A critical analysis of South Africa’s general anti avoidance provisions in income tax legislation

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Yaasir Haffejee
Date: 31 December 2009
Summary

This treatise was undertaken to critically analyse the new general anti avoidance rules (new GAAR) as set out in sections 80A to 80L of the Income Tax Act\(^1\).

A discussion on the difference between tax evasion and tax avoidance was performed in the first chapter. The goals of this treatise were then set out.

An analysis of the requirements for the application of the new GAAR was performed in the second chapter. The courts have historically reviewed the circumstances surrounding an arrangement when determining whether tax avoidance has occurred. The new GAAR requires the individual steps of an arrangement to be reviewed in isolation.

Secondly, the courts have historically held that the purpose test, when determining the taxpayer’s purpose, was subjective. The wording of the new GAAR indicates that this test is now objective. Thirdly, the courts have historically viewed the abnormality of an arrangement based of the surrounding circumstances. The wording of the new GAAR requires an objective view of the arrangement.

An analysis of the secondary provisions contained in sections 80I, 80B and 80J of the new GAAR was performed in the third chapter. With regards to section 80B, it was submitted that the Commissioner should issue an Interpretation Note detailing all the methods “he deems appropriate”.

Keywords

- New GAAR
- Objective test
- Subjective test
- Purpose
- Tax benefit
- Round trip financing
- Effective date
- Abnormality

\(^1\) Act 58 of 1962
• Commercial substance
• General test
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Chapter I
Introduction

The payment of taxation by both natural and juristic persons is common in most countries throughout the world. Many people throughout South Africa complain of tough economic conditions, high rates of taxation and fruitless or wasteful expenditure incurred by government departments. These factors may have tempted some people to engage in tax evasion and tax avoidance arrangements to save tax.

Tax evasion involves the use of illegal and dishonest methods of paying the least amount of tax\(^2\). Taxpayers found guilty of tax evasion would face penalties prescribed in the Income Tax Act\(^3\) and possible imprisonment.

Tax avoidance involves the use of lawful means of paying the least amount of tax\(^4\). It has often been stated that a taxpayer may structure his affairs in a manner that would allow him to pay the least amount of tax\(^5\).

Although tax avoidance is not unlawful, many countries throughout the world have included general anti tax avoidance provisions in their respective tax legislation or have implemented an arsenal of specific anti avoidance provisions to counter such transactions. Examples of countries which have implemented general anti avoidance provisions include Canada by way of section 245 of the Canadian Income Tax Act, 1985, c. 1 (5th Supp.) and Australia by way of section 177 of the Australian Tax Assessment Act, 1997.

South Africa is no different. In this regard, the Income Tax Act has many provisions targeting specific schemes aimed at the avoidance of taxation.

Examples of these specific provisions are:

- Deeming certain dividends to be interest;\(^6\)
- Dealing with income received by a person in consequence of a donation made by

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\(^3\) Act 58 of 1962
\(^5\) IRC v Duke of Westminster (1936) 51 TLR 467,19 TC 490 at 520
\(^6\) Section 8E
another person;\textsuperscript{7}

- Dealing with income received by one person for services rendered by another person\textsuperscript{8}

- Dealing with the private or domestic consumption of trading stock\textsuperscript{9}

Note the above list is not all inclusive.

The first general anti avoidance provision was enacted by the Fiscus in 1941 encompassing section 90 of the old Income Tax Act\textsuperscript{10}. Since then, a number of changes have been made to section 90 of the old Income Tax Act and its successor section 103(1) of the current Income Tax Act.

In November 2005, The South African Revenue Services (SARS) issued a discussion paper on section 103(1) as it was perceived that this section was inappropriate and ineffective in combating complex and aggressive tax planning structures by certain sectors of society\textsuperscript{11}.

Following a lengthy process of consultation and public hearings, the Fiscus enacted sections 80A to 80L into the Income Tax Act. These sections are effective for arrangements entered into on or after 2\textsuperscript{nd} November 2006. These new sections form part of the Fiscus’s new plan to combat complex tax avoidance transactions in South Africa which are not covered by any of the specific provisions contained in the Act.

Certain components of these new provisions have incorporated requirements of the now repealed section 103(1) while certain sections have their origins in other parts of the world. The previous general anti avoidance provision section 103(1) has now been deleted from the Income Tax Act.

These new concepts are as follows:

- The GAAR applies the “sole or main purpose” test to steps or parts of an arrangement and not necessarily to the whole arrangement.\textsuperscript{12}

\textsuperscript{7} Section 7(2) to Section 7(10)
\textsuperscript{8} Para (c) of the Section 1 Definition of “Gross Income”
\textsuperscript{9} Section 22(8)
\textsuperscript{10} Act 31 of 1941
\textsuperscript{11} TE Brincker Taxation Principles of Interest and Other Financing Transactions (Electronic version last updated March 2009) in §ZA 3.1
\textsuperscript{12} Section 80H
The GAAR requires the Commissioner to give reasons for attempting to invoke the GAAR.\(^\text{13}\)

The GAAR details the remedies available to the Commissioner\(^\text{14}\) in respect of an impermissible avoidance arrangement.

The GAAR expands the abnormality test to include a “commercial substance”\(^\text{15}\) test for an arrangement entered into in the context of business and a “misuse or abuse test”\(^\text{16}\) for an arrangement entered into in any context.

The goal of this treatise is to provide a critical analysis of the new general anti-avoidance provisions set out in sections 80A to 80L of the Income Tax Act, 58 of 1962.

The research is carried out by way of a critical analysis of documentary data, including the following:

- Sections 80A-80L of the Income Tax Act;
- the now repealed section 103(1) and 103(4) of the Act;
- selected South African and foreign case law relating to the interpretation of general anti avoidance principles and words and expressions included in the legislation; and
- the writings of authoritative experts in the field of taxation.

Recommendations are made, where appropriate, for measures to address perceived problems in the new legislation. As all of the documentary data are in the public domain, no ethical considerations apply.

In the second chapter, the requirements for the implementation of the new GAAR will be critically analysed with the objective of ascertaining all weaknesses that exist and possible solutions to these weaknesses. Reference will be made to domestic and foreign case law together with commentary from local writers to assist with the interpretation of these provisions.

In the third chapter, the secondary provisions of the new GAAR encompassing sections 80I, 80B and 80J will be critically analysed. Reference will be made to local case law and commentary from local writers to assist with the interpretation of these provisions.

\(^{13}\) Section 80J
\(^{14}\) Section 80B
\(^{15}\) Section 80C(1)
\(^{16}\) Section 80A(c)(ii)
In the fourth chapter, a summary of the writer’s key findings and recommendations will be performed followed by the writers closing remarks regarding the new GAAR.
Chapter II

Requirements for the implementation of the new GAAR

Overall, for the new GAAR to be applied, the following needs to be established by the Commissioner.

1. There must be an avoidance arrangement\textsuperscript{17}.

2. The avoidance arrangement must have been entered into on or after 2nd November 2006\textsuperscript{18}.

3. The sole or main purpose of the taxpayer in entering into an avoidance arrangement must be to obtain a tax benefit\textsuperscript{19}.

4. The arrangement must include an abnormality element. The approach to determine abnormality is three fold and can be classified as a ‘business context’\textsuperscript{20} test, a ‘non business’\textsuperscript{21} context test and the ‘any context’\textsuperscript{22} approach test.

\textbf{2.1 Requirement one – There must be an avoidance arrangement}

An “arrangement” is defined in section 80L as ‘any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property’.

For an arrangement to be an “avoidance arrangement”, it must result in a tax benefit. The term “arrangement” was not previously included in the now repealed section 103(1).

Silke in §19.4 states, using the authority of the case \textit{FCT v Newton}\textsuperscript{23}, that an ‘arrangement has been interpreted as requiring a conscious involvement of two or more participants who arrive at an understanding. It cannot exist in a vacuum and presupposes

\begin{flushleft}
\textsuperscript{17} Section 80A(preamble)  \\
\textsuperscript{18} Section 80A(preamble)  \\
\textsuperscript{19} Section80A(preamble)  \\
\textsuperscript{20} Section80A(a)  \\
\textsuperscript{21} Section80A(b)  \\
\textsuperscript{22} Section80A(c)  \\
\textsuperscript{23} [1958] 2 All ER 759 (PC).
\end{flushleft}
a meeting of minds, which embodies an expectation as to future conduct between the parties, that is, an expectation by each that the other will act in a particular way.”

The implication of the above statement indicates that all parties to an arrangement must be in agreement or reach a consensus with all the relevant terms and conditions of the arrangement.

**Transaction, operation or scheme**

The first component of the definition of an “arrangement” makes reference to a “transaction, operation or scheme”.

In *Meyerowitz v CIR* the court held that the word “scheme” has a wide scope and could be applied if, viewed as whole, the steps taken were so connected one with the other that they led to an avoidance of taxation.

In the now repealed section 103(1), four requirements had to be satisfied before the courts would accept the applicability of this section. The first requirement was that, there had to be a “transaction, operation or scheme.”

In *CIR v Bobat & Others* the court only considered three of these four requirements. The three steps considered, did not include the “transaction, operation or scheme” requirement. The implication of these two cases are that the terms included in the definition i.e. (transaction, operation or scheme) are of very wide import and conceive almost every form of arrangement.

It was submitted by Broomberg, that there has never been any reported case where the Commissioner has failed on the grounds that there was no transaction, operation or scheme.

**An arrangement includes all steps or parts therein**

The definition of “arrangement” includes ‘all steps therein or parts thereof’. This provision has the effect of deeming all steps or parts of an arrangement to be an avoidance arrangement if they result in a tax benefit.

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25 *Meyerowitz v CIR* 1963 (3) SA 863 (A), 25 SATC 287
26 *CIR v Louw* 1983 (3) SA 551 (A), 45 SATC 113 at 134
27 *CIR v Bobat and Others* 2003 (N), 67 SATC 47 at 50
28 EB Broomberg SC ‘Then and Now-II’ (2007) 21 Tax Planning Corporate and Personal
In support of this provision, section 80H allows the Commissioner to apply the new GAAR to steps or parts of an arrangement. There was no similar section prior to the enactment of the new GAAR. On one hand this section is useful to the taxpayer because it forces the Commissioner to formally disclose exactly which aspects of the arrangement he is attacking.  

On the other hand this could create uncertainty for the taxpayer. Firstly, the ruling made in *CIR v Conhage* was that the courts would look at the whole of the transaction as opposed to reviewing its individual steps to ascertain if tax avoidance has taken place. The purpose of this new insertion therefore defeats the principal established in that case and widens the scope of what can be considered tax avoidance.

Secondly, the term “steps” or “parts” are not defined by the Act. This creates uncertainty because the Commissioner could possibly attack individual steps which are interlinked with other steps and are incapable of standing on their own. A commonsense approach in this regard would be for each step or part to be:

- A distinct and separable part of the arrangement.
- It must result in a tax benefit.

If the Commissioner were to attack a taxpayer on a particular step in isolation, Broomberg questions whether the Commissioner would be successful if the step or part loses its commercial substance when considered in isolation.

Thirdly there was no rule prohibiting the Commissioner to attack parts or steps in arrangement under section 103(1). In support of this point, the various cases discussed previously indicate that the term “transaction, operation and scheme” has a very wide meaning.

It is therefore submitted that the inclusion of “steps” and “parts” in the definition of an “arrangement” are not required and should be addressed by way of a legislative amendment.

29 EB Broomberg SC ‘Then and Now-II’(2007) 21 Tax Planning Corporate and Personal
30 CIR v Conhage (Pty)Ltd (formerly Tycon (Pty) Ltd) 1999(4) SA 1149 (SCA),61 SATC 391
31 EB Broomberg SC ‘Then and Now-II’(2007) 21 Tax Planning Corporate and Personal
An arrangement includes an agreement

The term “agreement” has not been defined by the Act. The act is therefore unclear whether the term “agreement” could possibly include:

- a cancelled agreement;
- a draft agreement which has since changed; or a
- a signed final agreement.

Note the above listing is not all inclusive.

Due to this term not being well defined, the Commissioner could rely on an invalid agreement on which to base an attack for the GAAR.

It is submitted that the agreement which directly relates to a tax benefit between the parties should be used for the purposes of assessing whether an avoidance arrangement has taken place.

An arrangement includes an understanding, whether enforceable or not

Another inclusion in the term arrangement is an “understanding (whether enforceable or not)”. In terms of section 177(1) of the Australian Income Tax Act, the term “scheme” includes the term “agreement” and “understanding whether enforceable or not”. This would indicate that the origin of these newly inserted terms into the GAAR comes from Australia.

The term “understanding” has not been defined in the Act. Literally it means any gentleman’s agreement, letter of wishes\(^{32}\) or a verbal understanding\(^{33}\).

Verbal agreements or understandings are valid and binding in terms of South African commercial law. This was evidenced in *Woods v Watters*\(^ {34}\) where Innes CJ stated: “The broad rule is that writing is not essential to the validity of a contract. The consensus of the parties need not be so evidenced.”

Verbal agreements or understandings are difficult to prove and the Commissioner may find it difficult to identify a comprehensive listing of all the steps or parts of a verbal understanding to attack an assessment utilising the provisions of the GAAR.

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\(^{32}\) L Olivier, DM Davis, D Uruquhart *Juta’s Income Tax* (2009) at 80A-4

\(^{33}\) D Clegg, R Stretich *Income Tax in South Africa* at §26.3.2

\(^{34}\) 1921 A.D 303
Alternatively, this could also have the effect of the Commissioner attacking the step which captures the least amount of tax avoidance as opposed to the step which creates the largest tax benefit from an avoidance perspective.

The term “enforceable or not” also creates uncertainty. If an arrangement is not enforceable, can the Commissioner or the court use this as a basis to rule on a particular arrangement? An example of such a situation could be the usage of a cancelled contract which dictates something while the taxpayers have engaged in other activities.

It is submitted that the Commissioner should issue an Interpretation Note to help clarify this issue and thus avoid any disputes between the taxpayer and himself at a later point in time.

**An arrangement includes the alienation of property**

Another inclusion in the term “arrangement” is “alienation of property”.

The term “alienation of property” was considered in the case *CIR v King*\(^{35}\). This term has also been incorporated into the new GAAR because of King’s case.\(^{36}\) The Explanatory Memorandum on the Income Tax Bill 1959 relating to section 90 of the old Income Tax Act provided that the term “alienation of property” is covered by the term “transaction”.\(^{37}\)

It is submitted that the inclusion of the term “alienation of property” is not required and should be addressed by way of a legislative amendment to the Income Tax Act.

**Tax Benefit**

In terms of section 80L, a tax benefit includes “any avoidance, postponement or reduction of any liability for tax. The term “tax” includes “any tax, levy or duty imposed by this Act or any other Act Administered by the Commissioner”. (Emphasis added).

The term “any” indicates that the term liability has a very wide meaning. This raises several potential issues.

\(^{35}\) 1947 2 SA 196 (A), 14 SATC 184

\(^{36}\) L Olivier, DM Davis, D Uruquhart *Juta's Income Tax* (2009) at 80A-6

Firstly, this would indicate that a tax benefit in respect of an avoidance of tax could relate to a current liability, an accrued liability or a past liability. This would create uncertainty for a taxpayer as it is possible that the Commissioner may attack a past liability in the current year of assessment.

In *Smith v CIR*\(^{38}\) the court held that the ordinary, natural meaning of avoiding liability for tax on income is to get out of the way of, escape or prevent an anticipated liability. An implication of the above case is that the avoidance of taxation relates only to an anticipated liability and this could create confusion for the taxpayer and SARS.

From a common sense perspective, the above principals should be upheld by the courts, however, it is submitted that this matter would need to await interpretation by the courts.

Secondly, the definition of “tax benefit” creates uncertainty for the taxpayer if the following day to day transactions were to take place:

- The taxpayer does not enter into any transaction and thus saves tax\(^{39}\).
- The taxpayer, for example, a company, purchases shares in listed companies and the dividend income received is exempt from tax.

Note the above listing is not all inclusive.

It is submitted that these common day to day arrangements could be attacked by the Commissioner utilising the new GAAR as they all relate to the avoidance, postponement or reduction of a tax liability creating a tax benefit. The success of the Commissioner in implementing the new GAAR will, however, be subject to the remaining requirements of section 80A.

In *CIR v King*\(^{40}\), Watermeyer J pointed out that: “There are many … ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income. For example, a man can sell investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in

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38 Smith v CIR 1964(1) SA 324(A), 26 SATC 1 at 2  
39 SC Broomberg ‘Then and now—II’ (2006) 21 *Tax Planning Corporate and Personal*  
40 1947 2 SA 196 (A), 14 SATC 184 at 191
buying shares which produce no income but may increase in value … He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation. If he is a professional man he may reduce his fees or work for nothing … He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that the Fiscus intended by the provisions of section 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out”.

From a common sense perspective, the above principals should be maintained by the courts when interpreting the new GAAR, however, it is submitted that this matter would need to await interpretation by the courts.

Thirdly, another implication of the definition of “tax benefit” is that the avoidance, postponement or reduction of any of the non Income Tax Act laws administered by the Commissioner would enable the GAAR to be effected by the Commissioner.

Previously in South Africa, the Commissioner only invoked the previous section 103(1) if the avoidance of a non income tax related tax or duty for example, estate duty and VAT) had an impact on the taxpayer’s liability in terms of the Income Tax Act as well. This principle was confirmed in *SIR v Gallagher*.41

In addition, some of these other Acts administered by the Commissioner also have their own respective anti avoidance provisions. An example of these Acts’ and their respective anti avoidance provisions are as follows:

Section 73 Value-Added Tax Act42 allows the Commissioner to determine the VAT liability of a taxpayer if a scheme has been entered into which has the effect of granting a tax benefit to any person and was entered into solely or mainly for the purpose of obtaining a tax benefit. Section 28 of the Estate Duty Act43 imposes fines and penalties upon any party making fraudulent or false statements in respect of any estate duty matter.

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41 *SIR v Gallagher* 1978(2) SA 463(A), 40 SATC 39
42 Act 89 of 1991
43 Act 45 of 1955
This would create uncertainty for the taxpayer dealing with the above two provisions as it indicates that an anti avoidance rule imported from another Act will be used to raise an additional assessment for them.

Alternatively this could also have the effect of the Commissioner being able to utilise the new GAAR in the alternative for a non income tax related issue.

Mitchell\textsuperscript{44} points out that an avoidance arrangement will now exist under section 80A if for example only VAT is avoided and not income tax in terms of the Act. He mentions the example of a vendor purchasing a truck instead of a motor car solely to obtain a VAT input credit.

Section 80B(2) states that the Commissioner can only issue amended assessments under the Income Tax Act. Therefore, if a taxpayer enters into an avoidance arrangement which could also have an impact on Value Added Tax, he will not be able to raise an assessment for VAT using the new GAAR.

Section 82 of the Income Tax Act, enforces the requirement that in the event of any dispute between a taxpayer and the Commissioner, the onus is on the taxpayer to prove that he is not liable for any tax.

The previous section 103(4) of the Income Tax Act stated: ‘Any decision of the Commissioner under [s103(1)]…shall be subject to objection and appeal and whenever in proceedings relating thereto it is proved that the transaction, operation or scheme…would result in the avoidance or the postponement of a liability for payment of any tax, duty or levy imposed by this act… it shall be presumed, until the contrary is proved…in the case of any such transaction, operation or scheme, that it was entered into or carried out solely or mainly for the purpose of the avoidance or postponement of such liability…’ (Emphasis added).

The effect of the underlined words above resulted in the South African courts deeming that section 82 did not apply to section 103(1).\textsuperscript{45} The Commissioner had to have sufficient evidence that an avoidance transaction had taken place before the onus shifted onto the taxpayer to prove that his sole or main purpose was not to obtain tax benefit\textsuperscript{46}.

\textsuperscript{44} L Mitchell ‘ Effect or Result’(2007) 84 Tax Planning
\textsuperscript{45} EB Broomberg ‘Then and now- II’(2006) 21 Tax Planning Corporate and Personal
\textsuperscript{46} EB Broomberg ‘Then and now- II’(2006) 21 Tax Planning Corporate and Personal
There is currently no equivalent wording in the new GAAR requiring the Commissioner to prove that there was a tax benefit in relation to the taxpayer. It was submitted by Clegg & Stretch\textsuperscript{47} that the onus of proof that a tax benefit exists, is that of the Commissioner and it is important for him to be able to prove, on a balance of probabilities, that a tax benefit has been received by the taxpayer before invoking the principals of the new GAAR. The writer concurs with this submission.

**Determination of a tax benefit**

There is no formal test to determine the existence of a tax benefit. A possible approach that could be used would be for the Commissioner to identify income that might have otherwise accrued to the tax planner\textsuperscript{48}.

However, in *CIR v Louw*\textsuperscript{49}, there was no income accruing to the tax planner. The directors of the company caused the entity to make loans to them as opposed to issuing dividends. The court accepted that taxable salaries would have been paid had the loans not been paid. The Commissioner then raised an additional assessment based on the tax payable in respect of those salaries.

It was submitted by Clegg & Stretch\textsuperscript{50}, and the writer agrees with this submission, that this approach was not correct as it involved the creation of notional income on which tax might have been paid.

In *ITC 1625*\textsuperscript{51}, the judgement held that a possible test would be to determine if the taxpayer would have incurred taxation but for the transaction. (Emphasis added). An implication of this case is that the Commissioner would need to determine or predict an alternative transaction that the taxpayer would have entered into.

The prediction of what the taxpayer could have done is very subjective in nature. The Commissioner may predict a certain alternative arrangement while the taxpayer may introduce evidence indicating that he would have adopted another course of action.

The above potential problem was discussed in the foreign case *FCT v Peabody*\textsuperscript{52}. In this regard the court stated: “A reasonable expectation requires more than a possibility. It

\textsuperscript{47} D Clegg, R Stretch *Income Tax in South Africa* (2009) at § 26.3.3  
\textsuperscript{48} D Clegg, R Stretch *Income Tax in South Africa*(2009) at §26.3.3  
\textsuperscript{49} CIR v Louw 1983 (3) SA 551 (A), 45 SATC 113  
\textsuperscript{50} D Clegg, R Stretch *Income Tax in South Africa*(2009) at §26.3.3  
\textsuperscript{51} (1996) 59 SATC 383  
\textsuperscript{52} FCT v Peabody (1994) 181 CLR 359 at 385.
involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.” The implication of this case is that the Commissioner will need to have a good defendable basis for making such a prediction.

A situation could exist where the taxpayer could have entered into several alternative transactions each yielding different risks, rewards and tax benefits and it is difficult to predict the taxpayer’s alternative course of action.

In the Australian case *FCT v Spotless Services Ltd*\(^{53}\) the High Court rejected an argument that the anti-avoidance provision could not apply because it was not possible to identify an alternative course of action the taxpayer might have taken but for the tax avoidance arrangement. In this case, the court also looked at the history of the taxpayer when considering an alternate course of action. This judgment could be of assistance to the Commissioner in this regard.

Alternatively, a situation could exist where the taxpayer would not have entered into any transaction other that the one he has implemented. In ITC 1625\(^{54}\), Wunch J addressed a similar issue holding that, in the case of a new income earning structure, it would be impossible for the Commissioner to prove that tax avoidance has taken place. As there is no existing income stream it would be difficult for the Commissioner to prove there is an anticipated liability for tax and he will thus not be able to invoke the new GAAR.

### 2.2 Requirement two: The arrangement must be entered into on or after the effective date

In *Ovenstone v CIR*\(^{55}\) the court held that “entered into” does not mean “formulated”: “Because of its context it has, I think, a connotation of implementation that is similar to “carried out”. Probably both expressions were used because it was considered that “carried out” is more appropriate to connote the implementation of a “scheme” while “entered into” is more apposite to connote the implementation of a transaction or operation’.

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\(^{53}\) 96 ATC 5201  
\(^{54}\) (1996) 59 SATC 383(T)  
\(^{55}\) 1980 (2)SA 721 (A), 42 SATC at 68
The implication of the above dictum is that the term “entered into” from a judicial perspective is relevant to the implementation of a “scheme” while the term “carried out” is relevant only to a “transaction or operation.”

The preamble of Section 80A requires that there must be an arrangement entered into on or after 2nd November 2006 for the new GAAR to apply. The definition of an “arrangement” as discussed previously includes a wide variety of concepts in addition to the term “scheme”. This would create confusion for taxpayers as it is unclear if section 80A only applies for “schemes” entered into on or after 2nd November 2006 or for the rest of the components forming part of the definition of arrangement, i.e. operations, transactions etc.

Section 80H indicates that the provisions of sections 80A to section 80L apply to steps or parts of an arrangement. The following scenario could exist:

- A taxpayer may have one avoidance arrangement comprising several different parts or steps.
- This arrangement has steps taking place before and after the effective date of implementation.

A strict interpretation of the Act would indicate that all steps taking place before the effective date should be tested under section 103(1) and all steps entered into after the effective date should be tested using the new GAAR provisions.

Louw submits and the writer concurs with this submission that steps in an arrangement entered into before the effective date should be tested using the now repealed section 103(1) while steps entered into after the effective date should be tested using the new GAAR.

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56 IDP Louw *The new General Anti-Avoidance Rule: A comprehensive discourse on this statute* (2007) at 17
2.3 Requirement three – The sole or main purpose was to obtain a tax benefit.

Definition of the term “sole or main”

In terms of section 80A “An avoidance arrangement is an impermissible avoidance arrangement if its **sole or main purpose** was to obtain a tax benefit”. (Emphasis added).

The term “main” was discussed in the case *SBI v Lourens Erasmus (Edms) Bpk*\(^57\) and was held to connote a quantitative measure of more than 50 percent.

The term “solely” literally connotes the only purpose of the taxpayer. Alternatively from a quantitative perspective, solely connotes 100%. This provision creates uncertainty in the event of a taxpayer having multiple purposes and it is difficult to establish the main purpose using the greater than fifty percent approach discussed above. In *CIR v King*\(^58\) the court ruled that in similar instances the taxpayer’s “dominant purpose” needs to be established.

It is submitted that the term “solely” is redundant as the term “main” would surely suffice when determining the taxpayer’s purpose in entering into the transaction. It is submitted that this matter should be addressed by way of a legislative amendment to the Income Tax Act.

**Is the test of purpose subjective or objective in nature?**

The previous section 103(1) provided that, for a scheme to fall foul of its provisions, it must have been “entered into or carried out solely or mainly for the purposes of obtaining a tax benefit”.

The implication of the above wording is that one has to take into account the purpose of the taxpayer when determining whether it was entered into for the purpose of obtaining a tax benefit.

This principle was confirmed in *SIR v Gallagher*\(^59\), Corbett JA, in his judgement, held the following: ‘It is submitted in the heads of argument of appellant’s counsel that in determining the purpose of a transaction, operation or scheme an “objective” test should

\(^{57}\) 1966 (4) SA 434 (A); 28 SATC 233

\(^{58}\) CIR v IHB King; CIR v AH King 1947 (2) SA 196 (A); 14 SATC 184

\(^{59}\) SIR v Gallagher 1978 (2) SA 463 (A); 40 SATC 39 at 48
be applied. By an objective test in this context is evidently meant a test which has regard rather to the effect of the scheme, objectively viewed, as opposed to a “subjective” test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme… In the circumstances it is appropriate to state that, in my view, the test is undoubtedly a subjective one.”

Section 80A states that an avoidance arrangement is impermissible if “its sole or main purpose” (emphasis added) was to obtain a tax benefit. A strict interpretation of this statute is that reference is made to the purpose of the arrangement and not to the purpose of the taxpayer.

As one cannot determine the state of mind of an arrangement and can only do so with a human being this would indicate that the purpose test is objective in nature. Broomberg elaborates that countries overseas have interpreted the legislation, “the purpose of an arrangement” using an objective test.

An objective test would require the court to look at whether the terms of the arrangement have the effect of creating a tax benefit as opposed to ascertaining the intention of the taxpayer when entering into an arrangement.

The sole or main purpose of the taxpayer under the old section 103(1) was also not judged on a “step by step” or “part basis”. In this regard it was submitted by Meyerowitz with reference to CIR v Louw which was confirmed in ITC 1606, that the taxpayer’s purpose, in evaluating the applicability of section 103(1) of the Act, must be ascertained by taking a transaction, operation or scheme into account as a whole.

In the current legislation the following scenario could exist:

- A taxpayer has entered into arrangement consisting of several steps and parts solely for commercial reasons.
- The overall purpose was strictly for commercial reasons. One of the steps has the effect of obtaining a tax benefit.

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60 EB Broomberg ‘Then and Now -II’ (2007) 21 Tax Planning Corporate and Personal
62 1983 (3) SA 551 (A), 45 SATC 113
63 (1995)58 SATC 328(C)
It is submitted that such arrangements can be attacked by the Commissioner under the new GAAR and the previous doctrines of determining the purpose of the taxpayer based on a totality of events (discussed earlier) seem to have been removed.

**Presumption of Purpose**

Section 80G(1) currently provides that once the Commissioner has proved that an avoidance arrangement exists, it is presumed that the sole or main purpose was to obtain a tax benefit, unless the taxpayer can prove otherwise.

As indicated in the previous section, the wording of the new GAAR is that the purpose test is objective in nature. Meyerowitz\(^4\) submits that it would be logically impossible for a taxpayer to prove an objective purpose when at the same time, the purpose is already presumed.

It was submitted by Louw\(^5\) and the writer concurs with this submission that in the event that a taxpayer faces two commercially acceptable choices yielding the same result but with different tax benefits, the scenario which allows him to pay the least amount of tax should not fall foul of the Act.

This “choice” principle was the cornerstone of the Duke of Westminster case and also confirmed in the Conhage\(^6\) case. Another important point that needs to be determined is when the purpose of the taxpayer should be determined.

In *Ovenstone v SIR*,\(^7\) Trollip JA, who delivered the judgment of the Appellate Division, said that ‘even if the purpose or effect of [a] scheme when it is formulated is not to avoid liability for tax, it may have that effect or that may become one of the taxpayer’s main purposes when he subsequently carries it out, thereby rendering s 103(1) [the predecessor of the GAAR] applicable if its other requirements are fulfilled’.

The implication of the above case is that the court will look at the overall purpose of the taxpayer taking into account the whole arrangement.

However with the definition of arrangement including steps or parts thereof, the taxpayer would need to prove that his purpose for an individual step was not tax avoidance.

\(^4\) D Meyerowitz ‘What is Tax Avoidance’ (2005) 54 *The Taxpayer* at 205
\(^5\) DP Louw ‘The new GAAR – a comprehensive discourse on this statute’ (2007) at 25
\(^6\) 1999 (4) SA 1149 (SCA), 61 SATC 391
\(^7\) *Ovenstone v SIR* 1980 (2) SA 721 (A), 42 SATC 55
2.4 Requirement four: The arrangement must contain an abnormality element.

The last requirement that must be satisfied before the GAAR is implemented is that the arrangement must be abnormal.

Abnormality Tests

There are three methods of determining whether abnormality exists in terms of the Act. These three methods are and will be discussed as follows:

1. Business context approach 68.
2. Non-business context approach 69.
3. In any context approach 70.

A very important point to note is that new GAAR has excluded the term “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” 71 from its preamble when determining the abnormality of an avoidance arrangement.

The implication of this omission is that the abnormality provisions require an objective application looking at the effect of the avoidance arrangement 72.

Business context approach

The business context test has two possible scenarios. They will be discussed as follows.

1. Business purpose test
2. Lack of commercial substance test

Business purpose test

The business purpose test per Section 80A(a)(i) requires that the arrangement must in a business context have been entered into and carried out by a means or manner that

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68 Section 80A(a)
69 Section 80A(b)
70 Section 80A(c)
71 Now Repealed 103(1)(b)
72 IDP Louw ‘The new GAAR – a comprehensive discourse on this statute’ (2007) at 25
would not normally be employed for bona fide business purposes other than obtaining a tax benefit.

This means that if an arrangement is a ‘normal’ business arrangement and results in a tax benefit, the arrangement cannot be subject to an attack by the Commissioner utilising this section of the new GAAR. This arrangement can however be attacked by the Commissioner if the arrangement falls foul of the non-business and any context abnormality tests.

The business purpose test was also included in the now repealed section 103(1) of the Income Tax Act. ‘The factual character of the judicial doctrine of “business purpose” is somewhat obscure. The wider statement of this rule is to the effect that if, in the context of business, an avoidance arrangement was entered into or carried out in a manner not normally employed for bona fide business purposes, it will be presumed that the avoidance of tax was the sole or one of the main purposes of the transaction. In other words, a transaction will not be given any effect for tax purposes unless it also achieves a valid business purpose. And saving of taxes alone is deemed not to constitute a valid business purpose.’

This first problem that emerges is that the term “bona fide” is not defined in the Income Tax Act. Secondly the term “business” and by implication “business context” has not been separately defined in the Income Tax Act either.

The term “business” has been included as part of the definition of the term “trade” in section 1 of the Act. A literal interpretation of this point is that any “business” is a “trade” but a “trade” is not necessarily a business.

A person who earns a salary will not be considered to be carrying on business and the earning of rental income will also not be considered to be carrying on business.

Reference must therefore be made to case law to ascertain the nature of the term “business”.

In *Smith v Anderson* the court accepted that the word “business” means “anything which occupies the time and attention and labour of a man for the purpose of profit or

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73 AP De Koker ‘Silke on South African Income’ (2009) in §19.7
74 (1880) 15 ChD 247 at 258
improvement”. In subsequent judicial considerations, however, it has been suggested that the profit motive is not essential.\textsuperscript{75}

There seems to be no definitive explanation of the word “business” and this creates uncertainty for the taxpayer. The phrase “carrying on business” can possibly be of assistance to both the taxpayer and Commissioner in interpreting the term “business”.

Per Beadle CJ in *Estate G v Commissioner of Taxes*\textsuperscript{76}: “The sensible approach, I think, is to look at the activities concerned as a whole, and then to ask the question: Are these the sort of activities which, in commercial life, would be regarded as carrying on business? The principal features of the activities which might be examined in order to determine this are their nature, their scope and magnitude, their object (whether to make a profit or not), the continuity of the activities concerned, if the acquisition of property is involved, the intention with which the property was acquired. This list of features does not purport to be exhaustive, nor is any one of these features necessarily decisive, nor is it possible to generalise and state which feature should carry most weight in determining the problem. Each case must depend on its own particular circumstances.’

It is submitted that from a logical perspective that the above considerations need to be taken into account when ascertaining the term “business” in the business purpose test.

The next issue that needs to be determined is what is meant by the term “bona fide” in the business purpose test. The term “bona fide”, as mentioned earlier, has not been defined in the Income Tax Act. Jarvis points out that the term “bona fide” probably bears the established judicial interpretation of “good faith”\textsuperscript{77}, while Clegg argues that a transaction must be real and not imaginary.\textsuperscript{78}

The implication of the above is that if a transaction is bona fide, i.e. performed in good faith, real and without any sinister intent but does not have a business purpose, then the arrangement could still be considered abnormal for the purposes of the GAAR.

The Act is also unclear as to what is the meaning of the term “normal” in a business context. Reference must therefore be made to case law to assist with the meaning of this

\textsuperscript{75} J Jarvis ‘Things are Seldom What They Scheme’ (1996) 4 *Juta’s Business Law* at 147-148

\textsuperscript{76} 1964(2) SA 701 (SR), 26 SATC 168 at 173–174

\textsuperscript{77} Jarvis J’Things are Seldom What They Scheme’ (1996) 4 *Juta’s Business Law* at 147-148

\textsuperscript{78} D Clegg ‘Business purpose test’ (2002) 16 *Tax Planning Corporate and Personal*
term. In *Hicklin v SIR*79 Trollip JA, who delivered the judgment of the Appellate Division of the Supreme Court, made the following comments about the test of normality: ‘Hence, in an at arm’s length agreement the rights and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by [s 103(1)(b)(ii)]. And the means or manner employed in entering into it or carrying it out are also more likely to be normal than abnormal in the sense envisaged by [s 103(1)(b)(i)].’

The implication of the above dictum is that a “normal” transaction is one that is conducted at arm’s length. An arm’s length transaction would also not create abnormal rights and obligations.

In *ITC 1712*80, the court accepted that the business purpose test encompasses a comparison between the transactions entered into versus a hypothetical enquiry of how the transaction should have taken place.

The nature of such a hypothetical enquiry is subjective in nature. The Commissioner may provide evidence indicating a particular alternate transaction, while the taxpayer may introduce evidence indicating an alternate course of action. The obvious implication of this matter is that the Commissioner must be in a position to justify the relevant hypothetical transaction if the matter is taken to court.

**Commercial Substance Test**

The commercial substance test has two components and it is considered to be an extension of the business purpose test.

They are and will be discussed as follows:

- A general test81
- A list of indicators which indicate a lack of commercial substance.82

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79 1980 (1) SA 481 (A), 41 SATC 179 at 195
80 (2000), 63 SATC 499
81 Section 80C(1)
82 Section 80C(2)
General Test

In terms of section 80C(1) an avoidance arrangement ‘lacks commercial substance if it would result in a significant tax benefit for a party but does not have a significant effect upon either the business risks or net cash flows of that party’.

Section 80C(2) then provides guidance on the indicators which lack commercial substance. This will be discussed in the next section. Broomberg\(^3\) indicates that the above test is an articulation of the so called economic substance doctrine which is prevalent in many countries throughout the world.

The above section has two parts. Firstly the avoidance arrangement must result in a significant tax benefit and secondly it must not have a significant effect on the business risks or net cash flows of a party.

The term “significant tax benefit” or “significant effect” have not been defined in the Act and would create uncertainty for a taxpayer. A possible definition of these terms is that they connote an arrangement to be material and relevant to a particular taxpayer\(^4\).

The term “material and relevant” to a taxpayer has a very wide meaning and there are several tests which can be used to ascertain the materiality and relevance to the taxpayer.

A possible example of such tests are:

- Comparing the amount of the transaction to the taxpayer’s earnings;
- Comparing the amount of the transaction to the taxpayer’s assets,

Note: This list is not all inclusive.

Another important point is that the nature of these tests are very subjective in nature. The Commissioner may consider something to be material to a taxpayer while at the same time the taxpayer can adduce other evidence indicating that it is not material or relevant to him.

It is submitted that the Commissioner should provide an Interpretation Note indicating exactly which factors he will consider when assessing if an arrangement results in a “significant” tax benefit.

\(^3\) EB Broomberg ‘‘Then and now- V’’(2008) 22 Tax Planning Corporate and Personal

\(^4\) L Olivier, DM Davis, G Uruquhart Juta Income Tax (2009) at 80C-2
This section also provides that an avoidance arrangement lacks commercial substance if it does not affect the cash flows of that party. The term “cash” denotes money only. This would indicate that only if the taxpayer’s cash position is not affected, then only will the section apply.

Transfers of property other than money may have a significant tax benefit for the taxpayer, for example a deduction for the purpose of determining taxable income, but does not affect the cash flows of the company and therefore escapes the “lack of commercial substance” indicator.

It was submitted by Olivier et al\textsuperscript{85} and the writer concurs with this submission that it would have been better for the Fiscus if they had used the term “funds” defined in section 80D(3) which includes money and money’s worth widening the net to cover all forms of property.

\textsuperscript{85} L Olivier, DM Davis, G Uruquhart \textit{Juta’s Income Tax}(2009) at 80C-1
Lack of commercial substance indicators

The opening part of section 80C(2) ‘for the purposes of this part, characteristics of an avoidance arrangement…’ (emphasis added)

The effect of the underlined words above is that section 80C(2) is not a deeming provision. Secondly, the wording of the opening paragraph creates the impression that this section needs to be interpreted independently of section 80C(1).

Section 80C(1) defines the concept of commercial substance. If an arrangement falls outside the definition of commercial substance in this section but meets the requirements of section 80C(2) and vice versa, this can possibly indicate that the term “commercial substance” has different meanings and thus creates confusion for taxpayers.

Furthermore section 80C(2) states that the factors mentioned in that section “include but are not limited to”. This would indicate that there are many factors that the Commissioner may consider when determining if an arrangement lacks commercial substance.

This would further create uncertainty for the taxpayer as he will not have a full listing of indicators that the Commissioner may use to determine if it lacks commercial substance. The taxpayer may enter into an arrangement which does meet any of the mentioned indicators referred to, but may possibly be attacked by the Commissioner.

It is further submitted that the Fiscus should incorporate a comprehensive listing of all the factors they would take into account when assessing if an arrangement lacks commercial substance by way of an amendment to the Income Tax Act.

Substance over form

Section 80C(2)(a) provides that an arrangement lacks commercial substance if the legal substance or effect of the arrangement differs from the legal form of the steps. At the outset this provision is unusual as it suggests that in business, the substance or effect of the whole transaction must be the same as its individual steps.

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86 EB Broomberg ‘Then and now- V’ (2008) 22 Tax Planning Corporate and Personal
87 EB Broomberg ‘Then and now- V’ (2008) 22 Tax Planning Corporate and Personal
Most arrangements require several activities or steps to yield the intended results for a taxpayer. It is therefore illogical that the legal effect of the whole transaction must be compared to a particular step in the arrangement.

Secondly the provision is confusing because the Act makes reference to the legal substance of the whole transaction against the legal form of the steps of the arrangement. Note the use of legal in both form and effect. Broomberg\textsuperscript{88} argues that the normal judicial parlance denotes that the term “legal” is usually used in order to draw a contrast between, on the one hand, the legal effects of an arrangement and, on the other hand, its economic or commercial effect.

The substance over form doctrine has already been established in the South African courts\textsuperscript{89} from a common law perspective. There have been several cases where the courts have sought to identify the substance of an arrangement when it differed from its form without invoking the principals of the old GAAR.

The substance of an arrangement generally differs from its form in a sham, disguised or simulated transaction. The meaning of a sham, disguised and simulated transaction was discussed in Innes CJ’s judgement in \textit{Zandberg v Van Zyl}\textsuperscript{90}.

An example of case which was decided on whether a set of transactions was a sham was \textit{Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR}\textsuperscript{91}. It is worth noting that this case was decided upon without invoking the now repealed section 103(1).

It was submitted by Williams and the writer concurs with this submission that, before invoking the principals of the new GAAR, the Commissioner should first attempt to fight any arrangement where the substance differed from the form of a transaction using common law principals and the principals of the new GAAR should only be considered if the common law principals are unable to reconcile a matter. The main reason provided is that the provisions of the GAAR are quite complex.\textsuperscript{92}

Thus resorting to common law principals will reduce the amount of time spent in court and thus save on legal fees.

\textsuperscript{88} EB Broomberg ‘Then and now- VI’ (2008) 22 Tax Planning Corporate and Personal
\textsuperscript{89} IDP Louw ‘The new GAAR – a comprehensive discourse on this statute’ (2007) at 30
\textsuperscript{90} 1910 AD 302
\textsuperscript{91} 1996 (3) SA 942 (A), 58 SATC 229, 1996 Taxpayer 206
\textsuperscript{92} RC Williams‘Smoke and mirrors or genuine commercial venture?’(2009)PriceWaterHouseCoopers Synopsis at 2-4
**Round trip financing**

Section 80C(2)(i) states that the presence of round trip financing as defined by section 80D will indicate that an arrangement lacks commercial substance.

Section 80D(1) states that round trip financing is present when funds are transferred between parties resulting in a tax benefit but would significantly reduce, offset or eliminate any business risks.

At the outset, the provisions of section 80D(1) are applicable when funds are transferred between parties. Almost every single commercial arrangement between two or more parties will involve the transfer of funds\(^{93}\), either physically or electronically.

This provision therefore creates an absurdity whereby every time funds are transferred between parties, the arrangement runs the risk of being considered round trip financing by the Commissioner.

Secondly the above section appears to clearly mirror the provisions of section 80C(1) as it relates to tax benefits and business risks. This would create confusion for the taxpayer as it appears that exactly the same issues are now being re-addressed in another section.

Broomberg\(^{94}\) suggests that section 80C(1) asks the question of whether round trip financing exists in relation to one particular taxpayer whereas section 80C(2) makes an enquiry as to whether round trip financing exits in relation to the other parties to an arrangement. The writer disagrees with this approach. For the Commissioner to determine if round trip financing is present, this would involve a review of the entire arrangement as opposed to looking at the impact of the arrangement on a particular taxpayer.

Furthermore, and in support of the above submission, section 80B allows the Commissioner to re-characterise, disregard or make compensating adjustments for all the other parties to the arrangement.

It is therefore submitted that this section is therefore a duplication of section 80C(1) and should be adjusted by way of an amendment to the Income Tax Act.

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\(^{93}\) EB Broomberg *Then and now - VI* 22 (2008) *Tax planning corporate and personal*

\(^{94}\) EB Broomberg *Then and now - VI* 22 (2008) *Tax planning corporate and personal*
Thirdly, the wording of this section could create confusion for the taxpayer. The literal meaning of the term “round trip” means that money needs to move in a circular manner between the various parties. Once money leaves a particular person, it would then pass through all the parties to the arrangement. He would thus not receive, or pay the money again.

What would happen if a taxpayer enters into a financing arrangement which is linear or diagonal in nature where money is passed to another party, then passed back to him and then passed to other parties?

Section 80D (2) and (3) requires that the test for round trip financing should ignore the rights and obligations between parties and the means and manner in which the funds are received. The ignoring of the means and manner of all transactions in the arrangement would have the effect of the Commissioner looking at every transaction where funds are transferred and meet the other requirements.

In the world of commerce, if there were a limited number of arrangements taking place, this provision would be feasible to administer, however with the many arrangements taking place on a daily basis, this will be a very difficult provision to apply.

The Act is also unclear whether the same amount of money received by a party needs to be transferred between the various parties. The provision makes reference to the means and manner and not amounts transferred between the various parties.

It is submitted that the Commissioner would need to clarify this issue by way of issuing an Interpretation Note.

**Accommodating or tax indifferent parties**

Section 80C(2)(b)(ii) states that the inclusion of an accommodating or tax indifferent party indicates a lack of commercial substance. Section 80E(1) sets outs the characteristics of an accommodating or tax indifferent party while section 80E(2) sets out that the parties to an arrangement need not be connected to each another.

Section 80E(3) then discusses the various instances where an accommodating or tax indifferent party indicator may be ignored. The exemptions mentioned in the section places a significant burden on both the Commissioner and the taxpayer. The Commissioner, as mentioned previously, is responsible for ascertaining whether an
arrangement is an impermissible avoidance arrangement based on the provisions including the exemptions set out in the new GAAR.

On the other hand, the taxpayer needs to be aware of the provisions and exemptions of the new GAAR before engaging in any potential trading activities to prevent any possible attack from the Commissioner using the new GAAR. These exemptions will be discussed below.

**Two thirds requirement**95

The biggest problem with the accommodating a tax indifferent party is that the taxpayer would need to ascertain for every transaction he enters into, whether the amounts stipulated and received or accrued to the other taxpayer would meet the requirements set out in section 80E(1)

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

The taxpayer, based on the above, would then need to determine the tax liability of the other party as if they were a resident. This is to some extent a simple exercise. The next part of the process is difficult. The taxpayer would then need to familiarize himself with the foreign statutes of the suppliers of every single country he conducts business with.

If the taxpayer has a limited number of suppliers then this exercise would be easy, but if he were to have many suppliers, as in the case of a multinational company, this would create an excessive burden for him.

Alternatively the taxpayer could hire tax consultants or accountants to do work for him which would result in higher cost. The taxpayer may be able to determine the amount of tax payable easily if tax is paid to only one sphere of government. However in a country like the United States which has over fifty states and each state has a slightly different tax system, the Commissioner may find it difficult to come up with a comprehensive calculation of all the taxes he has paid.

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95 Section 80E(3)(a)
Alternatively, the Act is unclear as to what constitutes taxes paid to other spheres of Fiscus. Would this constitute, Estate Duty or Value Added Tax? This matter needs to be addressed by the Commissioner by way of issuing an Interpretation Note.

The next requirement is that the taxpayer should calculate this tax using whatever assessed loss or tax credits that the foreign party may have. If these companies operate in a tax environment similar to South Africa, this information may not be readily available in the public domain.

Some suppliers may willingly provide and give consent to the taxpayer to release such information, whereas some may not willingly disclose such information on the grounds of confidentiality. This could result in the taxpayer being unable to effectively administer the new GAAR.

Substantive trading activities

The second exclusion is that the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months. These activities must be attributable to a place of business, place, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment as defined in section 9D(1) if it were located outside the Republic and the party in question were a controlled foreign company.

The above exemption has three components. They are

- There must be another party engaging in substantive active trading activities.
- The other party must be engaging with the taxpayer for the particular arrangement for at least eighteen months.
- These activities must be attributable to a business establishment and be considered a controlled foreign company.

The term substantive in the phrase “substantive active trading” has not been defined. The term can ordinarily denote material or substantial in relation to the other party. The term material or substantial can denote different things to different people and is open to interpretation. The Commissioner may be able to deduce that the other party has engaged in substantial activities using certain parameters, whereas the taxpayer and the courts may utilise different approaches yielding another result.
It is submitted that clarity on what constitutes substantive active trading needs to be clarified by the Commissioner by issuing an Interpretation Note.

The next requirement is that the other party was engaging with the taxpayer for a period of at least eighteen months. The Act is silent as to what would satisfy this requirement. From a common sense perspective the Commissioner would require the taxpayer to provide documentary proof that they together with the other party engaged in business activities for eighteen months.

An example of such proof will be the avoidance arrangement in question, invoices, copies of minutes of all meetings held and delivery notes between all the relevant parties.

Note the above list is not all inclusive.

However it is submitted that the Commissioner must clarify exactly what forms of evidence would be satisfactory to him to avoid uncertainty by issuing an Interpretation Note.

The next problem with this requirement is why would a company that has been in existence for less than eighteen months, but meets all the other criteria (for example significant activities) not benefit from this exemption.

The next requirement is that the other party needs to be classified as a controlled foreign company under section 9D. In order for this component of the exemption to be satisfied, the taxpayer would need to obtain the names and nationalities of every shareholder of the other party and determine if the company is a controlled foreign company.

For a small owner managed business with a minimal number of shareholders, this may be an easy exercise to perform, however if the other party is a large corporation with many shareholders, the taxpayer may find it difficult to determine if this company is controlled by South African resident shareholders.

Secondly, there is a possibility that “ordinarily” resident South Africans may in some cases utilise their dual nationalities and register themselves as shareholders in the foreign company using their dual citizenship. The taxpayer would then base any
judgement he makes on the shareholder registers provided to him, containing incorrect information.

The next requirement of the exemption is that the other party must be considered to be a foreign business establishment as defined in section 9D. Broomberg⁹⁶ indicates that the “foreign business establishment” definition raises some of the most difficult factual issues in the Act, and the fact that the tax-indifferent party may be a stranger to the taxpayer makes the requirements absurd.

The first part of the definition of a foreign business establishment in relation to a controlled foreign company per section 9D(c)(a) requires a place of business with an office, shop, factory, warehouse or other structure which is used or will continue to be used by that controlled foreign company for a period of not less than one year, whereby the business of such company is carried on. The above definition leads to the conclusion that the company must have a fixed and physical place of business for the purposes of this section.

This definition seems to ignore the fact that a large component of world trade takes place through the Internet. If a South African citizen purchases goods from a foreign company using his computer in South Africa, can it be therefore said that the supplier has an establishment in South Africa or is it overseas?

In answering this question, one would need to make a distinction between a website and a server.⁹⁷ A website is the software that stores all the electronic data containing product, delivery and pricing information.

A website is therefore an intangible asset and therefore cannot constitute a fixed place of business for the purpose of this definition. A server on the other hand is the hardware that hosts and drives the website software⁹⁸.

‘When an enterprise conducts its business through a website that is hosted on a server, such hosting arrangements do not result in the server and the website being at the disposal of the enterprise. This is because the enterprise does not have a physical

⁹⁶ EB Broomberg ‘Then and Now -VII’ (2008) 22 Tax Planning Corporate and Personal
presence at the location of the server as the website through which it operates is not tangible. 99

The converse of the above point would occur if the taxpayer were to have a server at his own disposal in a foreign country. This can be achieved by leasing the equipment, a server could then possibly constitute a foreign establishment in terms of section 9D 100.

However, based on the provisions mentioned above, it is essential that server be located in a place for a period of time and secondly business must be conducted in the place where the server is stored.

The next part of the definition postulates that the permanent establishment must be in existence for at least one year. Therefore a start-up company may be excluded from this definition. A taxpayer would thus need to be wary of engaging with such companies for fear of being attacked by the new GAAR. This could result in taxpayers ignoring such establishments and thus hampering world trade.

The next part of the definition requires the foreign business establishment to have certain characteristics. In terms of section 9D(c)(a)(i) the foreign business establishment must be suitably staffed with on-site managerial and operational employees. Per section 9D(c)(a)(ii), it must be suitably equipped and have proper facilities and lastly section 9D(c)(a)(iii) requires that the foreign business establish be located in a country other than the Republic for bona fide business purposes.

The first two parts of the provision place a significant burden on the taxpayer because he would need to assess whether the foreign business establishment is suitably staffed and suitably equipped. This would require him to have in depth knowledge of the workings of his suppliers. The taxpayer would then need to determine the strategic plans (future and current) of the company, the number of customers they have, the products they make, etc. to make this decision. This list is not all inclusive.

Certain suppliers may hand over such information, however some companies may reluctantly allow such information to be released resulting in the taxpayer not being able to utilise this exemption. Alternatively, the taxpayer may require the services of an

100 AW Oguttu ‘Transfer pricing and tax avoidance: Is the arms length principle still relevant in the e-Commerce Era’ (2006) 18 SA Merc LJ at 151
expert to perform such an evaluation for him at great cost to himself, thus hampering business.

Another problem with this requirement is that it requires an objective consideration of the staffing and machinery requirements of the company and excludes the consideration of economic circumstances. Therefore a company overseas which has incurred financial problems due to the world economic recession and has retrenched several staff members or disposed of equipment or machinery, may be considered to be inadequately staffed or inadequately equipped in terms of this provision.

**Elements that offset or cancel each other**

Section 80C (b)(iii) indicates that if an arrangement has elements that have the effect of cancelling or nullifying each other, this could indicate a lack of commercial substance in an arrangement.

This section did not previously exist under the now repealed section 103(1) and no further guidance on how to interpret this section has been provided by either the Fiscus or the Commissioner.

The purpose of this provision has been summed up as follows: ‘The self-neutralising mechanism draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called fiscal nullity doctrine. It is targeted primarily at complex schemes, typically involving complex financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another effectively neutralises the first leg for non-tax purposes’\(^{101}\). The terms cancelling or nullifying have the exact same effect of neutralizing a tax benefit.

It is therefore submitted that only one of these terms should have been used and should be addressed by way of a legislative amendment to the Income Tax Act.

For an arrangement where there are minimal steps, the Commissioner may be able to identify instances of cancellation or nullification and possibly invoke the new GAAR easily.

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\(^{101}\) AP De Koker *Silke on South African Income Tax* (2009) in §19.7
However for complex schemes where part of the scheme creates a tax benefit this year but the relevant cancelling provision is only enacted many years later, it may be very difficult for the Commissioner to identify and apply the new GAAR.

Alternatively a situation could exist where, from a legal perspective, two provisions appear to cancel each other out but from an economic perspective they do not.

It is submitted that for the purposes of this section

- one should consider and compare the economic substance of the various terms of an arrangement with each other to ascertain if they cancel or offset each other; and

- one should also consider and compare the legal substance of the various terms of an arrangement with each other to ascertain if they cancel or nullify each other.

**Non business context**

Section 80A(b) states that an avoidance arrangement is an impermissible avoidance arrangement if in a context other than business, it was entered into or carried out by a means or in a manner which would not be normally employed for a bona fide purpose other than obtaining a tax benefit.

The above provision indicates that if an arrangement has a bona fide purpose other than to obtain a tax benefit in any non-business arrangement, it will not fall foul of this section of the new GAAR.

The term bona fide was discussed in previous section relating to the business context approach. In the same section it was also established that there is no formal definition of “business”.

It is therefore possible that the Commissioner may take a bona fide business arrangement and assess it using the section 80A(b) as opposed to section 80A(a) and vice versa due to this term not being adequately defined.

**In any other context**

Section 80A(c) states that in “any context” an avoidance arrangement is an impermissible avoidance arrangement if:

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102 EB Broomberg ‘Then and now -VI’ 22 (2008) Tax planning corporate and personal
(i) it has created rights or obligations that would not normally be created between persons dealing at arm’s length\(^{103}\).

(ii) It would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part)\(^{104}\).

Section 80A(c)(i) existed in the now repealed section 103(1). The first point that needs consideration is that this section applies to “any context”. This would indicate that this provision has a very wide application. It was submitted by Cilliers that this section can be described as the heart of section 80A as a result of it applying in any context.\(^{105}\) An interesting point to note is that the term “nature of the transaction, operation or scheme” has been removed.

‘The absence of any requirement to consider the circumstances of the arrangement effectively neutralises the argument used under the equivalent test in section 103(1), that one has to consider the fact that the parties in certain arrangements are manifestly not at arm’s length\(^{106}\).’ (Emphasis added).

The court found in \textit{SIR v Geustyn Forsyth & Joubert}\(^{107}\) that the subjective circumstances surrounding the taxpayer’s operations needed to be considered when considering “normality”. An implication of this case is that the normality requirement could be relaxed under certain circumstances (business and family relationships) if they are not dealing at an arm’s length.

It is therefore submitted that the removal of the terms “nature of the transaction operation or scheme” would have the effect of the “normality” requirement being more strictly applied and commercial and family relationships will be ignored. This would have a significant impact of transactions between family members and holding and subsidiary companies.

Secondly, the Fiscus has gone to great lengths to define certain sections of the GAAR, but the term “arm length transaction” has not been defined in the new GAAR. Reference must therefore be made to case law to ascertain the meaning of this term.

\(^{103}\) Section 80A(c)(i)

\(^{104}\) Section 80A(c)(ii)


\(^{107}\) 1971(3) SA 567 (A) 33 SATC 113 at 131
The court ruled in *CIR v Hicklin*\(^{108}\) that it connotes a deal between two parties who are independent of each other in a willing buyer and seller environment.

The next test is whether the arrangement results in the misuse or abuse of the provisions of the Income Tax Act. This provision is new to the Income Tax Act and therefore reliance has to be placed on foreign case law for assistance on how to interpret these sections. The origin of this provision is the Canadian Income Tax Act which employs a similar provision in conjunction with a business purpose test. The relevant provision of the Canadian Income Tax Act is as follows:

Section 245(2) states – ‘Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.’

‘Subsection (2)(b) applies to a transaction only if it may reasonably be considered that the transaction would result directly or indirectly in an abuse, having regard to provisions of [the Income Tax Act] read as a whole.’

The above extract from the Canadian statue is written in a negative tone and provides that section 245(2) may not be applied when a transaction does not result in the misuse or abuse of the provisions of the statute\(^{109}\).

The South African statute on the other hand provides that section 80A will apply if it does result in the misuse or abuse of the provisions of the Act. Note the positive use of language.

With regards to the impact or effect of positive language, the following was stated by *Van Heerden J in Sayers v Khan*\(^{110}\): ‘Other semantic guidelines which have crystallised in the South African case law are to the effect that, whereas the use of negative language has a peremptory connotation, the use of positive language suggests that the relevant statutory provision is directory’.

\(^{108}\) 1980 (1) SA 481 (A), 41 SATC 179


\(^{110}\) [2002] 1 All SA 57 (C) at 61
An implication of this case is that the use of positive language results in such provisions being interpreted widely\textsuperscript{111}. This could result in a disturbance of the balance between the taxpayer conducting his business and the Fiscus and place the new GAAR in the similar situation that it was in before the judgement of CIR v King when its ambit was considered too wide\textsuperscript{112}.

In \textit{Canada Trustco Mortgage Co v Canada the Supreme Court}\textsuperscript{113} of Canada held that: ‘The GAAR may be applied to deny a tax benefit only after it is determined that it was not reasonable to consider the tax benefit to be within the object, spirit or purpose of the provisions relied upon by the taxpayer. ... [T]his means that a finding of abuse is only warranted where the opposite conclusion — that the avoidance transaction was consistent with the object, spirit or purpose of the provisions of the Act that are relied on by the taxpayer cannot be reasonably entertained. In other words, the abusive nature of the transaction must be clear. The GAAR will not apply to deny a tax benefit where it may reasonably be considered that the transactions were carried out in a manner consistent with the object, spirit or purpose of the provisions of the Act, as interpreted textually, contextually and purposively.’

The implication of the above case is that if an arrangement is carried out in a manner which is consistent with the spirit, object and purpose of the Act as interpreted textually, contextually and purposively, the taxpayer’s arrangement will not be considered to be a misuse or abuse of the provisions of the Income Tax Act.

The first problem relating to this provision is that it presupposes that all the other sections of the Income Tax Act have been appropriately applied and that all that needs to be determined is whether the arrangements of the taxpayer have the effect of misusing or abusing the statute\textsuperscript{114}.

If a statute is clear and unambiguous, how can a taxpayer’s arrangement then be considered for the misuse and abuse of the Act adopting a contextual, purposive and textual approach\textsuperscript{115}.

\textsuperscript{111} Van Schalkwyk L, Geldenhuys B.P 2009 Section 80A(c)(ii) of the Income Tax Act and the scope of Part IIA: the big boom—Part II South Africa, \textit{Accountancy SA} at 8

\textsuperscript{112} Van Schalkwyk L, Geldenhuys B.P 2009 Section 80A(c)(ii) of the Income Tax Act and the scope of Part IIA: the big boom—Part II South Africa, \textit{Accountancy SA} at 8

\textsuperscript{113} Canada Trustco Mortgage Company v Canada 2005 SCC 54

\textsuperscript{114} AP De Koker Silke on South African Income Tax (2009) in \S19.7

\textsuperscript{115} AP De Koker Silke on South African Income Tax (2009) in \S19.7
If the provisions of the statute are applied contextually and purposively as in the case of South Africa the obvious implication is that there appears to be no relevance to having a misuse and abuse provision in the Income Tax Act.

Thirdly, another implication of the above new statute is that it has the effect of cancelling the effect of certain provisions. If a taxpayer has an expense which meets the criteria for a deduction in terms of section 11(a), this deduction may be disallowed if the GAAR is implemented and the Commissioner is successful.

It is submitted that taking into account the method of interpreting legislation in South Africa the misuse and abuse provisions mentioned will be very difficult to administer.
Chapter III
Other Provisions

3.1 Section 80I

Section 80I empowers the Commissioner to use the GAAR in the alternative for or in addition to any other basis for raising an assessment. There was no similar provision in the previous section 103(1). The reason for this inclusion is to reduce the uncertainty of conflicting court decisions.¹¹⁶

The first obvious problem is that the GAAR can be applied in addition to a specific anti avoidance provision. This could have unintended consequences if the results of the GAAR and the specific anti avoidance provisions yield different results¹¹⁷. If they yield different results, the Commissioner will encounter problems in issuing a new assessment¹¹⁸. This is due to the fact that he may only issue one final assessment after all objections and appeals are resolved.

An example of the above is as follows:

The Commissioner applies section 8E and deems certain dividends to be interest. The Commissioner then raises the GAAR in addition to this provision. The Commissioner using the GAAR intends to re-characterise this transaction as if it did not occur using section 80B. As can be seen, the Commissioner is attempting to increase the tax liability using section 8E and then at the same time nullifying the whole transaction with the GAAR.

Alternatively, if a court rules that a specific provision yielding a particular result is valid and accepts that the GAAR (which yields a different result) may also be applied, this would send conflicting signals as to the strength of the tax system as a whole in South Africa.

¹¹⁶TE Brincker Taxation Principles of Interest and Other Financing Transactions (Electronic version last updated March 2009) in § ZA 6.11
¹¹⁷TE Brincker Taxation Principles of Interest and Other Financing Transactions (Electronic version last updated March 2009) in § ZA 6.11
¹¹⁸TE Brincker Taxation Principles of Interest and Other Financing Transactions (Electronic version last updated March 2009) in § ZA 6.11
Another obvious implication is that this section empowers the Commissioner to raise the GAAR in the alternative to a specific provision. Broomberg\textsuperscript{119} indicates that it has been a long standing principal of SARS not to attack a transaction with section 103(1) if the matter was specifically dealt with in the Act.

From a common sense perspective it appears illogical that the Fiscus enacts and then raises a specific anti avoidance provision against an arrangement, then at the same time is able to raise a general avoidance provision against the same arrangement as well. In ITC 1625\textsuperscript{120}, the court ruled that the previous section 103(1) could not be applied in the alternative to any tax dispute. In this case SARS contended that the transaction was simulated and in the alternative that section 103(1) was applicable. The court stated that for section 103(1) to apply, the Commissioner must be satisfied that tax avoidance has taken place. The court referred to a hypothetical scenario, where the Commissioner has firstly refused to allow an expense as a deduction under section 11(a) of the Act and in the alternative contends that tax avoidance has taken place and intends on raising section 103. The court concluded that that by appealing section 103(1) in the alternative, the Commissioner is in fact, presupposing the validity of allowing the expense as a deduction. A similar finding was determined in ITC 1833\textsuperscript{121}.

It was submitted by Mazansky and the writer agrees with this submission, that the use of the GAAR in the alternative is illogical. On one hand the Commissioner is stating that an arrangement is not allowed and at the same time he is saying that the arrangement is allowed but he intends implementing the new GAAR.\textsuperscript{122}

### 3.2 Section 80B

Section 80B includes a detailed description of all the tax consequences of an impermissible avoidance arrangement. The remedies available to the Commissioner include, disregarding an arrangement, re-characterising the entire arrangement or components of an arrangement etc.

\textsuperscript{119} TE Brincker Taxation Principles of Interest and Other Financing Transactions(Electronic version last updated March 2009) in §ZA 6.11
\textsuperscript{120} (1996) 59 SATC 383(T)
\textsuperscript{121} (2008) 70 SATC 238(G)
\textsuperscript{122} E Mazansky ‘A new GAAR for South Africa-The Duke of Westminster is Struck a Blow’(2006) 59 Bulletin for International Fiscal Documentation 3 at 130
The determining of a tax liability by disregarding a transaction has been called the “power to annihilate” the transaction for tax purposes.\textsuperscript{123} The weakness of such a power is that the ignoring of a transaction or the annihilation of them so to speak, does not, itself create a liability for tax\textsuperscript{124}. By disregarding steps or parts of an arrangement, the Commissioner is in effect restoring the taxpayer to the situation he was in prior to entering into the avoidance arrangement. While this may be a fairly simple method of correcting a situation it would have a nil effect on the Fiscus, i.e. no revenue will be earned from this process. In the normal course of business, the benefit of a transaction must exceed its cost. The Commissioner may thus incur a large amount of costs to receive a minimal benefit.

Section 80B(f) states that the Commissioner may remedy an arrangement by “treat[ing] the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such a manner as in the circumstances of the case, the Commissioner deems appropriate.” (Emphasis added).

The first component of section 80B(f) allows the Commissioner to treat an avoidance arrangement as if it had not been entered into or carried out. This has the effect of disregarding an arrangement. The exact same concept is repeated under section 80B(1)(a) to 80B(1)(e). This creates confusion for taxpayers as the same issues are being duplicated in the same section by another provision.

The second effect of this section is that it gives the Commissioner a right to remedy a situation using any ‘method he deems appropriate’. The term ‘he can deem appropriate’ is not defined in the Act and creates uncertainty. This could result in the taxpayer receiving an assessment for a significantly higher amount of tax than he should based on the Commissioner’s hypothetical view of events. This would result in unnecessary lengthy legal proceedings and by implication excessive legal costs being incurred by both parties to initiate or defend proceedings.

Alternatively, in a similar situation, it was held in $H \text{ v } COT$\textsuperscript{125} that this section ‘allows the Commissioner to select those parts of the structure which he wishes to ignore for tax purposes, while allowing others to stand for this purpose, so long as double taxation

\textsuperscript{123} RC Williams \textit{Income Tax in South Africa 2 ed} (2005) at 590

\textsuperscript{124} RC Williams \textit{Income Tax in South Africa 2 ed} (2005) at 590

\textsuperscript{125} H v COT 1972 (2) SA 719 (RAD), 34 SATC 39.
does not result. On this reasoning, which is considered to be correct, both alternatives presuppose the existence of income which can be taxed in the hands of the taxpayer by eradicating or ignoring all or part of the structure erected by the taxpayer in terms of the transaction, operation or scheme in question. It is considered that this does not mean that the Commissioner can create income, or subject to tax notional income which does not exist’. However in *CIR v Louw*¹²⁶ discussed earlier, the court took a different view taxing the taxpayers based on a notional receipt of income. These conflicting decisions would further create uncertainty for the taxpayer.

“The approach taken by the United Kingdom courts could be of assistance in this connection. It is considered that the correct approach is to ascertain the relevant transaction, as these courts have done. It is this transaction which the Commissioner is entitled to subject to tax. Since the relevant transaction must produce the same end result, in the form of legal rights and obligations, as the transactions which were in fact carried out, this approach is entirely inconsistent with the approach taken in the *Louw* case. Whatever the correct interpretation of the powers given the Commissioner by s 103, the section cannot be applied so as to give rise to double taxation and appropriate adjustments must be made, if necessary, to assessments previously made, to avoid this. However, if the section is applied and the Commissioner subsequently seeks to subject to tax an amount which the taxpayer considers has been taxed in terms of section 103, the taxpayer must be able to prove this contention, which may well involve prior planning”¹²⁷.

It is submitted that the Commissioner should make it clear as to what additional remedies he could utilise to create certainty for taxpayers by issuing an Interpretation Note.

S80B(2) requires the Commissioner to make compensating adjustments that he or she is satisfied are necessary and appropriate to ensure the consistent treatment to all parties to an avoidance arrangement. This could create potential problems for a Commissioner.

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¹²⁶1983 (3) SA 551 (A), 45 SATC 113 
The term “party” is defined in section 80L and includes a

- person;
- permanent establishment in the Republic of a person who is not a resident;
- permanent establishment outside the Republic of a person who is a resident;
- Partnership; and
- joint venture.

Partnerships, joint ventures and permanent establishments are not separate tax-paying legal entities in South Africa. Therefore a strict interpretation of the Act is that the Commissioner would not able to make any reasonable adjustments to their tax returns.

It is therefore logical to assume that the Commissioner would need to identify all the separate tax-paying entities in the arrangement and assess them individually. If a taxpayer is disallowed a deduction because it is of a capital nature, the compensating adjustment would ordinarily be to deny the other taxpayer the right to include this amount in his gross income even though this may be of a revenue nature for this party.

Another situation could exist where a taxpayer receives a tax benefit related to the Income Tax Act and at the same time receives a VAT benefit in the form of an input deduction.

If the Commissioner were to disregard this transaction or re-characterise it, the possibility that VAT could no longer be claimed exists. A common sense approach would be for the Commissioner to deny the VAT input claim.

However section 80B limits the Commissioner to only disregarding, re-characterising etc. an arrangement under the Income Tax Act and he can thus not exercise any powers over the VAT Act. Another problem with the Commissioner’s unlimited “power he deems fit” is that it could give him the right to lift the corporate veil of a statutory entity.

Section 80B (2) is subject to section 79, 79A(2)(a) and 81(2)(b). Section 79 has a prescription period of three years from the date of any assessment.
The following scenario could exist:

The Commissioner intends on invoking the new GAAR a month before the three year period is completed.

By the time the taxpayer and Commissioner respond to the respective notices, the prescription period is over. Alternatively the prescription period may be applicable while the taxpayer and the Commissioner are in court.

The Commissioner may be able to issue an amendment to the current taxpayer’s assessment but may be unable to issue a compensating adjustment to the other parties to the arrangement. This could create a scenario where income is deemed to be received in one person’s hand, but no deduction is allowed for the other taxpayer. This would create an in-equitable tax system in South Africa.

3.3 Section 80J

Section 80J provides that the Commissioner must lodge in writing with the taxpayer his intention of invoking the GAAR. The taxpayer is then given 60 days to respond as to why the GAAR should not be implemented\(^{128}\). The Commissioner then has 180 days to respond to any reasons provided by the taxpayer\(^{129}\).

The provision is unclear as to whether the term “day” is the same as term “day” denoted in Part III of the Income Tax Act\(^{130}\). This confusion may result in a taxpayer submitting his reasons too late, as to why the Commissioner should effect the GAAR and thus causing hardship to the taxpayer.

The Commissioner should thus issue an Interpretation Note to clarify these issues. Secondly the provision makes reference to the Commissioner notifying a “party” and then allowing the “party”60 days to respond.

Section 80L indicates that the term party includes a joint venture\(^ {131}\) and a partnership\(^ {132}\). These parties, as mentioned in previous sections, are not separate tax-paying entities and the Act is therefore unclear as to how these parties will be given notice or opportunities to respond, giving rise to uncertainty on the part of taxpayers.

\(^{128}\) Section 80J(2)
\(^{129}\) Section 80J(2)
\(^{130}\) IDP Louw ‘The new GAAR – a comprehensive discourse on this statute’(2007) at 42
\(^{131}\) Section 80L Definition of Party subsection (d)
\(^{132}\) Section 80L Definition of Party subsection (d)
It is therefore submitted that the Commissioner should address this matter by way of an Interpretation Note.

The Act is also unclear as to what would happen should a taxpayer and the Commissioner fail to respond within the 60 day and 180 day period respectively. A common sense response would be that the Commissioner would by default invoke the GAAR if the taxpayer fails to respond on time. However what would then happen if the Commissioner were to fail to respond within the 180 day period. Would he then not be able to invoke the GAAR? These questions have been left unanswered by the new GAAR.

It is therefore submitted that the Commissioner should issue an Interpretation Note indicating the repercussions for both himself and the taxpayer should they fail to respond within the relevant period.
Chapter IV

Conclusion

The purpose of this treatise was to critically analyse the provisions of the new GAAR as set out in sections 80A to 80L of the Income Tax Act. Historically, the fundamental principle established by the courts was that a taxpayer is entitled to arrange his affairs so as to pay the least amount of tax.

South Africa has implemented a new GAAR. The reason for the implementation of the new GAAR was that the now repealed section 103(1) was ineffective and inappropriate at combating complex tax schemes.

Firstly, as can be seen, many of the provisions within the new statute originate from the old section 103(1), however several concepts have been brought in which have their origins in other parts of the world. The effect of having these new concepts is to defeat several of the old principles established by the South African courts.

Firstly, in this regard the courts have historically determined whether tax avoidance has taken place based on a review of the total circumstances surrounding an arrangement. However the new GAAR requires the Commissioner to review individual steps of an arrangement in isolation to ascertain whether tax avoidance has taken place.

Secondly, the courts have historically held that the purpose test, when determining if the sole of main purpose of the taxpayer was to obtain a tax benefit, was subjective in nature. The wording of the new GAAR, indicates that this test is now objective in nature. This would have the effect of almost all arrangements resulting in a tax benefit being scrutinised for tax avoidance by the Commissioner.

Thirdly, the courts have historically viewed the abnormality of an arrangement in the light of the surrounding circumstances, for example family relationships and commercial practices. The wording of the new GAAR now requires an objective application of the arrangement without taking into account the surrounding circumstances. This would have the effect of preventing transactions between family members or holding and subsidiary companies as they face the possibility of being attacked by the Commissioner using the new GAAR.
The wording of the new GAAR also poses potential problems for the Commissioner when administering the new GAAR. In this regard:

Section 80A is effective for arrangements entered into on or after 2nd November 2006. It was submitted that the old GAAR should be used for all steps or parts entered into before the effective date and the new GAAR should be utilised to assess steps entered into after the effective date.

The Fiscus has implemented a very detailed definition of an arrangement. It has historically been established that the terms “transaction, operation or scheme” are of very wide import and conceive almost every form of arrangement. It was therefore submitted that certain of the inclusions to this definition were not required and should be resolved by way of an amendment to the Income Tax Act.

The new GAAR does not prescribe how to determine the existence of a tax benefit. In certain instances, the Commissioner may consider predicting an alternative arrangement and comparing it to the one conducted using the taxpayer’s past history of transactions. However, in the instance where the taxpayer would not have entered into any arrangement other than the one enacted, there is no solution currently available. It was submitted that the Commissioner may not be able to implement the new GAAR in this regard.

The new GAAR does not define the term “business” for the purposes of section 80A(a)(i). A review of various cases did not provide any conclusive definition for this term. This could result in the Commissioner incorrectly applying section 80A(a)(i) to an arrangement as opposed to section 80A(b), or vice versa.

Section 80A(c)(ii) is written in positive language and as such maybe open to a wide application. The conclusion reached was that if a statute is interpreted purposively and contextually, there is no need for the insertion of this provision.

Section 80I allows the Commissioner to raise the GAAR instead of or in addition to any specific provision. This would have unintended consequences if the application of a specific provision and the GAAR have opposite results. It was submitted that it was illogical for the Commissioner using this provision to contend that an avoidance arrangement is not allowed, yet at the same time be able to contend that an arrangement is allowed but he intends to implement the new GAAR.
Section 80B allows the Commissioner to remedy an avoidance arrangement using “any method he deems appropriate”. This could result in the Commissioner levying higher taxes on a taxpayer than are warranted, resulting in lengthy and costly legal battles. It was submitted that the Commissioner should issue an Interpretation Note detailing all the methods he deems fit in this regard.

Section 80I, is unclear whether the definition of the term “day” is the same as that mentioned in part III of the Income Tax Act. It was submitted that the Commissioner should issue an Interpretation Note in this regard to avoid any uncertainty or misunderstandings.

South Africa is currently in a recession and would require large amounts of foreign and local investment to boost the economy. The new rigid, onerous and in certain cases cryptic rules of the new GAAR may result in many arrangements being investigated by the Commissioner for tax avoidance. This may be counterproductive to the development of South Africa.
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