



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

**Psychological predispositions and the inefficacy of the general
anti-avoidance rules as determinants of tax evasion in South Africa.**

By

Keanen Daryll Naidoo

Student no: 18106235

Submitted in partial fulfilment of the requirements for the degree

Master of Laws (LLM Tax)

In the

Faculty of Law

University of Pretoria

December 2022

Supervisor: Dr AB Nyaude

DECLARATION OF ORIGINALITY

Full names of student: Keanen Daryll Naidoo

Student number: 18106235

Declaration

1. I understand what plagiarism is and am aware of the University's policy in this regard.
2. I declare that this mini-dissertation is my own original work. Where other people's work has been used (either from a printed source, Internet or any other source), this has been properly acknowledged and referenced in accordance with departmental requirements.
3. I have not used work previously produced by another student or any other person to hand in as my own.
4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.

DATE: 2 December 2022

SIGNATURE OF STUDENT:



ABSTRACT

“Every man is entitled to, if he can, order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be”. The heavily cited judgment of *IRC v Duke of Westminster* confirms a taxpayer’s right to plan their taxes however, such right has been exploited for decades by taxpayers to the extent that it constitutes tax evasion. Tax evasion involves the illegal non-payment of the correct amount of tax that would be properly payable under the tax laws of a country. As a developing country, South Africa heavily relies on taxes paid by its citizens as a major source of revenue. Tax evasion thus has a significant impact on the finances of the country.

This research interrogates why taxpayers continuously engage in impermissible avoidance arrangements (i.e. tax evasion) in spite of South Africa possessing the general anti-avoidance rules (GAARs) which were developed to deter taxpayers from unlawfully avoiding taxes. To answer this question, this research examines the efficiency of the 2006 amendments to the South African GAARs in addressing previously identified weaknesses and, more importantly, in curbing tax evasion. Such assessment is not done in isolation, as one must consider the taxpayer’s psychological predispositions and its bearing on tax evasion. These predispositions influence a taxpayer’s tax morale, which has been described as the taxpayer’s intrinsic motivation to pay their taxes. Therefore, this research also seeks to determine whether a taxpayer’s psychological predispositions have any bearing on their tax compliance.

Using the 2005 discussion paper by SARS, the 2006 amendments to the GAARs, case law and various authors writing on this subject, it was found that the inefficiency of the GAARs has an impact on tax evasion. In addition to this, empirical evidence founded in surveys and studies, as well as the opinions of various authors writing on the subject are analysed, which show that psychological predispositions of the taxpayer also have an impact on tax evasion. Recommendations are made to improve the GAARs as well as the implementation thereof. Recommendations are also made to improve tax morale through treating psychological predispositions of taxpayers as a priority.

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION	1
1.1 Introduction	1
1.2 The difference between tax evasion, tax avoidance and tax planning	2
1.3 Research problem.....	4
1.4 Research questions.....	5
1.5 Overview of Literature.....	6
1.5.1 Psychological factors potentially influencing tax evasion.....	6
1.5.2 The effectiveness of the general anti-avoidance rules in South Africa	9
1.6 Research methodology and approach.....	12
1.7 Limitations of the study	12
1.8 Structure and outline of chapters.....	13
CHAPTER 2: PSYCHOLOGICAL FACTORS AS A DETERMINANT OF TAX EVASION	15
2.1 Introduction	15
2.2 Aspects of tax morale and their role in tax evasion	15
2.3 Quality of governance and its impact on tax compliance	17
2.4 The psychological tax contract between taxpayers and the state	19
2.5 The impact of the financial strain of paying taxes.....	22
2.6 Conclusion.....	22
CHAPTER 3: THE EFFICACY OF SOUTH AFRICA'S GENERAL ANTI-AVOIDANCE RULES (GAARS)	24
3.1 Introduction	24
3.2 Section 103 of the ITA	24
3.3 Inherent weaknesses of section 103 of the ITA	27
3.3.1 Section 103(1) is not an effective deterrent.....	27
3.3.2 Shortcomings of the “abnormality requirement”	28
3.3.3 The fragility and subjectivity of the purpose requirement	29

3.3.4	Procedural and administrative defects inherent in section 103(1).....	30
3.4	Section 80A – 80L of the ITA: The new GAARs	31
3.5	Addressing the inherent weaknesses of the GAARs	36
3.5.1	Addressing the abnormality requirement	37
3.5.2	Addressing the purpose requirement	38
3.5.3	Addressing the procedural and administrative issues	39
3.6	Powers of SARS to discipline non-compliance by taxpayers.....	39
3.7	The effectiveness of the amendments to the GAARs from a case law perspective	41
3.8	Conclusion.....	43
CHAPTER 4: THE INTERPLAY BETWEEN THE PSYCHOLOGICAL FACTORS IMPACTING TAX COMPLIANCE AND THE INEFFICACY OF THE GAARS		46
4.1	Introduction	46
4.2	The potential harm of over-regulation of tax laws.....	46
4.3	The complexity dilemma	47
4.4	Relationship between taxpayers and tax officials	49
4.5	Conclusion.....	51
CHAPTER 5: SUMMARY AND RECOMMENDATIONS		53
5.1	Introduction	53
5.2	Psychological factors as a determinant of tax evasion.....	53
5.3	The inefficacy of the GAARs	55
5.4	Interplay between psychological factors and the GAARs.....	56
5.5	Recommendations.....	57
BIBLIOGRAPHY		60
6.1	Articles	60
6.2	Books	61
6.3	Case Law.....	61
6.4	Internet Sources.....	62

6.5	Legislation	63
6.6	Theses and Dissertations	63

CHAPTER 1: INTRODUCTION

1.1 Introduction

Rising fuel prices, the ever-volatile utilities condition¹ and a general increase in the cost of living are just some of the predicaments encountered by taxpayers in South Africa. In this context, it is not surprising that the average South African would seemingly seize any opportunity to save every cent possible. The logical point of departure from this perspective would thus be to save where a large part of our income is spent, taxes.

It would be needless to ask why a taxpayer would want to pay less taxes, yet a more compelling question arises when we see taxpayers illegally evading taxes through fraud, non-disclosure of finances and dishonesty in their tax returns. Tax evasion is one of the leading contributors to the decrease in state revenue, but what precipitates taxpayers going to such lengths to evade paying taxes?²

Tax evasion is a worldwide issue involving the purposeful avoidance of paying a true tax liability.³ The main reasons behind this could be psychological predispositions

¹ South Africa has experienced constant power outages due to an insufficient supply of energy compared to the country's demand. South Africa's sole power utility, Eskom has been blamed for such a plight due to insufficient maintenance of the energy infrastructure. See Shabangu *et al.* "Microbial fuel cells for electrical energy: outlook on scaling-up and application possibilities towards South African energy grid" 2022 *Sustainability* 14(21) 14268. Large urban and rural parts of South Africa have also recently faced regular water outages due to an ongoing water supply crisis in areas such as Cape Town. See also Bischoff-Mattson *et al.* "Shape of a water crisis: practitioner perspectives on urban water scarcity and 'Day Zero' in South Africa" 2020 *Water Policy* 22(2) 193–210.

² South African National Treasury, "Budget review 2022/23" available at: <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf> (accessed on 21 October 2022).

³ Kagan "Tax evasion: meaning, definition and penalties" Investopedia 2022 available at: <https://www.investopedia.com/terms/t/taxevasion.asp> (accessed on 29 November 2022). Bergman notes that tax evasion is not a localised issue and is found in all parts of the world. See Bergman *Tax evasion and the rule of law in Latin America* (2009) 2.

influencing a taxpayer to avoid paying their true taxes and the ineffectiveness of a country's general anti-avoidance rules. Psychological predispositions refers to concepts such as tax morale⁴ as well as a taxpayers perception of the tax authorities and the state. General anti-avoidance rules are laws empowering a country's revenue authority to deny tax benefits stemming from transactions which do not have commercial substance and only aims to gain tax benefits.⁵

This research aims to evaluate the two leading determinants of tax evasion in South Africa; identified as, psychological predispositions of the taxpayer and insufficient general anti-avoidance rules. These two concepts will not only be examined and discussed in isolation, but the interplay between the two will also be explored.

1.2 The difference between tax evasion, tax avoidance and tax planning

The minimisation of taxes is an avenue of saving often employed by taxpayers. At the outset, it is important to note that it is not illegal for a taxpayer to organise and plan their taxes in a manner which allows them to pay as little taxes as possible. The court in the heavily cited case of *IRC v Duke of Westminster*⁶ held that:

“Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.”⁷

The aforementioned principle has continued to be actively applied in our law with more recent judicial decisions confirming the said principle. The court in *CIR v Sunnyside Centre (Pty) Ltd* (“*Sunnyside Centre*”)⁸ held that “a taxpayer is entitled to order his

⁴ Hasseldine defines tax morale as a taxpayer's intrinsic and nonpecuniary motivation to pay his/her taxes. See Hasseldine *Advances in Taxation* (2018) 154.

⁵ PWC “General anti-avoidance rule” available at: <https://www.pwc.com/cz/cs/danove-sluzby/danova-politika/assets/gaar-general-anti-avoidance-rule-en.pdf> (accessed on 29 November 2022).

⁶ 1936 AC 1; 19 (TC).

⁷ 1936 AC 1; 19 (TC) 490.

⁸ 1996 58 SATC 319 (A).

affairs so as to pay the minimum of tax”.⁹ In addition to this, the Supreme Court of Appeal held in *CIR v Conhage* (“*Conhage*”)¹⁰ that “within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner”.¹¹ The above established principle refers to practices known as tax planning and tax avoidance. The legal concepts of tax planning and tax avoidance are, however, exploited by taxpayers in such a manner that it constitutes tax evasion.

Tax evasion can broadly be defined as illegal activities deliberately undertaken by a taxpayer in an attempt to free themselves from a tax burden.¹² Such illegal activities include the non-payment of a tax that would be chargeable, had a full and honest financial disclosure been made.¹³ Essentially tax evasion entails the provision of incorrect or incomplete information to the revenue authorities with the aim of obtaining a tax benefit.¹⁴

Conversely, tax avoidance refers to the legal practice in which a taxpayer has arranged their affairs in such a manner, so as to pay as little tax as possible.¹⁵ Similarly, Hoffman defines tax planning as a taxpayer’s capacity to arrange their tax affairs in such a manner so as to suffer a minimum expenditure for taxes.¹⁶ Unlike tax evasion, the practices of tax avoidance and tax planning are not unlawful practices,

⁹ 1996 58 SATC 319 (A) 327. See also Kanamugire “A critical analysis of tax avoidance in the South African Income Tax Act 58 of 1962, as amended” 2013 *Mediterranean Journal of Social Sciences* (4) 351.

¹⁰ 1999 4 SA 1149 (SCA).

¹¹ 1999 4 SA 1149 (SCA) 1155.

¹² Stiglingh *et al. Silke: South African income tax* (2022) 1158.

¹³ *Ibid.* Slemrod defines tax evasion as a case whereby a person unlawfully pays less tax than the law mandates through the commission of fraud. See Slemrod “Cheating ourselves: the economics of tax evasion” 2007 *Journal of Economic Perspectives* 21(1) 25-48.

¹⁴ Furuseth *The interpretation of tax treaties in relation to domestic GAARs* (2018) 41.

¹⁵ Stiglingh *et al.* 1158.

¹⁶ Hoffman “The theory of tax planning” 1961 *The Accounting Review* 36(2) 274-281. Wahab & Holland define tax planning as all activities designed to produce a tax benefit. See Wahab & Holland “Tax planning, corporate governance and equity value” 2012 *The British Accounting Review* 44(2) 111-124.

as confirmed by case law. The definition of tax planning is akin to that of tax avoidance and thus the two terms will be used interchangeably for the purposes of this dissertation.

1.3 Research problem

Tax revenue constitutes one of the largest sources of revenue in South Africa, accounting for approximately 90% of total revenue in the 2022/23 fiscal year.¹⁷ The reliance on tax revenue as a source of income for the country cannot be underestimated. South Africa's non-tax revenue, at just under 10%, is one of the lowest ratios of tax to non-tax revenue among African countries.¹⁸ These already staggering statistics are even more relevant to this research when one considers that personal income tax was the largest contributor towards tax revenue in the 2022/23 fiscal year, accounting for just over 36% of all tax revenue in South Africa.¹⁹

The impact of a threat to one of the most important sources of revenue in the country cannot be overlooked. Tax evasion occupies such a position by directly decreasing personal income taxes which should be, but are not, collected by the state. Dalu argues that states which experience high rates of tax evasion are likely to experience lower productive investment and thus less economic growth, as well as adversely affecting state-run enterprises.²⁰ The necessity of this research is thus rooted in the current and potential impact of tax evasion on our economy.

¹⁷ South African National Treasury, "Budget Review 2022/23" available at: <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf> (accessed on 21 October 2022).

¹⁸ Organisation for Economic Co-operation and Development ("OECD"), "Better Life Index: South Africa" available at: <https://www.oecdbetterlifeindex.org/countries/south-africa/> (accessed on 9 July 2022).

¹⁹ South African National Treasury, "Budget Review 2022/23" available at: <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf> (accessed on 21 October 2022). Other contributors of tax revenue in South Africa are value-added tax (27.5%), corporate income taxes (16.9%) and taxes on international trade and transactions (3.9%).

²⁰ Dalu *et al.* "The impact of tax evasion and avoidance on the economy: a case of Harare, Zimbabwe" 2012 *African Journal of Economic Sustainable Development* 1(3) 284-296. Aumeerun argues that tax

Furthermore, SARS in their 2005 discussion paper on tax avoidance and section 103 of the Income Tax Act 58 of 1962 (“ITA”)²¹ noted that impermissible tax avoidance does not only result in short-term revenue loss but can also cause long-term economic damage to the tax system and the economy.²²

Key to solving any problem is the identification of the causes thereof. The comprehension and evaluation of psychological predispositions and inefficiency of the general anti-avoidance rules as determinants of tax evasion is central to the aim of this research. In identifying the causes of tax evasion, this research will evaluate the manner in which they promote tax evasion and how they interact with one another. If we are to combat the issue of tax evasion, it is imperative that we understand why it continues to occur.

1.4 Research questions

The aim of this research is to examine the rationale behind tax evasion. The two identified determinants, namely psychological predispositions and inefficiency of the general anti-avoidance rules, form the foundation of this research and, instead of being rivalled against one another, the relationship between them will be explored. The research questions are the following:

- a) Do psychological factors of the taxpayer such as attitude towards the law and the government, as well as a taxpayer’s underlying values and beliefs, impact whether they evade taxes or not?

evasion negatively impacts government expenditure and economic growth. See Aumeerun *et al.* “Tax evasion: empirical evidence from sub-Saharan Africa” 2016 *Journal of Accounting and Taxation* 8(7) 70-80.

²¹ Income Tax Act 58 of 1962 (herein after referred to as the “ITA”).

²² SARS “Discussion paper on tax avoidance and section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)” 2005 available at: <https://www.sars.gov.za/wp-content/uploads/Legal/DiscPapers/LAPD-LPrep-DP-2005-01-Discussion-Paper-Tax-Avoidance-Section-103-of-Income-Tax-Act-1962.pdf>

(accessed on 8 August 2022).

- b) Are the general anti-avoidance rules (“GAARs”)²³ in South Africa effective in curbing tax evasion, or are they so ineffective that they, contrarily, promote tax evasion?
- c) If established as determinants of tax evasion, is there a link between the inefficacy of the general anti-avoidance rules and a taxpayer’s psychological impression of tax payment?

1.5 Overview of Literature

1.5.1 Psychological factors potentially influencing tax evasion

In assessing the impact of psychological factors on tax evasion, key arguments from various authors will be interpreted. It will later be seen that support of many of these arguments stem from surveys and studies conducted in a variety of different jurisdictions.

Bergman argues that the reason behind countries with similar tax systems having different rates in compliance lies in the reception of rules and norms within a country.²⁴ He argues that perception of government authorities as well as the general taxpayer attitude towards the rule of law within a country largely impacts tax compliance rates.²⁵

The factors argued by Bergman relate to a concept widely known as “tax morale”. The concept of tax morale will be central to the discussion on psychological factors as a determinant of tax evasion. This concept can be defined as the willingness or “intrinsic motivation to pay taxes” by a taxpayer.²⁶ Tax morale encapsulates various factors which influence a taxpayer’s attitude towards taxation.²⁷ Torgler argues, using data

²³ Hereinafter referred to as the “GAARs”.

²⁴ Bergman 3.

²⁵ *Ibid.*

²⁶ Torgler “Tax morale and institutions” 2003 available at: <https://ssrn.com/abstract=663686>. Hasseldine defines tax morale as the taxpayer’s intrinsic and nonpecuniary motivation to comply with tax laws and expectations. See Hasseldine (2018) 154.

²⁷ Torgler (2003) 4.

from a *Taxpayer Opinion Survey*, that tax evasion is notably reduced in the presence of higher tax morale.²⁸ This research will thus consider the various factors impacting tax morale and demonstrate how the presence of these factors shift and affect the levels of tax evasion. Factors such as guaranteed economic rights, attitude towards the government and relationship with tax officials are argued by various authors, such as Torgler and Riahi-Belkaoui, to be contributors towards tax morale.²⁹

A contributor to tax morale which will be highlighted is a so-called “feeling of being controlled”.³⁰ Frey and Feld argue that over-regulation of tax laws could potentially result in taxpayers feeling negatively controlled to pay taxes which lowers tax morale.³¹ This notion is further supported by Kong and Wang who show, with reference to tax compliance research, that countries in Southern Europe with the most stringent legal provisions regulating tax, had some of the lowest rates of tax compliance in Europe.³²

In addition to tax morale, behavioural factors, argued by Kong and Wang, such as tax fairness and general knowledge of the tax system (also referring to the complexity of the tax system) will also be discussed as determinants of tax evasion in the psychological sphere.³³ The impact which the tax system and, more specifically, a taxpayer’s level of understanding of such system has on tax evasion will be discussed and scrutinized. Tax compliance research conducted by economists and tax experts are referred to by Kong and Wang. These studies are imperative in understanding the relationship between tax knowledge, including the complexity of the tax system, and tax evasion.³⁴

²⁸ *Ibid.*

²⁹ Riahi-Belkaoui “Relationship between tax compliance internationally and selected determinants of tax morale” 2004 *Journal of International Accounting, Auditing and Taxation* 13(2) 135-143.

³⁰ Frey L & Feld B “Deterrence and morale in taxation: an empirical analysis” 2002 available at: <https://ssrn.com/abstract=341380> (accessed 9 July 2022).

³¹ *Ibid.*

³² Kong & Wang “The determinants of tax evasion: a literature review” 2014 *Gdańskie Studia Azji Wschodniej* (5) 70-78.

³³ *Ibid.*

³⁴ *Ibid.*

Due to the nature of this determinant, surveys, experiments and studies conducted by various economists and tax experts around the world become essential to observe. Albeit an empirical study, the research conducted by Riahi-Belkaoui in 2004 on tax compliance will be analysed.³⁵ This study uses data from 30 jurisdictions, measuring tax compliance and comparing it against various factors such as economic freedom and violent crime rates to demonstrate a positive or negative influence.³⁶

Furthermore, lessons will be drawn from an “artefactual field experiment” conducted utilizing data from South Africa and Botswana.³⁷ The 2009 study centres around the impact of behavioural aspects on tax compliance, highlighting the effects of political norms and perceptions of public institutions on tax compliance.³⁸ Employing surveys and experimental data, the study calls attention to aspects such as good governance, corruption and relationships between state officials and the general public.³⁹ In comparing two countries with similar tax systems yet differing historical development and general attitude towards the state, this study proves a useful tool in understanding the effects of psychological factors on tax evasion.⁴⁰

The last aspect considered under this research question is the notion that tax compliance constitutes a so-called social contract.⁴¹ Various authors, whose work is referenced in this research, refer to the concept of an implicit social contract which is imperative in understanding the psychological side of tax evasion.⁴² In respect of this, Riahi-Belkaoui refers to the state guaranteeing services in exchange for tax compliance.⁴³ Feld and Frey make reference to a “psychological tax contract” in which

³⁵ Riahi-Belkaoui 135-143.

³⁶ *Ibid.*

³⁷ Cummings *et al.* “Tax morale affects tax compliance: evidence from surveys and an artefactual field experiment” 2009 *Journal of Economic Behaviour & Organization* 70(3) 447-457.

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ Cummings *et al.* 449.

⁴¹ Riahi-Belkaoui 136.

⁴² *Ibid.*

⁴³ *Ibid.*

“incentives” are offered in exchange for tax compliance.⁴⁴ They, however, dive deeper by noting the impact of government policies and behaviour of state officials on such contract.⁴⁵

1.5.2 The effectiveness of the general anti-avoidance rules in South Africa

In questioning the effectiveness of the GAARs in South Africa, the practical point of departure would be to, firstly, analyse the rules themselves and the development thereof. Thereafter the opinions and writings of scholars will aid in uncovering the “inherent weaknesses” of the GAARs. Lastly, an analysis of case law will be useful in understanding whether the 2006 amendments to the GAARs were impactful or did not adequately address prior weaknesses.

For a number of years, section 103(1) of the ITA encompassed a general anti-avoidance rule.⁴⁶ This section prohibited transactions which were entered into for the sole purpose of avoiding or reducing tax liability. In 2005, the South African Revenue Service (“SARS”)⁴⁷ issued a discussion paper on the effectiveness, or rather the inefficiency, of section 103(1) as an anti-avoidance rule.⁴⁸ In this discussion paper, SARS identified and contemplated four inherent weaknesses in the GAARs at that stage.⁴⁹ These four inherent weaknesses, namely, that the GAARs are not an effective deterrent, the fundamentally weak “abnormality requirement”, the subjective “purpose requirement” and the procedural/administrative issues in enforcing the GAARs will be

⁴⁴ Feld & Frey 5.

⁴⁵ *Ibid.*

⁴⁶ Stiglingh 1159.

⁴⁷ Hereinafter referred to as “SARS”. SARS is an organ of state that is responsible for the collection of tax in South Africa. SARS is established, and draws its powers, from the South African Revenue Services Act 34 of 1997 (the “SARS Act”). Section 4 of the SARS Act obliges SARS to enforce national legislation relating to the collection of revenue in South Africa (a non-exhaustive list of such legislation can be found in Schedule I of the SARS Act). See the SARS website for further information regarding the organization, available at: <https://www.sars.gov.za> (accessed on 26 October 2022).

⁴⁸ SARS (2005).

⁴⁹ SARS (2005) 41.

analysed insofar as considering whether the 2006 amendments to the ITA adequately addressed them.⁵⁰

Due to identification of inherent weaknesses in this section, the ITA was amended to add new provisions on impermissible tax avoidance arrangements.⁵¹ Sections 80A-80L were added into the ITA and these provisions expand on what constitutes an impermissible tax avoidance arrangement (and thus amounts to tax evasion) by referring to the requirements thereof.

Briefly, section 80A of the ITA defines an impermissible tax avoidance arrangement as follows:

“An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit.”

The section adds further requirements which must be met for the arrangement to be considered an impermissible tax avoidance arrangement. There are requirements which apply in a business context with other requirements applying in contexts other than in business. Further elaboration and contemplation of this section will be done in the upcoming chapters. This research will assess the actual wording of these sections to determine whether the GAARs are inefficient in preventing tax evasion. A complete legal interpretative study on the wording of these sections exceeds the scope of this dissertation, however the wording of the new GAARs will be analysed insofar as it relates to addressing the weaknesses of the old GAARs.

While testing the aforementioned weaknesses against the amended GAARs will prove useful in determining the effectiveness of the GAARs today, further sources must also be considered. In order to extensively critique the effectiveness of these rules, the opinions and interpretations of scholars become imperative. Kujinga writes on factors limiting the efficacy of the GAARs and provides constructive insight as to why the

⁵⁰ SARS (2005) 41-43.

⁵¹ Stiglingh 1159.

GAARs have and still prove to be ineffective in curtailing tax evasion.⁵² He highlights general uncertainty, the role of the judiciary and taxpayer aggression as factors negatively impacting the effectiveness of the GAARs.⁵³ Kujinga also importantly provides a global perspective on GAARs by highlighting the effectiveness of the GAARs in jurisdictions such as Australia and Canada, comparing them to the South African GAARs.⁵⁴ He further notes the lack of a universally accepted notion of the “impermissible avoidance arrangement” as an inherent weakness of GAARs and defining factor contributing to the current plight in South Africa regarding tax compliance.⁵⁵

In addition to this, a 2011 dissertation by Calvert will be considered insofar as it considers the effectiveness of the GAARs from a case law perspective.⁵⁶ Calvert argues the ineffectiveness of the 2006 amendments to the GAARs by applying the new GAARs to previous judgments whereby the old GAARs failed to hold taxpayers accountable for tax evasion. A later dissertation by the same writer will also be considered insofar as it confirms the arguments advanced in her 2011 dissertation and shows that the problems identified still persist.⁵⁷ Mzila supports this argument by similarly arguing that the 2006 amendments to the GAARs still possess inherent weaknesses.⁵⁸

⁵² Kujinga “Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada” 2014 *Comparative and International Law Journal of Southern Africa* 47(3) 429-459.

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ Calvert “An analysis of the 2006 amendments to the general anti-avoidance rules: a case law approach” 2011 available at: https://repository.nwu.ac.za/bitstream/handle/10394/6280/Calvert_T.pdf?sequence=1&isAllowed=y (accessed on 8 May 2022).

⁵⁷ Pidduck “The South African general anti-avoidance rule and lessons from the first world: a case law approach” 2017 available at: <https://commons.ru.ac.za/vital/access/services/Download/vital:27768/SOURCE1?view=true> (accessed 29 November 2022).

⁵⁸ Mzila “An analysis of the South African general anti-avoidance rule: lessons from New Zealand” 2020 available at:

1.6 Research methodology and approach

This study will utilize various research methodologies. When analysing the psychological factors influencing tax evasion, empirical research is tremendously important, as will be seen in later chapters. Such empirical evidence will be drawn from surveys and findings by scholars and researchers. The study will also take an analytical and descriptive approach in the interpretation of such findings, however, this methodology will be utilized more thoroughly when assessing the GAARs. These laws will be scrutinized and tested against existing case law in an attempt to assess its efficacy. It is, however, important to note that although empirical evidence will be central to some of the arguments posed, this research remains a desktop study.

This research is not a comparative study, though it may consider international trends and averages in respect of tax compliance. When assessing psychological factors influencing tax compliance, the government and economy where the taxpayer finds themselves act as determinants of tax morale, and various governments and economies must therefore be assessed. Countries such as Botswana will be key to the argument surrounding tax morale and its impact on tax evasion.

1.7 Limitations of the study

As previously stated, empirical evidence, which requires observation of evidence in a practical setting, is imperative in understanding the psychological factors impacting tax evasion. Data for the psychological factors impacting tax evasion is limited and thus the opinions of scholars need to be heavily relied on in this part of the research. In addition to this, many of the surveys and studies which detail the influence of tax morale on tax evasion are relatively dated, however, they do still remain extremely relevant. The variables utilised in these studies still hold today, and this will become clear in the following chapters.

https://repository.up.ac.za/bitstream/handle/2263/80489/Mzila_Analysis_2020.pdf?sequence=1&isAllowed=y (accessed 28 November 2022).

Additionally, it is important to note that this is not a comparative study and as such the GAARs of South Africa will not be scrutinized against the GAARs of other countries but rather previous versions of the GAARs and case law in South Africa. The GAARs of other countries will thus not be discussed in any detail, however international trends and averages may be mentioned merely to illustrate certain points that are made.

Further, the GAARs have not been tested and tried tremendously against the rigour of the South African courts and thus theoretical debates on how tax disputes would play out are necessary. Tax evasion is an illegal activity and is thus hidden (for the most part) which makes measurement of tax compliance difficult. It must therefore be noted that studies utilised in this research only represent a fraction of the jurisdiction studied. As such, results from said studies do not represent tax compliance in a specific jurisdiction to perfection, but it can be reasonably inferred that the ultimate conclusion holds true in respect of the broader picture.

Lastly, due to the nature of the psychological factor determinant, being that it relates to an individual, this research will focus on tax evasion in the personal income tax sector, rather than delving into tax evasion by companies and other juristic persons. Topics such as tax evasion regarding value added tax (VAT) and other taxes, such as customs and excise duties will thus also not be discussed.

1.8 Structure and outline of chapters

Chapter 1 consists of the introduction and background to this study by outlining the purpose of this research and the key points which will be considered. This chapter provides an insight into the two determinants of tax evasion which form the centre piece of this research and summarises the literature which will be utilised in assessing these determinants. Additionally, this chapter also defines key terms and makes important distinctions to make these concepts clear for the reader in later chapters. Lastly the research methodology used is set out in this chapter as well as the limitations of this study and the structure of the chapters.

Chapter 2 of this research elaborates on psychological factors as a determinant of tax evasion. This chapter makes use of various types of sources including tax surveys, tax statistics as well as scholarly articles and opinions of authors as tools to illustrate how behavioural and attitude-based factors impact tax compliance. The use of empirical evidence is central to this chapter as it assesses the numerous factors encompassing “tax morale”, which in turn affects tax compliance.

Chapter 3 will follow a similar approach to chapter 2 in that it focuses on a determinant of tax evasion, namely, the ineffectiveness of the GAARs. In assessing the past and present GAARs, this chapter will look to legislation, case law and scholarly articles in an attempt to understand why the ineffectiveness of the GAARs can be considered a determinant of tax evasion. Inherent weaknesses identified by SARS as well as the opinions of scholars will be assessed against the GAARs in the ITA.

Chapter 4 will approach both determinants evaluated in chapters 2 and 3 above and comment on the interplay between the two. This chapter will seek to understand whether the two determinants act in isolation in the promotion of tax evasion or whether they influence each other in the promotion tax evasion.

Chapter 5 will conclude this research and provide the verdict as to whether tax evasion is a product of psychological factors, ineffective GAARs, both or none. This chapter will summarise the most important conclusions made in this research and propose recommendations to combat the two identified determinants of tax evasion.

CHAPTER 2: PSYCHOLOGICAL FACTORS AS A DETERMINANT OF TAX EVASION

2.1 Introduction

It is trite that tax compliance rates vary internationally, and the central point of this discussion relates to why this is so.⁵⁹ When contemplating the impact that psychological factors may have on a taxpayer's tax compliance, it is key to consider the socio-economic issues affecting such taxpayer. Further to this, one must consider the political narrative present in the taxpayer's country. These factors play a fundamental role in ascertaining the potential impact of a taxpayer's psychological state on their tax compliance rates.

This chapter will explore the chief determinants of tax morale and the effect of this concept on tax evasion. Additionally, this chapter will look at behavioural factors which speak to a taxpayer's knowledge of the tax system and its effect on tax compliance rates. Economic factors such as income will also be briefly considered insofar as they act as deterrents from paying taxes. Support of these concepts contributing to tax evasion can be found in surveys and studies and such results will be analysed in this chapter.

2.2 Aspects of tax morale and their role in tax evasion

Torgler defines tax morale as the intrinsic motivation or willingness by a taxpayer to pay their taxes.⁶⁰ Whereas concepts such as tax evasion and tax compliance relate to a behaviour, Torgler suggests that tax morale speaks rather to a taxpayers attitude.⁶¹ As one would notice, the concept of tax morale seemingly needs to be measured and studied from a subjective approach. A difficulty evidently arises when we consider that tax evasion and tax compliance rates are measured from an objective perspective.

⁵⁹ Riahi-Belkaoui 3.

⁶⁰ Torgler 4.

⁶¹ *Ibid.*

Consequently, surveys and tax compliance studies across various jurisdictions allow for a certain level of objectivity to be applied to the study of psychological factors impacting tax evasion.

Building on this definition, Torgler perceives tax morale as a moral obligation that a taxpayer bears the burden of in the effort of contributing towards society.⁶² Riahi-Belkaoui seemingly supports this definition by providing the notion of a social-contract between the taxpayer and their government.⁶³ Ultimately, such contract forms part of the relationship between the taxpayer and the state; with such relationship being one of the many aspects of tax morale which will be discussed below.

Torgler further extends this definition of tax morale by making mention of the inverse, in that tax morale could relate to the guilt one feels when submitting a tax return which lacks the attribute of candour.⁶⁴ Essentially, the argument made here is that when administering one's personal taxes, a taxpayer is guided by their conscience and morals. Clearly, such an argument cannot be directly proven through raw data, simply as a result of the nature of the concept of tax morale. Scholars who speak to tax morale, have identified aspects of tax morale in an attempt to study the impact of such aspects individually, which eventually contributes toward the overarching concept of tax morale.

Tax morale encompasses a variety of different aspects as there are many factors which could influence a taxpayer's motivation to pay taxes. These include a taxpayer's attitude towards the government, the taxpayer's relationship with tax officials and the state as well as economic rights afforded to a taxpayer by the state.⁶⁵ In essence, these aspects boil down to the political narrative, quality of governance and background which taxpayers find themselves in. South Africa possesses a rich and complex history and background, especially concerning political narratives. In the

⁶² *Ibid.*

⁶³ Riahi-Belkaoui 3.

⁶⁴ Torgler 4.

⁶⁵ *Ibid.*

discussion to follow, these factors will become important when assessing the concept of tax morale from a South African perspective.

2.3 Quality of governance and its impact on tax compliance

Political aspects such as the level of corruption, government accountability and general perception of government effectiveness by taxpayers all contribute to the relationship a taxpayer has with their government. In a 2009 study by Cummings, the tax compliance rates of South Africa and Botswana are compared in an attempt to detail the effect of quality of governance on tax compliance.⁶⁶

Justification for the use of South Africa and Botswana as the two jurisdictions in the aforementioned study is founded in the similarities between the tax systems of the two countries. While each possessing unique and, at times, opposing political histories and government perceptions, South Africa and Botswana have relatively similar tax systems.⁶⁷ Features such as a self-reporting system as well as the tax audit system in the two countries are where the similarities of the two systems are found.⁶⁸ These similarities prove useful by acting as the controlled variable in this tax compliance experiment.

Cummings differentiates South Africa from Botswana by noting stark differences in the political histories of the two countries.⁶⁹ Despite gaining independence at similar times, South Africa remained in the apartheid regime for 30 years after gaining complete independence from the British.⁷⁰ Even after gaining independence in 1994, South Africa still experiences the after-effects from apartheid today. South Africa thus saw constant changes in governance and ruling whereas Botswana has had a stable political history since gaining independence, having the same ruling party since 1966.

⁶⁶ Cummings *et al.* 447.

⁶⁷ Cummings *et al.* 449.

⁶⁸ *Ibid.*

⁶⁹ *Ibid.*

⁷⁰ South Africa gained complete independence (the British monarch ceased to be the head of state in South Africa) in 1961 while Botswana gained independence from the British in 1966.

Cummings elaborates on these political dissimilarities in his research on the election systems of the two countries, referring to Botswana's as a "quiet affair" while South Africa's elections are constantly riddled with violence and corruption allegations.⁷¹ Further, the perception of fairness of the tax system was identified to be notably higher in Botswana than in South Africa.⁷² This study found, as expected, tax compliance rates to be significantly higher in Botswana than in South Africa by approximately 10-15%.⁷³

Further possible contributors towards the perception of the government were that South Africa was found to have less control over corruption than Botswana (as per the Transparency International Corruption Perceptions Index).⁷⁴ Botswana was also found to have a much higher level of political stability than South Africa.⁷⁵ The aforementioned findings all give the impression that South Africa possesses a much more volatile political narrative than Botswana. Such political plight unquestionably influences a taxpayer's perception of the government, thereby straining the relationship between them.

In addition to this, Bergman utilises a similar methodology as Cummings in his 2009 book on tax evasion in Argentina and Chile.⁷⁶ Bergman argues that taxpayers in Argentina perceive their tax authority figures as less effective and legitimate than taxpayers in Chile resulting in lower tax compliance in Argentina despite the two countries' similar tax systems.⁷⁷

Admittedly, such a relationship cannot be the only contributor towards tax evasion, nor can it be said to be a contributor at all solely based on the mere comparison of two

⁷¹ Cummings *et al.* 449.

⁷² *Ibid.*

⁷³ Cummings *et al.* 455.

⁷⁴ Cummings *et al.* 451. See also Transparency International Corruption Perceptions Index available at: <https://www.transparency.org/en/cpi> (accessed on 28 November 2022).

⁷⁵ Cummings *et al.* 451.

⁷⁶ Bergman 3-6.

⁷⁷ *Ibid.*

jurisdictions. While the above comparison of the two countries cannot, in itself, infer a direct correlation between a taxpayer's relationship with the state and their tax compliance rates, it nevertheless creates a compelling argument. Even though the statistics and findings paint such a picture, it is imperative to analyse this relationship on a deeper level to establish a clear correlation.

Tax morale is, however, undisputedly very closely intertwined with the relationship between the taxpayer and the state. Frey and Feld define such relationship as a psychological tax contract.⁷⁸ Analysis of the intricacies and attributes fuelling such a contract will now be discussed to understand the nature of the relationship between the taxpayer and the state.

2.4 The psychological tax contract between taxpayers and the state

The notion of an implicit tax contract is based on a simplified version of a contract of exchange whereby taxpayers surrender a portion of their salary in the form of personal income tax to the state, which then provides said taxpayers with certain utilities, services and amenities.⁷⁹ From the perspective of any ordinary contract where both parties uphold their obligations in terms of said contract, there is hardly any reason for the contract itself not to be upheld. One would deduce that where one party fails to uphold their obligations in respect of any contract, the aggrieved party would naturally hesitate in the performance of their own obligations. From this analogy, it is clear to see that where a state fails in the provision of services to taxpayers, a taxpayer may question why they should comply with tax payments. The relationship between a taxpayer and the state is, by nature, a vertical relationship. However, Frey and Feld note that where a taxpayer is rather treated in a horizontal capacity, as a party to a psychological contract, tax morale is increased leading to higher tax compliance rates.⁸⁰

⁷⁸ Feld & Frey 1.

⁷⁹ Feld & Frey 5.

⁸⁰ Feld & Frey 10. Frey and Feld's argument is based on apprehension experienced by taxpayers when the State engages with said taxpayers through an authoritarian lens. This argument by Frey and Feld must thus be understood from the viewpoint of a contract between the taxpayer and the State. The

It must be understood that the motivation to pay taxes stems from a perceived mutually beneficial relationship between taxpayers and the state. Where the benefit is not materialised, it becomes plain to see why a taxpayer would be inclined to not pay their taxes. These benefits more specifically include economic freedom and prevention of serious crime (ensuring the safety of citizens), as identified by Riahi-Belkaoui.⁸¹ In a 2004 study utilising data from 30 different jurisdictions, it was found that there is a link between such aforementioned “benefits” and tax compliance.⁸² This study found that tax compliance was higher in jurisdictions with low serious crime rates, high economic freedom and important equity markets.⁸³ The inverse being that countries with high serious crime rates, little to no economic freedom and volatile equity markets were seen to have lower tax compliance rates.⁸⁴

To revert back to the analogy made in the beginning of this sub-section, it seems that where the state upholds their obligations in respect of the “implicit tax contract”, taxpayers are more likely to uphold their obligations and comply with tax payment. According to the aforementioned research, the analogy holds true for the inverse as well, in that taxpayers are reluctant to adhere to the contract where their respective governments do not comply with their obligations in terms of said contract by failing to provide and maintain adequate economic rights and public services.

Clearly, one can find many reasons to identify South Africa with the latter, mainly due to the high serious crime rate in the country as well as sub-standard public services.⁸⁵

notion of horizontal treatment refers to, according to Frey and Feld, mutual respect and fair treatment as a party to a contract which, in turn, would have a positive psychological effect on the taxpayer.

⁸¹ Riahi-Belkaoui 10.

⁸² *Ibid.*

⁸³ *Ibid.*

⁸⁴ *Ibid.*

⁸⁵ According to the United Nations Office on Drugs and Crime, South Africa has one of the highest serious crime rates in the world, experiencing 34 annual killings per 100 000 people (the sixth highest rate in the world). More data proving South Africa to be plagued by serious crime at a rate higher than most countries is available at <https://dataunodc.un.org/dp-intentional-homicide-victims> (accessed on 28 November 2022). Franks characterises the public services in South Africa as riddled with

If the South African government fails to uphold their obligations in respect of this implicit psychological tax contract, there is likely a lack of encouragement for South African taxpayers to uphold their end of the contract and pay their taxes.

In addition to this, Frey and Feld note the impact of treatment of taxpayers by tax officials on tax compliance rates.⁸⁶ They note two components of this aspect, the first being the procedures in the processing and auditing of a taxpayers report and secondly the treatment of a taxpayer's personality by the tax officials.⁸⁷ When it comes to the personality treatment, Frey and Feld argue that the manner in which tax officials engage with taxpayers through their treatment of them affects tax evasion.⁸⁸ This notion ties in with the above argument relating to the treatment of taxpayers in a horizontal capacity rather than in a vertical one.

As previously mentioned, tax compliance is said to be higher when a taxpayer is treated as a party to a psychological tax contract, in a horizontal capacity, rather than an authoritative treatment model.⁸⁹ This amounts to whether taxpayers are treated respectfully by tax officials.⁹⁰ Frey and Feld analogise the aforementioned statement by referring to a situation whereby a consumer would much rather purchase the same product from a supplier who provides friendly and respectful treatment than one who does not.⁹¹ Similarly, a taxpayer would be much more inclined to pay taxes to tax officials (albeit an authoritative figure) who treats them respectfully.⁹² It must, however, be noted that respectful treatment by tax officials may not, in itself, curb tax evasion all together.

unaccountability, corruption and particularism. See Franks "The crisis of the South African public service" 2014 *The Journal of the Helen Suzman Foundation* (74) 48-56.

⁸⁶ Feld & Frey 10.

⁸⁷ *Ibid.* See paragraph 4.3 for a discussion regarding tax morale and procedural aspects.

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

⁹⁰ Taxpayers engage with the State, in respect of tax payments, through tax officials and thus perceive treatment by tax officials as treatment by the State.

⁹¹ Feld & Frey 10.

⁹² Feld & Frey 10

2.5 The impact of the financial strain of paying taxes

When considering determinants of tax evasion, one cannot ignore the enormous financial strain that income tax can bear on its payer. With the issues of tax evasion and tax compliance being financial issues at their core, it is clear as to why a taxpayer's financial position must be considered. While the general cost of living is considerably lower in South Africa than in other jurisdictions, the average South African household income is much lower than the OECD average for household income around the world, according to the OECD's Better Life Index.⁹³

The OECD reported that in 2021, the net disposable income of an average South African household was found to be approximately 70% lower than the OECD average.⁹⁴ The same situation can be found in South Africa's employment rate for adults aged 15-64 which stands at 39% while the OECD employment rate average stands at 66%.⁹⁵ One does not need to engage in extensive research of empirical evidence to understand the relationship between the aforementioned employment plight and tax evasion. It is clear that financial strain would always play a role in an individual's decision to evade taxes.

2.6 Conclusion

It is clear from the above discussion that tax morale does have some bearing on tax compliance rates. This chapter considered theoretical discussions advanced by Torgler regarding aspects influencing tax morale. Concepts such as the relationship between the taxpayer and tax officials may support the argument logically from a subjective point of view, however the levels of tax evasion and tax compliance are measured objectively. While important in the discussion, these subjective and theoretical debates do not prove the link between tax morale and tax evasion.

⁹³ OECD, "Better life index: South Africa" available at: <https://www.oecdbetterlifeindex.org/countries/south-africa/> (accessed on 9 July 2022).

⁹⁴ *Ibid.*

⁹⁵ *Ibid.*

Empirical evidence put forth by Cummings takes a more objective stance in proving that tax morale has some bearing on tax compliance rates by comparing such rates in Botswana and South Africa.⁹⁶ By utilising two countries with similar tax systems yet completely different political backgrounds, Cummings is able to link concepts such as the relationship between the state and the taxpayer to tax compliance rates.⁹⁷

In addition to the above, Riahi-Belkaoui provides the notion of a social contract between the taxpayer and the state and such argument is also considered by other authors such as Frey and Feld. While Frey and Feld consider the concept of a psychological tax contract from a theoretical perspective, Riahi-Belkaoui notes such a contract and utilises his empirical evidence to support such an idea.⁹⁸

Lastly, being largely a financial issue, a taxpayer's financial situation must be considered when analysing reasons as to why said taxpayer would evade taxes. In respect of this, statistics from the OECD show South African taxpayers to experience, on average, a worse financial situation than other countries.

The above factors, however, do not excuse a mere disregard for morality and the law. Essentially, regardless of a taxpayer's financial situation, no person is above the law. Therefore, while financial factors may play a role in a taxpayer's decision to evade taxes, there must be larger factors at play. In this chapter, we have considered the psychological factors which influence a taxpayer's compliance rates and we will now consider the South African tax system, more specifically the efficiency of our general anti-avoidance rules.

⁹⁶ Cummings *et al.* 451.

⁹⁷ *Ibid.*

⁹⁸ Riahi-Belkaoui 10.

CHAPTER 3: THE EFFICACY OF SOUTH AFRICA’S GENERAL ANTI-AVOIDANCE RULES (GAARS)

3.1 Introduction

Chapter two made extensive use of empirical evidence as well as scholarly opinions to facilitate a discussion on whether psychological factors impact tax evasion. The aforementioned discussion proved to be largely rooted in the social sciences discipline. This chapter, while not seeking to rival the preceding chapter, will take a far more “legal” approach to the discussion regarding determinants of tax evasion; consisting of an interpretative analysis of the GAARs for a theoretical background, as well as case law analysis to ascertain their efficiency in practical scenarios. While the theoretical background will provide insight into the development of the GAARs by looking at the identified weaknesses and implemented solutions, the case law analysis will act as an indicator of the effectiveness of the GAARs at present.

3.2 Section 103 of the ITA

To wholly scrutinise the effectiveness of the current GAARs, one must consider previous GAARs in the South African tax system. Consideration of the old GAARs, and more specifically the reasoning behind the adoption of the new GAARs provides insight into the weaknesses identified by the lawmakers. Further, a comparison of the old GAARs to the new, will display whether lawmakers have adequately addressed said weaknesses. While this comparison cannot paint a true picture as to whether the GAARs act as an effective deterrent, it does provide insight into already identified weaknesses, allowing one to determine if there has been an improvement on the GAARs as a whole.

The mention of “old GAARs” refers to section 103(1) of the ITA which, as previously mentioned, had encompassed a general anti-avoidance rule for a number of years.⁹⁹ The aforementioned section reads as follows:

⁹⁹ Stiglingh *et al.* 1159.

“(1) Where any 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) has been entered into or carried out which has the effect of avoiding or postponing liability of any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act), or of reducing the amount thereof, and which in the opinion of the Commissioner, 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 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; or
- (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 the Commissioner is of the opinion that the avoidance or postponement of such liability, or the reduction of the amount of such liability was the sole or one of the main purposes of the transaction, operation or scheme, the Commissioner shall determine the liability for any tax, duty or levy on income 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 avoidance, postponement or reduction.”

This section dealt with transactions, operations or schemes which were entered into for the purpose of avoiding, postponing or reducing taxes on income. Interpretation of this section shows that four main components needed to be present for the Commissioner of the South African Revenue Services (the “Commissioner”)¹⁰⁰ to be empowered to determine the tax liability of a taxpayer, as if the transaction, operation or scheme had not been carried out.¹⁰¹ These four components were also recognised by the National Treasury in their Explanatory Memorandum on the Revenue Laws

¹⁰⁰ Section 1 of the ITA notes that reference to the “Commissioner” means the Commissioner for the South African Revenue Service appointed in terms of section 6 of the SARS Act or the Acting Commissioner designated in terms of section 7 of that Act.

¹⁰¹ Section 103(1) of the ITA.

Amendment Bill.¹⁰² Further to this, the judiciary also recognised these four components in *SIR v Geustyn, Forsyth & Joubert*.¹⁰³ The components briefly are as follows:

- a) There must be a transaction, operation or scheme;
- b) Leading to avoidance, reduction or postponement of a tax;
- c) Carried out in a manner not normally employed for a bona fide business purpose (other than obtaining a taxable benefit) or creating rights and obligations not normally created for persons dealing at arm's length; and
- d) Entered into for the sole or main purpose of postponing, reducing or avoiding a tax liability.¹⁰⁴

The aforementioned components relate to a business context, so in a non-business context, the third requirement (in a manner not normally employed for a bona fide business purpose) is changed to: in a manner not normally employed for that specific transaction, operation or scheme.¹⁰⁵

Upon inspection of the above breakdown of the repealed section 103(1) of the ITA, one would notice that the provision purports itself to be somewhat of a remedy to tax evasion. We can perceive this section as an empowering provision as it empowers the Commissioner to determine the tax liability of a taxpayer as if the impermissible transaction had not been entered into. While the intention of the legislature may be apparent at first glance of this section (that being empowering the Commissioner to identify and rectify activities constituting tax evasion), the intended object of the provision had not been achieved, with SARS themselves identifying weaknesses inherent in the provision.¹⁰⁶ In 2005, SARS identified four inherent weaknesses of

¹⁰² SARS "Explanatory memorandum on the Revenue Laws Amendment Bill" (2006) 61 available at: <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2006-01-Explanatory-Memorandum-Revenue-Laws-Amendment-Bill-2006.pdf> (accessed on 27 October 2022).

¹⁰³ 1971 3 SA 567 (A) 571-572.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.*

¹⁰⁶ See paragraph 3.3 for an in-depth discussion on this topic.

section 103(1) in their discussion paper titled “Discussion paper on tax avoidance and section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)”. The weaknesses will be discussed in detail below.¹⁰⁷

3.3 Inherent weaknesses of section 103 of the ITA

To identify whether the current GAARs are sufficient, a logical starting point would be to ascertain whether the weaknesses of the old GAARs were in fact addressed by the new GAARs. In its 2005 Discussion Paper on section 103(1) of the ITA, SARS noted important shortcomings inherent in the provision.¹⁰⁸ The section acted as a deterrent of tax evasion and thus such shortcomings could encourage tax evasion. The salient question that arises is: were the inherent weaknesses in the old GAARs of such a nature that it could foster tax evasion? The short answer to the posed question is affirmative and as we dissect each weakness identified by SARS, one will notice the inefficiency of the provision. The follow-up question would then be, whether the amendments satisfactorily addressed these weaknesses.

3.3.1 Section 103(1) is not an effective deterrent

The first weakness identified by SARS is that section 103(1) is not an effective deterrent to tax evasion. SARS notes that the provision has not held up against complex and sophisticated schemes employed by taxpayers which aim to reduce the tax payable by the said taxpayers.¹⁰⁹ This could possibly be due to the simplicity and vagueness of the provision attempting to rival complex transactions which, at the outset, may seem bona fide but, upon further inspection, show signs of impermissibility in respect of the provisions of the ITA. One cannot test complex transactions against a vague and simple provision expecting a just outcome. A conflict arises here when we consider that tax legislation and its application should be simple enough for the

¹⁰⁷ SARS (2005) 41.

¹⁰⁸ SARS (2005) 41.

¹⁰⁹ SARS (2005) 42.

ordinary taxpayer to understand it.¹¹⁰ A balance needs to be struck in this instance as while tax legislation should be simple, it cannot be so simple that it allows for tax evasion to occur with ease. In seeking to address this weakness, the new GAARs should therefore seek to strike a balance between simplicity and effectiveness against complex transactions.

3.3.2 Shortcomings of the “abnormality requirement”

The second weakness identified by SARS refers to the third component of the provision in that the transaction in question must be carried out in a manner not usually employed for a bona fide business purpose (in the business context) or in a manner not usually employed for that specific transaction (in a non-business context). The issues identified with the so-called abnormality requirement refers to the complexity of transactions in that we cannot classify them as either being bona fide or impermissible strictly.¹¹¹ SARS further refers to instances whereby transactions, often utilized in a bona fide manner, are abused by schemers in an attempt to evade taxes.¹¹² Once again, the complexity of tax transactions proves to be the Achilles heel of the GAARs. It is further noted by SARS that it is not difficult for tax evaders to devise schemes and transactions which sound plausible for a bona fide business purpose. According to SARS, this is largely due to the fact that techniques employed in bona fide transactions are “hijacked” by tax evaders and are used to create impermissible tax avoidance schemes.¹¹³ It is clear from SARS’ argument that bona fide techniques can be abused, and thus the requirement that the transaction must be abnormal for a bona fide business purpose does not hold.

Kujinga notes that the abnormality requirement is problematic as certain tax evasion schemes may be so commonly used allowing tax evaders to argue the normality of a tax evasion scheme without difficulty.¹¹⁴ This creates the issue whereby schemes

¹¹⁰ Stiglingh *et al.* 8.

¹¹¹ SARS (2005) 42.

¹¹² *Ibid.*

¹¹³ SARS (2005) 43.

¹¹⁴ Kujinga 443.

conjured for the purpose tax evasion are so commonly used by tax evaders for a specific transaction that they are considered to be “normally employed for a bona fide business purpose”, and evaders are thus able to circumvent the abnormality requirement. Kujinga further highlights the fact that the abnormality requirement was not adequately defined in the old GAARs, leaving excess room for interpretation by the courts, which usually results in inconsistencies in the application of the provision.¹¹⁵ The new GAARs should thus seek to address the mere inadequacy of this requirement to improve on the efficiency of the GAARs, while still aiming to not overcomplicate the tax legislation.

3.3.3 The fragility and subjectivity of the purpose requirement

The third weakness identified by SARS is found in the fourth component of section 103(1) which states that the sole or main purpose of the transaction should be to obtain a tax benefit.¹¹⁶ The so-called purpose requirement is problematic as it excludes all transactions whereby a tax benefit is obtained but such benefit can be trumped by another purpose of such transaction. SARS notes that this can be problematic where a transaction has both a tax benefit purpose and commercial purpose and thus, impermissibility of the transaction can only be proven if it is shown that the tax benefit purpose was the predominant one.¹¹⁷ Tax evasion is not a scheme done openly and thus most tax evasion schemes are hidden behind a commercial transaction. This therefore ensures that there is always somewhat of a commercial purpose for a tax evader to fall back on, which is essentially the salient issue with the purpose requirement. Instead of acting as part of a greater deterrent for tax evasion, the purpose requirement essentially uncovers a loophole allowing tax evaders to circumvent section 103(1) of the ITA.

¹¹⁵ *Ibid.*

¹¹⁶ SARS (2005) 44.

¹¹⁷ *Ibid.* It is important to note, at this point, that the components of section 103(1) are read conjunctively. The phrase "sole or main purpose" is thus key in scenarios where there appears to be a dual purpose to a transaction.

It is further noted by SARS that proving the purpose requirement entails a subjective test which cannot be easily argued by SARS.¹¹⁸ When ascertaining the predominant purpose of a transaction, we look to the intention of the taxpayer in the purpose they sought to achieve, which is essentially a test of the subjective intention of the taxpayer. The subjective nature of the test makes proving the purpose of tax evasion a strenuous challenge.¹¹⁹

3.3.4 Procedural and administrative defects inherent in section 103(1)

The fourth weakness identified by SARS relates to the uncertainty when applying section 103(1) from a procedural and administrative perspective.¹²⁰ Two distinct uncertainties were noted by SARS, the first has regard to whether the provision may be applied to “steps” in a larger transaction.¹²¹ While a majority of a transaction may avoid being associated with section 103(1) by not meeting all the requirements for section 103(1) to apply, there may be certain parts or steps of said transaction which meets all four requirements for section 103(1) to apply. Section 103(1) clearly relates to a “transaction, operation or scheme” and as such uncertainty arises when we question whether the provision may apply to a suspect step/s within what purports to be a bona fide transaction.

The second uncertainty noted by SARS relates to whether section 103(1) can be invoked by the Commissioner as an alternative where another section of the ITA is in contention.¹²² SARS raises the question that, where a transaction is able to circumvent assessment on the basis of a provision in the ITA, can the Commissioner invoke section 103(1) as an alternative basis of assessment?¹²³ The importance of noting this deficiency in the section arises when we consider that taxpayers may escape assessment due to the specificity of other provisions in the Act whereas section 103(1)

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*

¹²⁰ SARS (2005) 45.

¹²¹ *Ibid.*

¹²² *Ibid.*

¹²³ SARS (2005) 57.

encompasses a much more general basis of assessment. Any amendments to the GAARs must therefore aim to address these uncertainties by specifying whether section 103(1) may be invoked against certain steps in a transaction and whether it may be invoked as an alternative basis of assessment.

Optimistically, the benefit one can take away from the identification of the above four weaknesses is that they were, in fact, identified by SARS. The awareness and practical thinking of the lawmakers in the tax space allows for the development of more pragmatic GAARs which address previously identified issues. Whether the new GAARs address these weaknesses will be contemplated in the following paragraphs.

3.4 Section 80A – 80L of the ITA: The new GAARs

In 2006, the ITA was amended with the addition of sections 80A to 80L. These sections constitute what is referred to in this research as the “new GAARs” and apply to any arrangement, or parts thereof, entered into after 2 November 2006. Section 80A defines an impermissible avoidance arrangement and reads as follows:

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

(a) in the context of business—

- (i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
- (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

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

(c) in any context—

- (i) it has created rights or obligations that would not normally be created between persons dealing at arm’s length; or
- (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).”

Upon interpretation of section 80A, one will notice that three components present in the old section 103(1) are also present in the new GAARs, namely, the arrangement requirement; obtaining a tax benefit; and the purpose requirement. Section 80A further notes that the arrangement so referred to must meet one of the requirements listed in the provision. Stiglingh and others neatly break down section 80A of the ITA in an attempt to demonstrate the new requirements for the Commissioner to be empowered to take action in terms of section 80B.¹²⁴ Further to the three requirements mentioned above, the arrangement must meet any one of the requirements in subsections (a), (b) or (c) to constitute an impermissible avoidance arrangement. If the arrangement in question complies with the requirements set out in section 80A of the ITA, the Commissioner will be empowered to take action in terms of section 80B.¹²⁵

Sections 80C through to 80L of the ITA form the rest of the GAARs and provide flesh to section 80A. These sections aid the interpretation of section 80A by defining concepts while also specifying the manner in which the GAARs may be applied. Section 80C reads as follows:

“Lack of commercial substance.— (1) For purposes 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 obtained 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

¹²⁴ Stiglingh *et al.* 1160.

¹²⁵ See paragraph 3.5 below for an in-depth discussion on section 80B of the ITA.

(iii) elements that have the effect of offsetting or cancelling each other.”

Section 80C essentially supplements section 80A(a)(ii) by defining the term “lack of commercial substance”. Where an avoidance arrangement lacks commercial substance, the Commissioner may be empowered to take action in respect of section 80B. Section 80C thus provides clarity in the interpretation of section 80A(a)(ii). Furthermore, section 80C of the ITA provides for a non-exhaustive list of specific characteristics present in an arrangement which may lack commercial substance as further supplementation of section 80A(a)(ii). These include the presence of round-trip financing¹²⁶ or an accommodating or tax indifferent party¹²⁷ which are defined in detail in sections 80D and 80E of the ITA respectively.

Section 80F of the ITA thereafter sets out the powers of the Commissioner in relation to the treatment of accommodating or tax-indifferent parties which further supplements and provides clarity to the application of section 80C of same Act. The section reads as follows:

“Treatment of connected persons and accommodating or tax-indifferent parties.—For the purposes of applying section 80C or determining whether or not a tax benefit exists for purposes of this Part, the Commissioner may—

¹²⁶ Section 80D of the ITA defines the concept of round trip financing to supplement section 80C of the ITA which names round trip financing as an indicator of an avoidance arrangement lacking commercial substance. Section 80D defines round trip financing as any avoidance arrangement wherein funds are transferred between parties and such transfer would result in a tax benefit and reduce or eliminate any business risk incurred by any party to such avoidance arrangement.

¹²⁷ Section 80E of the ITA defines in great detail what constitutes an accommodating or tax-indifferent party. The section, for example, states that a party will be considered accommodating or tax-indifferent if any amount received by said taxpayer in connection with the arrangement is not subject to normal tax. The section details the instances wherein a party will be considered an accommodating or tax-indifferent party and, like section 80D of the ITA, supplements section 80C of the ITA which refers to the presence of accommodating or tax indifferent parties as an indicator of an avoidance arrangement lacking commercial substance.

- (a) treat parties who are connected persons in relation to each other as one and the same person; or
- (b) disregard any accommodating or tax-indifferent party or treat any accommodating or tax-indifferent party and any other party as one and the same person.”

Section 80G provides for the presumption of purpose and reads as follows:

“Presumption of purpose.—(1) 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 a 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.

(2) The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole.”

Section 80G of the ITA supplements the definition of an impermissible avoidance arrangement present in section 80A of the ITA. Section 80A refers to the gaining of a tax benefit being the sole or main purpose of the arrangement. Section 80G clarifies the interpretation of this by providing for a rebuttable presumption of purpose in any avoidance arrangement. It places the onus on the party obtaining such a tax benefit to prove that the sole or main purpose of the arrangement was not to gain a tax benefit.

Section 80H relates to application of sections 80A to 80L of the ITA to steps in or parts of an arrangement and reads as follows:

“Application to steps in or parts of an arrangement.—The Commissioner may apply the provisions of this Part to steps in or parts of an arrangement.”

Section 80H of the ITA thus further aids interpretation of its preceding sections by confirming that those sections may be applied to certain steps in, or parts of, an arrangement. In doing this, this provision extends the Commissioner’s powers to apply this part of the ITA to steps within an arrangement and not just the arrangement as a whole.

Similar to section 80H, section 80I of the ITA aids the interpretation of the preceding sections and refers to the use of this part of the ITA in the alternative. Section 80I reads as follows:

“Use in the alternative.—The Commissioner may apply the provisions of this Part in the alternative for or in addition to any other basis for raising an assessment.”

This provision further extends the Commissioner’s powers by allowing him/her to apply the GAARs as an alternative basis of raising an assessment.

Section 80J of the ITA provides for administrative and procedural rules in respect of the application of section 80B of the same Act by the Commissioner. The provision reads as follows:

“Notice.—(1) The Commissioner must, prior to determining any liability of a party for tax under section 80B, give the party notice that he or she believes that the provisions of this Part may apply in respect of an arrangement and must set out in the notice his or her reasons therefor.

(2) A party who receives notice in terms of subsection (1) may, within 60 days after the date of that notice or such longer period as the Commissioner may allow, submit reasons to the Commissioner why the provisions of this Part should not be applied.

(3) The Commissioner must within 180 days of receipt of the reasons or the expiry of the period contemplated in subsection (2) —

- (a) request additional information in order to determine whether or not this Part applies in respect of an arrangement;
- (b) give notice to the party that the notice in terms of subsection (1) has been withdrawn; or
- (c) determine the liability of that party for tax in terms of this Part.

(4) If at any stage after giving notice to the party in terms of subsection (1), additional information comes to the knowledge of the Commissioner, he or she may revise or modify his or her reasons for applying this Part or, if the notice has been withdrawn, give notice in terms of subsection (1).”

Section 80J of the ITA clearly provides for the manner in which the Commissioner may exercise his/her powers in terms of section 80B. This provision provides for notice to

be given to the taxpayer in question, and allows such taxpayer 60 days to provide reasons as to why they believe the GAARs should not apply in said case. Thereafter the Commissioner may request additional information, withdraw the notice or determine the tax liability of the party in terms of section 80B of the ITA within 180 days of receipt of reasons for the arrangement.

This provision thus allows for transparent communication between the taxpayer and tax officials while promoting taxpayer rights by affording the taxpayer an opportunity to provide insight into the transaction in question.

Section 80K of the ITA deals with interest in respect of tax attributable to the application of the GAARs. Such section is however pending amendment as it will be repealed by section 271 of the Tax Administration Act (“TAA”)¹²⁸ read with paragraph 66 of Schedule 1 to the TAA. The effective date however, has not yet been determined by the President.¹²⁹

Section 80L of the ITA provides for the definitions of commonly used terms in respect of sections 80A to 80L of the ITA such as “arrangement”, “party” and “tax benefit” to name a few. This section does not introduce any new anti-avoidance procedures strictly speaking, but it does act as a useful interpretative tool for purposes of the GAARs.

3.5 Addressing the inherent weaknesses of the GAARs

The first weakness of section 103(1), that the GAARs are not an effective deterrent, relates to the GAARs as a whole and is thus quite a general weakness. The first weakness can thus only be analysed from a pragmatic perspective or by taking into account the other identified weaknesses. The second weakness, being that the abnormality requirement is inadequate, is addressed by section 80A. The third

¹²⁸ Tax Administration Act 28 of 2011 (herein after referred to as the “TAA”).

¹²⁹ In Proclamation No. 51 in *Government Gazette* 35687 of 14 September 2012, the Tax Administration Act 2011 (Act 28 of 2011) was proclaimed to come into effect on 1 October 2012 save for certain provisions. These provisions which had their effective date suspended for a later time included “any provision of Schedule 1 to the [TAA] that amends or repeals a provision of a tax Act relating to interest under that tax Act, to the extent of that amendment or repeal”.

weakness, which relates to the fragility and subjectivity of the purpose requirement, is addressed by section 80G which introduces an objective standard, however, not to the extent that it solves this issue in whole. The fourth weakness, relating to the procedural issues with section 103(1), is directly addressed in section 80H and 80I. The manner in which the new GAARs address previously identified issues will be discussed below.

3.5.1 Addressing the abnormality requirement

The salient issue with regards to the abnormality requirement related partly to the fact that there were no more requirements besides it. SARS, as discussed above, noted how bona fide (normal) transactions are abused by taxpayers in an attempt to evade taxes and, it is for this reason that tax evaders are easily able to circumvent this requirement. While the abnormality requirement is retained in the new GAARs, the amendments to the ITA introduces more instances which can render an arrangement impermissible. The lack of commercial substance requirement is introduced as a basis for rendering an arrangement impermissible in a business context. Considering Kujinga's arguments relating to schemes being so commonly used that they become "normal" in a business context, it seems as if this amendment seeks to address such weakness. While a taxpayer may successfully argue that a scheme is normal, by virtue of it being so commonly employed by tax evaders, such a scheme may lack commercial substance due to it being solely a tax avoidance scheme.

Additionally, section 80A(c) introduces two other instances wherein an arrangement can be considered an impermissible avoidance arrangement in both a business and non-business context.¹³⁰ These are that the arrangement created rights and obligations not normally created between persons dealing at arm's length and the arrangement results in the misuse or abuse of provisions in the ITA either directly or indirectly. These two other instances introduced in section 80A(c) extend the scope of the GAARs instead of limiting it to abnormality. Thus, even if an arrangement is able to circumvent the GAARs in respect of abnormality, the additional provisions limit the room for escape.

¹³⁰ Section 80A(c)(i) and (ii) of the ITA (see paragraph 3.4 above for description of such sub-sections).

It has, however, been argued that some of the content added to the GAARs may be futile. Langenhoven, argues that section 80A(c)(ii) may be an unnecessary addition as it simply prevents the use of the provisions in the ITA in a manner that contravenes the purpose or object of the ITA.¹³¹ In addition, Langenhoven argues that this provision is merely included as a tainted element and not as a limiting factor which means that the other requirements in the GAARs still need to be considered and this provision is not conclusive.¹³² One must therefore be mindful that the addition of more content to the GAARs is not directly indicative of stronger GAARs.

3.5.2 Addressing the purpose requirement

In the SARS Discussion Note on the proposed amendments, they noted that an objective standard should be introduced to the purpose requirement in order to remedy its defects.¹³³ Section 80G of the ITA now creates the presumption that an avoidance arrangement was entered into for the sole or main purpose of obtaining a tax benefit until the party obtaining the benefit proves, reasonably in light of the relevant facts and circumstances, that the sole or main purpose was not to obtain a tax benefit. This amendment introduces an objective standard to the purpose requirement by placing a rebuttable presumption in the purpose requirement. When looking to concepts such as reasonability with reference to surrounding circumstances, we apply a sense of objectivity.

This thereby addresses the issue of tax evaders easily proving that their main, subjective intention was not to obtain a tax benefit however, the sole or main purpose requirement still persists. SARS notes that the aim of this amendment is to make it

¹³¹ Langenhoven “Does the South African GAAR criteria of the ‘misuse or abuse’ of a provision included in Section 80A(c)(ii) of the Income Tax Act add any value?” 2016 available at: https://open.uct.ac.za/bitstream/handle/11427/22857/thesis_com_2016_langenhoven_allenda_glynn_%20%281%29.pdf?sequence=1&isAllowed=y (accessed 30 November 2022).

¹³² Langenhoven (2016) 49-52.

¹³³ SARS (2005) 56.

more difficult for a taxpayer to rebut the presumption of a tax avoidance purpose where a tax benefit has been obtained.¹³⁴ It seems as if the weakness identified by SARS has been directly addressed herein, however, the effectiveness thereof can only be seen in practical application of the new GAARs. In most cases, taxpayers conceal tax evasion schemes behind legal transactions which serve their own purpose. If a taxpayer can still prove that the sole or main purpose behind the transaction is the commercial agreement and not the tax benefit, they are still able to escape this provision. As a result of the new GAARs being judicially untested, Pidduck notes that it is difficult to predict to what extent the courts would consider avoidance arrangements subjectively and to what extent they would consider them objectively.¹³⁵

3.5.3 Addressing the procedural and administrative issues

The amendments to the ITA directly address the two administrative issues identified in the SARS Discussion Note on section 103(1) of the ITA.¹³⁶ Section 80H addresses the uncertainty regarding whether the GAARs may be applied to steps within a larger transaction by stating that the Commissioner may apply that part of the Act (which consists of the GAARs) to steps within larger transactions. Further to this, section 80I addresses the uncertainty surrounding whether the GAARs may be invoked in the alternative as a basis for assessment. Section 80I empowers the Commissioner to invoke the provisions encompassing the GAARs as an alternative basis for assessment. These provisions are clear and direct improvements to the old GAARs as they provide certainty where it was once clearly lacking.

3.6 Powers of SARS to discipline non-compliance by taxpayers

While defining an impermissible tax avoidance arrangement and deeming it to be unlawful may, in itself, act as a deterrent against tax evasion, a greater deterrent may be found in the ability of SARS to reprimand non-compliant taxpayers. Section 80B of

¹³⁴ SARS (2005) 56.

¹³⁵ Pidduck (2017) 283.

¹³⁶ SARS (2005) 44.

the ITA empowers the Commissioner to determine the tax consequences of any impermissible avoidance arrangement. The section provides for different means in which the Commissioner may determine tax consequences of an impermissible avoidance arrangement and they are as follows:

- “(a) disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
- (b) disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;
- (c) deeming persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;
- (d) reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
- (e) re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
- (f) treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.”

This section clearly provides for a number of possible avenues for the Commissioner to correct the tax consequences of an impermissible transaction (as defined in section 80A of the ITA) by determining the tax liability of a taxpayer who is non-compliant. One can, however, observe that compliance may not, in itself, be an effective deterrent against tax evasion.

In respect of this, the TAA provides for understatement penalties which would be applied in addition to the Commissioner exercising his powers in terms of section 80B of the ITA. Thus, the Commissioner will determine an evader’s taxable liability and apply understatement penalties as per the TAA. Section 221 of the TAA includes in the definition of an understatement, “any prejudice to SARS or the fiscus as a result of an impermissible avoidance arrangement”. Further section 222 of the TAA states that where an understatement occurs, the taxpayer must pay a penalty in addition to the tax payable for such period. The understatement penalties are calculated as per a table in section 223 of the TAA. Such table considers factors such as the type of

understatement (i.e. intentional tax evasion, gross negligence or impermissible avoidance arrangement), whether a voluntary disclosure is made by the taxpayer and whether the understatement is a repeat case.

It is clear that SARS is empowered to not only determine the correct tax consequences where an impermissible avoidance arrangement has occurred but also to impose penalties for the evasion of taxes. SARS is therefore legislatively empowered to punish non-compliant taxpayers which should act as a deterrent of tax evasion. One can say that the understatement penalties provided for in the TAA thus strengthen section 80B as they would both be actively applied to an avoidance arrangement.

3.7 The effectiveness of the amendments to the GAARs from a case law perspective

As previously alluded to, the effectiveness of the amendments to the GAARs can be assessed more clearly through a consideration of practical scenarios. Particularly, the first inherent weakness of the GAARs discussed above, that the GAARs are not an effective deterrent, can be assessed herein to a certain extent. In respect of this, a review of judicial decisions which consider section 103 of the ITA become relevant. On the 2006 amendments to the GAARs, Calvert considers judicial decisions which dealt the application of section 103 of the ITA, and thereafter considers whether the outcome of these cases would have been different had the new GAARs hypothetically been in force at the time.¹³⁷ This methodology is imperative as the new GAARs have yet to be tested against the rigour of the courts. A similar approach will be followed herein while also referring to Calvert's findings regarding the posed question.

Most of the cases referred to by Calvert concern the GAARs in a business perspective. While the primary objective of this research relates to tax evasion from an individual taxpayer perspective, due to the nature of the determinant discussed in Chapter 2, case law which considers the GAARs in a business perspective are still relevant. The relevance is founded in that firstly, they provide insight as to how the courts interpret

¹³⁷ Calvert (2011).

the GAARS. Secondly, it is important to note that, in the context of business, large companies committing tax evasion are nevertheless run by individuals who can be impacted by psychological predispositions. Consideration of case law which considers primarily business contexts is thus not without value.

In *Secretary for Inland Revenue v Gallagher* (“*Gallagher*”)¹³⁸ the court grappled with the purpose requirement. The *point-in-limine* presented in this case was whether the respondent had discharged the onus of proving that gaining a tax benefit from the transaction in question was not the sole or main purpose of such transaction. As previously mentioned, section 103 of the ITA, through its wording, comprised of a subjective test. The court in *Gallagher* referred to the courts’ interpretations of section 103 of the ITA in *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (“*Geustyn*”)¹³⁹ and in *Glen Anil Development Corporation v Secretary for Inland Revenue* wherein it was held that the subjective purpose of the arrangement is the relevant test to be applied.¹⁴⁰ The court in *Gallagher* thus agreed with the *court a quo* who held in favour of the respondent. It was held that the taxpayer’s subjective intention was not to gain a tax benefit, which was easily proven by said taxpayer. Therefore section 103 of the ITA was not successfully applied in this case due to the element of subjectivity inherent in section 103 of the ITA.

If we consider the amendments to the GAARs discussed above, we will note that section 80G of the ITA introduces a sense of objectivity to the GAARs by adding the phrase “reasonably considered in light of the relevant facts and circumstances” to the rebuttable presumption of purpose. The court in *Gallagher* heavily relied on a subjective approach to the case when ruling in favour of the respondent. The objective characteristic added to the GAARs would have urged the court to consider the facts reasonably in light of the relevant circumstances surrounding the case, which may include the eventual effect which the arrangement had (that being obtaining a tax benefit). The appellant, in their heads of argument, argued that an objective test be

¹³⁸ 1978 (2) SA 463 (A).

¹³⁹ 1971 (3) SA 567 (A) 576.

¹⁴⁰ 1978 (2) SA 463 (A) 471.

applied considering the eventual effect of the transaction.¹⁴¹ While we cannot be certain as to how the court would have interpreted the new GAARs in light of the facts in *Gallagher*, the new GAARs clearly support the arguments advanced by the appellant in such case which indicates an improvement in the effectiveness of the GAARs. However, the outcome may have still remained the same as the respondent still need only prove that the tax benefit was not the sole or main purpose behind the transaction.

Calvert discusses various cases whereby the Commissioner was unsuccessful in attempting to apply section 103 to arrangements in such cases.¹⁴² Calvert then compares the outcomes of these cases to hypothetical outcomes had the new GAARs been in force at the time. The cases of *Geustyn* and *Conhage*, amongst others, were used to illustrate the findings.¹⁴³ Calvert found that in both *Geustyn* and *Conhage*, the outcome of the decisions would not be significantly affected if the new GAARs were applied.¹⁴⁴ Calvert argues that the decisions would remain the same due to the purpose requirement still requiring that the “sole or main purpose” should be to gain a tax benefit for the GAARs to apply. As a result of this, tax evaders are able to conceal tax evasion behind larger commercial transactions wherein the commercial element of such a transaction could easily be described as the “sole or main purpose” of the arrangement.

The new GAARs thus do raise valid points for the Commissioner and reinforce their arguments, especially in connection with invoking an objective standard to the purpose test. However, the new GAARs still fall short of holding taxpayers accountable for entering into impermissible avoidance agreements.

3.8 Conclusion

¹⁴¹ 1978 (2) SA 463 (A) 471.

¹⁴² Calvert (2011).

¹⁴³ *Ibid.*

¹⁴⁴ Calvert (2011) 55-71.

This chapter sought to evaluate the efficacy of the GAARs. In doing this, one needed to consider already identified weaknesses and whether they were adequately addressed by the implementation of the 2006 amendments to the GAARs. The foundation of this discussion was founded in the discussion paper by SARS, titled “Discussion paper on tax avoidance and section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)” wherein SARS identified four inherent weaknesses in the GAARs and proposed amendments which would rectify such weaknesses.

In scrutinizing the identified weaknesses against the proposed amendments, we notice clear and direct improvements to the old GAARs. Where there was once uncertainty and controversy, we now find clarity in the new GAARs. The application of the GAARs to steps within a transaction and as an alternative basis of assessment, for example, was uncertain, however, the new GAARs have directly addressed such issues through sections 80H and 80I respectively. Further to this, the amendments brought clarity to the powers of the Commissioner in respect of impermissible avoidance arrangements by specifying such powers in section 80B of the ITA.

Conversely, when we look at the attempt to remedy the weakness identified in the purpose requirement, somewhat of an opposing outcome is seen. The issue identified with such requirement was that its wording in section 103 of the ITA called for a subjective approach. When subjectively applying the purpose requirement, we look to the subjective intention of the taxpayer in entering the arrangement rather than the objective effect thereof. This results in taxpayers easily proving that their main subjective intention was not to gain a tax benefit but rather their intention was the completion of the presented commercial transaction under which the tax benefit hides. The legislature attempted to rectify this by introducing an objective standard to the purpose requirement, as discussed above. While this is step in the right direction, the purpose requirement still seems to be hindering the Commissioner from holding taxpayers accountable when they enter into impermissible avoidance arrangements. A short overview of case law showed that judicial decisions where the taxpayers were able to escape the purpose requirement and thus section 103, were likely to have the same outcome had the new GAARs been applied.

We have clearly seen the attempt by the legislature to rectify the inherent weaknesses in the GAARs. While some weaknesses have been clearly and directly addressed, others have fallen short when applied in practical scenarios. The 2006 amendments to the GAARs are thus a step in the right direction, however they are not yet at a satisfactory level as we still see similar issues arising. The ineffectiveness of the GAARs can be seen as a determinant of tax evasion and this is founded in its rare application to avoidance arrangements as a result of the weaknesses contained therein; thus making tax evasion a simpler task for taxpayers.

CHAPTER 4: THE INTERPLAY BETWEEN THE PSYCHOLOGICAL FACTORS IMPACTING TAX COMPLIANCE AND THE INEFFICACY OF THE GAARS

4.1 Introduction

The previous two chapters analysed two possible determinants of tax evasion largely in isolation. While such previous analysis was necessary to fully comprehend the impact of each determinant on tax evasion, determinants of tax evasion do not act in isolation in the real world. This chapter will seek to understand these two determinants more realistically by looking at the possible overlap between the two from a more holistic perspective. In doing this, an analysis of the manner in which one determinant contributes to, or even hinders, the other will be considered.

As discussed in Chapter 3, SARS identified four issues with the South African GAARs which they sought to rectify in the 2006 amendments to the GAARs. This extension of the GAARs was done by specifying the powers of the Commissioner while broadening the scope of identifying an impermissible avoidance arrangement. These amendments sought to achieve broader application of the GAARs to more arrangements wherein taxpayers attempt to impermissibly reduce their tax liability. One must however be mindful of how the extensive amendments to the GAARs affects the taxpayers attitude towards the tax system in general.

4.2 The potential harm of over-regulation of tax laws

When attempting to improve the GAARs, one tends to focus on addressing past flaws without paying mind to the creation of future flaws. Particularly, the focus placed on the inadequacy of the pre-2006 GAARs may have overshadowed any consideration being given to the prevention of over-regulation within the tax system. Various authors writing on the psychological factors impacting tax evasion have discussed the notion of over-regulation but have not detailed it to a great extent.

Kong and Wang noted that some of the countries with the most stringent legal provisions have been shown to have some of the lowest rates of tax compliance.¹⁴⁵ They indicated that some Southern European countries (such as Albania and Malta), that previously attempted to improve tax compliance by increasing enforcement of tax laws, were actually the countries with the lowest tax compliance rates.¹⁴⁶ While the cause for such low tax compliance could merely be inadequate improvements to GAARs in those countries, the possibility that over-regulation negatively impacts tax compliance nevertheless remains.

This possibility could stem from taxpayers feeling compelled to pay taxes rather than on their own accord. As discussed above, tax morale refers to a taxpayer's intrinsic motivation to pay their taxes. Various authors such as Riahi-Belkaoui as well as Cummings have argued and shown with empirical evidence that countries with a higher tax morale have better tax compliance rates and lower tax evasion rates.¹⁴⁷ Frey and Feld make mention of the notion of over-regulation by referring to a so-called "feeling of being controlled in a negative way".¹⁴⁸ Taxpayers may have a lower tax morale when they feel as if they are being forced to pay their taxes rather than possessing the intrinsic motivation to do so.¹⁴⁹ Consequently, there may be a causal link between highly-regulated tax systems and tax evasion.

4.3 The complexity dilemma

While the "feeling of being controlled", discussed above, may be a product of complex tax systems, another consequence of stringent legal provisions could merely be that the taxpayer struggles to understand such complexities. In over-regulating the tax system, the risk of involuntary tax non-compliance thus arises as taxpayers are unable to understand or remain knowledgeable of such additions to the tax legislation.

¹⁴⁵ Kong & Wang 75.

¹⁴⁶ *Ibid.* See also Jackson & Milliron "Tax compliance research: findings, problems & prospects" 1986 *Journal of Accounting Literature* (5) 125-165.

¹⁴⁷ Riahi- Belkaoui. Cummings *et al.*

¹⁴⁸ Feld & Frey 10.

¹⁴⁹ *Ibid.*

Taxpayers may thus be unaware of their non-compliance due to an over-complicated and over-regulated system which is difficult to remain knowledgeable of. In essence, taxpayers cannot be expected to comply with tax legislation if, firstly, they are unable to remain informed of consistently changing legislation, and secondly, they are unable to understand such additions or amendments.

Further to this, as we attempt to improve on the weaknesses of the GAARs (as discussed in Chapter 3), we run the continuous risk of over-complicating tax legislation. The tax system should be simple and certain enough for the average taxpayer to understand their rights and obligations in terms of the tax law.¹⁵⁰ In this context, the legislature must be mindful of the basic principles of taxation when amending the GAARs. The principle of certainty in taxation is one of the four major principles of taxation established by the prominent Adam Smith.¹⁵¹ In terms of such principle, the timing, amount and manner of tax payments should be certain especially when the legislature introduces new provisions into the tax legislation.¹⁵² Further to this, the simplicity principle, which is not one of Adam Smith's four major principles but is an internationally recognised principle, compels the legislature to ensure that tax laws are easily understandable.¹⁵³ While the efficiency of the anti-avoidance rules should be at the forefront of the discussion, the legislature cannot ignore the basic principles of taxation.

In applying such principles, the legislature must attempt to keep the tax laws simple enough for the taxpayer to understand yet not so simple that they run the risk of creating loopholes within such laws. The complexity dilemma thus arises where the legislature attempts to strike a balance between the effectiveness of anti-avoidance rules and the simplicity and certainty thereof.

If we revisit the GAARs pre-2006, there were provisions which, while fairly simple, were flooded with uncertainty and had questions raised as to their effectiveness. Since

¹⁵⁰ *Ibid.*

¹⁵¹ Stiglingh et al. 5.

¹⁵² *Ibid.*

¹⁵³ Stiglingh et al. 8.

the 2006 amendments, the legislature improved certainty and attempted to improve effectiveness; but this added an increased complexity to the GAARs. The legislature added additional notions and requirements to the GAARs which a taxpayer would need to interpret. These added layers inevitably result in more complex legislation for the taxpayer to interpret. This practical example clearly demonstrates this complexity dilemma that the legislature encounters when attempting to improve existing legislation. The manner in which the complexity dilemma affects tax evasion can, in itself, be quite complex, but to demonstrate it plainly: we cannot expect taxpayers to comply fully with tax legislation if they do not understand said legislation; and such compliance includes not evading taxes.

4.4 Relationship between taxpayers and tax officials

As discussed in Chapter 2, the relationship between taxpayers and tax officials is one of the concepts which affects tax morale. Frey and Feld argue that the treatment of taxpayers plays an important role in the creation of tax morale and thus affects tax compliance rates.¹⁵⁴ Their argument in respect of this notion centres around the treatment of taxpayers at a procedural level by tax authorities.¹⁵⁵ This would thus relate to the treatment of taxpayers in the application and enforcement of the GAARs. As discussed in Chapter 3, section 80B of the ITA empowers the Commissioner to determine the tax liability of a taxpayer, who engaged in an impermissible avoidance arrangement, in various different manners. Further section 80J of the ITA prescribes a certain process to be followed in respect of notice to the taxpayer, submission of reasons as well as request for additional information. Such a process, as contemplated in section 80J of the ITA, entails continuous communication and engagement between the taxpayer and tax authorities.

Frey and Feld argue that two procedural treatments of taxpayers exist, namely a respectful treatment model and an authoritarian treatment model.¹⁵⁶ The former is

¹⁵⁴ Feld & Frey 10.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

indicative of a horizontal relationship rather than a vertical relationship between taxpayers and the state where taxpayers feel more respected as a party to a contract whereas the latter is indicative of quite the opposite. This notion, according to Frey and Feld, promotes the creation of tax morale and thus leads to higher tax compliance rates.¹⁵⁷ A possible reasoning behind this being that taxpayers are more likely to comply with their obligations in respect of the implicit tax contract with the state when they feel as if they are being treated in a fair and respectful manner (as any party to any contract wishes to be treated). The latter authoritarian treatment model, however, is indicative of a vertical relationship whereby taxpayers are treated as “inferiors in a hierarchical relationship”.¹⁵⁸ In such cases, Frey and Feld argue that taxpayers are less likely to have the motivation to pay taxes towards authority figures who treat them as inferiors.¹⁵⁹

When we consider the above in light of the South African GAARs, the application and enforcement of sections 80B and 80J may impact tax morale and thus tax compliance rates. Section 80B is an empowering provision which provides for the manner in which the Commissioner may determine the taxable liability of a taxpayer engaging in an impermissible avoidance arrangement. Section 80J prescribes for certain notices to be given to the taxpayer as well as providing the taxpayer with an opportunity to submit reasons as to why they believe that part of the ITA (consisting of the GAARs) does not apply to them. These provisions, by virtue of their existence, impact tax morale due to the contact it entails between the revenue authority and the taxpayer. These provisions were discussed as clear improvements on the GAARs in theory however, it is the duty of the revenue authority (SARS) to manage the relationship with the taxpayer through these provisions in practice. If taxpayers are disrespected or treated inferiorly throughout such process, they may feel less obliged to fulfil their obligations in respect of the psychological tax contract.

¹⁵⁷ *Ibid.*

¹⁵⁸ *Ibid.*

¹⁵⁹ Frey and Feld 10.

4.5 Conclusion

This chapter sought to comment on the relationship between the two identified determinants of tax evasion, more specifically how they interact with one another realistically. When considering this relationship, three major notions were noted namely, the harm of over-regulation of the tax law, the complexity dilemma and the relationship between taxpayers and tax officials.

In respect of the harm in over-regulation of the tax law, we see the overlap between the two determinants when we considered the notion of “feeling of being controlled in a negative way”. This concept impacts tax morale negatively as taxpayers feel as if they are not paying their taxes on their own accord but rather are forced to pay taxes.

In considering the complexity dilemma, the impact of the taxpayers knowledge on tax evasion was considered. The complexity dilemma essentially entails a balancing act, whereby the lawmakers are tasked with ensuring that the tax law is simple enough for taxpayers to understand their rights and obligations under such laws but not so simple that they leave room for uncertainty and confusion in the law. The complexity of the GAARs were shown to impact tax morale as the more complex the GAARs become, the more difficult it becomes for taxpayers to understand.

Lastly, when considering the relationship between taxpayers and the state, consideration was had to the impact of treatment of taxpayers by tax officials. Utilising Frey and Feld’s comments on such relationship, the argument made was that the application of the GAARs has an impact on tax morale as it impacts the taxpayer’s attitude towards the state. While taxpayers perceive the State through their interaction with state officials (such as tax officials), it was importantly noted that this relationship between taxpayers and tax officials cannot in itself curb tax evasion.

The overarching argument of this chapter is essentially that no matter how appealing the GAARs may seem on paper, they impact taxpayers on a deeper level. The complexity, intensity and enforcement of the GAARs have been shown to have an impact on tax morale. When amending the GAARs, the legislature must concern

themselves with the impact of the amendments on tax morale. More importantly, tax officials must be mindful of the impact that their treatment of taxpayers may have on tax compliance rates.

CHAPTER 5: SUMMARY AND RECOMMENDATIONS

5.1 Introduction

The aim of this research was ultimately to understand why tax evasion occurs in South Africa. As a developing country, South Africa relies on the income generated by its citizens as a source of revenue to a great extent.¹⁶⁰ Tax evasion illegally lowers the amount of revenue to be collected by SARS. Tax evasion thus directly impedes on the country's economic growth which makes this study relevant. This research evaluated possible determinants of tax evasion as once we understand the root cause of the problem, only then can we address it.

At the outset, two leading determinants were identified, namely, psychological factors and the inefficiency of the South African GAARs in curbing tax evasion. It was made clear that this research does not seek to rival these two determinants against one another to ascertain a primary determinant of tax evasion. The salient question rather is whether they are in fact determinants of tax evasion and if so, why they continue to promote tax evasion. This research firstly scrutinized each determinant and its impact on tax evasion in South Africa and secondly took a holistic view on the interplay between the two determinants.

5.2 Psychological factors as a determinant of tax evasion

In chapter 2, psychological factors as a possible determinant of tax evasion were considered. The concept of tax morale and the factors which contribute towards tax morale were central to this discussion. Due to the subjectivity of such factors (including attitude towards the government and knowledge of the tax system) and the objectivity

¹⁶⁰ South African National Treasury, "Budget Review 2022/23" available at: <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf> (accessed on 21 October 2022). See also paragraph 1.3 for a discussion on the reliance of tax revenue as a source of income.

of whether tax evasion occurs, surveys and empirical evidence were of key importance in this discussion.

Empirical evidence gathered by Riahi-Belkaoui as well as Cummings illustrated the key findings of this chapter. In Riahi-Belkaoui's 2004 study, it was shown that tax compliance was higher in jurisdictions with low serious crime rate and guaranteed economic freedoms.¹⁶¹ Further to this, Cummings came to similar conclusions in his 2009 article comparing the tax compliance rates in Botswana and South Africa.¹⁶² Cummings utilized two jurisdictions with similar taxation systems yet differing political narratives and historical development. Cummings showed that South Africa had much lower tax compliance rates compared to Botswana. In doing this, Cummings commented on the volatile political narrative in South Africa compared to a relatively stable political narrative in Botswana. These two studies demonstrated clear links between psychological factors and tax evasion. However, this research cannot end there as these psychological factors are not the only factors at play realistically.

Additionally, the notion of a psychological tax contract was considered to contextualise the psychological factors impacting tax evasion. Various authors such as Frey and Feld as well as Riahi-Belkaoui support the notion that taxation entails a psychological tax contract in their respective articles.¹⁶³ This concept entails a mutually beneficial relationship between the taxpayer and the state wherein the taxpayer surrenders a portion of their income in exchange for certain amenities from the state. In this discussion it was considered how the state not complying with their obligations in respect of such contract impacts the taxpayer's compliance. It was clear from these discussions that taxpayers would be reluctant to comply with their obligations in respect of such a contract (pay taxes) where they cannot see reciprocal behaviour from the state. In South Africa, elements such as high levels of corruption, high serious crime rate and poor public services can clearly impact a taxpayer's perception of the government and thus their inherent motivation to pay taxes.

¹⁶¹ Riahi- Belkaoui (2004).

¹⁶² Cummings (2009).

¹⁶³ Frey & Feld (2002); Riahi- Belkaoui (2004).

Lastly, the impact of a taxpayer's financial situation was considered. Tax evasion is inherently a financial issue and thus the financial situation of the taxpayers under scrutiny must be considered. It was not necessary to detail the impact of a taxpayer's financial situation on their tax compliance as it is quite evident. According to the OECD, South African taxpayers find themselves earning considerably less than the OECD average of household income.¹⁶⁴

The psychological factors at play in South Africa thus all contribute towards a lower tax morale and thus higher tax evasion rates. Although most taxpayer's contribute towards income tax through their employers, taxpayers earning high incomes through other sources of revenue may act dishonestly in disclosing such income to SARS when tax morale is low. Further taxpayers may feel less obliged to simply file their tax returns which increases the administrative burden borne by SARS to collect taxes in respect of non-compliance penalties for example. As mentioned in concluding chapter 2, however, the psychological factors at play do not excuse a complete disregard of the laws in place. Consequently, such laws had to be evaluated.

5.3 The inefficacy of the GAARs

In chapter 3, the efficiency of the GAARs was considered. To do this, the weaknesses identified by SARS when amending the GAARs in 2006 were considered. SARS identified four inherent weaknesses in the old GAARs (section 103 of the ITA) which the legislature attempted to rectify in the 2006 amendments to the GAARs.

Chapter 3 considered sections 80A to 80L of the ITA (the new GAARs) and whether they addressed the inherent weaknesses identified by SARS. The procedural and administrative weaknesses which related to applying the GAARs to steps within a transaction and applying the GAARs as an alternative basis for assessment were directly addressed by sections 80H and 80I respectively. These two sections provided clarity where it was once lacking. Furthermore, the addition of section 80B provides

¹⁶⁴ OECD, "Better life index: South Africa" available at: <https://www.oecdbetterlifeindex.org/countries/south-africa/> (accessed on 9 July 2022).

clarity with regards to the power of the Commissioner to determine the consequences of impermissible avoidance arrangements. Additionally, section 80J protects the taxpayer by providing for a clear and transparent process to be followed in respect of addressing potential impermissible avoidance arrangements. However, when considering the weaknesses relating to the abnormality requirement and the purpose requirement, we do not see the same outcome.

At first glance, the amendments to the GAARs seemingly addresses previously identified issues regarding the purpose and abnormality requirements, by adding a sense of objectivity to the purpose requirement and adding flesh to the abnormality requirement. These amendments, however, have shown not to impact the practical application of the GAARs. A short review of cases wherein the Commissioner attempted to invoke section 103 and failed was considered in this chapter. Utilizing a method applied by Calvert in her 2011 thesis on the same topic showed that such cases would likely have similar outcomes even when applying the new GAARs.¹⁶⁵ The purpose requirement notably still failed in such cases. While the GAARs have clearly been improved upon, there still remains weaknesses in the purpose and abnormality requirements which have not been addressed by the legislature. The ineffectiveness of the GAARs can thus still be considered as a determinant of tax evasion due to the inherent weaknesses still present in the new GAARs.

5.4 Interplay between psychological factors and the GAARs

In chapter 4, this research considered how the two identified determinants of tax evasion interact with one another. Realistically, these determinants do not act in isolation and the interplay between them had to be evaluated in this research. In discussing concepts such as over-regulation of tax laws, the complexity dilemma and the relationship that the taxpayer has with the state, the ways in which the GAARs affect the taxpayer's psyche were explored.

¹⁶⁵ Calvert (2006).

The content of the GAARs as well as the implementation thereof was shown to clearly impact the attitude that taxpayers have towards the law and tax officials. In attempting to amend the tax laws and more specifically the GAARs, the legislature must pay mind to how such amendments may affect the taxpayer's attitude towards the law. Concepts such as complexity of the law and more importantly, treatment of taxpayers during the implementation of such laws were shown to impact tax morale and thus has the potential to impact tax evasion.

5.5 Recommendations

In chapters 2 and 3, psychological factors and the inefficiency of the GAARs were respectively shown to impact tax evasion for a number of reasons. In chapter 4, the interplay between those two determinants were discussed. It became plain to see that the two identified determinants of tax evasion do not act in isolation and clearly impact one another. In attempting to lower tax evasion in South Africa, discussions to improve the GAARs which ignore the impact of psychological factors will not be fruitful. However, it is important to note that the GAARs only become necessary to enforce after tax evasion occurs in order to rectify such situation.

It was shown that the legislature had directly addressed previously identified weaknesses through the 2006 amendments to the GAARs, such as addressing the procedural and administrative issues through section 80H and 80I.¹⁶⁶ These sections provide clarity where there was once contention which directly address the weakness identified by SARS. However, the purpose requirement still showed to be ineffective when applied to practical scenarios as a result of its subjectivity.¹⁶⁷ Even when a sense of objectivity was introduced in the 2006 amendments to the GAARs, the subjective element which remained seemingly still favoured the taxpayer in the hypothetical case law discussion. The GAARs could possibly be more effective if it were clear in that the

¹⁶⁶ See paragraph 3.4.1 (iii) for an in-depth discussion on this topic.

¹⁶⁷ See paragraph 3.6 for an in-depth discussion on this topic.

purpose requirement should be applied objectively having no regard to the subjective intention of the taxpayer and rather focus on the objective effect of the transaction.¹⁶⁸

A better solution, however, may be to stop tax evasion from occurring at all rather than attempting to rectify the issue after occurrence. This can only be done through the creation of tax morale. Support of this argument can be found in the artefactual field experiment conducted by Cummings which compared South Africa and Botswana's tax compliance in light of the differing political narratives in the countries.¹⁶⁹ Botswana and South Africa have similar tax systems, yet the tax compliance rates are completely different. This could indicate that psychological factors are more influential in the hinderance or promotion of tax evasion.

The creation of a higher tax morale is by no means a simple task, especially in South Africa. There are, however, some entry points which the government can consider in an attempt to create a higher tax morale. The most important aspect when it comes to the creation of tax morale may simply be awareness within the revenue authorities. As previously discussed, the implementation of certain GAARs, such as sections 80B and 80J of the ITA, by the revenue authorities may have a major impact on tax morale.¹⁷⁰

Additionally, the best solution to tax evasion, albeit a long-term plan would be the compliance of obligations in respect of the psychological tax contract by the South African government. This can be done through the improvement of public services and amenities as well as combatting high serious crime rates and economic corruption. It has been shown that taxpayers are much more likely to comply with tax payments to governments that guarantee such services and freedoms. The South African government can potentially embark on this process by prosecuting the relevant public service officials who are responsible for poor service provision due to corruption and mismanagement of funds and reclaim monies lost from such persons.

¹⁶⁸ Pidduck 321.

¹⁶⁹ Cummings (2009).

¹⁷⁰ See paragraph 4.3 for an in-depth discussion on this topic.

While the legislature has attempted to address the effectiveness of the GAARs, we cannot say that much attempt has been made to address the tax morale in South Africa. The creation of tax morale may be a more intensive task than simply amending the GAARs however, it may be a more efficient long-term solution in the effort of reducing tax evasion in South Africa.

BIBLIOGRAPHY

6.1 Articles

Aumeerun B, Jugurnath B, Soondrum H “Tax evasion: empirical evidence from sub-Saharan Africa” 2016 *Journal of Accounting and Taxation* 8(7) 70-80.

Bischoff-Mattson Z, Maree G, Vogel C, Lynch A, Olivier D, Terblanche D “Shape of a water crisis: practitioner perspectives on urban water scarcity and ‘Day Zero’ in South Africa” 2020 *Water Policy* (2) 193–210.

Cummings RG, Martinez-Vasquez J, McKee M, Torgler B “Tax morale affects tax compliance: evidence from surveys and an artefactual field experiment” 2009 *Journal of Economic Behavior & Organization* 70(3) 447-457.

Dalu T, Maposa VG, Pabwaungana S “The impact of tax evasion and avoidance on the economy: a case of Harare, Zimbabwe” 2012 *African Journal of Economic Sustainable Development* 1(3) 284-296.

Franks PE “The crisis of the South African public service” 2014 *The Journal of the Helen Suzman Foundation* (74) 48-56

Hoffman WH “The theory of tax planning” 1961 *The Accounting Review* 36(2) 274-281.

Jackson BR & Milliron VC “Tax compliance research: findings, problems & prospects” 1986 *Journal of Accounting Literature* (5) 125-165.

Kanamugire JC “A critical analysis of tax avoidance in the South African Income Tax Act 58 of 1962, as amended” 2013 *Mediterranean Journal of Social Sciences* (4) 351.

Kong F & Wang C “The determinants of tax evasion: a literature review” 2014 *Gdańskie Studia Azji Wschodniej* (5) 70-78.

Kujinga B “Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada” 2014 *Comparative and International Law Journal of Southern Africa* 47(3) 429-459.

Riahi-Belkaoui A “Relationship between tax compliance internationally and selected determinants of tax morale” 2004 *Journal of international accounting, auditing and taxation* 13(2) 135-143.

Shabangu KP, Bakare BF, Bwapwa JK “Microbial fuel cells for electrical energy: outlook on scaling-up and application possibilities towards South African energy grid” 2022 *Sustainability* 14(21) 14268.

Slemrod J “Cheating ourselves: the economics of tax evasion” 2007 *Journal of Economic Perspectives* 21(1) 25-48.

Wahab NSA & Holland K “Tax planning, corporate governance and equity value” 2012 *The British Accounting Review* 44(2) 111-124

6.2 Books

Bergman M *Tax Evasion and the Rule of Law in Latin America* (2009) Pennsylvania State University Press.

Furuseth E *The Interpretation of Tax Treaties in Relation to Domestic GAARs* (2018) IBFD Publications USA, Incorporated.

Hasseldine J *Advances in Taxation* (2018) Emerald Publishing Limited.

Stiglingh M *et al Silke: South African Income Tax* (2022) Lexis Nexis Online.

6.3 Case Law

CIR v Conhage 1999 (4) SA 1149 (SCA).

CIR v Sunnyside Centre (Pty) Ltd 1996 58 SATC 319 (A).

IRC v Duke of Westminster 1936 AC 1; 19 (TC).

Security for Inland Revenue v Gallagher 1978 (2) SA 463 (A).

Secretary for Inland Revenue v Geustyn, Forsyth and Joubert 1971 (3) SA 567 (A).

Glen Anil Development Corporation v Secretary for Inland Revenue 1978 (2) SA 463 (A).

6.4 Internet Sources

Feld L & Frey B “Tax evasion, tax amnesties and the psychological tax contract” 2007 *International Studies Program Working Paper Series GSU paper 729* available at: <https://icepp.gsu.edu/files/2015/03/ispwp0729.pdf> (accessed 29 May 2022).

Frey L & Feld B “Deterrence and morale in taxation: An empirical analysis” 2002 available at: <https://ssrn.com/abstract=341380> (accessed 9 July 2022).

Kagan J “Tax evasion: meaning, definition and penalties” *Investopedia* 2022 available at: <https://www.investopedia.com/terms/t/taxevasion.asp> (accessed on 29 November 2022).

Organisation for Economic Co-operation and Development, “Better life index: South Africa” available at: <https://www.oecdbetterlifeindex.org/countries/south-africa/> (accessed on 9 July 2022).

PWC “General anti-avoidance rule” available at: <https://www.pwc.com/cz/cs/danove-sluzby/danova-politika/assets/gaar-general-anti-avoidance-rule-en.pdf> (accessed on 29 November 2022).

SARS “Discussion paper on tax avoidance and section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)” 2005 available at: <https://www.sars.gov.za/wp-content/uploads/Legal/DiscPapers/LAPD-LPrep-DP-2005-01-Discussion-Paper-Tax-Avoidance-Section-103-of-Income-Tax-Act-1962.pdf> (accessed on 8 August 2022).

SARS “Explanatory Memorandum on the Revenue Laws Amendment Bill” (2006) 61 available at: <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2006-01-Explanatory-Memorandum-Revenue-Laws-Amendment-Bill-2006.pdf> (accessed on 27 October 2022).

South African National Treasury, “Budget Review 2022/23” available at: <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf> (accessed on 21 October 2022).

Transparency International Corruption Perceptions Index available at: <https://www.transparency.org/en/cpi> (accessed on 28 November 2022).

Torgler B “Tax morale and institutions” 2003 available at: <https://ssrn.com/abstract=663686> (accessed on 8 May 2022)

United Nations Office on Drugs and Crime available at: <https://dataunodc.un.org/dp-intentional-homicide-victims> (accessed on 28 November 2022).

6.5 Legislation

Income Tax Act 58 of 1962.

Tax Administration Act 28 of 2011.

6.6 Theses and Dissertations

Calvert T “An analysis of the 2006 amendments to the General Anti-Avoidance Rules: A case law approach” 2011 available at: https://repository.nwu.ac.za/bitstream/handle/10394/6280/Calvert_T.pdf?sequence=1&isAllowed=y (accessed on 8 May 2022).

Kujinga B “A comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible tax avoidance in South Africa” 2013 available at: <https://repository.up.ac.za/handle/2263/33430> (accessed 28 November 2022).

Langenhoven A “Does the South African GAAR criteria of the ‘misuse or abuse’ of a provision included in Section 80A(c)(ii) of the Income Tax Act add any value?” 2016 available at: https://open.uct.ac.za/bitstream/handle/11427/22857/thesis_com_2016_langenhove

[n_allenda_glynn%20%281%29.pdf?sequence=1&isAllowed=y](https://repository.up.ac.za/bitstream/handle/2263/80489/Mzila_Analysis_2020.pdf?sequence=1&isAllowed=y) (accessed 30 November 2022).

Mzila T “An analysis of the South African General Anti-Avoidance Rule: lessons from New Zealand” 2020 available at: https://repository.up.ac.za/bitstream/handle/2263/80489/Mzila_Analysis_2020.pdf?sequence=1&isAllowed=y (accessed 28 November 2022).

Pidduck T “The South African General Anti-Avoidance Rule and lessons from the first world: a case law approach” 2017 available at: <https://commons.ru.ac.za/vital/access/services/Download/vital:27768/SOURCE1?view=true> (accessed 29 November 2022).