The Sasol Oil case – would the present South African GAAR stand up to the rigours of the court?

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Abstract

South Africa finds itself vulnerable to exploitation by the measures taken by multinational enterprises (MNEs) who seek to enter into tax avoidance schemes that artificially shift profits to low- or no-tax jurisdictions. While common law, specific and general anti-avoidance measures may be used as a defence against these schemes, there has been no judicial consideration of the current South African general anti-avoidance rule (GAAR) since its replacement in 2006. In this context this paper makes two contributions. First, the paper applies the current GAAR to a recent case where the predecessor to the current GAAR was applied to a scheme entered into by an MNE. This is done in order to determine if the current GAAR (unlike its predecessor) is able to stand up to the rigours of court when presented with similar facts. In doing so it demonstrates how the untested GAAR may be interpreted and applied. Second, the paper makes suggestions for amendment to the current GAAR in order to improve its efficacy in an international context.

Keywords: tax, avoidance, GAAR, case law, multinational enterprise, cross border.

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1. Introduction

> "…we must persevere; we must prune and pluck away at the rot, until there is growth."
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> (National Treasury, 2019, p. 4)

This call to action was delivered by South Africa's Minister of Finance in the 2019 Budget Speech and refers to South Africa's financial situation and the need to safeguard its finances. In the same address, the Minister recognises that South Africa has a small, open economy that is impacted by events in the global economy (National Treasury, 2019, p. 6). In this context, it is critical to note that the global economy is struggling to combat global tax avoidance. Specific attention is placed on tax avoidance measures employed by multinational enterprises (MNEs) where it is estimated that US$500 billion is lost in government revenues annually (United Nations World Institute for Development Economics Research, 2017, p. 21). More importantly, it is recognised that the intensity of these losses is substantially greater in low- and lower-middle income countries, particularly in sub-Saharan Africa (United Nations World Institute for Development Economics Research, 2017, p. 21). South Africa finds itself vulnerable to exploitation by measures taken by MNEs who seek to enter into tax avoidance schemes that artificially shift profits to low- or no-tax jurisdictions. This is one example of the type of "rot" that should be "plucked away" in order to grow much needed tax revenues in South Africa.

Closing the tax avoidance gaps in legislation exploited by MNEs is not an easy task and countries often employ three main anti-avoidance measures to curb international tax avoidance, including common law, general anti-avoidance and specific anti-avoidance measures (Oguttu, 2015, p. 104). South Africa employs all of these measures, but the general anti-avoidance rule (GAAR) is the focus of this paper.

Historically, research conducted on the GAAR in South Africa has been centred on critical theoretical analyses of its efficacy after it failed to stand up to the interpretation of the

courts (Pidduck, 2017, p. 5). These studies focus on analysing and interpreting the GAAR and related literature in order to identify weaknesses and areas for improvement (Pidduck, 2017, p. 5). However, since its amendment in 2006, no cases have been brought before the courts to test the efficacy of the current GAAR (Pidduck, 2017, p. 5). Therefore, the more traditional forms of research employed (using hindsight to evaluate the effectiveness of the provision) are not appropriate.

In November 2018, the most recent judgment concerning the preceding GAAR was released: *Sasol Oil v CSARS* (2018) ZASCA 153 (A) (*Sasol case*), after appeal from the Tax Court (*Income Tax Case No. 1910* (2018) 80 SATC 353). As a brand, Sasol may be considered a household name and in South Africa it is one of the largest corporations listed on both the Johannesburg Stock Exchange and the New York Stock Exchange. In addition to this, the *Sasol case* is particularly relevant when taking into account that it is a case concerning an MNE structure. In this regard, the International Bureau of Fiscal Documentation defines an MNE as a "company or group of companies with business establishments in two or more countries" (International Bureau of Fiscal Documentation., 2015, p. 319). Further, the structure "may consist of a company established in one country with sales outlets, production facilities, joint venture projects etc., in other countries, or a number of companies in various countries that are connected by shareholdings in each other" (International Bureau of Fiscal Documentation., 2015, p. 319). Sasol (2019) indicates that it operates in 32 countries, has customers in over 130 countries, and its complex group structure consists of multiple business units, regional operating hubs and strategic business units, which provides evidence of its MNE status.

The *Sasol case* is one of the few cases in South Africa that is of particular relevance in the international tax context. In the *Sasol case*, the predecessor of the GAAR was considered (in the alternative) in the Supreme Court of Appeal (the current GAAR was not considered by

the court as the transactions occurred before its effective date). Since the predecessor to the GAAR was not successfully applied in the judgment, an important question is left unanswered: Would the application of the current GAAR to the facts of the case result in a different outcome?

In this context this paper makes two contributions. First, the paper demonstrates how the untested current GAAR may be interpreted and applied to the facts of the *Sasol case*. Second, the paper makes suggestions for amendment to the current GAAR in order to improve its efficacy in the context of an MNE with significant cross-border transactions. This paper thus aims to contribute to the research regarding the current GAAR in order to identify aspects that may be amended to protect South Africa's international corporate tax revenues, as called for by the Minister of Finance (National Treasury, 2019, p. 4).

The intention of this paper is not to focus on the outcome of the *Sasol case* judgment, but on the efficacy of the current GAAR when applied to the facts of the *Sasol case*. A qualitative research design and methodology, consisting of a "structured pre-emptive analysis" (Pidduck, 2019, p. 201), has been employed. This approach is a combination of doctrinal and reform-oriented approaches (Alley and Bentley, 2008, p. 129; Council of Australian Law Deans, 2005, p. 3; Hutchinson and Duncan, 2012, p. 101; Pearce, Campbell, & Harding, 1987, par. 9.10–9.15; Pidduck, 2019, p. 201; Salter and Mason, 2007, p. 113). This methodological approach is specifically designed for qualitative research in the absence of judicial inquiry for the legislation in question (Pidduck, 2019, p. 201). It makes use of the facts of practical cases and applies untested legislation to these facts in a structured manner, whilst introducing measures to cater for improved validity, robustness and replicability (Pidduck, 2019, p. 206-217). The case was selected not simply to describe it, but also to see patterns, relationships and the dynamics that focus on one issue (the GAAR) that is considered significant (Creswell,

2007, p. 74; Lymer and Oats, 2009–2010, p. 242). The case selected may be considered significant as it was presented before the Supreme Court of Appeal, where judicial precedent is established, and it is one of the few cases in South Africa that considers transactions entered into by an MNE.

While it is recognised that the outcome of the study cannot be generalised, it may be argued that the outcome is symptomatic of what is going on more generally, as suggested by Gomm, Hammersley, and Foster (2000, p. 99), and by Yin (2009, p. 47).

The paper is presented in four parts. Following this introduction, part 2 commences with a discussion on the GAAR regime, both before and after the 2006 amendments. In part 3, the current GAAR is applied to the facts from the *Sasol case,* while concluding comments are made in part 4.

2. The GAAR

Since its inclusion in South African taxation in 1941, the GAAR has been the subject of much criticism by commentators (Katz, 1996, p. 11.2.2; Kolitz, 1999, p. 105; Kolitz, 2000, p. 31; Margo, 1988, par. 27.28; National Treasury, 2005, p. 3; South African Revenue Service [SARS], 2005, pp. 41–44; *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A); *Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)). Before being replaced in 2006, the GAAR was housed in section 103(1) of the Income Tax Act No. 58 of 1962 (the Act) and that version of the GAAR is discussed briefly below (National Treasury, 2006, p. 61; Revenue Laws Amendment Act No. 20 of 2006, p. 34).

The preceding GAAR (Income Tax Act section 103(1)) at that time consisted of four main requirements:

- There must be a transaction, operation or scheme

- that resulted in the avoidance, reduction or postponement of tax and
- was entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit (the *abnormality requirement*); and
- the transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the *purpose requirement*).

Section 103(1) of the Act called for the existence of all four of these requirements before the preceding GAAR could be successfully applied to a transaction. However, the preceding GAAR was notoriously ineffective and its weaknesses were described by the South African Revenue Service (SARS) (2005, pp. 41–44) as follows:

- **Not an effective deterrent** – Aggressive and increasingly sophisticated schemes entered into by taxpayers (often marketed by boutique financial institutions) resulted in exploitation of the preceding GAAR. In addition to this, the significant commitment of time and resources dedicated to detecting and combating these schemes was costly; and lengthy battles over these schemes had a negative impact on the relationships between SARS and taxpayers (SARS, 2005, pp. 41–42).
- **Abnormality requirement** – *Bona fide* transactions were often hijacked by scheme promoters for the purposes of impermissible tax avoidance and promoters found it relatively easy to manufacture a plausible sounding business purpose (SARS, 2005, pp. 42–43). Therefore, if a particular form of transaction was widely used, it meant that the abnormality test was passed (SARS 2005 pp.42-43, citing Katz, 1996, par. 11.2.2; Margo, 1988, par. 27:28).
- **Purpose requirement** – The problems identified within the abnormality requirement were compounded by the use of the purpose requirement, as the Commissioner was placed in the difficult position of having to disprove a taxpayer's assertion that the predominant purpose

for entering into the transaction was not to obtain a tax benefit (SARS, 2005, p. 43). This weakness was often abused by taxpayers in light of the judgment in *Commissioner for Inland Revenue v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA), 61 SATC 391, where the raising of capital for an overall transaction was sufficient to inoculate the steps in a larger scheme (SARS, 2005, p. 43).

- **Procedural and administrative issues** – Firstly, there was uncertainty regarding the extent to which the preceding GAAR could be applied to individual steps within a larger transaction (*Commissioner for Inland Revenue v Louw* 1983 (3) SA 551 (A), 45 SATC 113). Secondly, there was uncertainty as to whether the Commissioner had the authority to apply the preceding GAAR in the alternative where another provision was also disputed (SARS, 2005, p. 44).

As a result of these weaknesses section 103(1) was deleted in 2006, and a new GAAR was introduced in 2006 that is now encapsulated in sections 80A to 80L of the Act. The current GAAR is discussed briefly below.

2.1. The current GAAR

The most pivotal provision of the current GAAR is section 80A of the Act, where the term "impermissible avoidance arrangement" is defined (Pidduck, 2017, p. 75). The remaining provisions expand on this provision, provide for the remedies, and deal with related procedural and administrative aspects. Section 80A of the Act provides that an avoidance *arrangement* will only be impermissible if the sole or main purpose of the avoidance arrangement is 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 *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…"

In terms of the objectives of the present article, this current GAAR will be applied to the facts in the *Sasol case*. In order to prevent bias in the manner in which the current GAAR is interpreted and applied, a standardised method (the purposive approach) for interpreting the rule is used (Goldswain, 2008, p. 109). This approach interprets the legislation by taking cognisance of the intention of the legislature by promoting the general underlying purpose of the statutory provision (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); *Income Tax Case No. 1396* (1984) 47 SATC 141; *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA)). The steps taken for interpretation may be described as follows:

- Firstly, this is done by having regard to the words used and giving them, unless specifically defined, their ordinary grammatical meaning in conjunction with the purpose of the

legislation, thereby attempting to determine what the courts would find in applying this word, sentence or piece of legislation (*Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) (4) SA 593 (SCA)) (Goldswain, 2008, p. 109).

- Secondly, if giving the words such a meaning would lead to absurdities or anomalies that could not have been contemplated by the legislature, the legislature's intention must be considered of paramount importance in order to remain within the bounds of the Constitution (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); Goldswain, 2008, p. 109).
- Thirdly, where a word, sentence or piece of legislation has already come before the courts (in a similar context and with a similar intention), the interpretation used by the courts is used (Pidduck, 2017, p. 53).
- Lastly, the interpretation of anti-avoidance legislation adds an additional consideration in that it must be interpreted widely to "suppress the mischief" and advance the remedy of the revenue authority, but must also not stretch the meaning beyond what the language permits (*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)).

In this interpretational context, the facts of the *Sasol case* and the interpretation and application of the components of the current GAAR are discussed in part 3 below.

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

3.1. Facts of the case

The matter concerns contracts of sale between Sasol Oil (Pty) Ltd (Sasol Oil), Sasol International Services Ltd (SISL) and Sasol Oil International Ltd (SOIL). In terms of these agreements, SOIL agreed to procure crude oil and deliver it to SISL, where SISL would sell and deliver this crude oil to Sasol Oil. As a result of these contracts, that SARS considered to

be simulated, additional assessments were issued in relation to the 2005 to 2007 years of assessment.

The basis of the dispute, may be traced back to 1991, when the Sasol group commenced purchasing oil directly from foreign suppliers in the Middle East and Western Africa. At that point, the Sasol group established businesses in different locations, including Sasol Trading International Ltd (STI) in the Isle of Man (IOM) and Sasol Trading Services Limited in the United Kingdom (UK) (whose name changed to SISL in 1998). Both STI and SISL were wholly owned subsidiaries of Sasol International Holdings (Pty) Ltd (SIH), which was incorporated in South Africa.

Prior to 2001, the Sasol group had for many years purchased crude oil from suppliers under term contracts negotiated by STI. The oil was delivered to Sasol Oil in Durban, South Africa. In 2001, the procurement structure was amended and STI purchased oil from the suppliers, but then sold it to SISL on a free on board port-of-loading basis, which then resold and arranged shipment of the oil to Sasol Oil in Durban on a delivered ex ship basis.

Thereafter, SIH underwent a name change and became known as Sasol Investment Company and SOIL was formed in IOM as a subsidiary of Sasol Oil. Following this, the acquisition of crude oil remained the responsibility of SOIL, who resold this oil (on a free on board basis) to SISL, who, as before, sold and delivered the oil to Sasol Oil.

The dispute arose in 2010 when SARS claimed that the contracts of oil sales in the 2005, 2006 and 2007 years of assessment were simulations. SARS contended that there was no reason for SOIL to sell the oil to SISL and for SISL to sell it back to back to Sasol Oil, and that the real intention of the parties was the sale of oil to Sasol Oil by SOIL. The view taken was that SISL was not intended to assume any commercial risk or purpose in the transaction. On this basis, SARS imputed the profits derived by SOIL to Sasol Oil (invoking section 9D of

the Act to do so) and additional assessments were raised. In the alternative, SARS asserted that the transactions were entered into for purposes of tax avoidance as contemplated by the preceding GAAR (as set out in section 103(1) of the Act at the time). Sasol Oil raised objections which were disallowed. Following this, the Tax Court (*Income Tax Case No. 1910* (2018) 80 SATC 353) held in favour of the Commissioner, finding that the contracts were a sham and that the real contract was for SOIL to sell the oil directly to Sasol Oil.

For the purposes of this paper, the application of the common law is not discussed; the application of the current GAAR to the facts of the case is the focus of the paper (the alternative argument raised by the Commissioner). The interpretation and application of the current GAAR to the facts of the *Sasol case* are set out below.

3.2. Arrangement requirement

The first requirement that must be met for the provisions of the current GAAR to apply is the presence of an arrangement. An arrangement is defined in section 80L of the Act as "any transaction, operation or scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property".

The words "transaction, operation or scheme" have previously been widely interpreted by the judiciary (*Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A)) and allow for steps within larger arrangements to be included in the requirement. Further, section 80H of the Act specifically provides for the application of the current GAAR to individual steps within larger arrangements. The inclusion of this provision is intended to prevent taxpayers from inserting steps with a tax savings effect into a larger arrangement that, as a whole, has a non-tax purpose (Kujinga, 2013, p. 106).

In applying the current GAAR to the facts presented in the *Sasol case*, it is evident that the sale of oil between SOIL and SISL and between SISL and Sasol Oil in the three relevant years of assessment does constitute an arrangement as envisaged in section 80L of the Act. However, it is clear that the Commissioner identified the interposition of SISL between Sasol Oil and SOIL as the specific step of the arrangement to which the preceding GAAR should be applied.

3.3. Tax benefit requirement

For this arrangement to be considered an avoidance arrangement it must first be determined if it "results in a tax benefit" in terms of section 80L of the Act. This is the second requirement of the current GAAR and the presence of a tax benefit derived from the arrangement is a critical requirement regardless of the amount of tax benefit. Three interpretations of the term "tax benefit" have been used for the purposes of applying the current GAAR to the facts of the *Sasol case*:

- A tax benefit only arises if a taxpayer avoids an anticipated liability for tax (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A)). This may be contrasted with avoiding an existing liability for tax as this would constitute tax evasion and not tax avoidance (Pidduck, 2017, p. 81).
- A tax benefit arises where the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability (*Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A)).
- The "but for" test should be applied in determining whether a tax benefit exists and requires the following question to be asked: Would the taxpayer have suffered tax but for the transaction? (*Income Tax Case No. 1625* (1996) 59 SATC 383; *Smith v Commissioner for*

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

For the second requirement of the current GAAR it is necessary for a tax benefit to be a consequence of the arrangement identified. However, it seems that there are two primary arguments that may be made in determining the tax benefit in this case. Each of these arguments is discussed below.

3.3.1. Comparison with transactions occurring before the restructure

The first argument compares the oil procurement and management before and after the restructuring of the Sasol group. In undertaking this comparison it may be argued that Sasol Oil did not have any participation rights in STI (who performed the procurement functions before SOIL) before the restructuring; rather, the shares in STI were held by SIH. Therefore, if any controlled foreign company profits were to be imputed (as provided in section 9D of the Act) as a result of the crude oil sales contracts, they would have been attributable to SIH and not Sasol Oil. In applying this reasoning, Sasol Oil did not step out of the way of an anticipated liability for tax as no additional income would have been imputed in respect of the transactions before the restructuring occurred. In addition, the foreign business establishment exclusion (where the business is carried on through a fixed place of business that meets certain operational criteria implying that activities are carried out with some degree of permanency) was applicable. If this method of determining the tax benefit is correct, then it may be argued that the Commissioner incorrectly identified Sasol Oil as the taxpayer when it should possibly have identified SIH, by whom the tax benefit was derived as a result of the restructuring. However, had the Commissioner selected SIH (for the 2005–2007 years of assessment), it is

doubtful whether the current GAAR would have applied as SIH was not in fact party to the contracts and SOIL was not a controlled foreign company of SIH.

At this point it is important to note that when the preceding GAAR was applied in the alternative in the *Sasol case,* this comparative argument was applied (the Court compared the sale transactions that occurred in 2005, 2006 and 2007 to those occurring before these dates). It was identified that the changes in the group structure from 2001 and 2004 did not result in a much different tax position as SOIL merely replaced STI in its procurement functions and therefore no anticipated tax liability was avoided and Sasol Oil had no imminent tax liability that was escaped.

It is submitted that this argument is incorrect for purposes of the current GAAR, as it does not take into account the specific part of the arrangement identified by the Commissioner (interposition of SISL between Sasol Oil and SOIL for the 2005–2007 years of assessment). This argument would only have been applicable had the Commissioner identified the larger arrangement including the restructuring of the Sasol group. Notwithstanding, it is relevant to consider the opinion of De Koker and Williams (2019, par. 19.37) who argue that the Commissioner would need to show what arrangement would otherwise have been entered into to produce the same commercial result and the tax consequences, in order to prove what tax benefit resulted from the arrangement entered into (discussed in 3.3.2 below).

3.3.2. Comparison with alternative transaction asserted by Commissioner

The second argument may be derived from the Commissioner's contention that the oil should have been sold directly to Sasol Oil by SOIL (removing the interposition of SISL). In this case, the net income of SOIL would have been imputed to Sasol Oil (as SOIL was a controlled foreign company in terms of section 9D of the Act). The interposition of SISL (non-resident)

was the only reason that the amounts would not have been taken into account for the purposes of section 9D of the Act and resulted in Sasol Oil stepping out of the way of the tax liability. Further, Sasol Oil would have suffered the tax "but for" the interposition.

Therefore, the comparison of the oil sales in 2005, 2006 and 2007 to those occurring before, historically, should have no bearing on the consideration of the tax benefit requirement. While this observation may seem trivial, it is critical as this comparison may reintroduce the weaknesses of the predecessor to the current GAAR with regard to the abnormality requirement, where a taxpayer (Sasol Oil in this case) could justify that similar transactions had occurred before and therefore are not abnormal (as noted in the weakness of the preceding GAAR in part 2 above).

These conflicting arguments for the determination of the tax benefit raise two critical issues that may in fact be relevant in the context of many MNEs. Firstly, in MNE group structures, it is common for multiple entities to exist within the larger group. Each of these entities may be used to escape the application of specific anti-avoidance rules, such as section 9D of the Act (controlled foreign company provisions). It is submitted that while such group structures and arrangements may be in conflict with the intention of the legislature, the judiciary is bound to promote the general underlying purpose of the statutory provision, but not beyond what the language permits (*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)). Therefore, the use of complex group structures and multiple entities may designedly facilitate the use of transactions that do not fall foul of the legislation but for the application of the current GAAR. Secondly, the Commissioner is restricted to attacking a taxpayer and not a group of companies and therefore chose to attack Sasol Oil (to whom a tax benefit would have accrued at the time of the transactions) and not SIH (to whom a tax benefit may have been attributed before the restructuring).

In light of these observations, it is evident that research is required to determine the viability of a "group tax system" in South Africa. A system may reduce the options available to MNEs, to structure their affairs in a manner that achieves tax benefits, that was not the intention of the legislature. Such a group tax system may reduce the need for the application of GAAR as it may already cater to some schemes entered into by MNEs, but may also improve the efficacy of the GAAR as the Commissioner could attack the group as opposed to individual entities.

3.4. Sole or main purpose requirement

Once it has been determined that the avoidance arrangement has resulted in a tax benefit, the third requirement of the current GAAR is that of sole or main purpose. The wording used by the legislator in drafting the sole or main purpose requirement of the current GAAR is similar to that used for its predecessor (Pidduck, 2017, p. 82). Therefore, the findings of our courts in the past should apply *mutatis mutandis* to the sole or main purpose of an arrangement in terms of the current GAAR (Pidduck, 2017, p. 82). Nevertheless, section 80G of the Act creates a presumption that the sole or main purpose is the obtaining of a tax benefit and, as a result, a taxpayer would be required to provide conclusive evidence to discharge the onus that the obtaining of the tax benefit is not the sole or main purpose of the arrangement (De Koker and Williams, 2015, par. 19.38). However, due to conflicting views (De Koker and Williams, 2019, par. 19.38) on whether this test should be applied subjectively or objectively, both the objective test (in respect of the effect of the transaction) and the subjective test (the stated intention of the taxpayer) are applied to the facts of the *Sasol case*.

In the *Sasol case*, the stated intention (subjective test) of the arrangement may be ascertained from the representations made by the witnesses who testified about the reasons for

the manner in which the oil sales were undertaken. Essentially, the group required a base in London that was considered a trading and financial centre and had excellent shipping infrastructure. UK tax rates were high however and therefore a business establishment in the IOM was necessary to mitigate the UK tax implications. The IOM was suitable as it was considered a tax haven. Therefore, the procurement and shipping of oil functions were split across two entities (one in London and one in the IOM), resulting in the ultimate delivery of oil to Sasol Oil in Durban. Other representations that were made included:

- the location of the principal oil trader (in the IOM) who refused to relocate to London during the reorganisation exercise (his skills were essential to the acquisition of crude oil);
- the risk that historical profits from STI may be taxed in the UK since it was possible that SISL may have been regarded as a branch of STI (therefore the necessity to incorporate SOIL in the IOM); and
- concerns regarding the renegotiation of term contracts for oil with Middle East suppliers.

The objective effect of the arrangement supported the non-tax motive as the commercial results anticipated were achieved. While evidence was provided by the taxpayer in an attempt to discharge the presumption of purpose, it is uncertain if the evidence provided in the *Sasol case* discharged the onus of proof. A detailed description of the evidence has not been included in this paper, but in the original judgment, the taxpayer was able to justify why the specific arrangement was undertaken and was able to provide grounds to reject the alternative suggested by the Commissioner (sale of the oil directly from SOIL to Sasol Oil). In this regard, the following factors were considered:

- The alternative arrangement put forward by the Commissioner could arguably have achieved the same commercial results (the sale of oil directly from SOIL to Sasol Oil). However, the location and other duties of the principal oil trader, the UK tax implications,

the risk related to the renegotiation of the term contracts, and the location of the trading and financial centre could all have been used as arguments against the proposed alternative. Therefore, for the purposes of the *Sasol case*, it would be relatively easy for the taxpayer to justify why the alternative arrangement would not have achieved the same commercial results or was not viable.

- The dominant subjective purpose of the larger arrangement was to achieve a non-tax business purpose (acquisition of oil by a London-based business with shipping and other business located in the IOM), which indicates that the obtaining of a UK tax benefit, and not a South African tax benefit was the sole or main purpose of the arrangement.

In light of the above, it could be argued that the sole or main purpose of the arrangement in the *Sasol case* was not to obtain a South African tax benefit. Similarly, it is relevant to consider the importance of the alternative transactions presented by the Commissioner because the reasonability or viability of these transactions may impact the conclusions reached when applying the sole or main purpose requirement objectively and in determining and quantifying the tax benefit.

This further highlights that a well-drafted GAAR will succeed only where the correct scheme and taxpayer are identified by the Commissioner, together with viable alternatives. It is notable here that the Commissioner is at a considerable disadvantage with regard to the suggestions related to alternatives, as the taxpayer is able to justify the use of certain mechanisms to achieve the same commercial outcome with relative ease. Similarly, the Commissioner would have limited access to the decision making process used to decide on the arrangement employed and may therefore not be aware of the possible reasons for the use of a specific mechanism that would render its alternatives unsuitable. Nevertheless, the submissions made by the taxpayer in the *Sasol case* lead to the conclusion that the sole or main purpose of

this part of the arrangement was not to achieve a South African tax benefit. Rather, the sole or main purpose was to manage the procurement and shipping of oil functions across two entities (one in London and one in IOM), resulting in the ultimate delivery of oil to Sasol Oil in Durban.

As scepticism regarding the sole or main purpose requirement (application of the test subjectively or objectively) remains, it is impossible to determine if the evidence provided by the taxpayer would be considered conclusive from an objective perspective. This is particularly relevant where certain evidence that contradicted the subjective purpose provided by the taxpayer was brought to light (including minutes of meetings where tax optimisation was recorded but was refuted by representations by witnesses).

3.5. Tainted element requirement

The last requirement of the current GAAR is that the avoidance arrangement must contain one or more of the so-called tainted elements in order to be subject to the current GAAR. While the onus of proving that one of these tainted elements is present lies with the Commissioner, sections 80C to 80E of the Act contain guidelines and definitions that the Commissioner may rely on to discharge this onus (Kujinga, 2013, p. 111; Meyerowitz, 2008, par. 29-11).

In applying the current GAAR to the facts of the *Sasol case*, it is submitted that the transactions were undertaken in the context of business, as this was a venture undertaken by a group of companies. Similarly, the scheme was intended to achieve a commercial purpose (to manage the procurement and shipping of oil functions across two entities, resulting in the ultimate delivery of oil to Sasol Oil in Durban). Each of the tainted elements that is applicable to the arrangement in the *Sasol case* is discussed individually below.

3.5.1. Abnormality

The first tainted element is that of abnormality. When interpreting the abnormality element, an arrangement should be compared to a "normal" business transaction entered into for a consideration other than a tax benefit (section 80A(a)(i) of the Act). Therefore, the question to be asked is: "Is there a difference between a transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration?" This approach is consistent with the intention of the provision as it does not give rise to absurdities or anomalies. The application of this element in practice is, however, more difficult as it requires the judiciary to determine what is "normal", while the *bona fide* component creates confusion (De Koker and Williams, 2019, par. 19.39; Kujinga, 2013, p. 112).

Emphasis is again placed on the alternative transactions presented by the Commissioner, as they become relevant for purposes of the abnormality element. This is because the alternative transactions can be considered to be examples of "normal" transactions in the absence of a tax consideration. In the *Sasol case,* it is likely that the alternative arrangement identified by the Commissioner (that could have yielded the same commercial outcomes in the absence of the tax consideration) may have been rejected as it was not a commercially reasonable or viable option (given the evidence provided with regard to the sole or main purpose requirement discussed above). In addition to this, the representations made by witnesses (specifically Foster at par 45-49 of the *Sasol case*) indicate that it was common to have one procuring entity and one shipping entity within the industry. Therefore, it is likely that the arrangement may not be considered abnormal for purposes of the first tainted element.

3.5.2. Lack of commercial substance

The second tainted element concerns a lack of commercial substance in the context of business. This test is divided into a general test (section 80C(1) of the Act) and a list of indicators (section 80C(2) of the Act). For the general test, the question to be asked is: "Does the arrangement have no significant effect upon the net cash flows or business risks?" In discharging the onus of proving lack of commercial substance, the Commissioner will be assisted to the extent that he is able to point to the indicators contained in sections 80C to 80E of the Act (Meyerowitz, 2008, par. 29-11). The general test and other indicators have been interpreted and applied individually below.

General lack of commercial substance test

Determining if the arrangement resulted in a significant effect upon the net cash flows and business risks raises some concerns for the purposes of the *Sasol case*. Firstly, there is some concern regarding the meaning attached to the term "significant". However, for the purposes of the *Sasol case*, it seems that the representations made by Sasol Oil witnesses may allow for the term to be quantified at R3 million (as this amount was referred to when the cost savings of the rationalisation of the group were first considered). Where business risks are concerned, there is little guidance as to how this concept will be interpreted (Pidduck, 2017, pp. 86–94).

In terms of the *Sasol case* in particular, the Commissioner identified that the risks related to SISL were hollow, specifically with regard to risks of ownership, delivery, and right of entitlements of ownership. However, Sasol Oil was able to provide commercial justification for the transaction and reasons for SISL control and management of the risk as owner while the oil was in transit. In this regard, it is likely that without sufficient guidance on how this

aspect of the current GAAR should be applied, a similar conclusion can be drawn for the purposes of applying the current GAAR to the case. Therefore, it is doubtful that the general lack of commercial substance test (section 80C(1) of the Act) would have been successfully applied.

Substance over form indicator

The substance over form indicator is intended to determine if the risks and rewards resulting from the arrangement are those that can be expected from such an arrangement (Pidduck, 2017, p. 91). Where the risks and rewards are not consistent with the legal form, the arrangement is considered to be simulated (*Commissioner for South African Revenue Service v NWK Ltd* (2011) 2 All SA 347 (SCA); 73 SATC 55). Further, it must be considered whether the taxpayer has remained insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary (SARS, 2005, p. 20).

Since the substance over form test is derived from South Africa's common law, a consideration of the aspects relating to the common law is necessary (National Treasury, 2006, p. 64). In this regard, in the *Sasol case*, the Commissioner alleged that the contracts were simulations and the real intention of the parties was the sale of oil to Sasol Oil from SOIL. The Tax Court (*Income Tax Case No. 1910* (2018) 80 SATC 353) found in favour of the Commissioner, but the Supreme Court of Appeal overturned this judgment (with specific reference to Maritime law). However, dissenting opinions were expressed in the judgment in the Supreme Court of Appeal. Therefore, it is submitted that the substance over form test is a highly subjective one (refer par 96 – 140 of the *Sasol case*). It is therefore likely that there would be similar controversy in applying the test for the purposes of the current GAAR, based on the facts of the case.

In light of these observations, it is submitted that a judgment in terms of the common law principles may complicate the application of the substance over form indicator if it is later applied in the alternative for the purposes of the current GAAR. This is a factor to be considered by the Commissioner before it comes before the courts. In such a case the Commissioner may choose the application of GAAR in isolation and not in the alternative, as this indicator is one of many to be considered for the purposes of the tainted elements and commercial substance provisions. Therefore, the Commissioner may have greater success in applying the GAAR as opposed to an attack in terms of the common law.

Round trip financing indicator

The round trip financing indicator is used to determine if funding has been transferred between parties through some form of reciprocal action, resulting directly or indirectly in a tax benefit (Pidduck, 2017, p. 93). De Koker and Williams assert that this test is intended to prevent a situation where:

> "…money is made to appear to pass between the participants by way of a commercial consideration, but the funds simply travel in a circle and, when all is said and done, everyone is financially in the same position as they were in the beginning, save for the creation of a tax benefit and the payment of fees to the intermediaries." (2019, par. 19.39)

There are aspects of the arrangement in the *Sasol case* that indicate the presence of round trip financing, specifically when considering the effect of the transactions for SISL. In this regard, the timing, sequence, means or manner in which this was done does not negate the presence of round trip financing (section 80D of the Act). Similarly, the obligation to receive or pay cash (such as those derived from the contracts of sale between the three parties) is included in the definition of round trip financing.

For the purposes of the *Sasol case*, the reciprocal actions resulted in a tax benefit (section 80D(1)(b)(i) of the Act) as they prevented the application of section 9D of the Act. In particular, reference may be made to the reciprocal funding between SISL and SOIL and immediately thereafter, SISL and Sasol Oil. While this provision may be open to interpretation it is submitted that there may be some doubt regarding its application. Nevertheless, it is submitted that for purposes of the *Sasol case* it is likely that the round trip financing indicator would have been met if the tax benefit requirement had also been met.

Tax-indifferent party indicator

This indicator (section 80E of the Act) requires the presence of a party to the arrangement to be identified who effectively transferred its tax advantage to others, irrespective of its relationship with any of the contracting parties, and includes parties who are not subject to normal tax (Pidduck, 2017, pp. 95–97). The obvious choice is to point to SISL as a tax-indifferent party, specifically because it is incorporated in the IOM, which was referred to as a "tax haven" by the witnesses in the *Sasol case*. However, it is unlikely that it would be considered a tax-indifferent party due to what is submitted is an error in the drafting of the current GAAR. The reason for this is that the provisions of section 80E(3)(b) of the Act provide that, in certain instances, a controlled foreign company (that is considered to have a foreign business establishment, like SISL in the *Sasol case*) would not be considered a tax-indifferent party. This is problematic as the use of one or more controlled foreign companies in an MNE context is not unusual and MNEs may seek to create these entities in such a way as to comply with section 9D of the Act in a manner that was not intended by the legislature. Therefore, the consequences of excluding a controlled foreign company for purposes of the tax-indifferent party provision of the current GAAR was possibly not considered in the drafting process.

In light of this analysis, it is submitted that the use of controlled foreign companies for the purposes of section 9D of the Act in an MNE context may undermine the effectiveness of the tax-indifferent party provision of the current GAAR. Therefore, the *Sasol case* has highlighted the need to amend the current provisions in order to improve the efficacy of the current GAAR as applied in an MNE context, where the existence of multiple controlled foreign companies in a group could be used as tax accommodating or indifferent parties without meeting the requirements of section 80E of the Act.

Offsetting or cancelling indicator

The offsetting or cancelling indicator (section 80C(2)(b)(iii) of the Act) requires the identification of elements within the transaction that have the effect of offsetting or cancelling each other. Essentially, this would indicate that such offsetting parts of the transaction were contrived for the purpose of obtaining a tax benefit, and would indicate a lack of commercial substance (De Koker and Williams, 2019, par. 19.39). In the *Sasol case*, there are elements within the transaction that may be considered to have the effect of offsetting or cancelling each other, specifically with regard to SISL, when considering the sale revenues (from Sasol Oil) and corresponding expenditures (from SOIL) of the oil transactions. In addition to this, the issue of quarterly credit notes by SISL to Sasol Oil may also be considered as an element of offsetting or cancelling. These observations indicate that there are parts of the arrangement that were contrived for the purpose of obtaining a tax benefit (non-imputation of profits from SOIL to Sasol Oil in terms of section 9D of the Act). However, it is submitted that, in this case, these offsetting or cancelling aspects were introduced due to other commercial considerations (as discussed in the analysis of the sole or main purpose requirement above).

Further, this offsetting or cancelling element of the current GAAR was introduced because its presence may indicate that the arrangement (or part thereof) has no fiscal consequence and becomes of consequence only if the arrangement had a sole or main purpose of obtaining a tax benefit (De Koker and Williams, 2019, par. 19.39). If this is applied to the *Sasol case*, it is submitted that because the tax benefit and sole or main purpose requirements may not be satisfied, the presence of offsetting or cancelling aspects could not be considered as an element for the achievement of the tax benefit. Therefore, this test may arguably not be satisfied in terms of the current GAAR if the tax benefit requirement is not satisfied.

In concluding on the tainted elements of the lack of commercial substance in the *Sasol case,* it is submitted that for the purposes of the general test it is likely that, without sufficient clarity on its interpretation and application, the general test may not be successfully applied. However, the round trip financing and offsetting or cancelling indicators may be successfully applied subject to successful application of the tax benefit requirement. Therefore, in this instance, the arrangement could be considered as lacking in commercial substance. However, in light of the conflicting views expressed in relation to the tax benefit requirement, it is possible that the offsetting or cancelling test may also not succeed.

Nevertheless, there are often instances where the parties to an arrangement or transaction are connected to each other and it may be assumed that relationships between the parties often yield benefits that are not connected to one specific taxpayer, but may in fact benefit the group as a whole. This leads to the conclusion that where a group prospers, each individual party may benefit. If this principle is applied in the *Sasol case*, by entering into these arrangements, it achieved benefits for the group as a whole. It does not seem reasonable to exclude considerations such as these when evaluating the commercial substance of the

arrangement and this is an aspect that may result in adverse or inconsistent judicial interpretations.

3.5.3. Creation of rights or obligations not at arm's length

The third tainted element is the creation of non-arm's-length rights or obligations within the arrangement. For the purposes of this element, it has been interpreted to mean that each of the parties is not striving to get the utmost possible advantage out of the transaction for itself; or unconnected persons would not have done the same in the situation (*Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A)).

One aspect of the *Sasol case* that may be considered not to have been at arm's length is that SISL did not derive a profit from these oil transactions. In this regard, it does not seem reasonable that any party to a transaction would have entered into such an arrangement (without reward or incentive) in the absence of the relationships it had with the other companies in the group. Therefore, it may be argued that the arrangement did have the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length.

3.5.4. Misuse or abuse

The last tainted element is the misuse or abuse element. For the purposes of this article, it has been interpreted to mean the frustration, exploitation or manipulation of any of the provisions of the Act (van Schalkwyk and Geldenhuys, 2009, p. 19). Alternatively, it may mean that the arrangement uses provisions of the Act to achieve a result not intended by the legislator (van Schalkwyk and Geldenhuys, 2009, p. 19; Australian Government, 1999, par. 6.2c).

As discussed in the tax benefit requirement, it is evident that section 9D of the Act was not applicable due to the fact that SISL was inserted between SOIL and Sasol Oil. If this

assertion holds true, then it may be considered that the imposition of SISL was artificial and that the arrangement was employed in a manner that was not intended by the legislator when drafting section 9D of the Act (i.e. the arrangement abused section 9D). In addition to this, it may be argued that the alternative transaction suggested by the Commissioner (the sale of oil directly from SOIL to Sasol Oil) would have resulted in the same commercial result.

If, however, the representations by Sasol Oil are considered, it may be argued that the arrangement was not designed to misuse or abuse section 9D of the Act, but rather the arrangement was designed to manage the procurement and shipping of oil functions across two entities (one in London and one in IOM), resulting in the ultimate delivery of oil to Sasol Oil in Durban. As a result of the lack of guidance (by the courts or SARS) for the application of the provision, it is impossible to say with certainty how the courts would apply it in a case such as this. However, it seems that the detailed provisions of section 9D of the Act were applied in a manner that did not stretch the provision beyond that which was permitted; and there is a strong case to be made that the arrangement may not be considered abusive of the legislation.

3.6. Case conclusion

In analysing the results of applying the current GAAR to the facts of the *Sasol case*, it is submitted that the transactions may be considered an avoidance arrangement as it may be argued that the arrangement did result in a tax benefit (where the interposition of SISL prevented the imputation of net income of SOIL to Sasol Oil in terms of section 9D of the Act). There are, however, alternative arguments that the tax benefit requirement does not exist.

In addition, it is likely that the sole or main purpose requirement would not be met, as both the subjective and objective tests support the contention that the sole or main purpose for the arrangement was to manage the functions of procurement and shipping of oil across two

entities (one in London and one in IOM), resulting in the ultimate delivery of oil to Sasol Oil in Durban. However, in analysing the tainted elements requirement, there are strong arguments to be made that the arrangement may have lacked commercial substance. As it is unlikely that, as the arrangement would satisfy all the requirements of the current GAAR, it would not be considered an impermissible avoidance arrangement. A summary of the requirements of the current GAAR as applied to the facts of the *Sasol case* is represented in Table 1 below.

Table 1: Application of the GAAR to the facts of the *Sasol case*

Requirements of the South African GAAR	***Sasol case***
1 - Is there an arrangement?	Yes
2 - Does the transaction/operation/scheme result in a tax benefit?	Yes
3 - Is the sole or main purpose to obtain such a tax benefit?	No
4 - Tainted elements requirement	Yes
One of the following with regard to business transactions:	
- ***Was the transaction entered into in a manner not normal for* bona fide *business purposes?***	No
- ***Does the transaction lack commercial substance?***	Yes
One of the following with regard to transactions in any context:	
- ***Has the arrangement created rights and obligations that are not at arm's length?***	Yes
- ***Is there misuse or abuse of provisions of the Act?***	No

3.6.1. Recommendations for the efficacy of the current GAAR

While it is submitted that the arrangement in the *Sasol case* would, on the balance of probabilities, not be considered an impermissible avoidance arrangement, there are recommendations that may be made to improve the efficacy of the GAAR:

- The incorrect identification of the arrangement could result in the current GAAR not being applied successfully to the arrangement. Therefore, before the current GAAR is applied, the Commissioner should assess the arrangement identified (or steps therein), to ensure that the application of GAAR will succeed.
- The determination of the tax benefit should be made with reference to the specific part of the arrangement identified by the Commissioner as alternative comparative arrangements that relate to the larger arrangement (and the corresponding tax consequences), that was not in questioned by the Commissioner, may undermine the efficacy of the current GAAR.
- The use of complex group structures by MNEs may facilitate the reduction of the tax burdens of parties within the group that are not expressly disallowed in terms of the Act. The introduction of a group tax system may reduce the options available to MNEs to structure their affairs in a manner that achieves tax benefits that are not the intention of the legislature. This group tax system may already cater for some schemes entered into by MNEs, but it may also improve the efficacy of the current GAAR, as the Commissioner could attack a group as opposed to one party in the group.
- Careful consideration of the reasonability or viability of the alternative transactions that the Commissioner may assert is of critical importance, as these alternatives may affect the conclusions reached when applying the sole or main purpose requirement objectively.
- Guidance regarding the objective or subjective nature of the inquiry regarding the sole or main purpose is required (and the weight attributed to representations made by the taxpayer) in order to prevent the recurrence of the weaknesses of the preceding GAAR.
- Guidance is required for interpretation of the term “normal”, as well as many other undefined terms, as these terms may inherently reintroduce the weaknesses of the preceding GAAR, and it will be left to the courts to determine what is normal.

- The definition of a "tax-indifferent party" in section 80E of the Act should be amended to cater for those schemes where controlled foreign companies may be used as vehicles to avoid tax.
- Guidance with regard to the impact of connected persons and group objectives in assessing the tainted elements should be provided. Such guidance may aid in preventing taxpayers from using these relationships to escape tax burdens in a manner that is in conflict with the intention of the legislature. There are instances, however, where the parties to an arrangement are connected to each other and these relationships often yield benefits that are not connected to one specific party, but may in fact benefit the group as a whole, resulting in the creation of non-arm's-length rights and obligations for individual entities. It does not seem reasonable to ignore the effect of group transactions for the purposes of applying the tainted elements requirement.
- Guidance should be provided with regard to the interpretation of the misuse or abuse indicator.

4. Concluding comments

As the world struggles to combat the aggressive schemes entered into by MNEs, South Africa cannot afford to be left behind and should equip itself to combat such schemes. While the GAAR may be used as a defence against these schemes, it has not yet stood up to the rigours of the courts since its replacement in 2006. Testing the effectiveness of this untried current GAAR is necessary to prevent significant tax losses when confronted with the schemes that may be employed by MNEs to shift profits outside of South Africa. The pre-emptive approach employed in this paper makes two contributions to this goal. Firstly, it demonstrates how the untested current GAAR may be interpreted and applied to transactions entered into in the

context of an MNE, as applied to the *Sasol case*. Secondly, it makes it possible to make suggestions for amendments to the current GAAR in order to improve its efficacy in an international context. Undoubtedly, the interpretation and application of the current GAAR to the *Sasol case* in this paper involved some subjectivity on the part of the researcher, specifically where lack of guidance by the legislator has been identified. In addition to this, the facts of the case (as presented in the judgments) were used for the application of the current GAAR. Consequently, any facts not included in the judgments that were not taken into consideration, may be considered a limitation to the findings of the study. Decisions in courts are derived from the views of the judiciary, where the interpretation by judges of the facts of the case or the application of the law may differ. Differences of opinion are inherent to the interpretation and application of statutes, but by using a structured approach for applying the current South African GAAR, the findings provide insight into the workings of the current GAAR as they may be applied by the judiciary.

The outcome of the study cannot be generalised to all cases that may be brought before the courts but there is an argument to be made that the findings may be indicative of those evident in other MNE cases. The findings of this study provide insight, particularly in relation to MNEs, that may contribute to the discourse on the current GAAR and any future reforms that may be necessary in order to improve its efficacy in an international context.

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