AN ANALYSIS OF THE JUDICIAL APPROACH TO THE INTERPRETATION
OF TAX AVOIDANCE LEGISLATION IN SOUTH AFRICA

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DECLARATION

I declare that this project is an original piece of work which is made available for photocopying, and for inter-library loans.

Signed……………………………………………………

Dated…………………………………………………
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<tr>
<td>CIR</td>
<td>Commissioner of Income Revenue</td>
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<td>GAAR</td>
<td>General Anti- Avoidance Rule</td>
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<td>ITA</td>
<td>Income Tax Act No. 58 of 1962</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>SARS</td>
<td>South African Revenue Services</td>
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SUMMARY

Tax evasion and avoidance costs South Africa billions of rand each year. This treatise examines the judiciary’s view and/or attitude to the dividing line between legitimate and illegitimate tax avoidance. It seeks to find out how South African courts have ultimately dealt with the old GAAR section 103(1).

The treatise seeks to establish the role that the judiciary plays in tax avoidance and whether it has been pro-fiscus or pro-taxpayer in its deliberations of tax avoidance cases. The treatise focuses specifically on the judicial responses to the General Anti-avoidance Rule Section 103 of the Income Tax Act No. 58 of 1962. In order to show the judicial approaches and/or responses to tax avoidance in South Africa, a selection of income tax cases have been used to illustrate how the judges have interpreted the GAAR and whether they have been sympathetic to the tax payer or to the fiscus. The cases used in this study stem from the old GAAR section 103. There have not been important cases dealing with the new GAAR section 80A to 80L of the Income Tax Act.

In the final analysis of this research it would seem that the effectiveness and scope of the GAAR depends ultimately on its interpretation by the courts. Many of the cases that have been decided under section 103 (1) have provided disappointing outcomes for SARS. However it is noteworthy that the courts which were previously taking a restrictive
approach and were pro-taxpayer in their deliberations are beginning to take a different
approach and are gallant in their interpretation of the GAAR. Judges are slowly
abandoning the long standing judicial approach which was that taxpayers are entitled to
arrange their affairs in any legal way in order to minimize their tax and are going further
and examining the real substance and purpose of the transactions entered into by
taxpayers as opposed to the form of the transactions.

The Supreme Court of Appeal has now set a precedent which goes deeper and examines
the true intention of parties in entering into transactions and does not tie itself to labels
that parties have attached to their transactions. This recent judicial attitude and zeal
exhibited by the courts will without a doubt hinder tax avoidance activity and strengthen
the effectiveness and scope of the new GAAR sections 80A to 80L.

KEY WORDS

Tax Avoidance
Interpretation
General Anti-avoidance Rule (GAAR)
Income Tax Act
SARS
Tax payer
Fiscus
CHAPTER 1

1 INTRODUCTION AND BACKGROUND TO THE RESEARCH

1.1 DEFINITION OF TAX AVOIDANCE.

Tax avoidance is the legal utilization of the tax regime to one’s own advantage, in order to reduce the amount of tax that is payable by means that are within the law.

The Organization for Economic Co-operation and Development (OECD) suggests that tax avoidance is “an arrangement of a taxpayer’s affairs that is intended to reduce his liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow.”

In Australia the Review of Business Taxation in 1999\(^1\) offered the view that “tax avoidance is a misuse or abuse of the law that is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of the law and a focus on form and legal effect rather than substance.”

One of the clearest definitions of tax avoidance was provided by Lord Templeman in *CIR v. Challenge Corporation Ltd [1987] A C 155*, where he noted that,

> “Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not

reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.”

By contrast tax evasion is the term used to describe efforts by individuals, firms, trusts and other entities to evade tax by illegal means. OECD has noted that it involves,

“illegal arrangements through or by means of which liability to tax is hidden or ignored such that the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities.”

This usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. In most countries, tax evasion is a crime and the guilty party is subject to fines and/or imprisonment. However, some tax evasion will not always be criminal, it can be innocent.

“Tax planning” is concerned with the organization of a taxpayer’s affairs (or the structuring of transactions) so that they give rise to the minimum tax liability within the law without resort to…impermissible tax avoidance…”

There is a thin line between unacceptable tax avoidance and acceptable tax planning.

In South Africa, the Income Tax Act contains various provisions that are designed to counter schemes aimed to avoid tax. These are the specific anti-avoidance provisions, examples are:

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2 OECD Programme of Co-operation with Non- OECD Economies.
• Paragraph (c) of the definition of gross income in section 1 deals with the receipt or accrual by a person of amounts for services rendered or to be rendered by another person.

• Section 7(2) – (10) deals with income derived by a person in consequence of donations by another person.

• Section 8E deems certain accruals to be interest.

• Section 9D deals with net income of controlled foreign companies.

• Section 22(8) deals with the donation or private consumption of trading stock.

• Sections 54 to 64 deal with donations tax.

The general anti-avoidance provisions act as a safety net in respect of certain transactions which are not dealt with by the specific anti-avoidance provisions. The General anti-avoidance provisions were recently amended and are now contained in Section 80A to 80L of the ITA.\(^5\) Previously, the GAAR’s were found in Section 103 of the ITA.

1.2 STATEMENT OF THE PROBLEM

Tax avoidance activity is a worldwide concern that has grown significantly over the years which impacts negatively on the national tax jurisdictions as the government loses revenue. Adam Smith in his famous work on the “Wealth of Nations”\(^6\) states:

“…the subjects of every state ought to contribute towards the support of the government as nearly as possible in the proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state. The expense

\(^5\) Ibid fn 4.

\(^6\) A. Smith “An inquiry into the nature and causes of the Wealth of Nations (1776) Vol.2 at 350-351.
of governments to the individuals of a great nation is like the expense of management to the joint ventures of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. … the observance or neglect of this maxim consists what is called equality or inequality of taxation…”

Impermissible tax avoidance causes various problems which are pervasive and varied. There is loss of revenue for the fiscus, disrespect for the tax system and the law, an increase in the compliance burden for everyone, and an unfair shifting of the tax burden.

Judicial, legislative and administrative barriers to tax avoidance have been enacted. Despite the existence of the GAAR, tax avoidance is still rampant. This is mainly due to the fact that taxpayers and their advisers will always devise new and complex arrangements which have not yet been fully captured by the legislature.

Whatever a statute may provide, it has to be interpreted and applied by the courts. Courts have no power to amend a tax statute. Cases relating to tax avoidance and tax planning have constituted one of the major areas of tax litigation. There is a concern however, whether the judiciary is able to deal with the onslaught of tax avoidance and whether it has played a significant role in allowing impermissible tax avoidance to flourish or it has in fact acted as a barrier to impermissible tax avoidance.

Over the years, judicial attitudes to tax avoidance schemes have varied dramatically. This study is designed to assess and analyze selected South African cases to find out the direction of judicial thinking in the adjudication of tax avoidance cases in South Africa.

1.3 RESEARCH QUESTIONS
Specifically, answers will be sought to the following research questions:

1. Is the judiciary capable of dealing with the onslaught of tax avoidance arrangements?
2. Does the judicial system encourage tax avoidance/is it sympathetic to tax avoidance?
3. Has judicial law developed in such a way as to indicate clearly to taxpayers what will and what will not be acceptable tax avoidance?
4. Is the way that judges have interpreted the law on the previous GAAR sec 103 going to cause problems for SARS with the new GAAR sec 80A to 80L?

1.4 OBJECTIVES OF THE STUDY

The major objective of this study is to assess the judicial approach and/or response to tax avoidance in South Africa using an analysis of judicial precedent.

The other research objectives of this evaluation are:

- To find out what role the judiciary plays in tax avoidance and whether or not it is sympathetic to tax avoidance.
- To find out whether there is certainty in tax avoidance cases due to the presence of GAAR.
- To find out the attitudes of judges to the correct development of case law on anti-avoidance.
To find out if judicial law has developed in such a way as to indicate with clarity to taxpayers what will and what will not constitute acceptable tax avoidance.

1.5 LITERATURE REVIEW

A review of related literature and research revealed that no such study has been conducted in South Africa to assess the reaction of the judiciary to the anti-avoidance provisions. The literature reviewed in this study includes published works from different backgrounds on the subject of tax avoidance. All these studies are unanimous in the notion that tax avoidance is a common problem in all the concerned jurisdictions although it may be in varying degrees. The findings of the studies also indicate that the tax avoidance activity has been growing significantly in recent years. The judicial responses and judicial barriers to tax avoidance have been varied in different jurisdictions.

Chris Evans in his article\(^7\) found that in the U.K many of the cases that have recently been decided have provided disappointing outcomes to revenue authorities. He further contends that there has been significant development in the jurisprudence in this area of tax avoidance and there is certainty in the approaches that the courts are likely to take in statutory interpretation of the anti-avoidance legislation.

Janie Tremblay in her theses\(^8\) arrived at the following conclusion on Canada’s GAAR\(^9\), that despite the lack of case law interpreting the GAAR in Canada, the current judicial

\(^7\) Barriers to Avoidance: Recent legislative and judicial developments in Common law jurisdictions.
\(^8\) The General Anti-Avoidance Rule: Has it changed the face of tax avoidance?
trend revealed that the GAAR’s success is subject to a judicial system of society which encourages tax avoidance.

Judith Freedman wrote a paper\textsuperscript{10} on the Canadian and U.K. approaches to tax avoidance. She found that despite there being a GAAR in Canada and no statutory provision dealing with tax avoidance in the U.K., the courts in both countries have reached almost similar positions on the application of the general principles of tax avoidance. She further found that the judiciaries in both the U.K. and Canada have a profound concern with their constitutional role that still results in their applying a self-limiting ordinance especially when it comes to taxation. They may go beyond a literal interpretation of a taxing statute but they will not stray into what appears to them to be the creation of new rules that Parliament might have introduced had it thought about it but which, in fact, it did not. In the area of taxation, she found that Parliament often does not cover the situations that taxpayers and their advisers manage to devise.

She concluded that despite the existence of a GAAR in Canada, the most recent judgments of the Supreme Court are arguably more conservative than the latest tax avoidance decisions of the House of Lords in the U.K. where there is no GAAR. An inference can therefore be made that the GAAR in Canada did not give a legislative signal to judges to be bold in fighting and curbing tax avoidance but it seems to have made them all the more careful and apply a restrictive approach so as to protect and be sympathetic to the taxpayer. The GAAR in Canada added nothing to the modern principles of statutory interpretation.

\textsuperscript{10} Converging tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance.
Ian Sanders in an article\textsuperscript{11} states that U. K. judges see anti-avoidance doctrines as one of statutory construction. He continues to state that the role of judges has been twofold: first to construct their own doctrine and secondly to interpret legislative rules in that sphere. He concludes by stating that the judicial attitude to anti-avoidance cases must guide the revenue.

\textbf{CHAPTER 2}

\textbf{2. INTERPRETATION OF FISCAL LEGISLATION.}

\textbf{2.1 INTRODUCTION}

In the Republic of South Africa the Constitution is the supreme law. Any law which is inconsistent with the Constitution is invalid and the Constitution prevails. All the laws in South Africa including the Income Tax Act must therefore promote the spirit, purport and objects of the Constitution.

\textsuperscript{11} Recent Trends in the United Kingdom Anti-Avoidance Law 1993.
Courts function to give meaning to certain statutory words. Judicial precedent forms an integral part of the Income Tax Law. A rule of law established in a previous judgment is binding upon a lower court and courts of equal ranking must follow their own previous decisions. In the same vein, judgments of courts of other jurisdictions have a persuasive value on decisions made by South African courts and are sometimes applied by judges in the Republic in arriving at their decisions.

In this chapter the rules developed by the courts to assist with the interpretation of statutes are explored. These rules each take different approaches to interpretation of a statute. Some judges prefer one rule, while other judges prefer another. Some judges also feel that their role is to fill the gaps and ambiguities in the law whilst others think that it should be left to Parliament as the supreme law-maker.

2.2 LEGISLATION/STATUTE LAW

Statute law is a body of written laws laid down by a legislative body. The individual laws are called statutes or Acts of Parliament. The Courts function is to interpret and apply the law as it stands.

2.3 STATUTORY INTERPRETATION

Statutes have difficult passages in them with certain words having wide meanings. The burden on such occasions lies on Courts to decide on such difficulties and determine what

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construction to place upon the wording. The word construction is derived from the word ‘construe’ the art of combining words grammatically to give a clear meaning. The basic principle in statutory interpretation is that it is the duty of the Court to arrive at the true intention of the legislators, so far as that is possible from the actual wording of the statute. The court’s duty is therefore to interpret and apply the law.

There are certain rules of Interpretation that courts rely upon in the process of giving meaning to any statute. These include:

**The ‘literal’ Rule:** - It states that words of an Act of Parliament have their ordinary, literal meaning in their normal, grammatical sense. If this interpretation of the word does not give rise to any absurdity, ambiguity or inconsistency, then it says what Parliament intended and the Courts will not adopt or accept arguments in favour of some more fanciful interpretation. Rowlatt J. in *Cape Brandy Syndicate v Inland Revenue Commissioners*[^13] and adopted by Centlivres J.A in *Commissioner for Inland Revenue v Simpson,*[^14] said as follows:

> “In a taxing statute one has to look merely at what is clearly said. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used.’

This means that the literal and/or plain meaning of the words used should be applied.

There have been instances where the South African courts have refused to deviate from the literal meaning of the statute regardless of whether the intention of the legislature is clear and have resorted to a more restrictive approach to the interpretation of the words and/or phrases in the statute. However, some Judges like Corbett JA were of the opinion that there should be a level of equity about tax and when interpreting fiscal legislation the results must be equitable both from the point of view of the taxpayer and the fiscus and therefore tax law should not be interpreted in an overly strict manner.

When the statute is expressed in clear, precise and unambiguous words, the court is not entitled to do otherwise than interpret those words in their ordinary and natural sense. Nicholas JA, delivering the judgment of the Appellate Division of the Supreme Court in *R v Koster & Son (Pty) Ltd & Another v CIR*:

“…the rule is well established ‘that in construing a provision of an Act of Parliament the plain meaning of its language must be adopted unless it leads to some absurdity, inconsistency, hardship or anomaly which from a consideration of the enactment as a whole a court of law is satisfied the Legislature could not have intended.’”

**The ‘Golden’ Rule:** The rule is to the effect that Parliament never intends to enact a manifest absurdity, and if words amount to an absurdity, or an interpretation that is at odds with the intention of the statute, then the Courts will modify the wording just

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15 in Commissioner for Inland Revenue v Nemojim (Pty) Ltd 1983 (4) SA 935 (A) at 958 [45 SATC 241 at 267].
16 (1985 A) at 32.
enough to get round the difficulty, but not further. In **Re Sigsworth**,\(^{17}\) the common law rule that a person he/she has murdered was used to overrule the Administration of Estates Act, 1925. This Act said that the estate should be divided among the dead person’s ‘issue’ and the murderer was her only child. It was held that it would be a manifest absurdity to follow the statute. This principle has been approved of and repeatedly referred to by the South African Courts. Botha JA, stated in *Glen Anil Development Corporation Ltd v SIR*\(^{18}\):

…it is clear from the remarks of Wessels CJ in the Delfos Case….that even in the interpretation of fiscal legislation the true intention of the legislature is of paramount importance, and I should say, decisive.”

The Golden rule of interpretation is concerned with ascertaining the true intention of the lawmaker from a study of the provisions of the enactment in question. This entails reading the preamble to a statute and together with the object of the Act, title, marginal notes and probably the legislative history.

**The ‘Mischief’ Rule:** - It is also known as the rule in *Heydon’s case*\(^{19}\). The rule was laid down in 1584 and calls on judges to discover the following:-

(a) What was the common law before the Act was passed?

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\(^{17}\) Re Sigsworth (1935). A son had murdered his mother. The mother had not made a will, but in accord with rules set out in the Administration of Justice Act 1925 her next of kin would inherit (who was the son). There was no ambiguity in the wording of the Act, but the court was not prepared to let a murderer benefit from his crime. So it was held that the literal rule should not apply, the golden rule being used to prevent a repugnant situation.

\(^{18}\) (1975 A) at 334.

\(^{19}\) Heydon's Case (1584).
(b) What was the mischief in the common law which the Act was passed to solve?

(c) What remedy had Parliament resolved upon to cure the mischief?

(d) What is the true remedy? If the wording complained of is defective then the court must interpret the wording so as to defeat the mischief and advance remedy.

In deciding these four points the following rules apply:-

(a) Look at the whole enactment because courts must interpret what the intention of Parliament was when it passed the Act.

(b) Consult the Preamble of the Act to discover if Parliament’s intention is outlined.

(c) Marginal notes appear in many acts to give interpretation of a section.

2.4 RULES OF LANGUAGE

The courts may also choose to look at other words in the statute to ascertain the meaning of specific words. To enable them to do this they have developed a number of rules of language to help make the meaning of words and phrases clear. There are four main rules of language:
The ‘Ejusdem Generis’ Rule: - ‘Ejusdem Generis means of the same class or genus.

It is to the effect that if a word used as a general word and a dispute arises as to whether this general word includes a particular class, the decision must depend on whether the word in dispute is of the same class clearly covered by the Act. In Powell v Kempton\textsuperscript{20}, a ring at a racecourse was held not to fall within the terms ‘house, office, room or other place’ because the list of words indicated that ‘other place’ should be construed as an indoor place. However, this rule is subject to the qualification that the particular context of the statute in question may require a more restricted interpretation. Often a word of wide and general meaning receives a restricted interpretation on the application of the *ejusdem generis* rule. The mere fact that general words follow particular words does not necessarily invoke the application of the *ejusdem generis* rule. This rule has been applied in a number of cases dealing with interpretation of the words ‘donation’ settlement or other disposition’ in s 7(3) and equivalent provisions under previous statutes. In *ITC 551* where the court interpreted the words ‘or other disposition’ as being *ejusdem generis* with a deed of donation or settlement and not as referring to a contract of partnership which was bilateral.

**The ‘Noscitur a sociis’ Rule:** - It says that the meaning of a word may be known by the company it keeps, in other words the context in which it is used. In *CIR v Lunnon* the question before the court was whether a voluntary amount received as gratuity on termination of services constituted a benefit granted in respect of employment. Innes CJ

\textsuperscript{20} (1899) AC 143.
referred to the Commissioner’s main argument that the transaction was covered by the words ‘any other benefit or advantage of any kind granted in respect of employment contained in s.6 of the Income Tax Act 41 of 1917 as follows:

‘This general expression related to the particular words ‘salaries, stipends, wages, and allowances’. These were all granted ‘in respect of employment’ in the sense that they were paid in return for the employment. The immediately preceding words ‘estimated annual value of any quarters or board or residence’ undoubtedly referred to cases where such privileges formed part of the consideration paid for employment, and adopting the maxim Noscitur a Sociis, the ‘other benefits or advantages of any kind’ must be confined to such as the employee was entitled to demand. They could not include a gift that the employer was under no obligation to bestow.”

*Casus Omissus* is a matter or provision that should have been inserted or provided in the law but has not been so inserted or provided for. The courts will not fill a *casus omissus*, or gap in a statute but the courts will interpret a statute so as to avoid a *casus omissus* when its language makes this reasonably possible. Where a word in an Act is capable of two meanings, that meaning which is in accordance with the rest of the Act should be given to it by the courts.

*Mutatis Mutandis* - This means ‘subject to the necessary alterations’ and require that the provisions referred to in an act shall apply as fully as the altered circumstances permit. This maxim is illustrated in s. 19(1) of the Income Tax Act, which provides that ‘the provisions of paragraphs (a) and (b) of s.11 and s.20 shall… *mutatis mutandis* apply in relation to any income derived by any person in the form of dividends. The effect of this
provision is that if provisions of s. 11 (a) are to be applied *mutatis mutandis* to dividend income, the requirements, of s.11 (a) will have to be applied to such income. In other words, the deduction of expenditure and losses actually incurred in the Republic in the production of income in the form of dividends is allowable, provided the expenditure and losses are not of a capital nature.

### 2.5 CONCLUSION

The courts play an important role in the interpretation of fiscal legislation in South Africa. Many of South Africa’s primary legal principles have been made and developed by judges (rather than by Parliament) from a case by case analysis in what is called judicial precedent; where the lower courts are bound to follow principles established by the higher courts in previous cases. This judge-made law is as important as the law made by Parliament. The judiciary also plays an important role in statutory interpretation. Whilst the meaning of law in a statute should be clear and explicit, this is not always achieved. Many cases come before the courts because there is a dispute over the meaning of a word in a statute. We have seen in this chapter that in order to assist with the interpretation of statutes the judiciary has developed a number of rules which all take slightly different approaches to the interpretation of statutes. The judiciary does not always agree on which approach should be used, so the interpretation of a statute may depend on the judge hearing the case. Once that interpretation has been made, however, it may form a precedent for later cases. Therefore judicial decisions remain an important tool as they fill in the gaps where there is no statute law and they interpret the meaning of statutory law in situations where there is ambiguity.
CHAPTER 3

3.0 THE RELEVANT LEGAL FRAMEWORK/SOUTH AFRICAN GAAR
3.1 INTRODUCTION

It is believed that tax is a life issue, not just an economic matter and further urged that those who claim that the well off will reduce their effort in the face of tax rises entirely miss the point. However, a certain percentage also agrees to the phenomenon adopting the assumptions of conventional micro-economics, with all its flaws on the laws on taxation. Are these assumptions wrong? Can people respond to changes in tax? Are the laws friendly to tax avoidance and the penalties in tax evasion?

Poor communication of new rules and or regulations designed to assess the compliance by the practitioners through the office of the commissioner has been a major concern to tax payers. This chapter will therefore look at the legal framework on tax legislation in South Africa focusing on the application of the GAAR vis a vis tax avoidance, and analyse and recommend the existing gaps thereto.

3.2 THE CONSTITUTION OF SOUTH AFRICA\textsuperscript{21}

The above is the supreme law of the Republic of South Africa. Any other law that contradicts the constitution is null and void and its obligation must be fulfilled. The

\textsuperscript{21} Was adopted on 8 May 1996 and amended on 11\textsuperscript{th} October 1996 by the constitutional assembly.
supreme law guarantees the principle of equity and equality of all citizens before the law under section nine (9). It further imposes on money bill limiting provincial taxes, levies, duties or surcharges abolishing inter alia grants from exemption and authorised direct charges against a Provincial Revenue Fund under section 120(2-3).

3.3 THE INCOME TAX ACT, 1962

The above law was enacted to consolidate the law relating to the taxation of incomes and donations, to provide for the recovery of taxes on persons, to provide for the deduction by employers of amounts from the remuneration of employees in respect of certain tax liabilities of employees, and to provide for the making of provisional tax payments and for the payment into the National Revenue Fund of portions of the normal tax and interest and other charges in respect of such taxes, and to provide for related matters.

3.4 THE GAAR CONCEPT

Tax avoidance, usually denotes a situation in which the taxpayer has arranged his affairs in a perfectly legal manner, with the result that he has either reduced his income or that he has no income on which tax is payable. It is submitted by the writers that no

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22 Equality includes the full and equal enjoyment of all rights and freedoms. No discrimination against categories of persons.
23 Revenue allocated through a province to a local government in that province subject to section 214 of the constitution, it’s a direct charge against that province’s Revenue Fund. See also section 176(3).
24 Legislative authority to define procedures on money bill.
25 Chapter three of Keith Jordaan and Stiaan Klue publication on Tax avoidance.
obligation rests upon a taxpayer to pay a greater tax than is legally due under the taxing Act. Therefore, a taxpayer cannot be stopped from entering into a bona fide transaction which, when carried out, has the effect of avoiding or reducing a tax liability, provided that there is no provision in the law designed to prevent the avoidance or reduction of tax.

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. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow-taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax26.

It is crucial to identify tax avoidance and tax evasion where evasion means an illegal offence resulting to several penalties and possible imprisonment whilst avoidance being a legitimate process where a tax payer organises his affairs to limit his liability by an Act of parliament27.

The new GAAR came about after discussions between stakeholders and SARS. During the discussion, reasons were given that the old GAAR was obsolete and made worse by judicial interpretations which undermined existing statutes in an attempt to end tax avoidance mechanisms28. However, according to Meyerowitz, SARS criticism diminishes the functions of the court to protect taxpayers and the fiscus and therefore the inadequacy

26 This principle is derived from the judgment of Lord Tomlin in Duke of Westminster v IRC (1953) (at 520).
28 The Commissioner misused the provision by attacking legitimate transactions with respect to section 103.
of the GAAR could not be blamed on the court\textsuperscript{29}. On the other hand the old GAAR can only be applied under section 103(1) and the new sections 80A – 8-L if there exists a transaction, operation or scheme that results in the avoidance, reduction or postponement of a tax liability levied in terms of the ITA.

In particular, transactions incorporating the use of circular flows of funds, special purpose vehicles and other accommodating parties and the use of derivatives have been identified as being the source of anti-avoidance transactions. A distinction is made between impermissible tax avoidance and legitimate tax planning. Legitimate tax planning entails a transaction where a taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and generally suffers the economic consequences that the legislature intended to be suffered by those taking advantage of the option. An example of this type of transaction would be whether or not a new business would be operated through means of a company or a sole proprietorship. The concept of impermissible tax avoidance has been indicated to include the manipulation of the law and the focus on form and legal effect rather than substance. These transactions generally have little or no actual economic impact upon the taxpayer. The so-called badges of anti-avoidance schemes have been said to be:\textsuperscript{30}

- the lack of economic substance;
- the use of tax indifferent accommodating parties or special purpose vehicles;
- unnecessary steps and complexity;
- inconsistent treatment for tax and financial accounting purpose;

\textsuperscript{29} Taxpayer, volume 54 No 4, April 2005, p. 61/2.
\textsuperscript{30} New General Anti-Avoidance Rule for South Africa? Emil Brincker of Edward Nathan (Pty) Ltd
• high transaction costs;
• fee variation clauses or contingent fee provisions;
• tax haven arrangements;
• the use of derivatives.

SARS serves as an administratively autonomous organ of the state: it is outside the public service, but within the public administration. So although South Africa's tax regime is set by the National Treasury, it is managed by SARS. Its aim is to provide an enhanced, transparent and client-orientated service to ensure optimum and equitable collection of revenue and its main functions are to:

• Collect and administer all national taxes, duties and levies;
• Collect revenue that may be imposed under any other legislation, as agreed on between SARS and an organ of state or institution entitled to the revenue;
• Provide protection against the illegal importation and exportation of goods;
• Facilitate trade; and
• Advise the Minister of Finance on all revenue matters.

It has been urged that the GAAR has inherent weaknesses. Recently a case on its validity and the application of section 103 was argued as here under.

“...a taxpayer may minimize his or her tax liability by arranging his or her affairs in a suitable manner. In determining whether the sole or main purpose of any transaction,
operation or scheme was to obtain a tax benefit, one must look at the transaction or scheme as a whole and not merely at certain elements thereof.”

Thus as long as the scheme as a whole was undertaken for commercial purposes, individual steps therein could not be attacked even if the sole or main purpose of those individual steps was tax avoidance. The new GAAR defines the terms “arrangement”, “avoidance arrangement”, “impermissible avoidance arrangement”, “party”, “tax” and “tax benefit” repealing section 103 but introducing new terms among others; commercial substance to measure non-exclusive indicators.

Another problem faced by SARS in enforcing the section is that there had to be abnormalities involved, depending on the circumstances. For example, in a business context, the scheme must have been entered into in a manner which would not normally be employed for bona fide business purposes other than the obtaining of a tax benefit. In any other context the transaction, operation or scheme must have been entered into by means or in a manner which would not normally be employed in such a transaction, operation or scheme. In the alternative to both of these, the scheme must have created rights or obligations which would not normally be created between persons dealing at arm's length.

The controversy is the understanding of the word “normal”. In many cases, a scheme was devised and became widespread, and the taxpayer argued that so many people were doing it that it must have been normal. Consequently, new GAAR provisions were inserted in

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31 A ruling at the Supreme Court of Appeal in Conhage see fn 48.
32 See section 80C.
33 Section 80A (a) ii –taking into account of s.80C. (see the preamble to understand the definitions).
sections 80A to 80L\(^{34}\) and apply to any arrangement entered into on or after 2 November 2006. In effect therefore, S 103(1) no longer applies to a transaction entered into on or after 2\(^{nd}\) November 2006. So that, if a transaction was entered into prior to 2\(^{nd}\) November 2006, the new GAAR will not apply to the transaction regardless of the fact that a significant step in the transaction has been undertaken after 2\(^{nd}\) November 2006.

The underlying concept of the new GAAR\(^{35}\) is not much different compared to s.103 (1). In the sense that the following four elements still have to be present in a commercial undertaking if it is to be classified as a prohibited tax avoidance transaction: There must be a transaction, operation or scheme (now termed an ‘arrangement’ and expanded to encompass an agreement or understanding, whether enforceable or not, including all steps in it or parts of it). The effect of the arrangement must be to obtain a tax benefit (this requirement is the same as in section 103 (1) and is now known as an ‘avoidance arrangement’). The sole or main purpose of arrangement must be to obtain a tax benefit although nothing has changed in this regard\(^{36}\).

The old GAAR section 103 (1) of the Income Tax Act contained the following four requirements which all had to be met for the provision to apply: –

- There must be a transaction, operation or scheme;

\(^{34}\) Contained in part 11A of chapter III of the Act.

\(^{35}\) Section 90 of the Act 31 of 1941 amended to the CIR v. King (1947 A) judgment to improve constructions, and on the recommendation of Katz commission.

\(^{36}\) Ernest Mazansky Director Werksmans Tax.
• The transaction, operation or scheme must result in the avoidance, reduction or postponement of tax i.e. there must be a tax benefit;

• The transaction, operation or scheme must have been entered into or carried out in a manner not normally employed for a transaction of that nature i.e. the abnormality requirement;

• The transaction, operation or scheme must have been entered into solely or mainly for the purpose of obtaining a tax benefit.

The new GAAR sections 80A – 80L are an improved and expanded version of the old GAAR section 103 (1).

In terms of section 80A, the terms transaction, operation or scheme as used in section 103 (1) have been replaced with the term “arrangement”. Therefore an “impermissible avoidance arrangement” is subject to attack by SARS. An avoidance arrangement is impermissible if:

• The sole or main purpose is to obtain a tax benefit;

• It is carried out in a manner which would not normally be employed for bona fide business purposes other than obtaining a tax benefit;

• It is 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; it lacks commercial substance in whole or in part;

• It creates rights or obligations which are not normally created between persons dealing at arm’s length;

• It results directly or indirectly in the misuse or abuse of the Income Tax Act.
The following are indicators that an avoidance arrangement is abnormal and lacks commercial substance:\(^{37}\):

- The substance of the transaction differs from the form of the transaction;
- The participation in the transaction of a tax indifferent party;
- Round trip financing/circular flow of assets;
- The time at which the arrangement or any step or part thereof was entered into and the length of period during which the arrangement or step was carried out;
- The inconsistent treatment of any items or amounts for tax purposes by the parties to the arrangement;
- The lack of any change in the financial position of any person resulting from the arrangement;
- The absence of reasonable expectation of a pre-tax profit.

It is up to a taxpayer to discharge the burden of proof that the transaction is not abnormal given the circumstances in question. Once abnormality is proved, the burden of proof is also on the taxpayer to discharge the onus on what the sole or one of the main purposes to the transaction may have been. This requirement will now be tested objectively, which may be relatively difficult as a main purpose would more often than not be present, even though it may not be the predominant purpose in the circumstances.

The provision on the misuse or abuse of the Income Tax Act in the new GAAR was introduced to cover all avoidance arrangements that may not fall within the abnormality provisions.

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\(^{37}\) Supra fn. 30
3.5 CONCLUSION

The new GAAR provisions were introduced to aid in curbing tax avoidance after the old GAAR’s proved to be inconsistent and ineffective deterrents in the face of highly sophisticated forms of tax avoidance. In addition, a number of conflicting court decisions had created uncertainty in the application of the old GAAR. The new GAAR’s were formulated by taking into account international general anti-avoidance provisions\(^{38}\).

Interpretation of a statute mainly depends on the judge hearing the case. It is therefore hoped that the courts will be able to interpret the new GAAR sections 80A – 80L with certainty and clarity and develop good precedents for use by other courts when faced with similar cases.

\(^{38}\) The New General Anti-Avoidance Rules; Le Roux Roelofse and Melanie Mileskie
CHAPTER 4

4. THE JUDICIAL APPROACHES AND REACTIONS TO TAX AVOIDANCE IN SOUTH AFRICA; AN ANALYSIS OF JUDICIAL PRECEDENT

4.1 INTRODUCTION

The South African law relating to the new anti-avoidance laws\(^{39}\) has not yet been fully developed due to the fact that the sections have only been recently introduced. This chapter will deal with the South African Courts approach or application of the old GAAR section 103 and analyze specific South African cases on tax avoidance where the old GAAR\(^{40}\) was applied to \textit{inter alia}; find out the direction of judicial thinking in the adjudication of tax avoidance cases in South Africa. This chapter also aims to find out whether or not the courts favoured the tax payer or the fiscus in arriving at their judgments as to whether or not there was impermissible tax avoidance.

4.2 SOUTH AFRICAN CASE LAW

4.2.1 COMMISSIONER FOR INLAND REVENUE v. HOOSEN MIA BOBAT, ISMAIL EBRAIM MOOSA AND FAROUK ESSOP MOOLLA \(^{41}\)

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\(^{39}\) Sections 80A to 80L.

\(^{40}\) Section 103.

\(^{41}\) In The High Court of South Africa Natal Provincial Division Case No.: Ar.232/02.
This was a case which was heard and judgment delivered in March 2003 by Booysen J, Combrink J and Msimang J. The Commissioner for Inland Revenue was the Appellant. The three taxpayers Mr. H.M.A. Bobat, Mr. I.E. Moosa and Mr. F.E. Moolla were the first, second and third taxpayers respectively.

**Facts of the case**

The wives of the first and third taxpayers, Ayesha and Zuleka respectively are sisters of the second taxpayer, and all three of them were the vested beneficiaries in a trust called the E.M. Moosa Family Trust. The trust had been set up by their father Mr. E.M. Moosa who held directorship positions in a group consisting of several family companies. The trust controlled two companies, being Trueart Furniture Sales (Pty) Ltd. and KIM Investments (Pty) Ltd. In 1990, a very complex scheme was devised whereby Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd. were deregistered and certain payments made to each of the three beneficiaries. The first and third taxpayers did not reflect these receipts in their returns but the second taxpayer described his receipt as a capital distribution received from the trust. The three taxpayers were therefore not taxed on the receipts.

On being informed of the matter, the Commissioner was of the opinion that Section 103(1) of the Income Tax Act, No. 58 of 1962 as amended, applied to the said scheme. He then went ahead and taxed the said receipts by the three taxpayers as dividend income. On appeal, the question that arose was whether or not Section 103(1) applied to the said scheme.
The taxpayers led evidence through a Mr. Wilson, a chartered accountant to show that there was a cross-holding between Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd in that as far as Trueart Furniture Sales (Pty) Ltd was concerned, the trust held 50% of its shares and the other 50% was held by Kim Investments (Pty) Ltd; and as far as Kim Investments (Pty) Ltd was concerned, the trust held 57.2% of its shares and the other 42.8% was held by Trueart Furniture Sales (Pty) Ltd. The taxpayers claimed that both companies were investment holding companies which owned many small businesses and that the scheme had been devised with estate duty savings in mind.

The said Mr. Wilson stated that there was a trust deed which provided that in the event of the death of a beneficiary the capital would go to his or her children. Each beneficiary had a vested interest in the proceeds of the trust and estate duties would become payable upon his or her death. Only one of the companies in the group was running a furniture business which was flourishing and was expected to continue doing so. The dividends of the said furniture business would ultimately find their way to Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd, whose assets would thereby increase substantially. Concern about the death duties of the beneficiaries' estates was considered to be a material difficulty and was expected to become even more serious as the trust's assets increased.

On advice that was received from the taxpayers' attorney, it was decided that the vesting trust should be replaced by a discretionary trust and that Trueart Furniture Sales (Pty) Ltd should no longer remain a shareholder in the company carrying on the furniture business
but should be a partner with the concerned company. The company in the group which carried on the furniture business therefore sold its business to another company in the group, which later changed its name to Trueart Furniture Factory (Pty) Ltd. and which from the time of the sale was in fact the disclosed partner in a partnership with the trust. The balance of the purchase price owed by Trueart Furniture Factory (Pty) Ltd. which amounted to more than R4 000 000.00 was not paid to the selling company, but was instead in the meantime left in a loan account.

Most of the companies in the group were inactive and the cross-holdings between Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd. required to be broken up and the two companies needed to be deregistered. This meant that the substantial deregistration dividends would be payable to the trust, and because such dividends would in turn have to be paid over to the beneficiaries (the second taxpayer and the wives of the first and third taxpayers) they would be taxable in their hands. At the time dividends payable to an individual were taxable, while those payable to a company were not.

The definition of a dividend in the Income Tax Act No. 58 of 1962, at the time, excluded cash paid to a shareholder to the extent that it represented a reduction of the company's share premium account, which in terms of the Companies Act formed part of the share capital. It was therefore possible for a company to take the necessary steps to reduce its share capital by in fact reducing its share premium account, and in terms of the Income Tax Act any monies paid in such a case would not be regarded as a dividend. The scheme required the creation of a share premium account and therefore a third party, Facet Investments (Pty) Ltd. was introduced to the scheme and a big portion of the shares of
Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd were issued at a substantial premium which went to a share premium account and it was out of the reduction of that share premium account that the beneficiaries would be paid.

The third party was a company because as a company, ordinary dividends would not be taxable in its hands. Facet Investments (Pty) Ltd had no assets and in order to acquire the issued shares at a premium it required a substantial loan of R9 100 000.00 from the group’s bank who issued the loan without any security being offered as it was assured of repayment within twenty-four hours. Vital to this scheme was that both Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd would pass certain similar resolutions which would have the effect of restructuring the capital structure of the companies prior to the introduction of a new shareholder, facilitating the regulation of the rights of the new, existing and the intended shareholders, protecting the rights of the existing Class "A" shareholder prior to an issue of shares to a new shareholder and facilitating the introduction of a new shareholder.

At a director's meeting it was resolved that the company allots 1 000 000 Class "C" ordinary shares to Facet Investments (Pty) Ltd. for a total issue price of R8 212 129. These shares were issued at a substantial premium, the premium amounting to R8 212 029 which went into the share premium account. At the meeting of members it was decided that the Class "B" ordinary share capital of the company be reduced by transfer to the holders of the Class "B" ordinary shares and that a dividend be paid to the holders of the Class "B" ordinary shares. This in effect was a restructuring of the capital structure of the company following the introduction of a new shareholder and led to the
elimination of cross-holdings between the companies. The share premium account of the company was also reduced by payment of cash to the holders of the Class "A" ordinary shares and the transfer of accounts receivable. This reduced the contributed capital of the company. In effect the company had no liabilities and had cash and assets in surplus to its requirements.

There was an extraordinary general meeting of shareholders, where it was resolved that a dividend be declared to the Class "A" and Class "C" shareholders. Since Facet Investments (Pty) Ltd. held the greater majority of the shares, it was to receive the substantial part of that dividend. When Trueart Furniture Sales (Pty) Ltd and Kim Investments (Pty) Ltd were deregistered, deregistration dividends became payable. Because the trust’s shareholding in each company was minimal, the tax payable thereon was nominal. The bulk of the deregistration dividends became payable to Facet Investments (Pty) Ltd. but since it was a company those receipts were not taxable in its hands. The dividends received by Facet Investments (Pty) Ltd. totalled R9 328 896.

The final step in the scheme was the substitution of the trust by a discretionary trust and the vesting trust distributed all of its funds to the beneficiaries, who in turn re-advanced them to the discretionary trust, and the discretionary trust advanced them to the partnership between itself and the disclosed partner Trueart Furniture Factory (Pty) Ltd.

The question in this appeal was whether this complex scheme was covered by Section 103(1) of the Income Tax Act.
A transaction can be attacked in terms of Section 103 (1) of the Income Tax Act No. 58 of 1962 if the following four elements are present:

a) There must be a transaction, operation or scheme;
b) Which has the effect of obtaining a tax benefit;
c) Whose sole or main purpose is the obtaining of a tax benefit; and
d) The transaction must have been entered into in an abnormal manner.

The above four requirements must all be met before Section 103(1) of the Income Tax Act can apply.

**There must be a transaction, operation or scheme.**

First, the court must be satisfied that a transaction, operation or scheme was entered into or carried out.

In *Meyerowitz v. CIR*\(^ {42} \) the question arose as to whether various transactions amounted to “schemes” within the meaning of section 90 of the Income Tax Act (which was the forerunner to section 103(1) and Beyer J stated,

“ …Even if it were otherwise, I think that there is sufficient unity about the whole matter to justify its being called an arrangement for this purpose, because the ultimate object is to secure for somebody money free from what would otherwise be the burden or the full burden of surtax. Merely because the final step to secure this objective is left unresolved

\(^{42}\) 25 SATC 287
at the outset, and decided on later, does not seem to me to rob the scheme of the necessary unity to justify its being called an “arrangement”.

In the present case, the taxpayers through the advice of their accountant and their attorney devised a scheme whereby they formed the E.M. Moosa Family Trust and made the wives of the three taxpayers to be the vested beneficiaries of the trust. Since the trust controlled two companies being Trueart Furniture Sales (Pty) Ltd. And KIM Investments (Pty) Ltd. they deregistered the two companies which controlled the trust and thereafter made certain payments to each of the three beneficiaries which payments in their view did not attract tax. The arrangements or schemes were conceived and were all carried out in one tax year. There was sufficient unity about the whole matter and it is therefore justified to call it an arrangement or scheme.

The first requirement has therefore been satisfied in that indeed there was a transaction, operation or scheme entered into or carried out by the taxpayers.

**The transaction, operation or scheme must have the effect of obtaining a tax benefit.**

Once it has been proved that there was a transaction, arrangement, or scheme which was carried out or entered into, it must be determined whether the transaction, operation or scheme has the effect of the avoidance, postponement or reduction of the payment of any tax or duty.
In *CIR v. King* Watermeyer CJ examined the meaning of “avoiding tax” and stated,

“…there is a real distinction between the case of a man who so orders his affairs that he has no income which could expose him to liability for income tax, and the case of a man who so orders his affairs that he escapes from liability from taxation which he ought to pay upon the income which is really his. Similarly there is a distinction between reducing the amount of tax from what it would have been if he had not entered into the transaction and reducing the amount of tax from what it ought to be in the tax year under consideration.”

Watermeyer CJ was of the opinion that the legislature intended the words “avoiding tax” to cover the case whereby a man orders his affairs that he escapes from liability from taxation which he ought to pay upon the income which is really his and reducing the amount of tax from what it ought to be in the tax year under consideration.

Watermeyer CJ’s interpretation of the words “avoiding liability” was held not to be applicable in the case of *Smith v. CIR* whereby Steyn J was of the opinion that the ordinary meaning of avoiding liability for tax on income should be applied and it meant “to get out of the way of, escape or prevent anticipated liability.”

In the present case, from the above interpretation given by Steyn J in *Smith v. CIR*, it is clear that the taxpayers had devised a complex scheme whose aim was to avoid or reduce estate duty otherwise payable upon the deaths of the beneficiaries.

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43 (1947 A)  
44 26 SATC 1  
45 Supra fn 44
Therefore the second requirement of section 103 (1) has been satisfied in that the transaction, operation or scheme had the effect of obtaining a tax benefit (estate duty).

**The sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit.**

The third requirement of section 103(1) is that the sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit.

In determining the sole or main purpose of the scheme regard must be had to the evidence of the taxpayers as to why the scheme had been carried out. This proposition is supported by Kroon J in *Income Tax Case 1636* where he stated that:

“The test to be applied is a subjective one, i.e. what was the subjective intention of the taxpayer in entering into or carrying out the transaction? Because a subjective approach is to be applied in the determination of the purpose of the transaction, the evidence of the taxpayer, the progenitor of the transaction, as to why it was entered into or carried out, is of prime importance. The *ipse dixit* of the taxpayer is, however, not decisive and it must be measured against the credibility of the witnesses who give the evidence, the other evidence adduced and the probabilities.”

As to the meaning of “main purpose” Nicholas J stated in *Income Tax Case 1307;*

\[46 \text{ SATC 267}\]
“The word ‘main’ means principal, major and most important and the ascertainment of a main purpose involves a weighing against each other of the various purposes of a scheme. In a case such as the present, where at most two purposes have been suggested (a saving on income tax and a saving on estate duty), if one purpose preponderates over the others, it cannot be said that the other is the main purpose.”

The taxpayers in the present case displayed through the evidence of their accountant Mr. Wilson that the scheme had been entered into to avoid or reduce liability for estate duty payable by the estates of the beneficiaries upon their deaths. However, just because a transaction results in a tax benefit it does not mean that the sole or main purpose of the transaction was to obtain a tax benefit.\(^\text{47}\)

The Commissioner in this case argued that the sole purpose of the scheme was to avoid or reduce the taxpayer's liability for income tax and secure payment to the beneficiaries of the full amounts available from the companies, through the trust, without the beneficiaries having to pay any income tax thereon.

The court held that the avoidance or reduction of income tax that would otherwise have been payable by the taxpayers had nothing to do with the purpose of the scheme. There had been two purposes only; the avoidance of the estate duty problem that had faced the beneficiaries, and the necessity to tidy up the group especially because of the complications resulting from the crossholdings between the companies in the trust.

\(^\text{47}\) Trollip JA in *Ovenstone v. Secretary for Inland Revenue* 42 SATC 55
It was therefore held that the scheme as a whole was not carried out solely or mainly for the purposes of avoiding the payment of tax and the appeal by the Commissioner was dismissed with costs.

Since the third requirement of section 103 had not been met, Section 103(1) did not apply to the scheme, and the taxpayers' appeal was upheld.

The decision has greatly favoured the taxpayer. The court ignored the complex transactions undertaken by the taxpayers in trying to counter any future liability for estate duty on the part of the beneficiaries which motivated the scheme. In this case strict proof was required that one purpose was dominant over others for the purposes of compliance with Section 103(1) (c).

Section 103 (4) of the Income Tax Act provides that when it is proved that a transaction would result in the avoidance of liability for the payment of tax, it is presumed until the contrary is proved that the transaction was entered into or carried out solely or mainly for the purposes of such avoidance. The onus therefore rests on the Commissioner to prove that the transaction would result in the avoidance of tax liability.

The Commissioner in this case proved and the court concurred that the complex scheme entered into by the taxpayers would result in the avoidance/reduction of estate duty otherwise payable upon the deaths of the beneficiaries. This shows that the Commissioner had discharged the onus of proving that the transaction would result in the
avoidance of tax liability. The burden of proof then shifted to the taxpayer to rebut the conclusion that the scheme had been entered into solely or wholly for the purpose of avoidance of estate duty. The courts chose to believe the taxpayers evidence that the avoidance of estate duty was not its dominant purpose.

Indeed the courts have a difficult task in determining the dominant purpose in cases where there are many purposes motivating a transaction. There are no clear guidelines for ascertaining which the dominant purpose is and which one is not. All taxpayers will obviously argue that the main purpose of the transaction entered into is not the avoidance of liability for tax. As seen above that a taxpayer’s evidence is crucial in determining the purpose of a transaction, it will be very hard for the fiscus to prove otherwise and convince a Court that a taxpayer’s sole or main purpose in entering into a transaction is the avoidance of liability for tax.

Therefore, the judiciary’s interpretation of the GAAR in this case by following a purposive approach limits the GAAR’s scope rendering it ineffective thereby facilitating and enabling tax avoidance.

4.2.2 COMMISSIONER FOR INLAND REVENUE V CONHAGE (PTY) LTD

Facts of the case

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48 (Formerly Tycon (Pty) Ltd) (606/97) [1999] Zasca 64 (17 September 1999).
This case revolved around two sets of agreements which in form were a sale and leaseback agreement between the taxpayer (“Tycon”) and Firstcorp Merchant Bank Ltd (“Firstcorp”). Tycon and Firstcorp Merchant Bank entered into two agreements for the sale and leaseback of some of the Tycon’s manufacturing plant and equipment. Tycon subsequently sought to deduct the rentals paid to Firstcorp Merchant Bank in terms of the leasebacks as expenditure in the production of income under s 11(a) of the Income Tax Act 58 of 1962 but the Commissioner refused to allow the deduction and stated that the agreements were not what they purported to be and that Tycon had in substance borrowed the purchase price for the equipment from Firstcorp Merchant Bank. The Commissioner then went ahead and invoked s 103 of the Act.

Tycon appealed to the Special Court which allowed the appeal and this in turn led the Commissioner to appeal against this decision.

The question in this appeal was what was the true nature of the sale and leaseback agreements and whether the Commissioner correctly invoked section 103 of the Income Tax Act.

Under Section 103 (1) of the Income Tax Act No. 58 of 1962 a transaction can be attacked if all of the following four elements are present:

a) There must be a transaction, operation or scheme;

b) Which has the effect of obtaining tax benefit;

c) Whose sole or main purpose is the obtaining of a tax benefit; and

d) Was entered into in an abnormal manner.
There must be a transaction, operation or scheme.

The first step involves an inquiry as to whether there is a transaction, operation or scheme that was entered into or carried out.

In the present case Tycon required capital to expand its business and Firstcorp was prepared to make the funds available. Both parties were aware of the tax benefits to be gained from sales and leasebacks and decided to follow that course. There were extensive negotiations which were conducted with Firstcorp experts which culminated in the parties entering into sale and leaseback agreements.

The sale and leaseback agreements that were entered into or carried out by the taxpayer (Tycon) and Firstcorp Merchant Bank amount to transactions, operations and/or schemes that were entered into and this satisfies the first requirement of Section 103(1).

The transaction, operation or scheme must have the effect of obtaining a tax benefit.

Once it has been proved that there was a transaction, arrangement, or scheme which was carried out or entered into, there must be an inquiry as to whether the transaction, operation or scheme has the effect of the avoidance, postponement or reduction of the payment of any tax or duty.
A tax benefit is defined as amongst other things, including any avoidance, postponement or reduction of any liability for payment of any tax, duty or levy imposed by the Act or by any law administered by the Commissioner.

In this case the Commissioner contended that the sale and leaseback agreements entered into by Tycon and Firstcorp were structured so as to reduce the company’s tax liability. Tycon on the other hand stated that the financing it received form Firstcorp could be structured either as a loan or as a sale and lease back; but Tycon decided on a sale and lease back as opposed to a loan so as to save on income tax. The reduction of Tycon’s tax liability by saving on income tax was therefore one of the purposes of the transaction as envisaged in section 103 though Tycon argues that it was not the main purpose of the transaction. Therefore the second requirement of section 103 (1) has been satisfied in that the transaction, operation or scheme had the effect of obtaining a tax benefit; saving on income tax.

**The sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit.**

The third requirement of section 103(1) is that the sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit.

Once it is proved that the transaction would result in the avoidance or postponement of tax liability or in a reduction thereof, it is presumed that this requirement has been met until the taxpayer proves the contrary.
In the case of *SIR v Gallagher*\(^49\) the court held:

“…the provision of section 103 (4) (a)… creates a presumption (until the contrary is proved) that the sole purpose or one of the main purposes of the transaction, operation or scheme in issue was the avoidance, postponement or reduction of income tax, once it is proved that a transaction, operation or scheme would result in such avoidance, postponement etc…”

In determining the purpose of a taxpayer, the test to be applied is a subjective one. Corbett JA in *SIR v Gallagher*\(^50\) pointed out that section 103(1) makes a clear distinction between the “effect” of a scheme and the “purpose” thereof. The learned Judge went further to emphasise the importance of the evidence of the taxpayer as to why the scheme had been carried out when determining the purpose of the scheme.

Even if the purpose or effect of the scheme when it was first formulated was not to avoid liability for tax, when the scheme is subsequently carried out this could have become the effect and section 103(1) would be applicable. Secondly, just because a transaction results in a tax benefit, this does not mean that the sole or main purpose of the transaction was to obtain a tax benefit.

As to the meaning of “main purpose” Nicholas J stated in *Income Tax Case 1307;*

\(^{49}\) 40 SATC 39  
\(^{50}\) Supra fn. 49
“The word ‘main’ means principal, major and most important and the ascertainment of a main purpose involves a weighing against each other of the various purposes of a scheme. In a case such as the present, where at most two purposes have been suggested (a saving on income tax and a saving on estate duty), if one purpose preponderates over the others, it cannot be said that the other is the main purpose.”

Watermeyer J in *ITC 983*\(^{51}\) expounded on the meaning of ‘solely’ or ‘mainly’ and stated that:

“…for the section to operate the avoidance of tax must at least have been the principal purpose of the taxpayer. In the present case the court is satisfied that although the avoidance or reduction of tax was one of the purposes, it was not the main purpose. The main purpose was to obtain a production unit which could go into immediate operation, as indeed the Appellant company did.”

Kroon J in *ITC 1636*\(^{52}\) stated:

“…In short, to qualify as the main purpose, the purpose in question, must preponderate over any other purpose (or, possible, at least be as important as any other purpose).”

The taxpayer in this case argued that the purpose of the whole exercise it entered into i.e. the sale and lease back agreements was to obtain capital and not to reduce tax. It argued that if the reduction of its tax liability can be regarded as a purpose of the transactions, then it was not the main purpose of the transaction. From the above decisions and dicta

\(^{51}\) (1961) 25 SATC 48

\(^{52}\) Supra fn. 46
by learned Judges, although the reduction of income tax was one of the purposes, it was not the main or principal purpose.

It was held in this case that the sale and lease back agreements served the dual purpose of providing Tycon with capital and the advantage of the tax benefits to be derived from that type of transaction. The learned Judge further stated that even if the type of transaction had been chosen purely because of the tax benefits, Tycon would not have entered into the transaction at all if it had not required capital. Therefore Tycon did not approach Firstcorp because it wanted to reduce its tax burden but rather because it needed capital and this was the main purpose of the transaction. Therefore this third requirement fails.

The transaction was entered into in an abnormal manner.

The Commissioner is empowered by section 103 to determine a taxpayer’s liability for income tax and other taxes by disregarding any abnormal transaction which the latter has entered into for the purpose of avoiding or postponing his tax liability or reducing the amount thereof. A transaction is regarded as abnormal if it 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 of the nature of the transaction in question; or has created rights or obligations which would not normally be created between persons dealing at arms length under a transaction of the nature of the transaction in question.

An abnormal transaction may be disregarded if it was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax or the reduction of the amount of such liability. The effect, purpose and
normality of a transaction are essentially questions of fact. The onus is on the Commissioner to prove that its effect was to avoid or postpone the liability for tax or to reduce the amount thereof. Upon proof that this was the case it is presumed (in terms of ss (4)) that the effect of the transaction was also its sole or main purpose.

The Commissioner’s case was that despite the form of the agreements, Tycon did not sell and lease back its equipment, but in substance borrowed the “purchase price” from Firstcorp. The Commissioner accepted that the parties did not act fraudulently by deliberately disguising their transactions but he said the agreements lacked the essential elements of a sale. He stated that there was no agreement for sale or an intention to transfer and acquire ownership. The Commissioner further stated that the two parties to the sale and lease back agreement had no real intention to enter into agreements of sale and leaseback and that the parties dishonestly concealed the true nature of their transactions.

In this case, the Court found that the onus of proving the authenticity of the agreements was on Tycon and that onus had been discharged. Further that the Commissioner had not established the abnormality of the sales and leasebacks and that Tycon had established the absence of the purpose requirement. The Court held that it was not unusual to find provisions in a sale and lease back agreement which do not typically appear in a contract of purchase and sale or in a contract of lease as evidence was led on behalf of Tycon by its signatory and two Firstcorp officials who had negotiated the transactions that the parties intended to give effect to the transactions according to their terms.
Hefer JA gave three points to be considered when determining the normality or abnormality of a transaction.

First, although the Commissioner may invoke Section 103 (1) when he is satisfied that all the requirements have been met, a special court may re-hear the whole case.

Secondly, when deciding on the effect, purpose and normality of a transaction, these are questions of fact and the onus is on the Commissioner in this regard.

Thirdly, what has to be determined in every case is the subjective purpose of the taxpayer.

The taxpayer once again won in this case. The court looked at the agreement as a whole and did not look at the sale separately and the lease separately. The courts favoured the taxpayers and dismissed the appeal. The court found that the abnormality of the sale and leaseback had not been established and the fact that there were advantageous tax benefits to a sale and leaseback as opposed to a straightforward loan does not necessitate the invoking of section 103. The court further looked at the dominant purpose of the transaction as opposed to looking at each step separately. It held that the raising of finance was the main purpose of the transactions and it remained the underlying and basic purpose thereof. It was stated that Tycon did not approach Firstcorp in order to alleviate its tax burden but that in fact had Tycon not needed capital, there would not have been any transaction at all.
The judiciary in this case is sympathetic to the taxpayer. Despite the fact that the agreements of sale and leaseback served the dual purpose of providing Tycon with capital and taking advantage of the tax benefits to be derived from that type of transaction, the court in this case was reluctant to examine the transactions in full and discover the true character of the transactions entered into. The court chose to tie itself to the labels that the parties attached to their transactions. No party will come out and admit that it entered into a transaction solely for the purpose of obtaining a tax benefit. A tax payer will always have other purposes in entering into a transaction and will never admit that its main purpose for entering into the transaction is to avoid or reduce its tax liability.

It should be noted that this decision is not in line with the recent view taken by the Supreme Court of Appeal in the Commissioner for the South African Revenue Service v. NWK Limited\textsuperscript{53} where the courts have adopted the doctrine of substance over form. The Supreme Court of Appeal confirmed that there was nothing wrong in principle with entering into arrangements that are tax effective but said that it is wrong to dress up or disguise a transaction to make it appear to be something that it is not. The court stated that an examination of the commercial sense of a transaction should be carried out in determining the real substance and purpose of a transaction.

\textbf{4.2.3 COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE V. NWK LIMITED}\textsuperscript{54}

\textbf{Facts of the case}

\textsuperscript{53} Refer to fn. 54  
\textsuperscript{54} (27/10) [2010] ZASCA 168 (1 December 2010)
In this case a financial institution approached the taxpayer with an offer which involved six agreements. The taxpayer was to borrow a larger sum of R96 million though it initially intended to borrow R50 million only and it was to make repayments in kind by delivering maize to the financial institution. The two parties sealed this deal by entering into a contract on the said terms. Pursuant to these six agreements, the financier was in a position to apply for set off so that the obligation to repay the R96 million which was borrowed by the taxpayer would be extinguished when the time came for the taxpayer to make re-payment. In each of the years of assessment for income tax the taxpayer claimed and was granted a deduction from income in terms of s. 11(a) of the Income Tax Act in respect of the interest paid to the financier.

On being informed of the matter, the Commissioner issued additional assessments and disallowed the deductions previously made. The Commissioner also imposed additional tax of 200 per cent and interest. The taxpayer objected to the additional assessments but the commissioner disallowed the objections. The taxpayer then moved to the Tax Court and appealed against the assessment and the levying of additional tax and interest. The Tax Court found in favour of the taxpayer on the basis that the parties intended to give effect to their contract. The Tax Court also declined to invoke Section 103(1) of the Income Tax Act on the basis that it could not be used as an alternative ground to a finding that the transaction was simulated. The Commissioner being dissatisfied with the judgment of the Tax Court appealed to the Supreme Court of Appeal.
On appeal the Commissioner contended that the series of transactions constituted a “transaction, operation or scheme and he sought to rely on the anti-avoidance provisions contained in section 103 of the Income Tax Act. The Commissioner was of the view that the agreement between the taxpayer, the financier and its subsidiary did not reflect the substance of the real transaction. He was of the opinion that the subsidiary of the financier, Slab was included as a party to the series of complicated transactions solely for the purpose of reducing or evading liability for income tax. Furthermore the Commissioner contended that the form of the transaction was to create a simulation where the payments which comprised capital plus interest were disguised as interest only thereby creating an artificial loan amount. The effect of this was that the payments made by the taxpayer (being in reality capital plus interest) were in form reflected as only interest and that this involved intentional tax evasion.

For the taxpayer evidence was given through Mr. E. Barnard its financial director that it had not requested for a loan of R96 million from the financial institution but for a loan of R50 million but due to the stature of the financier and its perceived expert knowledge in the structuring of financial transactions the taxpayer agreed to be advanced R96 million. The taxpayer stated that it had no hand in the drafting of the structure and that there was an honest intention on its part to execute the contracts in accordance with their tenor and therefore the claims for deductions were valid. The taxpayer contended that the loan for the full capital amount was correctly reflected and no portion of the payment made by it was of a capital nature.
The questions for determination by the Supreme Court of Appeal in this case were whether the transactions entered into by the financial institution and the taxpayer were simulated and whether as an alternative ground the transactions could be attacked by Section 103 of the Income Tax Act.

The court considered the anti-avoidance rules in finding that the transactions entered into by NWK and the financier were simulated. The Supreme Court of Appeal also differed with the judgment of the Tax Court by making it clear that section 103 could be invoked as an alternative ground for assessment contrary to what the Tax Court had ruled. Lewis JA stated:

“…There appears to me to be no reason why an invalid transaction cannot also be abnormal and concluded for the purpose of avoiding tax. Had the Commissioner not proved that the loan was a simulated contract, it would have been open to the Tax Court to consider the soundness of an assessment under Section 103.”

To constitute tax avoidance, the following four elements must be present:

a) There must be a transaction, operation or scheme which has been carried out;

b) Which has the effect of avoiding, postponing or reducing the liability for the payment of any tax, duty or levy imposed by the Act;

c) Whose sole or main purpose was the obtaining of a tax benefit; and

d) Which transaction was entered into in an abnormal manner.
There must be a transaction, operation or scheme which has been carried out

The first requirement is that there must be a transaction, operation or scheme which has been entered into or carried out.

*Meyerowitz v. CIR*\(^{55}\) is an authority which clearly defines what amounts to a scheme, transaction or operation which has been carried out or entered into.

In the present case, the financial institution devised a series of schemes or a structure whereby it advanced a loan of R96 million to the taxpayer and the repayments made by the taxpayer which comprised capital plus interest would be reflected as interest only. This in effect created a different loan amount from what was initially borrowed by the taxpayer. The agreements entered into by the financial institution and the taxpayer can all be safely defined as transactions, arrangements or schemes and the first requirement has therefore been satisfied.

The transaction, operation or scheme must have the effect of obtaining a tax benefit.

It has already been shown that there was a transaction, arrangement, or scheme which was carried out or entered into by the taxpayer and the financial institution which involved six agreements and which allowed the taxpayer to borrow a larger sum than what it had originally required. The said transaction enabled the financier to apply for set

\(^{55}\) Supra fn. 42
off so that the obligation to repay the amount borrowed by the taxpayer was extinguished when the time came for the taxpayer to make re-payment. It must therefore be determined whether the said transaction, operation or scheme had the effect of the avoidance, postponement or reduction of the payment of any tax or duty.

In *CIR v. King* 56 Watermeyer CJ examined the meaning of “avoiding tax” and stated,

“…there is a real distinction between the case of a man who so orders his affairs that he has no income which could expose him to liability for income tax, and the case of a man who so orders his affairs that he escapes liability from taxation which he ought to pay upon the income which is really his. Similarly there is a distinction between reducing the amount of tax from what it would have been if he had not entered into the transaction and reducing the amount of tax from what it ought to be in the tax year under consideration.”

Watermeyer CJ was of the opinion that the legislature intended the words “avoiding tax” to cover only the situation whereby a man orders his affairs that he escapes from liability from taxation which he ought to pay upon the income which is really his and reducing the amount of tax from what it ought to be in the tax year under consideration.

Watermeyer CJ’s interpretation of the words “avoiding liability” was held not to be applicable in the case of *Smith v. CIR* 57 whereby Steyn J was of the opinion that the ordinary meaning of avoiding liability for tax on income should be applied and it meant, “…to get out of the way of, escape or prevent anticipated liability.”

56 Supra fn. 43
57 Supra fn 44
In the present case NWK concluded various agreements and the forward sales and cessions knowing that they were simulated transactions in order to gain a tax advantage. The agreements in effect cancelled out the obligation to deliver maize. The real sum that was lent to NWK was R50 million while the deductions on interest claimed by NWK were for R96 million. NWK therefore got a tax advantage by claiming a deduction from income tax on interest paid on R96 million instead of R50 million.

In this case, Lewis JA stated:

“…But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law…in my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.”
The taxpayer and the financial institution devised and deliberately entered into a series of transactions where NWK disguised its contract to borrow R50 million from the financier as a transaction in terms of which it would borrow R96 million repayable by the delivery of maize which was never intended.

The court found that the real purpose of the loan was to enable the taxpayer NWK obtain a tax benefit and also enable the financier to apply for set off on the loan amounts repaid by the taxpayer which were reflected as interest only while in effect they were capital plus interest repayments.

The second requirement of section 103 (1) has therefore been satisfied in that the transaction, operation or scheme had the effect of obtaining a tax advantage to the taxpayer and the financial institution.

**The sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit.**

Once it has been established that the transaction, operation or scheme had the effect of obtaining a tax benefit, it must be shown that the sole or main purpose of the said transaction, operation or scheme was to obtain a tax benefit.

Watermeyer J in *ITC 983*\(^{58}\) expounded on the meaning of ‘solely’ or ‘mainly’ and stated that:

\(^{58}\) Supra fn 51
“…for the section to operate the avoidance of tax must at least have been the principal purpose of the taxpayer. In the present case the court is satisfied that although the avoidance or reduction of tax was one of the purposes, it was not the main purpose.”

Nicholas J in *Income Tax Case 1307* expounded on the meaning of “main purpose” and stated;

“The word ‘main’ means principal, major and most important and the ascertainment of a main purpose involves a weighing against each other of the various purposes of a scheme. In a case such as the present, where at most two purposes have been suggested (a saving on income tax and a saving on estate duty), if one purpose preponderates over the others, it cannot be said that the other is the main purpose.”

There is no clear cut formula or method which can be used to be able to deduce the main purpose of a transaction, arrangement, scheme or operation. Each case must be determined and examined based on its own facts therefore the evidence of the taxpayer and the financial institution must be taken into consideration as to why they devised and entered into the scheme.

In this present case the taxpayer led evidence through its financial director Mr. Barnard that the contracts concluded between itself and the financier and its subsidiary were performed in accordance with the terms of the agreements and were not simulated. The taxpayer stated that it had not requested for a loan of R96 million but for R50 million. The taxpayer averred that the only reason that it agreed to be advanced R96 million
instead of R50 million was due to the stature of the financier and its perceived expert knowledge in the structuring of financial transactions.

The Commissioner contended that the transaction entered into between the taxpayer and the financier constituted of intentional tax evasion. The Commissioner took the position that the transaction was intended to create a simulation where the payments which comprised capital plus interest were disguised as interest only thereby creating an artificial loan amount and effectively rendering the payments made by the taxpayer to be reflected as only interest. It was argued for the Commissioner that the agreements had to be viewed in context and having regard to all other evidence. The Commissioner also argued that various features of Mr. Barnard’s evidence showed that he was not a credible witness.

The court considered the evidence given by Mr. Barnard on behalf of the taxpayer and concluded that the various inconsistencies in his testimony led to the inference that he was not a credible witness. The Court went ahead and made a finding that the transactions entered into were simulated to enable the taxpayer increase the amount lent so that deductions of interest on a greater amount could be claimed.

It can therefore be said that the agreements entered into between the taxpayer and the financier were carried out solely or mainly for the purposes of avoiding the payment of tax and the third requirement of section 103 (1) has been met.

The transaction was entered into in an abnormal manner.
The fourth requirement to be met in order for Section 103 (1) to be applicable is that the transaction must have been entered into in an abnormal manner.

A transaction is regarded as abnormal if it 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 of the nature of the transaction in question; or has created rights or obligations which would not normally be created between persons dealing at arms length under a transaction of the nature of the transaction in question.

An abnormal transaction may be disregarded if it was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax or the reduction of the amount of such liability. The effect, purpose and normality of a transaction are essentially questions of fact. The onus is on the Commissioner to prove that its effect was to avoid or postpone the liability for tax or to reduce the amount thereof. Upon proof that this was the case it is presumed (in terms of ss (4)) that the effect of the transaction was also its sole or main purpose.

The Commissioner was of the view that the agreements concluded between NWK and the financier and its subsidiary did not reflect the true substance of the transaction. The Commissioner stated that the loan was a “mere paper exercise and/or simulation” as none of the parties to the agreements intended to trade in maize before or after the transactions were entered into. The Commissioner tabled evidence to show that the purchase price for the maize was based on a fictitious value and was determined without reference to the
value of the maize at the time of entering into the contracts. Furthermore the Commissioner stated that the parties to the contract did not take into account the risks involved with the delivery of maize five years after the conclusion of the sales.

The taxpayer on its part stated that the contracts between itself and the financier reflected the true intention of NWK and were performed in accordance with their terms. NWK contended that the loan for the full capital amount was correctly reflected and no payment made to the financier was of a capital nature. NWK claimed that the contracts were concluded solely or mainly for the purpose of securing loan finance.

The Court stated that the mere production of the agreements by NWK was not enough to discharge the onus that the loan was not simulated. In reaching its finding, the Court took into account the decision of Hefer JA in *Erf 3183/1 Ladysmith (Pty) Ltd. v. CIR*\(^{59}\),

“…This is plainly not so. That the parties did indeed deliberately cast their arrangement in the form mentioned, must of course be accepted; that, after all, is what they had been advised to do. The real question is, however, whether they actually intended that each agreement would *inter partes* have effect according to its tenor. If not, effect must be given to what the transaction really is.”

Lewis JA also considered the views of Harms JA in *Relier (Pty) Ltd v. CIR*\(^{60}\) where it was held that if agreements in issue were taken at face value the taxpayer would have to

\(^{59}\) 1996 (3) SA 942 (A) at 953A-F

\(^{60}\) 60 SATC 1 (SCA) at 7
succeed: but the agreement in question had ‘unusual and unreal aspects to it’ which raised questions as to the real intention of the taxpayer.

The Court took into account the substance of the transaction and removed the veil in which the transaction was wrapped in so as to examine its true nature and substance of the transactions. Lewis JA held,

“…There is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law…”

In this case, the Court held that the transaction was a simulation and that the transactions between the taxpayer and the financier and its subsidiary had no commercial substance and did not make any business sense. The Court further held that the substance over form principle does not merely mean that the parties must intend to give effect to their agreements. Lewis JA explained:

“…In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to their transaction on the terms agreed. This test should go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that the parties do perform in terms of the contract does not show that
it is not simulated: the charade of performance is generally meant to give credence to their simulation.”

As the fourth requirement of abnormality or simulation of the transaction has been met, the transactions entered into by the taxpayer and the financier fall under the ambit of Section 103 (1) of the Income Tax Act.

The unanimous decision of the Supreme Court of Appeal in this case has favoured the fiscus. The Supreme Court of Appeal should be applauded for being bold enough to formulate a new test to determine whether the substance of an agreement is linked to the form of the agreement.

The scope of the application of the GAAR has therefore been extended by the courts by going further and examining the commercial purpose of the series of transactions entered into by the financier, its subsidiary and the taxpayer. The court looked at the real substance and purpose of the complex transactions as opposed to the form of the transactions and the supposed intention of the parties to implement a transaction in accordance with its terms. The approach of the court is that a court should not only look to the outward trappings of a contract but also what the parties really sought to achieve.

4.3 CONCLUSION

Case law reveals the mind of the Courts and works to enrich the jurisprudence of the tax law regime. The judiciary therefore must set acceptable principles which their decisions
are founded on. From an analysis of the above cases, the judiciary had been found to be timid in its approach to adjudge a scheme, transaction or arrangement as constituting tax avoidance and the Courts tended to be sympathetic to the taxpayer. However, with the latest judgment of the Supreme Court of Appeal, the Courts seem to be slowly departing from the longstanding judicial approach that parties are entitled to arrange their affairs in any legal way in order to minimize their tax.

Judicial law has also not developed clearly in such a way as to indicate to tax payers what will and what will not be acceptable tax avoidance. There is uncertainty in this area and the judicial approaches and/or response to tax avoidance in South Africa has also been uncertain.

However, the GAAR has definitely been strengthened by this decision of the Supreme Court of Appeal. This decision will act as a deterrent and will hopefully jolt taxpayers and their advisers to revisit the commercial reasons for the structures that they have devised or are in the process of devising so as to avoid being successfully attacked by SARS. In future this landmark decision combined with the new anti-avoidance rules in section 80A to 80L will help SARS immensely in deterring tax avoidance activity.
CHAPTER 5

5. CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSIONS

There has been significant development in the jurisprudence in the area of tax avoidance. This treatise has assessed the judicial approaches and/or responses to tax avoidance in South Africa by analyzing selected South African case law on tax avoidance based on the old General Anti-Avoidance Rules, section 103 of the Income Tax Act. The study aimed to find out the role and attitudes of judges in the development of case law on anti-avoidance and whether there is certainty and clarity due to the presence of the General Anti-Avoidance Rules as to indicate what constitutes acceptable or unacceptable tax avoidance.
The judiciary plays a very important role in tax avoidance and judicial interpretation is very important as it determines whether there will be an increase in tax avoidance. Waincymer J\textsuperscript{61} stated,

“…one intuitive lesson to learn from the Australian experience is that when tax avoidance became virtually sanctioned by the High Court in the 1970’s, supermarket style off the shelf tax avoidance packages reached epidemic proportions. Having the Chief Justice of the High Court propound taxpayer’s rights would surely be a powerful rationalizing factor for taxpayers and advisers.”

The GAAR Section 103 of the Income Tax Act has proven to be an inconsistent and sometimes ineffective deterrent to the increasingly complex and sophisticated tax products that are being marketed by South African financial institutions.\textsuperscript{62} It seems to have made the judges all the more careful to protect the taxpayer. The courts have also been unable to deal with the onslaught of complex and sophisticated tax avoidance arrangements being devised by taxpayers. However it is noted that there can be no GAAR that is all encompassing to deter tax avoidance. Tax avoidance schemes are becoming increasingly complex making it difficult for drafters to anticipate schemes which would constitute impermissible tax avoidance. Justice Murphy of Australia stated in relation to the Australian section 260 of the ITAA 36,

\textsuperscript{61} The Australian Tax Avoidance Experience & Responses, A Critical Review.
\textsuperscript{62} 18 January 2006, Article by Emil Brincker
“…The resource of ingenious minds to avoid revenue laws has always proved inexhaustible and for that reason it is neither possible nor safe to say in advance what must be found…” 63

The approach of the judiciary to tax avoidance cases is vital to the effectiveness of anti avoidance measures. Many of the tax avoidance cases that have been previously decided have provided disappointing outcomes to SARS and the courts are more likely to find in favour of the taxpayer as has been seen from the brief survey of cases that has been attempted in Chapter 4 of this treatise. It can therefore be concluded that the courts are sympathetic of the taxpayer which in effect means that the courts have been encouraging tax avoidance indirectly or have been sympathetic to tax avoidance.

Judicial law has not yet fully developed in a way as to indicate clearly to tax payers what will and what will not constitute acceptable tax avoidance. This is mainly due to the fact that taxpayers will always devise new and complex arrangements which have not yet been fully captured within the ambit of judicial law/precedent. There is a fine line to be drawn between a transaction which offends and one that merits no condemnation. The cases discussed illustrate very clearly the absolute difficulty of determining with any degree of certainty where the border line lies between acceptable tax avoidance and unacceptable tax avoidance and it is extremely difficult to extract from the courts any guidelines as to where the line lie.

The courts have also been very conservative in their interpretation of the GAAR to the point where it has an extremely narrow application. However, the South African courts have undergone a metamorphosis and the courts are becoming bolder and more courageous in their formulation of new tests in combating tax avoidance as evidenced in the Supreme Court of Appeal judgment in the *Commissioner for the South African Revenue Service v. NWK Limited.*

In the final analysis it can be safely concluded that the Courts which were previously taking a restrictive approach and were pro-taxpayer in their deliberations are beginning to be gallant in their interpretation of the GAAR. The long standing judicial approach that taxpayers are entitled to arrange their affairs in any legal way in order to minimize their tax has in effect been abolished by the decision in the *Commissioner for the South African Revenue Service v. NWK Limited case.* This judicial attitude was wrong as it created conditions which promoted tax avoidance and emasculated the GAAR.

Hopefully the latest decision of the Supreme Court of Appeal combined with the new Sections 80A to 80L will help in deterring tax avoidance activity.

### 5.2 RECOMMENDATIONS

Tax avoidance is to a large extent facilitated by the judiciary’s interpretation of the GAAR thereby limiting GAAR’s scope and rendering it ineffective. Judges do more than

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64 Supra fn 54
65 Supra fn.54
decide controversies. Their decisions prompt the legislature to change the law. By deciding controversies, they often change the direction with which the law is taking. The South African judiciary should therefore take a stronger and bolder approach in curbing tax avoidance schemes and develop a more stringent attitude when adjudicating upon tax avoidance cases so as to appear not to be encouraging impermissible tax avoidance.

The courts should not apply a restrictive approach when dealing with cases relating to tax avoidance but they should be bold and construct their own doctrines as seen in the judgment of the Supreme Court of Appeal which will also guide the revenue.

The Courts should also abandon the excessively literal interpretation of the GAAR’s. This will help curtail future opportunities for taxpayers to exploit tax legislation. Courts are not bound by the labels that the parties have attached to their transactions; the Courts are entitled to examine all of the facts “to discover the true character in tax law of the transaction entered into.” 66

The legislature and the judiciary must keep pace with newly emerging tax avoidance schemes.

It is submitted that GAAR should be drafted in a manner that the judiciary is prevented from interpreting the GAAR so strictly as to render it useless as this in itself encourages tax avoidance. The GAAR ought to be drafted in a clear and concise manner.

“…the rules in the tax law obviously need to be clear, certain in their application, and consistent across applications. Certainty does not require inordinate detail. No matter

how much detail is provided in the law, there will be ambiguity. Indeed the more detailed
tax law is, the greater the likelihood of ambiguity or mistakes (from a principle
perspective) as detail has a tendency to bring principle. Likewise, clarity is often more
likely to be achieved by the statement of a principle rather than the elaboration of
detail...”67

The way forward is a complete overhaul of Section 103 (1) which has been done by
introducing new GAAR’s Section 80A to 80 L. The new GAAR still has the same four
elements as the old GAAR section 103(1) save an additional requirement that if the
arrangement lacks commercial substance and if the arrangement would result directly or
indirectly in the misuse and abuse of the provisions of the Act then the GAAR will be
invoked. It is hoped that with the introduction of the new section 80A to 80L the
judiciary in South Africa will have sufficient armoury to tackle and adjudicate on tax
avoidance cases before it and counter impermissible tax avoidance.

The Courts should apply clear and unambiguous principles and precedents which in turn
will assist litigants and legal practitioners alike in determining with some measure of
certainty the validity of claims long before they are instituted in court. This will also
guide the lower courts and maintain stability in the law and its application.

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EMIL BRINCKER, *New General Anti-Avoidance Rule for South Africa?*


JANIE TREMBLAY, *The General Anti-Avoidance Rule: Has it changed the face of tax avoidance?*

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PAUL A OGULA, *A Handbook on Educational Research*


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