80D of the Income Tax Act. The similarities and differences identified are discussed below:

- **The manner in which the arrangement is carried out** assists in determining what is achieved economically and commercially by examining the particular way in which a transaction is structured and whether the transaction has features that differ from usual commercial practice ((*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC) (Inland

Revenue, 2013:62)). Given the lack of guidance regarding the application of the abnormality element as discussed under Paragraph 2.5.3.1, it is submitted that considering the particular way in which a transaction is structured and whether it includes unusual features may assist in applying the current tainted element of abnormality in the South African GAAR.

- **The role of all the relevant parties and their relationships** involves an inquiry into the relationships between all the parties in the arrangement, as well as any relationship they may have with the taxpayer (Inland Revenue, 2013:63). The roles played by the parties may be relevant, for example where the parties are legally separate but economically form part of the same group. However, the roles and relationships of the parties may still be relevant even if the parties are unrelated (*BNZ Investments Ltd v CIR* (2009)24 NZTC 23,582 (HC) (Inland Revenue, 2013:63)). This factor is comparable to the presence of an accommodating or tax-indifferent party as contemplated in Section 80C(2)(b)(ii) of the Income Tax Act, but it is submitted that the wording used for purposes of the New Zealand GAAR is less restrictive than Section 80C(2)(b)(ii), as the latter provides a prescriptive definition of an accommodating or tax-indifferent party. The wording in New Zealand may therefore be adopted to improve the efficacy of the South African GAAR.
- **The economic and commercial effect of documents and transactions** factor involves an examination of documents used in an arrangement to determine whether they are consistent with the real outcomes of the arrangement (Inland Revenue, 2013:64). This factor further assists in establishing whether a transaction has a commercial basis and whether the transaction was merely created to obtain the resulting tax advantage *(Erris Promotions Ltd v Commissioner of Inland Revenue* (2003) 21 NZTC 18,330 (HC)). This factor is considered similar to the tainted element of lack of commercial substance in the South African GAAR in Section 80C of the Income Tax Act. However, the lack of commercial substance element in the South African GAAR contains a prescriptive definition as well as a list of indicators, while it has been left to the New Zealand courts to determine whether the documents and transactions within an arrangement indicate that the arrangement lacks the expected economic and commercial effects. It is therefore submitted that this factor may be incorporated into the test for lack of commercial substance test as it contains simpler wording and would leave it up to the South African courts to determine whether a transaction lacks commercial substance.

- **The duration of the arrangement** involves an inquiry into the timing aspects such as the duration of and the intervals between events in and within an arrangement (Inland Revenue, 2013:65). This factor was considered in the *Ben Nevis* case where it was held that the timing mismatch between when the taxpayers obtained the tax advantage and when the real economic consequences were incurred was one of the indicators that the scheme was a tax avoidance arrangement. Given that the South African GAAR does not contain a similar requirement and that there is currently insufficient guidance regarding the application of the general test for lack of commercial substance as contained in Section 80C(1) of the Income Tax Act, it is submitted that consideration of the timing aspects of an arrangement may be included in the South African GAAR in order to improve the provisions of Section 80C(1).
- **The nature and extent of financial consequences** for the taxpayer may be considered similar to the general test for lack of commercial substance in Section 80C(1), which considers whether an arrangement has a significant effect upon the taxpayer's business risks or net cash flows. It was noted under Paragraph 2.3.5.2 in Chapter 2 that the wording in Section 80C(1) contains terms that are not defined in the Income Tax Act and thus creates uncertainty regarding application of the South African GAAR. However, unlike the South African GAAR, the test for the nature and extent of financial consequences for the taxpayer in the New Zealand GAAR does not contain terms such as "significant effect upon business risks" or "significant tax benefit." It is therefore submitted that the wording of this factor for purposes of the New Zealand GAAR is preferable and should be adopted for the South African GAAR, as it is simpler and thus leaves it to the courts to determine whether the financial consequences suffered by the taxpayer are those that can be expected from such an arrangement.
- **The lack of business purpose** factor considers whether an arrangement has a commercial and non-tax avoidance purpose, even though it is not precluded from being a tax avoidance arrangement merely because a taxpayer is able to refer to a commercial reason for entering into the arrangement (Inland Revenue, 2013:78). According to the Interpretation Statement issued by New Zealand's Inland Revenue Department on the interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007, considering whether a transaction has a commercial purpose is not directly relevant to the parliamentary contemplation test, but rather assists in understanding the arrangement (Inland Revenue, 2013:79). A limited comparison may be made between this factor and

the substance over form indicator in the South African GAAR, as it considers an arrangement to still be simulated if its only object is to avoid tax, even though the parties are able to show performance in terms of their agreement (*Commissioner for South African Revenue Service v NWK Ltd* (2010) ZASCA 168 (SCA)). However, given that this factor is relevant in determining whether an arrangement is an impermissible avoidance arrangement and the fact that weaknesses were identified with the substance over form indicator under Paragraph 2 3.5.2, it is submitted that this factor would contribute to improving the efficacy of the South African GAAR.

- **The circularity of cash flows** is relevant for determining whether the movement of cash flows leads to a neutralisation of the outcomes of an arrangement, therefore concealing the real or underlying economic effect (*BNZ Investments Ltd v CIR* (2009) 24 NZTC 23,582 (HC), the *Peterson* case). The circularity of cash flows within an arrangement is sometimes illustrated where one party claims a deduction for an amount of expenditure while the recipient is not assessed on that same amount (Inland Revenue, 2013:72-73). This factor may therefore be considered similar to the presence of a round trip financing indicator of lack of commercial substance in Section 80C (2)(b)(i) of the Income Tax Act. However, for purposes of the South African GAAR, an arrangement can only be tainted by the presence of round trip financing if it meets the requirements listed in Section 80D(1)(a) and 80D(1)(b) of the Income Tax Act, while the New Zealand GAAR does not include a prescribed list of requirements that need to be met before the circularity of cash flows is considered present in an arrangement. As discussed under Paragraph 2.3.5.2 in Chapter 2, the fact that the requirements in Section 80D of the Income Tax Act contain terms that have been left undefined (for example “significantly reduce” “offset” and “business risk”) creates uncertainty regarding the application of this indicator. It is therefore submitted that South Africa should follow an approach similar to New Zealand by not providing a prescriptive definition of round trip financing and thus leaving it to the courts to determine whether a transaction is tainted by the presence of round trip financing to improve the efficacy of the GAAR;
- **The existence of offsetting or self-cancelling obligations** factor determines whether there are exchanges within an arrangement that have the effect of cancelling one another, resulting in no real economic consequences or economic outcomes that are not sustained by the taxpayer (*Westpac Banking Corporation v Commissioner of Inland Revenue* (2009) 24 NZTC 23,834 (HC)). This factor may be considered similar to the

presence of elements that have the effect of offsetting or cancelling each other contained in Section 80C(2)(b)(iii) of the Income Tax Act, which is indicative of lack of commercial substance. It was noted under Paragraph 2.3.5.2 that the wording in Section 80C(2)(b)(ii) is unambiguous and that the ordinary meaning of the words in this section should be followed (Pidduck, 2017:97). Therefore, similar to New Zealand, the South African GAAR does not contain a prescriptive definition to be followed in determining the existence of elements that have the effect of offsetting or cancelling each other;

- **Transactions that have a divergence between the economic and legal effects** or **transactions where the investor incurs no risk** consider whether the taxpayer has undertaken any risk as a result of the arrangement and whether the arrangement has features that remove the risk from the taxpayer, such as transactions where the taxpayer does not use their own funds or security arrangements within a loan agreement that effectively insulate the taxpayer from risk (*Dandelion Investments Ltd v Commissioner of Inland Revenue* [2003] 1 NZLR 600 (CA)). This factor may be considered similar to the general test for lack of commercial substance in Section 80C(1) of the Income Tax Act which refers to transactions that do not have a significant effect upon the business risks or net cash flows of the taxpayer. Firstly, the concept of significant business risk is not defined in the Income Tax Act and thus creates uncertainties regarding the application of this requirement when testing for the commercial substance of the arrangement. Secondly, it is also uncertain as to what constitutes a significant effect upon the net cash flows of a taxpayer, as a significant impact upon one taxpayer's cash flows may be considered insignificant for another, thus creating a level of subjectivity that may be involved in applying this test. These uncertainties could therefore be eliminated by making reference to transactions where the parties incur no risk and no impact upon their net cash flows and thereby remove the concept of "significant effect" from this requirement.
- **Transactions that have a divergence between economic and legal effects** as well as **transactions where the investor incurs no risk** may also be considered similar to the substance over form indicator in Section 80C(2) of the Income Tax Act. It was noted under Paragraph 2.5.3.2 that the substance over form indicator is derived from the common law doctrine of substance over form which is comparable to New Zealand's sham doctrine. A comparison of the South African substance over form indicator with New Zealand's substance over form doctrine reveals that determining whether a

transaction has a substance that differs from its legal form may not be as subjective, as the application of this doctrine in the *Ben Nevis* case did not give rise to a weakness similar to the one identified in the *Sasol Oil* case (Paragraphs 2.3.5.2 and 3.2.2). It is therefore submitted that this weakness may be addressed by developing an objective set of criteria to be applied in determining whether the substance of a transaction differs from its legal form.

- **Transactions with tax asymmetrical parties at uncommercial prices** may be considered similar to the lack of commercial substance indicator of using an accommodating or tax indifferent party in an arrangement contained in Section 80C(2)(b)(ii). However, the South African GAAR contains an exhaustive definition of an accommodating or tax indifferent party in Section 80E of the Income Tax Act which excludes controlled foreign companies. It was noted under Paragraph 2.3.5.2 that the exclusion of controlled foreign companies from this definition creates a weakness in the South African GAAR in the context of multinational enterprises. Unlike the South African GAAR, the New Zealand GAAR does not contain a similar prescriptive definition of a tax asymmetrical party and thus does not preclude controlled foreign companies from being considered tax asymmetrical parties. It is therefore submitted that the efficacy of the South African GAAR may be improved by including a less prescriptive reference to tax accommodating or tax indifferent parties.
- **Dealings between non-arm's length parties** may be considered similar to the tainted element of transactions that create rights or obligations not normally created between parties dealing at arm's length contained in Section 80A(c)(ii) of the Income Tax Act.

Despite the differences in application and interpretation of these individual factors when compared to the South African GAAR the above high-level comparison may be illustrated by Table 3 as follows:

Table 3: Comparison of indicators of artificial transactions in New Zealand

Indictors of artificiality or contrivance in the New Zealand GAAR	Tainted elements and indicators of lack of commercial substance in the South African GAAR
The manner in which the arrangement was carried out	Abnormality element in the context of business (Section 80A(a)(i))

The role of the relevant parties and their relationship with the taxpayer	Accommodating or tax indifferent parties (Section 80C(2)(b)(ii))
The economic and commercial effect of documents and transactions	Lack of commercial substance (Section 80C)
The duration of the arrangement	No South African similarity identified
The nature and extent of the financial consequence for the taxpayer	General test for lack of commercial substance (Section 80C(1))
Lack of business purpose	Substance over form indicator (Section 80C(2)(a))
Circularity of cash flows	Round trip financing (Section 80C(2)(b)(i))
The existence of offsetting or self-cancelling obligations	Elements that have the effect of offsetting or cancelling each other (Section 80C(2)(b)(iii))
Transactions where investors incur no risk or divergence between economic and legal effects of transactions	General test for lack of commercial substance (Section 80C(1)). Substance over form indicator (Section 80C(2)(a))
Transactions with tax asymmetrical parties at uncommercial prices	Accommodating or tax indifferent parties (Section 80C(2)(b)(ii))
Dealings between non-arm's length parties	Transactions that create rights or obligations not normally created between parties dealing at arm's length (Section 80A(c)(ii))

Source: Own design

The above comparison performed thus reveals that the factors considered by the New Zealand courts in determining whether a transaction is artificial or contrived are comparable to the tainted elements and the indicators of lack of commercial substance with the only indicator that does not have a similarity in the South African GAAR being the duration of the arrangement. According to the Interpretation Statement, considering the duration of an arrangement is one of the factors that assists in identifying which aspects of the arrangement to focus on when applying the test for tax avoidance (Inland Revenue, 2013:61). Therefore,

given the current lack of guidance on the indicators of lack of commercial substance, it is submitted that considering the duration of an arrangement may be used to improve the efficacy of the South African GAAR by identifying the aspects of an arrangement which the South African courts may consider when applying the test for lack of commercial substance.

In conclusion, the New Zealand GAAR and the South African GAAR contain certain similarities in the elements of tax avoidance and tax benefit, respectively. A comparison of the two GAARs indicates that the factors considered by the New Zealand courts in their test for tax avoidance are comparable to some of the tainted elements and indicators of lack of commercial substance in the South African GAAR. Further comparison reveals that for the South African GAAR, these comparable tainted elements and indicators of lack of commercial substance are not considered as part of the tax benefit requirement, as they are considered part of the separate fourth requirement of the South African GAAR. It is submitted that having these tainted elements and indicators as a separate requirement creates a weakness in the South African GAAR since the courts may fail to successfully apply the GAAR to an arrangement that results in a tax benefit if at least one of the requirements for the tainted elements is not met. Furthermore, the above comparison indicates that the South African GAAR contains a prescriptive definition for the accommodating or tax indifferent party indicator, which also limits the efficacy of the South African GAAR. Therefore, it is submitted that the efficacy of the South African GAAR may therefore be improved by considering the tainted elements a part of the tax benefit requirement by following the approach taken in New Zealand and by including a less prescriptive reference to accommodating or tax indifferent parties.

3.2.3. PURPOSE OR EFFECT

The third step of the New Zealand GAAR involves an inquiry into the purpose or effect of the arrangement. Section BG 1 of the Income Tax Act 2007 applies to an arrangement that has tax avoidance as its purpose or effect or one of its purposes or effects. The words ‘purpose’ and ‘effect’ pose an interpretive difficulty because they are not defined in the Income Tax Act 2007, and this is compounded by the fact that there is no common standard for determining a taxpayer’s purpose (Atkinson, 2012:25; Littlewood, 2011:5). The interpretation of these words by the courts should therefore be considered.

The meaning of the of these words was considered in the case of *Ashton v Commissioner of Inland Revenue* (1975) 2 NZLR 717 (PC) (the *Ashton* case) where it was held that the words refer to the end result achieved by an arrangement rather that the motive of the taxpayer. Elliffe and Cameron (2010:445) contend that although the courts may argue that this is an objective test, the existence of some subjective factors is likely to inform the court's decision and the authors further note that this was evident in the *Ben Nevis* case when the court considered a statement made by the taxpayer in determining the purpose of the arrangement. However, the interpretation in the *Ashton* case was confirmed in a case subsequent to the *Ben Nevis* case where it was held that the words require an objective examination (*Glenharrow Holdings Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC 23,236 (SC)). Similar contentions exist regarding the sole or main purpose requirement of the South African GAAR, as the case law set under the previous GAAR suggests that the test for purpose is a subjective test, while some academics hold the alternative view that it is an objective test despite similar wording ((de Koker & Williams, 2021:par.19.38); *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A); *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A)).

The conflicting judgments and views indicate that further guidance is required under both GAARs in determining whether an inquiry into the purpose of an arrangement should be a subjective or an objective test. It is submitted that an objective test for the sole or main purpose may be adopted to improve the efficacy of the South African GAAR.

More than a merely incidental purpose or effect

Once it has been determined that the arrangement has tax avoidance as its purpose or effect, it is necessary to determine whether the tax avoidance purpose or effect is more than merely incidental (Tretola, 2017:4). Elliffe (2014:152) notes that it is unusual to find transactions that have tax avoidance as their sole purpose as most transactions have tax avoidance as one of their purposes or effects. This requirement will therefore be applicable where there is more than one purpose or effect in order to determine whether the tax avoidance effect is merely incidental to other purposes and thus remove transactions that have an incidental tax advantage from the scope of the GAAR (Ellife, 2021:4; Littlewood, 2013:526; Ruddell, 2013:500). The concept of 'merely incidental' is not defined in the Income Tax Act 2007, but it was held by the court in the *Challenge Corporation Ltd v Commissioner*

of Inland Revenue (1986) 2 NZLR 513 that a tax avoidance purpose would be considered merely incidental if it arises as a natural concomitant of a non-tax avoidance purpose. This implies that the tax avoidance purpose must arise naturally and without contrivance because artificiality and contrivance indicate that the tax avoidance purpose is more than merely incidental (Ellife, 2021:4; Inland Revenue, 2013:93). The non-tax avoidance purposes in this case may include commercial and private purposes, as well as tax purposes where the use of the specific provision is within parliament's contemplation (Inland Revenue, 2013:86).

The 'merely incidental' requirement of the New Zealand GAAR may be contrasted with the sole or main purpose requirement of the South African GAAR. Tretola (2020:61) is of the view that the New Zealand GAAR provides a lower threshold as a result of the 'merely incidental' test since the tax avoidance purpose only needs to be more than incidental. This indicates that it may be easier for arrangements with a dual purpose to fall foul of the New Zealand GAAR, even if the tax avoidance purpose was not the main or dominant purpose. In South Africa, the court considered an arrangement that served a dual purpose in *Commissioner for Inland Revenue v Conhage (Pty) Ltd* (1999) (4) SA 1149 (SCA) (the *Conhage* case) and held that a particular transaction may be chosen solely for its tax benefits, provided the taxpayer has a commercial purpose for entering into that transaction. The principle established thus reveals a weakness in the South African GAAR because following the *Conhage* case, taxpayers argued that referring to a commercial purpose was sufficient to prevent the Commissioner from successfully applying the GAAR (SARS, 2005:44).

The above comparison thus indicates the possibility of improving the efficacy of the South African GAAR by including a merely incidental test as opposed to the current sole or main purpose test.

3.3. COMPARISON OF THE NEW ZEALAND AND THE SOUTH AFRICAN GAAR

The above analysis compared the New Zealand and South African GAARs in order to identify the similarities and differences that exist between the two GAARs. The goal of this analysis was to identify any lessons to be learnt from the New Zealand GAAR that may be included in the South African GAAR in order to improve its efficacy. The above analysis and comparison

therefore achieve the second and fourth objectives as stated in Paragraph 1.5 in Chapter 1 of this study.

3.3.1. HIGH LEVEL COMPARISON

A comparison of the two GAARs indicates the following similarities:

- The first requirement in both GAARs is that there must be an arrangement. The statutory definitions and the wide interpretation of the word 'arrangement' is also similar between the GAARs.
- While the South African GAAR requires a tax benefit to result from the arrangement, the New Zealand GAAR requires the arrangement to result in tax avoidance. Although the definition of tax avoidance in the New Zealand GAAR only makes reference to the avoidance of income tax, the statutory definitions of tax benefit and tax avoidance contain similar wording as both make reference to the avoidance, postponement or reduction of a liability to tax.
- Both GAARs require an inquiry into the purpose of the arrangement. The South African GAAR requires that the sole or main purpose of the arrangement must be to obtain the tax benefit, while New Zealand GAAR requires the tax avoidance purpose to be more than merely incidental.

The above analysis also revealed differences between the two GAARs, with the most obvious of these differences being that the South African GAAR consists of four main requirements, while the New Zealand GAAR only contains three main requirements. The additional requirement in the South African GAAR is in the form of one of the four tainted elements which is said to make the South African GAAR more onerous to apply (Pidduck, 2017:147). Calvert and Dabner (2012:54) note that the South African GAAR is more prescriptive in its definition of what constitutes an impermissible avoidance arrangement, which is evident from the fact that it contains a prescribed list of tainted elements and indicators of lack of commercial substance. Conversely, it has been left to the courts in New Zealand to consider a non-exhaustive list of factors that indicate tax avoidance, but it is not considered an additional separate requirement of the GAAR. Although Section 80C(2) of the Income Tax Act specifically states that the indicators provided are not limited, the South African courts may still feel constrained and this could limit the possibility of successfully applying the GAAR in court (Calvert & Dabner, 2012:74).

A comparison of the lengths and complexity of the two GAARs indicated that the South African GAAR is lengthier and more complex as it is contained in 12 sections of the Income Tax Act (Sections 80A to 80L of the Income Tax Act), while the provisions of the New Zealand GAAR can be found in 3 sections of the Income Tax Act 2007 (Sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007). Furthermore, Tretola (2017:25) notes that GAARs that attempt to provide an absolute definition of tax avoidance (as is the case with South Africa) do not create flexibility, as taxpayers will find new tax avoidance strategies that fall outside the prescriptive definition. The author further notes that the fact that the New Zealand GAAR does not provide a specific list of criteria leaves it to the courts to determine what constitutes an avoidance arrangement and thus renders the New Zealand GAAR a more effective deterrent against tax avoidance schemes. This is evidenced by the number of cases in which the New Zealand GAAR was successfully applied subsequent to the establishment of the Supreme Court. These cases include *Westpac Banking Corporation v Commissioner of Inland Revenue* (2009) 24 NZTC 23,834 (HC), *BNZ Investments Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 23,997 (HC*), Education Administration Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,238 (HC), *DT United Kingdom Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,369 (HC), *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 (HC), *Krukziener v Commissioner of Inland Revenue* (2010) 24 NZTC 24,563 (HC), the *Ben Nevis* case and the *Penny* case, *Vinelight Nominees Limited v Commissioner of Inland Revenue* (2012) NZHC 3306, *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* (2020) NZCA 383*, and Cullen Group Limited v Commissioner of Inland Revenue* (2019) NZHC 3110.

3.3.2 WEAKNESSES AND RECOMMENDATIONS TO IMPROVE THE SOUTH AFRICAN GAAR

The following recommendations are suggested in order to address the differences identified between the two GAARs and thus improve the efficacy of the South African GAAR:

- Although both GAARs require an arrangement and have similar interpretations of the word 'arrangement', differences were noted under Paragraph 3.2.1 in the approach followed for determining whether a taxpayer is considered party to an arrangement, as the South African GAAR requires the taxpayer to have knowledge of the tax avoidance

motive prior to the arrangement. It is submitted that South Africa should follow a similar approach by not requiring the taxpayer to have prior knowledge of the arrangement, making it irrelevant whether the taxpayer was party to the arrangement and participated with volition.

- The New Zealand courts employ a two-step parliamentary contemplation test informed by a list of factors in determining whether an arrangement has a tax avoidance purpose or effect, while South African courts have developed a 'but for' test in determining whether a tax benefit has resulted from the arrangement. The analysis under Paragraph 3.2.2 indicates that the factors considered by New Zealand courts may be considered similar to some of the tainted elements in the South African GAAR, and that it is not effective for the South African GAAR to have a list of tainted elements to be considered separately from the tax benefit requirement. It is therefore submitted that these tainted elements should rather be considered as part of the tax benefit requirement.
- The South African GAAR requires that the sole or main purpose of an arrangement be to obtain a tax benefit, while the New Zealand GAAR requires the tax avoidance purpose to be more than merely incidental. The analysis under Paragraph 3.2.3 reveals that the purpose requirement of the New Zealand GAAR has a lower threshold, while it may be easier for taxpayers to argue against the South African GAAR by referring to a commercial purpose if a transaction has more than one purpose. It is therefore submitted that the South African GAAR may be improved by also requiring a purpose that is more than merely incidental, rather than the current sole or main purpose requirement.
- A comparison of the purpose requirements under the two GAARs also indicates that there is currently limited guidance on whether an inquiry into the purpose of an arrangement is a subjective or an objective test, as there are conflicting views in both jurisdictions. However, it is submitted than an objective test may be adopted in order to improve the efficacy of the South African GAAR.
- While the South African GAAR contains a prescriptive list of tainted elements and detailed indicators of lack of commercial substance, the New Zealand GAAR does not contain any factors or criteria as it has been left to the courts to determine what constitutes a tax avoidance arrangement (and it is not considered a separate identifiable requirement of the GAAR but rather part of the 'tax benefit' requirement).

The factors considered by the New Zealand courts may be considered similar to the tainted elements and the indicators of lack of commercial substance, with the exception of the factor that considers the duration of the arrangement. It is submitted that the general test for lack of commercial substance may be improved by including consideration for the duration of the arrangement. Suggestions of what factors may be used to improve the South African GAAR are discussed below:

- It is submitted that including a test similar to New Zealand for **the manner in which the arrangement is carried out** may provide further guidance on abnormality, as it assists in determining what is achieved economically and commercially by examining the particular way in which a transaction is structured and whether the transaction has features that differ from usual commercial practice.
- **An inquiry into the role of all the relevant parties and their relationship with the taxpayer** is less restrictive than that of the South African GAAR's accommodating or tax indifferent party**.** Therefore, in an an inquiry into the relationships between all of the parties in the arrangement, as well as any relationship they may have with the taxpayer, the roles played by the parties even where the parties are legally separate but economically form part of the same group may be relevant. Similarly, the roles and relationships of the parties may still be relevant even if the parties are unrelated.
- An inquiry into **the duration of the arrangement** may be included in the South African GAAR that includes an inquiry into the timing aspects such as the duration of and the intervals between events in and within an arrangement (Inland Revenue, 2013:65).
- An inquiry into the **economic and commercial effects of documents and transactions** assists in establishing whether a transaction has a commercial basis and whether the transaction was merely created to obtain the resulting tax advantage and may improve the efficacy of the South African GAAR when compared to the prescribed definition of lack of commercial substance, as well a list of indicators. Similarly, it is submitted that the examination of documents used in an arrangement to determine whether they are consistent with the real outcomes of the arrangement may improve the South African GAAR by leaving it up to the courts to determine whether a transaction lacks commercial substance.

- **The nature and extent of financial consequences for the taxpayer** may be used to improve the South African GAAR, as the general test for lack of commercial substance currently contains terms that are undefined, such as "significant tax benefit" and "significant effect upon business risks and cash flows". It is submitted that the wording of the New Zealand GAAR is simpler and may thus be used to improve the provisions of Section 80C(1) of the Income Tax Act.
- The lack of business purpose factor may contribute to improving the efficacy of the South African GAAR since weaknesses were identified in the current substance over form indicator due to the subjectivity that may be involved when applying this indicator.
- **The circularity of cash flows** is considered in the New Zealand GAAR, while the South African GAAR contains a prescriptive definition of round trip financing which also includes undefined terms which limits the efficacy of the South African GAAR if this definition is not met (Paragraph 3.2.2). It is therefore submitted that the efficacy of the South African GAAR may be improved by not providing prescribed requirements of round trip financing, thus leaving it to the courts to establish whether a transaction is tainted by this indicator.
- The New Zealand GAAR refers to **transactions where the investor incurs no risk as well as transactions that show a divergence between the economic and legal effects.** It is submitted that the subjectivity that arises with the use of the words "significant effect upon business risks and net cash flows" in the general test for lack of commercial substance may be eliminated by referring to transactions where the investor incurs no risk in the South African GAAR. Additionally, comparison of the South African substance over form indicator with this factor reveals that determining whether a transaction has a substance that differs from its legal form may not be subjective in New Zealand, as the application of the substance over form doctrine in the *Ben Nevis* case gave rise to similar findings by the courts (Paragraphs 2.3.5.2 and 3.2.2). It is therefore submitted that this weakness may be addressed by developing an objective set of criteria to be applied in determining whether the substance over form indicator is met.
- While the New Zealand courts consider transactions with **tax asymmetrical parties at uncommercial prices**, Section 80E of the Income Tax Act contains an exhaustive definition of an accommodating or tax-indifferent party. It is submitted

that an approach similar to New Zealand may be followed to improve the provisions of Section 80E by including a less prescriptive reference to tax accommodating or tax indifferent parties.

- The South African GAAR makes use of a separate requirement for the tainted element of misuse or abuse of the Act, which results in a lengthier and more complex GAAR, while the New Zealand GAAR includes consideration for misuse of the legislation as part of the parliamentary contemplation. It is therefore submitted that the misuse or abuse of the Act element should form part of the tax benefit requirement.

3.4. CONCLUSION

This chapter presented a doctrinal analysis of the South African and the New Zealand GAARs with the aim of recommending improvements to the South African GAAR using lessons from New Zealand. The analysis revealed similarities and differences between the two GAARs with the most notable difference being the fourth requirement of the South African GAAR requiring an arrangement to be tainted by certain elements. This chapter therefore achieves the second and fourth research objectives and concludes the doctrinal aspect of this study.

The following chapter will present the reform-oriented research aspect of this study by applying the South African GAAR to the facts of the selected court case in order to understand the application of the South African GAAR and further identify weaknesses that arise upon practical application of the South African GAAR.

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

4.1. INTRODUCTION

Chapters 2 and 3 included the doctrinal analyses of the South African and New Zealand GAARs. In this chapter, the South African GAAR will be applied to the facts of the selected court case from New Zealand in order to identify elements of the South African GAAR that need improvement. The South African GAAR will be applied by using the framework included in Paragraph 2.5. This chapter therefore aims to achieve the third objective of this study by applying the South African GAAR to the facts of the *Ben Nevis* case. The findings of this chapter will enable a comparison to be drawn between the doctrinal and reform-oriented methodologies applied in order to conclude about the efficacy of the South African GAAR.

4.2. FACTS OF THE *BEN NEVIS* CASE

The taxpayers in the *Ben Nevis* case were nine investors in a complex 50-year forestry investment syndicate that involved the development of a forest known as the Douglas Fir Forest (the forest) through what is known as the Trinity Scheme. The forest had a 50-year rotation and was due to be harvested in 2048. The scheme and its contractual terms were designed by Dr Garry Muir, a tax lawyer and one of the investors in the scheme.

The scheme was initially devised in 1997 through acquisition of land for the establishment of the forest, which was owned by Trinity 3, one of the subsidiaries of a company known as Trinity Foundation Ltd. The land in question was properly described as Redcliffe Station and comprised of 538 hectares of which 484 hectares were to be planted as part of the agreement between Trinity 3 and the syndicate. Nine investors invested in the scheme through Trinity 3, formed a joint venture known as the Southern Lakes Joint Venture and formed Southern Lakes Forestry Ltd, a company that entered into various contractual agreements on behalf of the investors. Trinity 3 and Southern Lakes Forestry Ltd initially entered into an occupation licence agreement and a licence agreement, both of which were modified by a subsequent agreement entered into by the parties requiring the appointment of a forestry management company.

The first and second agreements pertained to an occupation licence in respect of Redcliffe Station granted by Trinity 3, as the owner to the syndicate for the establishment of the forest. The two licence agreements provided for the following:

- The agreements provided for the commencement and expiration dates of the licence period as 24 March 1997 and 31 December 2048, respectively;
- The investors were required to pay an amount of $1 350 on 21 March 1997 for each hectare of land for the establishment of the forest;
- The investors were also required to pay an amount of $1 946 for each hectare for the option to purchase the licenced land in 2048;
- This agreement further required the investors to pay an annual licence fee of $50 during the term of the licence;
- The investors undertook to establish, manage and protect the forest at their own expense;
- The investors were required to pay a premium of $2 050 518 multiplied by 484 hectares, being the number of hectares on which the forest was planted, and this payment was to be made at the end of the agreed term of the licence;
- The investors were required to arrange for the forest to be sold during the period of four years prior to the expiration of the licence agreement. The proceeds from these sales were to be used by Trinity 3 for the payment of Goods and Services Tax, cost of sales expenses and promissory notes given by the investors covering their obligation to pay the insurance premium and the premium payable on 31 December 2048. The remaining balance of the proceeds from the sale was to be paid to the syndicate at the end of the term on 31 December 2048.
- The investors were further required to take out insurance through Trinity 3 and Southern Lakes Forestry (further discussed below).

The above agreements were structured in a manner that would allow the investors to use the remaining proceeds from the sale of the forest to settle their obligations to pay the licence premium at the end of the 50 year period in 2048. In order to protect the investors and Trinity 3 against the risk of the proceeds being insufficient to cover this obligation, Dr Muir incorporated CSI Insurance Group (BVI) Ltd in the British Virgin Islands to provide insurance to the parties involved. The insurance agreement provided for the following terms:

- The purpose of the agreement was to insure the syndicate of investors and Trinity 3 in the event of the net proceeds from the forest not reaching the value of $2 050 518;

- The investors were required to pay insurance premiums of $1 307 per hectare in 1997 and $32 791 per hectare on or before 31 December 2047, while Trinity 3 was required to pay $410 104 per hectare on or before 31 December 2047;
- Both Trinity and the investors were required to provide promissory notes to cover their obligations to settle the licence premium at the end of the licence period.

Relying on the provisions of Section EG 1 of the Income Tax Act 2007, the investors claimed an annual deduction for the licence premium equal to a proportion of the amount of the premium of $2 050 518 amortised over the 50-year period on the basis that the licence premiums related to the right of use of land and thus met the requirements of Section EG 1. The investors also claimed a deduction of $34 098 for the insurance premium which consisted of the $1 307 paid in 1997 and the $32 791 payable on or before 31 December 2047. However, the Commissioner of Inland Revenue (the Commissioner) contested the tax position taken by the investors on grounds of three reasons. Firstly, it was argued that the licence premiums were not deductible as the licence granted by Trinity 3 to the investors was for the right to share in the net proceeds from the sale of the forest and not for the right of use of land. Secondly, the Commissioner argued that the insurance premium of $32 791 had to be deducted over the term of the licence agreement and not as a lump sum in 1997, and lastly, the Commissioner concluded that the investors had taken an abusive tax position which would result in the application of the GAAR.

The taxpayers initially challenged the conclusions of the Commissioner in the High Court and the case was later brought on appeal to the Court of Appeal and the Supreme Court. The progress of this in the New Zealand courts is presented in Table 4:

Table 4: Progress of the *Ben Nevis* case

	High Court	Court of Appeal	Supreme Court
Deductibility of licence premiums	Held in favour of the Commissioner	Held in favour of the taxpayer, subject to GAAR	Held in favour of the taxpayer subject to GAAR
Spreading of the insurance premiums	Held in favour of the taxpayer	Held in favour of the Commissioner	Held in favour of the taxpayer subject to GAAR

GAAR	Held in favour of the Commissioner	Held in favour of the Commissioner	Held in favour of the Commissioner

Source: Own design

4.3. APPLICATION OF THE SOUTH AFRICAN GAAR TO THE *BEN NEVIS CASE*

4.3.1. ARRANGEMENT

To determine whether the Trinity Scheme constitutes an impermissible avoidance arrangement, it is first necessary to establish the presence of an arrangement. From a review of the case, it is evident from submissions on behalf of the Commissioner that the entire Trinity Scheme was attacked for purposes of applying the GAAR and that it is necessary to look at all the steps entered into by the taxpayer from the time of purchase of the land (*Ben Nevis Forestry Ventures v Commissioner of Inland Revenue* [2008] NZSCTrans 16). Therefore, in applying the principles of Section 80H of the Income Tax Act and *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A), the following series of transactions or steps constituted the Trinity Scheme in the *Ben Nevis* case and are thus identified as an arrangement:

(1) The transaction for the purchase of the land on which the forest was to be planted;
(2) The incorporation of Southern Lakes Forestry Ltd;
(3) The first agreement for the granting of the occupation licence by Trinity 3 to the syndicate of investors through Southern Lakes Forestry Ltd in return for an annual licence fee and a licence premium at the end of the 50-year period;
(4) The second agreement setting out the terms of the licence agreement and providing for the sale of the forest in the period of four years prior to 31 December 2048;
(5) The third agreement modifying the above two agreements by requiring the appointment of a forestry management company;
(6) The incorporation of CSI Insurance Group (BVI) Ltd (CSI Insurance);
(7) The insurance contracts between the investors, Trinity 3 and CSI Insurance;
(8) The provision of the letter of comfort by Trinity Foundation Charitable Trust to CSI Insurance.

The taxpayers argued that only the business plan of CSI Insurance (Step 6) and the provision of a letter of comfort by Trinity Foundation Charitable Trust to CSI Insurance(Step 8) were the

offensive parts of the scheme, and because they had no knowledge of the contents of CSI Insurance's business plan and the letter of comfort, they were not party to the arrangement, but thus only affected by it (*Ben Nevis* case at (128)). In light of the judgment in the *ABSA* case, it is also necessary to determine whether the investors can be considered party to the arrangement for purposes of the South African GAAR. Certain actions taken by the investors suggest that they were willingly participating in the arrangement and thus acted with volition. Examples of these actions include paying for the forest (Step 1), undertaking to pay the licence and insurance premiums as well as arranging for the sale of the forest (Steps 3 and 4), and entering into insurance contracts with CSI Insurance (Step 7). The fact that the investors requested a solicitor to obtain advice from insurance brokers in order to establish whether CSI Insurance was a captive insurance company set up specifically for the forestry investment scheme indicates that the investors were aware of CSI Insurance's business plan (Step 6) and still continued investing in the Trinity Scheme and claiming the deductions (*Ben Nevis case* at (140)). Furthermore, some of the investors were aware that there was no real risk for CSI Insurance, which implies that they knew about the letter of comfort that was used as a risk mitigant for CSI Insurance (Step 8) (*Ben Nevis Forestry Ventures v Commissioner of Inland Revenue* [2008] NZSCTrans 16). While it is therefore submitted that the taxpayers acted with volition for the scheme as a whole for the purposes of applying the South African GAAR, it is not possible to conclude this with absolute certainty when considering the judgment of the *ABSA* case and therefore reveals a crucial weakness in the South African GAAR where taxpayers claim ignorance of specific steps of the arrangement, even though they were aware of the outcome of the arrangement as a whole and acted with volition.

The above application thus leads to the conclusion that the Trinity Scheme constitutes an arrangement, and the investors are considered party to the arrangement. Notwithstanding this conclusion, the above arguments on behalf of the Commissioner and the taxpayers reveals a weakness in the South African GAAR in instances where the Commissioner decides to only apply the GAAR to specific steps within an arrangement. This is because taxpayers may argue that even though they participated in some steps within a larger arrangement, they had no knowledge of the specific steps that are considered offensive by the Commissioner, resulting in failure to apply the GAAR due to the taxpayers not being "party" to an arrangement.

4.3.2.. TAX BENEFIT

The presence of a tax benefit resulting from the arrangement is the second requirement for application of the South African GAAR. The definition of a tax benefit in Section 1 of the Income Tax Act includes the avoidance, postponement or reduction of any liability for tax. The first test in determining whether the arrangement gave rise to a tax benefit is whether the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability, while the second test considers whether a liability for tax would have existed 'but for' this transaction.

In light of the definition of "tax benefit", the investors in the Trinity Scheme effectively reduced their tax liability by facilitating deductions relating to the insurance premiums and the amortisation of the licence premium of $2 050 518 over 50 years. The investors relied on Section DL 1(3) of the Income Tax Act 2007 in deducting the insurance premiums which consisted of the initial premium of $1307 and the deferred premium of $32 791. The fact that the insurance contracts met the definition of a "financial arrangement", as contemplated in Section OB 1 of the Income Tax Act 2007, ensured that the deferred premiums were not required to be spread over the term of the licence agreement and thus gave rise to a full deduction in the 1997 tax year. A tax benefit was therefore created by structuring the insurance contracts in a manner that gave rise to premiums that could be discharged by issuing promissory notes in 1997, even though the actual cash flows were set to take place in 2047. An alternative arrangement that may be used to illustrate the fact that tax benefit was created is an insurance contract where the taxpayer incurs insurance premiums monthly or annually rather than insurance premiums that are deferred to a future date.

Nevertheless, it is important to note that if the taxpayers had been able to prove that they were not in fact "party" to Steps 6 and 8 of the arrangement and did not act with volition, the outcome may be different for purposes of the tax benefit requirement. In this instance, if the insurance contracts had not been in place no tax benefit would have existed "but for" the arrangement (excluding Steps 6 and 8) and therefore the South African GAAR may have failed to apply to the case. Therefore, the ability of a taxpayer to claim ignorance of individual steps in an arrangement by using a promotor may place the taxpayer in a position of power that may disadvantage the Commissioner in applying the South African GAAR.

However, in applying the framework for the South African GAAR, it may be concluded that the Trinity Scheme resulted in a tax benefit and is therefore an avoidance arrangement.

4.3.3. SOLE OR MAIN PURPOSE

The third requirement of the South African GAAR is that the sole or main purpose of the arrangement must be to obtain a tax benefit. In applying the framework in Paragraph 2.5, a subjective test for the stated intention of the taxpayer is applied in conjunction with an objective test, which considers whether the actual effect of the arrangement supports the taxpayer's stated intention. The stated intention of Dr Muir, who was responsible for designing the scheme, may be deduced from a statement that he made in correspondence with a financial services company in the British Virgin Island prior to the incorporation of CSI Insurance (at 136):

> "The real benefits of the deal are the tax concessions that can be obtained now by the investors and the foundation. One of the conditions required to gain the tax relief is that the insurance must be in place. The actual outcome of the deal in 50 years' time is not considered material."

The above statement, considered in conjunction with a further statement made by Dr Muir in the Supreme Court that CSI Insurance was never exposed to any "real risk" from the scheme indicates that the incorporation of CSI Insurance was merely intended to facilitate the deduction of the insurance and the licence premiums for the investors. A review of the court's judgment reveals that the intention of the taxpayers was never stated to the court, therefore there is no evidence to conclude what the stated intention of the taxpayers was. However, the following objective factors were present in the Trinity Scheme and may assist in determining the purpose of the arrangement for purposes of applying the South African GAAR:

- The financial services company that assisted Dr Muir in incorporating CSI Insurance advertised their services as providing clients with opportunities to "reduce, defer and avoid taxes" and Dr Muir was aware of this fact;
- Dr Muir's statement that the potential tax advantages that could be obtained by the investors was the real benefit of the scheme;
- The letter of comfort supplied by the Trinity Foundation Charitable Trust to CSI Insurance in which it was agreed to donate the amount required to discharge the CSI Insurance's obligation under the insurance contracts indicates that a shortfall of the

net proceeds from the sale of the forest was anticipated and that the taxpayers did not expect the scheme to be profitable;

- The fact that the insurance contracts were structured to enable the investors to provide promissory notes to CSI Insurance in 1997 to create the impression that the insurance premiums were already incurred in 1997 and could thus already be deducted in the 1997 tax year indicates that the deduction of the insurance premiums for tax purposes was an important part of the scheme.

The investors relied on Sections EG 1 and DL 1(3) of the Income Tax Act 2007 in deduction of the licence and the insurance premiums. Section EG 1 allows taxpayers to deduct an amount of depreciation in respect of intangible property that relates to the right of use of land, while Section DL 1(3) allows taxpayers in the forestry business to deduct expenditure relating to insurance premiums. Therefore, the actual effect of the scheme was that the investors in the Trinity Scheme were able to meet the specific provisions of the Income Tax Act 2007 and thus qualified to deduct both the insurance premiums and the amortisation for the licence premium. This actual effect was consistent with the statement made by Dr Muir that the investors would obtain tax benefits through the scheme.

Notwithstanding the above, Section 80G of the Income Tax Act creates a presumption that the sole or main purpose of an arrangement that results in a tax benefit is to obtain the resultant tax benefit unless the taxpayer can prove that obtaining the tax benefit was not the sole or main purpose of the arrangement. An examination of the judgment in this case indicates that there was insufficient evidence provided by the taxpayers to discharge the onus to prove that the sole or main purpose of the Trinity Scheme was not to obtain the tax benefits.

Therefore, in applying the framework for the South African GAAR, it may be concluded that the sole or main purpose of the arrangement was to obtain a tax benefit. Nevertheless, it is important to note that if the taxpayers had been able to prove that they were not in fact “party” to Steps 6 and 8 of the arrangement and did not act with volition, the outcome may be different for purposes of the sole or main purpose requirement. In this instance, even though the presumption of purpose would still remain (and the facts of the case reveal that the taxpayers did not sufficiently discharge this onus), they may well have been able to escape

the tax benefit requirement and therefore also the sole or main purpose requirement, as no tax benefit would have existed "but" for the arrangement (excluding Steps 6 and 8).

4.3.3 TAINTED ELEMENTS

The final requirement of the South African GAAR is that the arrangement must be characterised by at least one of the tainted elements. Before considering whether any of the tainted elements are met, it is necessary to determine whether the arrangement in the *Ben Nevis* case must be considered in a business context, a context other than business or in any other context. It is submitted that the arrangement will be considered in the context of business as the scheme involved the use of companies, joint ventures and group insurance companies. The tainted elements in any other context will also be discussed, as they may be applicable even if the arrangement was entered into in a business context.

4.3.3.1. THE ABNORMALITY ELEMENT

The abnormality element is the first tainted element of the South African GAAR, and it involves an inquiry into whether there is a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration. The following features of the arrangement may be considered relevant in concluding that the scheme was carried out in a manner that would not normally be employed for *bona fide* business purposes:

- Based on evidence presented by experts to the Court of Appeal in this case, it was unlikely that the net proceeds from the sale of the forest in 2048 would be sufficient to cover the cost of the licence premium, indicating that the scheme was unlikely to be profitable in business terms;
- The land was acquired by Trinity 3 at $580 per hectare in 1997 and the investors were required to pay an amount of $1 946 (which was more than three times the cost of the land) per hectare for the option to acquire the land at half of its value in 2048;
- The fact that a greater portion of the insurance premiums was deferred to 2047 instead of being paid to CSI Insurance over the period to which the insurance contracts related thus created a timing mismatch between the incurral of the premiums from a legal perspective and the actual payment of the premiums to CSI Insurance.

- The fact that the investors had also acquired options to acquire the land on which the forest was established in 2047 at half of its 1997 market value also indicates abnormality as land is an asset that can be expected to appreciate in value.

A comparison of the arrangement in the Trinity Scheme to a transaction entered into for *bona fide* business purposes in the absence of a tax benefit is likely to indicate that such a transaction would not be entered into if not for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is unlikely that another taxpayer would enter into a similar transaction without a tax consideration.

4.3.3.2. LACK OF COMMERCIAL SUBSTANCE

The second tainted element of the South African GAAR relates to transactions that lack commercial substance and must be considered in the context of business. In applying the framework in Paragraph 2.5, each of the individual tests for lack of commercial substance will be considered separately as follows:

General lack of commercial substance test

The general test for lack of commercial substance is contained in Section 80C(1) of the Income Tax Act and deems a transaction to lack commercial substance if it results in a significant tax benefit but has no significant effect upon the net cash flows or business risks of the parties. There were two features of the scheme that indicated that the general test for lack of commercial substance would be met. Firstly, Dr Muir's statement to the Supreme Court (at 138) that "there was never any risk to CSI" suggests that the insurance was designed to facilitate substantial tax deductions for the investors and that there was no significant business risk for CSI Insurance resulting from the insurance contracts. Secondly, the scheme was structured in a manner that enabled the investors to deduct the insurance premium of $1 307 as well as the deferred insurance premium of $32 791 which was in fact only payable in 2047 in commercial terms. The deduction of the deferred insurance premium was facilitated by the use of promissory notes provided by the investors to CSI Insurance in 1997 to create the impression that the debt for the premium was discharged, even though in substance the debt remained unpaid because the cash outflow would have only occurred in 2047. These two features therefore indicate that the taxpayers were able to obtain significant tax benefits by deducting both insurance premiums in 1997 while incurring no significant

effect upon their business risks or net cash flows. However, given that the word ‘significant’ is not defined in the Income Tax Act, it cannot be said with absolute certainty that the tax benefit obtained was significant and that there was no significant effect upon the investors’ business risks.

In applying the framework for the South African GAAR, it may be concluded that the Trinity Scheme meets the general test for lack of commercial substance. Nevertheless, it is worth noting that the provisions of Section 80C apply to an avoidance arrangement as defined in Section 80L of the Income Tax Act. Therefore, had the taxpayers been able to prove that they were not “party” to Steps 6 and 8 of the arrangement, an avoidance arrangement would not exist due to there not being an arrangement that gave rise to a tax benefit.

Substance over form indicator

The substance over form test is met when the true intentions of the parties are not reflected in the agreement. It was noted under Paragraph 2.3.5.2 that the substance over form test in the context of the South African GAAR is influenced by the common law and in applying this indicator, it is necessary to consider whether the risks and rewards arising from the arrangement are those that can be expected from such a transaction. Under the Trinity Scheme, CSI Insurance insured the investors against the risk of a shortfall in the proceeds from the sale of the forest and in return, the investors had to pay insurance premiums to CSI Insurance. Similarly, the licence agreement conferred the right of use of land to the investors while the investors had the obligation to pay a licence fee and a premium for using the land. Consequently, it may therefore be concluded that the risks and rewards that arose from the agreements are those than can be expected from an insurance contract and a licence agreement respectively.

The above application indicates that the legal form of the Trinity Scheme may be considered consistent with its substance and that the substance over form indicator is not met.

Round trip financing indicator

In applying the framework for the South African GAAR, the presence of round trip financing is tested for by considering whether funds have been transferred in a reciprocal action, resulting in a tax benefit. The round trip financing indicator is further expanded in Section 80D of the

Income Tax Act with Section 80D(3), stating that the term “funds” includes cash, cash equivalents, and any right or obligation to receive or pay an amount. A promissory note would therefore be included in the definition of “funds” as it contains an obligation of one party to pay a stated amount of money to another party. The following features of the Trinity Scheme indicate the presence of reciprocal action and thus the round tripping of funds:

- CSI Insurance was incorporated to carry the “risk” of the shortfall in the net proceeds from the sale of the forest. As such the investors and Trinity 3 had to pay a deferred insurance premium to CSI Insurance in 2047;
- The investors and Trinity 3 were required to provide CSI Insurance with promissory notes to cover their obligations to pay the deferred insurance premium of $32 791;
- The Trinity Foundation Charitable Trust, a trust that controls Trinity Foundation Ltd, provided CSI Insurance with a letter of comfort stating that the trust would donate any sum of money required to settle the insurance payments to the investors at the end of the 50-year period. This letter of comfort indicates the presence of reciprocal action and that the promissory notes were granted to CSI Insurance in order to facilitate a tax benefit for the investors by allowing them to deduct the deferred insurance premiums in the 1997 tax year. The funds in this case were transferred from the investors to CSI Insurance and from the Trinity Foundation Charitable Trust to CSI Insurance.

It is submitted that the Trinity Scheme included an element of round trip financing and therefore meets this indicator of lack of commercial substance. Nevertheless, the round trip financing indicator would not be met if the taxpayers were able to successfully prove that they were not “party” to Steps 6 and 8 of the arrangement, as one of the requirements of round trip financing is that the transfer of funds must result in a tax benefit, which would not be the case if the parties proved that the insurance arrangements were the offensive parts of the scheme, as this is what gave rise to the tax benefit.

Tax-Indifferent parties indicator

In applying the framework for the South African GAAR, the test for tax-indifferent parties considers whether there is a party who effectively transferred its tax advantage to others, irrespective of its relationship with any of the contracting parties. The fact that CSI Insurance was incorporated in the British Virgin Islands which is considered to be a well-known tax

haven indicates that this insurance company effectively transferred its tax advantage of being subject to tax at a lower rate on the insurance premiums to the investors.

Therefore, in applying the framework for the South African GAAR, it may be concluded that the Trinity Scheme included the use of an accommodating or tax-indifferent party.

Offsetting or cancelling indicator

The last indicator that a transaction lacks commercial substance is the presence of elements that have the effect of offsetting or cancelling one another. The investors in the Trinity Scheme took out insurance with CSI Insurance to cover the risk of any event that would cause the net proceeds to be insufficient to cover the licence premium. It therefore appeared that CSI Insurance carried the risk of this event. However, the letter of comfort provided by the Trinity Foundation Charitable Trust indemnified CSI Insurance from this risk by providing that the trust would donate the amount required if CSI was unable to meet its obligations under the insurance contracts. The letter of comfort therefore had the effect of offsetting the insurance risk carried by CSI Insurance under the insurance contracts.

It may therefore be concluded that the indemnification of CSI Insurance by the Trinity Foundation Charitable Trust created elements that had the effect of offsetting or cancelling one another and thus meets this indicator for lack of commercial substance. It can however be argued that an insurance arrangement is intended to be offsetting, as one party's risk is usually taken over by another in exchange for premiums, thus the use of the word "offsetting" in this indicator creates a weakness in the South African GAAR by extending the scope of the GAAR beyond the legislator's intention. It is submitted that this may be improved by considering the context of the offsetting elements within an arrangement and whether the arrangement is expected to create elements that offset one another.

The above discussion reveals that the arrangement in the *Ben Nevis* case meets all of the indicators of lack of commercial substance, except for the substance over form indicator, and is thus tainted by the lack of commercial substance.

4.3.3.3. CREATION OF RIGHTS AND OBLIGATIONS NOT AT ARM'S LENGTH

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

- CSI Insurance was not allowed to undertake any other insurance business other than what was related to the scheme. It is therefore submitted that it was not the intention of the parties to obtain the best possible advantage of being an insurance company by undertaking other insurance contracts to maximise profits;
- The fact that the investors agreed to pay an amount of $1 946 per hectare of land which was acquired by Trinity 3 at $580 per hectare, which was more than three times the cost of the land, also indicates that the investors were not striving to get the utmost possible advantage from this specific step of the arrangement, even though it could be argued that the investors were getting a benefit from the arrangement as a whole. This application therefore reveals a potential weakness in the South African GAAR, as a specific step within an arrangement might create rights and obligations that are not at arm's length, while it appears as if the parties are striving to get utmost advantage from the arrangement as a whole. It is submitted that this weakness may be addressed by considering whether the parties are striving to get the utmost possible advantage out of each step or transaction within an arrangement;
- The fact that the investors obtained an option to acquire the land that was the subject of the licence agreement for half of its market value in 2048 is a term that would not have been agreed upon by unconnected parties and also indicates that Trinity 3 was not striving to obtain the utmost possible advantage from this transaction;
- It is also submitted that the provision of a letter of comfort by the Trinity Foundation Charitable Trust to CSI Insurance to indemnify CSI Insurance from its obligations under the insurance contracts is not an agreement that that would have been reached between parties who were unconnected, and that the only reason for this letter of comfort was to offset the insurance risk created in order to enable the investors to deduct the insurance premiums.

It may therefore be concluded that the arrangement created rights and obligations that would not be created between parties at arm's length, as unconnected persons would not have agreed to the same terms in this situation.

4.3.3.4. MISUSE OR ABUSE OF THE ACT

The last tainted element of the South African GAAR relates to transactions that misuse or abuse the provisions of the Act. In applying the framework for the South African GAAR, this element is tested for by considering whether the transaction frustrates, exploits or manipulates the purpose of any of the provisions of the Act by achieving a result that was not intended by the legislator when it enacted that provision.

Under the Trinity Scheme, both the licence premium and the insurance premiums met the requirements of the specific provisions under the Income Tax Act 1994, and the taxpayers therefore argued that the deductibility of the premiums was within the legislator's intention (Prebble & McIntosh, 2015:1030). However, it is not within parliament's intention to allow taxpayers deduction for which no real economic burden has been suffered (the *Peterson* case). It was noted that the taxpayers had not suffered any real economic burden on the deferred insurance premiums and that the liability was only discharged by the provision of promissory notes to CSI Insurance as the debt remained unpaid. Therefore, the use of the specific provisions of the act was outside the legislator's intention as the taxpayers deducted the premiums without incurring any real economic cost.

It is therefore submitted that the Trinity Scheme was tainted by the misuse or abuse of the provisions of the Act, as the specific provisions were used to achieve a result that was not intended by the legislator.

4.4. CONCLUSION

The results of applying the South African GAAR to the facts of the *Ben Nevis* case indicate that it is likely that the Trinity Scheme falls within the definition of an impermissible avoidance arrangement due to the presence of an arrangement the sole or main purpose of which was to obtain a tax benefit. Furthermore, the arrangement was tainted by all four elements in the fourth requirement of the GAAR. It is submitted that the successful application of the South

African GAAR may be as a result of the Commissioner's decision to apply the GAAR to the entire Trinity Scheme, rather than to the insurance agreements and the provision of a letter of comfort in isolation as argued by the taxpayers.

In applying the framework to the tainted elements requirement, it was concluded that the Trinity Scheme was tainted by the presence of all four elements, as it was found that it was abnormal, lacked commercial substance, created rights and obligations that are not at arm's length and resulted in misuse or abuse of the provisions of the Act. However, practical application of the requirement for the creation of rights and obligations not at arm's length revealed another potential weakness of the South African GAAR, as the application under Paragraph 4.3.3.3 indicates that a specific step within an arrangement might create rights and obligations that are not at arm's length, while it appears as if the arrangement as a whole gives rise to the utmost advantage for the parties involved. This is indicated by the fact that only certain steps within the Trinity Scheme were found to have created terms that would not have been created between parties dealing at arm's length, namely the incorporation of CSI Insurance, the purchase price agreed for the land, the provision of the letter of comfort, as well as the agreement to purchase the land at half of its market value. A further weakness identified from the practical application of the offsetting or cancelling indicator is that the use of the word offsetting may increase the scope of the GAAR to arrangements that inherently contain elements that offset each other such as insurance arrangements which may not be what is intended by the GAAR.

Although the Trinity Scheme was found to lack a commercial substance, the application of the substance over form indicator in Paragraph 4.3.3.2 was not met, as it was found that the risks and rewards created by the arrangement were similar to those that can be expected from such an arrangement.

Notwithstanding the likelihood of successfully applying the GAAR, the above application reveals further weakness that may potentially exist in the South African GAAR due to the requirement for prior knowledge of a tax avoidance motive and volition from the taxpayer, as determined in the *ABSA* case. This is because the application under Paragraph 4.3.1 indicates that it may be possible for taxpayers to avoid application of the South African GAAR by arguing lack of prior knowledge that certain steps (for example Steps 6 and 8) within an

arrangement have a tax avoidance purpose or motive. It is submitted that the Commissioner would therefore fail to apply the South African GAAR where those same steps are the ones that are considered to be in violation of the GAAR. Had the taxpayers in the *Ben Nevis* case been able to successfully argue that they were not party to Steps 6 and 8 of the arrangement, it may have had severe consequences for the application of the remaining requirements of the South African GAAR. In using ignorance as a defence, it may have resulted in possible failure to successfully find in favour of the Commissioner for the sole or main purpose, tax benefit, the general test for lack of commercial substance and the round trip financing indicator. This identified weakness is consistent with the discussion under Paragraph 3.2.1 in Chapter 3 that the requirement for a taxpayer to have had prior knowledge and volition when entering into the arrangement limits the efficacy of the South African GAAR. As submitted in Chapter 3, this could be addressed by not requiring taxpayers to be party to the arrangement before the GAAR may be applied.

In conclusion, the findings of this chapter indicate that it is likely that the South African GAAR would have been applied successfully against the Trinity Scheme. This is therefore consistent with the findings of the New Zealand Supreme Court, as it was concluded that the scheme was a tax avoidance arrangement for the purposes of the New Zealand GAAR. However, the findings of this chapter also revealed further weaknesses in the South African GAAR.

CHAPTER 5:
CONCLUSION

5.1. INTRODUCTION

As discussed in Chapter 1, governments worldwide have introduced GAARs into tax legislation to combat losses of tax revenue due to tax avoidance. South Africa is one of the countries that uses a GAAR in conjunction with specific anti-avoidance provisions, as well as common law doctrines to tax avoidance. Since its inclusion into the South African tax legislation, the GAAR has been amended several times with the most recent amendments being the subject of criticism for potentially inheriting some of the weaknesses of its predecessor (Pidduck, 2017:317). This considered in conjunction with the limited guidance provided by the South African courts, results in uncertainties regarding the interpretation and application of the GAAR and thus creates a necessity for research into the current South African GAAR.

In light of the existing issues regarding the South African GAAR, the goal of this study is to fill a gap in anti-avoidance research by analysing and comparing the South African GAAR to the New Zealand GAAR in order to identify weaknesses in the South African GAAR that may be addressed through amendments using lessons from New Zealand. In addition to the doctrinal analysis performed, the efficacy of the South African GAAR was analysed by applying it to the facts of a selected court case from New Zealand in order to identify further weaknesses and recommend amendments to improve its efficacy. The following research objectives were pursued in achieving the goal of this study:

1. To identify weaknesses in the current South African GAAR;
2. To compare the theoretical principles of the South African GAAR to the principles of the GAAR of New Zealand;
3. To apply the South African GAAR to the facts of a case from New Zealand where the GAAR was successful, so as to determine whether the South African GAAR would have been successful and thereby identify elements of the South African GAAR that need improvement; and
4. To suggest improvements to the South African GAAR so as to address the identified weaknesses.

A methodological approach known as structured pre-emptive analysis was followed in order to achieve the research objective. As discussed in Paragraph 1.6 of Chapter 1, this research methodology employs both doctrinal as well as reform-oriented research. Doctrinal research was used in analysing the South African GAAR, while reform-oriented research was applied in suggesting amendments that can be made to the South African GAAR in order to improve its efficacy.

5.2. ACHIEVEMENT OF THE RESEARCH OBJECTIVES

Chapter 2 of this study provided a discussion of the weaknesses that were identified in the previous South African GAAR and a critical analysis of the current South African GAAR using doctrinal research. This analysis revealed certain similarities between the current South African GAAR and its predecessor which may suggest that the current GAAR may have inherited some of the weaknesses that were identified in the previous GAAR, as discussed under Paragraph 2.2 of Chapter 2. In addition, the doctrinal analysis undertaken in Chapters 2 and 3 revealed differences between the two GAARs:

- The presence of an arrangement is a requirement of both GAARs, however the South African GAAR requires a taxpayer be party to the arrangement which requires prior knowledge and volition from the taxpayer, while the New Zealand GAAR does not.
- The New Zealand GAAR refers to arrangements that result in tax avoidance, while the South African GAAR refers to arrangements that result in a tax benefit. Although the definitions of tax avoidance and tax benefit contain similar wording, the New Zealand courts employ a parliamentary contemplation test which inquires whether the specific provisions of the legislation have been used within their intended scope, while South African courts have developed a “but for” test to determine whether the tax benefit would have existed but for the arrangement.
- Both GAARSs contain a requirement for the purpose of an arrangement. The South African GAAR requires a sole or main purpose of obtaining a tax benefit, while the New Zealand GAAR requires a tax avoidance purpose that is more than merely incidental.

  The New Zealand GAAR contains 3 requirements while the South African GAAR contains four requirements, which makes it lengthier and more prescriptive. The fourth requirement of the South African GAAR is the presence of tainted elements which are considered separately from the tax benefit requirement and when compared to New

Zealand, are not expressly included in the New Zealand legislation. However, the New Zealand courts consider factors that may be regarded as similar to the tainted elements and the indicators of lack of commercial substance included in the South African GAAR. The analysis under Paragraph 3.2.2 revealed one factor (being the duration of the arrangement) considered in New Zealand that is not comparable to any of the tainted elements or indicators of lack of commercial substance.

5.2.1. CASE OUTCOMES

The application of the South African GAAR to the facts of the *Ben Nevis* case indicated that the arrangement in this case is likely to be considered an impermissible avoidance arrangement and would thus fall foul of the South African GAAR. The following findings resulted from the application:

- The Trinity Scheme includes all steps involved and was identified as the arrangement in applying the framework. Even though an arrangement was identified, it is submitted that the Commissioner may fail to successfully apply the GAAR to specific steps within an arrangement where the taxpayers claim no knowledge of the steps identified as offensive. As submitted under Paragraph 4.4, this may be addressed by not requiring taxpayers to have actively participated or acted with volition to be considered party to the arrangement.
- The scheme resulted in a tax benefit as the investors were able to deduct a deferred insurance premium in 1997, even though in economic terms it was only payable in 2047. It is however submitted that a tax benefit would not have existed but for the insurance contracts, therefore if the taxpayers were able to prove that they were not “party” to the insurance contracts and the letter of comfort (Steps 6 and 8), the tax benefit requirement would not have been met.
- Although it was not possible to obtain the stated intention of the taxpayer from the judgment, the sole or main purpose requirement of the arrangement was considered to be to obtain the tax benefit, as certain objective factors indicated that the sole or main purpose was to obtain the deductions for the insurance premiums. In addition, there was insufficient evidence to conclude whether the taxpayers would have successfully discharged the onus of proving that the sole or main purpose of the Trinity Scheme was not to obtain a tax benefit in terms of Section DL 1(3) of the Income Tax Act 2007. Nevertheless, the outcome may have been different if the taxpayers had been able to

prove that they were not "party" to Steps 6 and 8 of the arrangement, as no tax benefit would have existed in the absence thereof. Thus if the taxpayers were not "party" to these steps, it would not have been possible to conclude that the sole or main purpose of the arrangement was to obtain a tax benefit.

- All four tainted elements were met as it was concluded that the Trinity Scheme was abnormal, lacked commercial substance, created rights and obligation not at arm's length and resulted in misuse or abuse of the provisions of the Act. It is however submitted that the lack of commercial substance element would not be met if the taxpayers were able to prove they were not "party" to Steps 6 and 8, as the element requires an avoidance arrangement as defined which implies the presence of a tax benefit. Therefore, in the absence of the tax benefit created by the insurance contracts there would be no avoidance arrangement and therefore the arrangement would not have been tainted by lack of commercial substance. The following were also identified from application of the tainted elements:
  - Although the general test for lack of commercial substance was considered to be met, there was uncertainty regarding the significance of the tax benefit obtained and whether the investors had incurred no significant effect upon their business risks or net cash flows as the word 'significant' is not defined.
  - The substance over form indicator was not met as there was consistency between the risks and rewards of the scheme and those that can be expected from a such an arrangement.
  - Specific steps within the scheme created rights and obligations not at arm's length. It is submitted that the South African GAAR may be improved by considering whether there are specific steps within a larger arrangement that create rights and obligations that are not at arm's length, even though the arrangement as a whole appears to be at arm's length.

The weaknesses of the South African GAAR as a result of the doctrinal analysis performed in Chapters 2 and 3 are summarised in Paragraph 5.2.1 below.

5.2.1. WEAKNESSES OF THE CURRENT SOUTH AFRICAN GAAR

The following weaknesses were identified from the analysis, comparison and application of the South African GAAR in Chapters 2, 3 and 4 respectively:

- The requirement for taxpayers to have prior knowledge of a tax avoidance motive and volition before they can be considered party to an arrangement puts them in a powerful position of avoiding application of the GAAR by claiming to be unwitting participants of the arrangement (Paragraphs 2.3.1 and 3.2.1).
  - The application of the South African GAAR reveals that should the Commissioner decide to apply the GAAR to specific steps within an arrangement, taxpayers may argue that even though they were party to some steps within the arrangement, they were unaware of the steps considered offensive by the Commissioner (Paragraph 4.3.1).
- Although Section 80H empowers the Commissioner to apply the GAAR to steps within a larger transaction, there is no guidance as to how this could be done without causing the entire arrangement to lose it commercial substance (Pidduck, 2017:159) (Paragraph 2.3.1).
- Placing the burden of proving that the arrangement resulted in a tax benefit by illustrating an alternative arrangement that would have created the same commercial effects on the Commissioner makes the GAAR more onerous for the Commissioner to apply due to time and resource constraints (Paragraph 2.3.1).
- There are opposing views and conflicting judgments regarding whether the inquiry into the purpose of an arrangement is a subjective or an objective test which indicates uncertainty regarding the application of this requirement (Paragraphs 2.3.3 and 3.2.3).
- The requirement that the sole or main purpose of an arrangement must be to obtain the resulting tax benefit creates a more onerous purpose requirement for the South African GAAR and thus makes it easier for taxpayers to escape application of the GAAR by referring to a commercial purpose if a transaction has more than one purpose (Paragraphs 2.3.3 and 3.2.3).
- The weakness identified in the previous GAAR requiring transactions to meet both the sole or main purpose and the abnormality requirement may have been retained in the current GAAR, as transactions are still required to meet the sole or main purpose requirement and at least one of the tainted elements. The current South African GAAR contains a fourth requirement for the tainted elements which is not specifically linked to the tax benefit requirement, and this could result in failure to apply the GAAR to

arrangements that result in a tax benefit if at least one of the tainted elements is not met (Paragraph 2.2 and 3.2.2).

- There is still a lack of guidance on what constitutes a normal transaction for purposes of applying the abnormality requirement which could lead to inconsistent judicial decisions that undermine the efficacy of the GAAR. This is consistent with the weakness identified in the previous GAAR (Paragraphs 2.2 and 2.3.4).
- The general test for lack of commercial substance in Section 80C(1) of the Income Tax Act contains terms that are undefined, including "significant effect upon business risks" and "significant effect upon net cash flows" which may lead to subjectivity and uncertainty when attempting to define these terms (Paragraphs 2.3.4.2 and 3.2.2). This is consistent with the outcome of applying this test in Chapter 4, as it could not be said with absolute certainty that the taxpayers in the *Ben Nevis* case had obtained a significant tax benefit, significant effect upon business risks and net cash flows (Paragraph 4.3.3.2).
- The judgment in the *Sasol Oil* case indicates that applying the common law substance over form doctrine may be subjective and this creates uncertainties regarding the application of the substance over form indicator in the context of the GAAR (Paragraphs 2.3.4.2 and 3.2.2).
- The round-trip financing indicator of lack of commercial substance contains a prescriptive definition which may limit application of the GAAR if the arrangement does not meet the requirements of this definition (Paragraphs 2.3.4.2 and 3.2.2).
- The South African GAAR provides a prescriptive definition of an accommodating or tax indifferent party which may limit the application of the GAAR if this definition is not met (Paragraphs 2.3.4.2 and 3.2.2).
- The exclusion of controlled foreign companies from the definition of accommodating or tax indifferent parties puts multinational enterprises in a powerful position of avoiding application of the GAAR by using controlled foreign companies as accommodating or tax indifferent parties (Paragraph 2.3.4.2).
- The use of the word "offsetting" in the offsetting or cancelling indicator may extend the scope of the GAAR beyond the legislator's intention, as certain types of arrangements inherently contain elements that are offsetting, for example insurance contracts (Paragraph 4.3.3.2).

- The application of the South African GAAR illustrates that it is possible for steps within a larger arrangement to create rights and obligations that are not at arm's length, while it appears as if the arrangement as a whole is at arm's length (Paragraph 4.3.3.3).
- There is currently a lack of guidance on how the test for misuse or abuse of the legislation element should be applied. Furthermore, this element is considered as a separate requirement in the South African GAAR instead of being specifically linked to the tax benefit requirement (Paragraphs 2.3.4.4 and 3.2.2).
- The GAAR contains many terms that are not defined in the Income Tax Act which creates uncertainties regarding how these terms should be interpreted. Examples of these terms include 'transaction', 'operation', 'scheme', 'normal', 'significant' 'business risk', 'significant tax benefit', 'significant effect upon business risks', 'significant effect upon net cash flows', 'offset', 'reduce', 'eliminate', 'between', 'among', 'misuse,' and 'abuse'.

5.2.2. RECOMMENDATIONS TO IMPROVE THE CURRENT SOUTH AFRICAN GAAR

The doctrinal analysis undertaken in Chapters 2 and 3 as well the reform-oriented research followed in Chapter 4 identified weaknesses that exist in the South African GAAR (summarised in Paragraph 5.2.2). It is submitted that the following recommendations may contribute to improving the efficacy of the South African GAAR:

- An approach similar to New Zealand may be followed by not requiring a taxpayer to be party to an arrangement, thus not requiring prior knowledge and volition from the taxpayer in identifying an arrangement (Paragraph 3.2.1).
- It is submitted that further guidance should be provided as to how the GAAR may be applied to steps within an arrangement without the entire arrangement losing its commercial substance (Pidduck, 2017: 159) (Paragraph 2.3.1).
- The onus of proving that the arrangement did not result in a tax benefit may be placed on the taxpayer in order to address the time and resource constraints faced by the Commissioner (Paragraph 2.3.1).
- An approach similar to New Zealand may be followed by requiring a purpose that is more than merely incidental instead of the current sole or main purpose requirement (Paragraph 3.2.3). It is further submitted that the inquiry into the purpose of an arrangement should be an objective test which is not affected by the taxpayer's stated intention (Paragraph 3.2.3).

- In order to address the weakness identified in the previous GAAR which may have been inherited by the current GAAR, the sole or main purpose requirement and the abnormality requirement may be amended into one test where the abnormality of an arrangement informs its purpose (Pidduck, 2017:164). Alternately it is submitted that following an approach similar to New Zealand by considering the tainted elements as part of the tax benefit requirement may improve the efficacy of the South African GAAR, as only three requirements would need to be met instead of the current four requirements (Paragraph 2.2 and 3.2.2).
- Considering the particular way in which a transaction is structured and whether it includes features that are unusual may contribute towards providing further guidance on the tainted element of abnormality (Paragraph 3.2.2).
- It is submitted that the following factors considered by the New Zealand courts may be incorporated into the South African GAAR to provide further guidance on the test for lack of commercial substance (Paragraph 3.2.2):
    - It should be left to the courts to decide whether the economic and commercial effect of documents and transactions within the arrangement indicate a of lack commercial substance;
    - The timing aspects of the arrangement such as the duration of and intervals between events in the arrangement may also be useful in determining lack of commercial substance;
    - Reference should be made to 'the nature and extent of financial consequences for the taxpayer' as this is simpler wording and leaves it to the courts to determine whether the financial consequences are consistent with those expected from the arrangement;
    - Considering transactions where the investor incurs no risk instead of transactions that do not have a significant effect upon the taxpayer's business risks or net cash flows may eliminate the current uncertainties as to what constitutes a "significant effect upon business risks".
    - An objective set of criteria may be developed to assist in applying the substance over form indicator in order to eliminate the subjectivity that may arise in determining whether the substance of the arrangement differs from its legal form. It is also submitted that determining whether a transaction lacks a business purpose may provide guidance in applying the substance over form indicator (Paragraph 3.2.2).

- An approach similar to New Zealand should be followed by not providing a prescriptive definition of round-trip financing which would leave it to the courts to determine whether a transaction is tainted by round tripped amounts (Paragraph 3.2.2).
    - It is also submitted that a less restrictive reference to accommodating or tax indifferent parties would improve the South African GAAR by also leaving it to the courts to consider the roles played by the relevant parties within the arrangement (Paragraph 3.2.2).
    - The context within which a transaction creates elements that offset each other should be considered in order to avoid applying the GAAR to transactions that inherently contain offsetting elements (Paragraph 4.3.3.2).
- When determining whether an arrangement has created rights or obligations that are not at arm's length, it should be considered whether there are steps within the arrangement that may have created rights and obligations not at arm's length even if the entire arrangement appears to be at arm's length (Paragraph 4.3.3.3).
- It is submitted that the uncertainty created by the terms that have not been defined in the Income Tax Act may be eliminated by defining these terms in order to eliminate subjectivity when applying the GAAR, as well as inconsistent interpretations by the courts.

5.3. LIMITATIONS OF THIS STUDY

It was identified in Chapter 1 that the purpose of this study is not to address all possible cases on tax avoidance that may be brought before the courts, as it is difficult to generalise the outcomes of a study that uses a case (Yin, 2009:38). The aim of the findings of this study regarding the interpretation and application of the South African GAAR should therefore be considered in the context of the GAARs of South Africa and New Zealand, as well as the facts of the *Ben Nevis* case.

5.4. FUTURE AREAS OF RESEARCH

The following areas have been identified for future research:

- A study that compares the South African GAAR to other jurisdictions that use a less prescriptive GAAR could be performed. This would assist in determining whether the

South African GAAR would be more effective if it was shorter and left out the determination of what an impermissible avoidance arrangement is.

- Reform-oriented research may also be undertaken to apply the South African GAAR to the facts of a case where the tainted elements are considered as part of the tax benefit requirement. This would assist in determining whether the South African GAAR would be more effective if the tainted elements were seen as part of the test for the presence of a tax benefit rather than being a separate requirement.

5.5. CONCLUSION

The findings from analysing and comparing the South African GAAR with the New Zealand GAAR indicate that similar to its predecessor, the current South African GAAR contains weaknesses that may render it ineffective against impermissible avoidance arrangements. It is submitted that the weaknesses identified present areas where the South African GAAR requires improvement by way of legislative changes and guidance on interpretation. The findings of this study suggest that some of the notable areas of improvement include changing the interpretation of the word "party" when determining the presence of an arrangement. In this context, the application of the South African GAAR undertaken in Chapter 4 indicates that the interpretation of the word "party" from the *ABSA* case may be problematic, where the Commissioner decides to apply the GAAR to steps within an arrangement where taxpayers are able to argue that even though they were aware of some of the steps, they were not party to the steps to which the Commissioner is applying the GAAR. The comparison to the New Zealand GAAR also suggests that requiring a sole or main purpose of obtaining a tax benefit makes it easier for taxpayers to escape application of the GAAR, and this may be addressed by referring to a purpose that is more than merely incidental instead of a sole or main purpose. It is also submitted that amending the sole or main purpose test to an objective test by having no regard to the stated intention of the taxpayer for entering into the arrangement may also improve the efficacy of the South African GAAR. The findings of this research also suggest that New Zealand's approach of not expressly including tainted elements as part of the GAAR but rather leaving it up to the courts to decide using a non-exhaustive list of factors may be more effective. It is therefore submitted that consolidating the tainted elements into the tax benefit requirement and supplementing these elements with non-exhaustive factors similar to those considered in

New Zealand would result in a more effective GAAR that leaves it to the courts to decide whether an arrangement is an impermissible avoidance arrangement.

In conclusion, the findings of this study indicate that the South African GAAR still contains weaknesses, and it may be possible to use lessons from the New Zealand GAAR to improve the efficacy of the South African GAAR.

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