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MASTERS IN TAX LAW

THE GENERAL ANTI-AVOIDANCE SECTION: A COMPARATIVE
ANALYSIS OF SECTION 80A OF THE SOUTH AFRICAN INCOME TAX
NO. 58 OF 1962 AND SECTION 35 OF THE TANZANIAN INCOME
TAX ACT NO. 11 OF 2004.

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STATEMENT

Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Masters in Tax Law in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of Masters in Tax Law dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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List of Abbreviations

| | |
|--------|--------------------------------------------------|
| AC | Appeal Case. |
| AD | Appellate Division. |
| All ER | All England Law Reports. |
| CA | Court of Appeal. |
| Ch. | Chapter |
| CIR | Commissioner for Inland Revenue. |
| COT | Commissioner of Taxes. |
| CSAR | Commissioner of South African Revenue Authority. |
| eg | For example |
| etc | et cetera |
| GAAR | General Anti-avoidance Rule |
| ie | in other words |
| IRC | Inland Revenue Commissioner |
| ITC | Income Tax Case. |
| KB | King's Bench Division. |
| LT | Law Times Reports. |
| Ltd. | Limited. |
| Pty. | Private. |
| SA | South African Law Report. |
| SARS | South African Revenue Services |
| SATC | South African Tax Cases |
| SCA | Supreme Court of Appeal. |
| SIR | Secretary for Inland Revenue. |

| | |
|------|--------------------------------|
| TC | Tax Case. |
| TLR | Times Law Reports. |
| TPD | Transvaal Provincial Division. |
| TTLR | Tanzania Tax Law Report. |
| VAT | Value Added Tax. |

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The term tax avoidance is not tax evasion; the two terms are different from each other. In their plain meaning, tax avoidance is ‘the minimisation of a taxpayer’s tax liability by lawful methods’¹ that are within the ambit of the law. On the other hand, tax evasion connotes ‘a deliberate failure to pay tax’² by a taxpayer done by way of fraud, failure to file tax monthly tax returns etc³ and it is considered to be a criminal offence in the eyes of the law.

Although,

‘no man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or his property as to enable the Inland Revenue to put the largest possible shovel into his stores...to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, as far as he honestly can, the depletion of his means by the Revenue.’⁴

Tax avoidance is one among major problems that tax authorities are concerned with⁵ and willing to take action upon by making sure tax laws prevent taxpayers from avoiding tax payments.

The South African Income Tax Act no. 58 of 1962 and the Tanzanian Income Tax Act no. 11 of 2004, stipulate two methods of how tax avoidance is prevented; the two Acts have provided for specific provisions dealing with tax avoidance on specific levels as well as the general anti-avoidance section that aims to only prevent tax avoidance practices but also reducing taxpayers’ abuse and misuse of the law.

¹ Chambers 20th Century Dictionary.

² Ibid.

³ M Lewis *British Tax Law: Income Tax: Corporation Tax: Capital Gain Tax* (1979) 25.

⁴ *Ayrshire Pullman Motor Services & D.M Ritchie v I.R.C* [1929] 14 T.C. 754 at 763 to 764.

⁵ PLL Mo *Tax Avoidance and Anti-Avoidance Measures in Major Developing Economies* (2003) 1.

1.2 Purpose of the Study

The study intends to cover the general anti-avoidance section of the South African Income Tax Act no. 58 of 1962 and the Tanzanian Income Tax Act no.11 of 2004. The main purpose is to make a comparison between two sections by delineating their similarities and differences whilst identifying their implications to taxpayers.

1.3 Scope and Methodology of the Study

The study will be based on a comparative analysis of the general anti-avoidance section of the South African Income Tax Act no. 58 of 1962 and the Tanzanian Income Tax Act no. 11 of 2004. The focus is on how the two provisions are interpreted by showing the similarities and differences.

The approach will be analytical and comparative, starting by showing the concept of tax avoidance and historical backgrounds of the two provisions.

1.4 Significance of the Study

Considering the fact that the two provisions are from different tax jurisdiction though purports to address the same issue, the interest is to see which jurisdictions is better on exercising its anti-avoidance measures.

1.5 Outline of the Study

The study is divided into four chapters;

Chapter one is the introductory chapter that introduces the aim and the importance of the whole study.

Chapter two is dedicated to an understanding of tax avoidance and anti-avoidance concepts, and will further show the historical background of the two concepts on South African and Tanzanian tax jurisdiction.

Chapter three is the interpretation that analyses how section 80A of the South African Income Tax Act and section 35 of the Tanzanian Income Tax are interpreted before courts of law.

Chapter four draws the conclusion to the whole study and makes recommendations.

CHAPTER TWO

THE GENERAL CONCEPTS OF TAX AVOIDANCE AND ANTI-AVOIDANCE MEASURES

2.1 Introduction

In order to understand the tax avoidance concept, it is important for the concept to be differentiated from tax evasion and tax planning. According to Murray and Prosser,⁶ they define tax avoidance not to be 'tax evasion' or 'tax planning' but rather 'a lawful way of obtaining tax advantages by exploiting a legislative loophole'⁷ and its legal measures used by the tax authorities are different to tax evasion or tax planning.

In this chapter, the general discussion is on the concepts of tax avoidance and anti-avoidance measures. The chapter discusses the difference between tax avoidance, tax evasion and tax planning. Furthermore, a detailed discussion of the historical background of anti-avoidance measures on the South African and the Tanzanian tax law.

2.2 Tax Avoidance

Historically, the general background of tax avoidance concept is traced in the British tax system of 1850s⁸ in the House of Lords in the case of *Levene v I.R.C*⁹ where it was stated that,

It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure, if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them.¹⁰

⁶ R Murray & KJ Prosser *Tax Avoidance* 1ed (2012) 1.

⁷ RA Tooma *Legislating Against Tax Avoidance* (2008) 12.

⁸ A Likhovski 'The Duke and the Lady: Helvering v. Gregory and the History of Tax Avoidance Adjudication' (2008) 70 *Tel Aviv University* at 16.

⁹ [1928] AC 217.

¹⁰ *Ibid.*

And in *Duke of Westminster v I.R.C.*¹¹ Lord Tomlin stated that,

‘Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity he cannot be compelled to pay an increased tax’,¹²

with the aim of enabling rich and wealthy people to avoid tax payments as a means of serving and protecting their interests within the society¹³ as well as having ‘social solidarity in times of emergency.’¹⁴

From the above authorities, it is clear that, the term tax avoidance can be referred to, any situation where a taxpayer engages or arranges their business affairs in a way that would result in them paying less amount of tax as required, or, have no tax liability at all.¹⁵ From the principles of the above cited cases, one can say, tax avoidance is either an arrangement or scheme that a taxpayer undergoes with the aim of either reducing tax liability or having no tax liability.

According to Victor Thuronyi,¹⁶ tax avoidance is a broad term and when interpreted in French as ‘*fraude à la loi*’, it will then mean, any activity not of a criminal nature done by a taxpayer with an intention of reducing tax or taxes.¹⁷ In other words, tax avoidance is “doing what you can with the law.”¹⁸

Needless to say, it can now be concluded that, tax avoidance is either an arrangement of any transaction or scheme done by a taxpayer

¹¹ [1936] AC 1, [1935] All ER Rep, 51 TLR. 467, 19 TC at 520.

¹² Ibid.

¹³ Likhovski op cit (n8) 16 to 17.

¹⁴ Ibid.

¹⁵ AS Silke *Tax Avoidance and Tax Reduction within the Framework of the South African Income Tax Legislation, with Special Reference to the Effect on the Fiscus and to Current Anomalies and Inequities* (1958) 1.

¹⁶ V Thuronyi *Comparative Tax Law* (2003) 154 to 155.

¹⁷ Ibid.

¹⁸ Ibid.

(natural person or companies) with an intention of obtaining ‘tax advantages, benefits or reductions’ in a way that the law permits.¹⁹

Under the South African Income Tax Act no. 58 of 1962 (hereinafter referred to the South African Income Tax Act) and the Tanzanian Income Tax Act no. 11 of 2004 (hereinafter referred to the Tanzanian Income Tax Act), the term tax avoidance is not expressly defined but rather explained on what may constitute a tax avoidance arrangement. According to the two laws, a taxpayer is said to have engaged or arranged his business affairs for the reason of reducing his tax liability or have no liability, if his arrangement;

- a) Lacks commercial substance.
- b) It is entered into or carried out in abnormal terms or manners.
- c) Does not consist of arm’s length rights or obligations.
- d) It is for the misuse and abuse of the provision of the Act.²⁰

Or

- a) If one of its main purposes is to avoid or reduce tax liability.
- b) If one of its main purposes is to prevent or obstruct collection of tax, or
- c) Its main benefit is either to avoid, reduce, prevent or obstruct collection of tax is expected within the period of three years following the completion of the same.²¹

2.3 Methods used to Avoid Tax

With the aim of reducing tax liabilities or having no liability, taxpayers have designed different methods of achieving their desired aim. Such methods includes;

¹⁹ KB Brown ‘Comparative Regulation of Corporate Tax Avoidance: An Overview’ in *A Comparative Look at Regulations of Corporate Tax Avoidance* (ed) (2012) 1.

²⁰ Section 80A of the Income Tax Act 58 of 1962.

²¹ Section 35(2) of the Income Tax Act 11 of 2004.

a) Income splitting.

This one the most common methods used by taxpayers on both tax avoidance and tax planning. Under this method, taxpayers reduce their 'marginal rate'²² or 'progressive rate'²³ of tax by splitting their income with other taxpayers or partners²⁴ with the aim of reducing their tax liabilities. The method is commonly used by either individual taxpayers²⁵ or partners.²⁶ It should be noted that, for income splitting to be effective and be considered as a tax avoidance method, it must be entered before the taxpayer has accrued his income²⁷ and that the agreement entered must be a 'contractual arrangement',²⁸ that will allow him to have low or no tax liability at all.²⁹

b) Dividend stripping

This method is mostly used by shareholders of companies with the intention of avoiding payment of taxes.³⁰ A company as a taxpayer, under its shareholders may use dividend stripping as a method of avoiding payment of taxes or paying less where, the said company is a shareholder of one of its solvent companies, that buys the solvent company, declares a large dividend and sales it at a loss or low market value³¹ or sometimes withholding its profits made from distributed dividends as a way of avoiding taxes.³²

c) Transfer Pricing

It is done by companies as taxpayers. Under this method, the taxpayer shifts it profits to another tax jurisdiction through different

²² FDDM Luoga *A Sourcebook of Income Tax Law in Tanzania* (2000) 39.

²³ Silke op cit (n15) 104.

²⁴ Luoga op cit (n22) 39.

²⁵ Silke op cit (n15) 106.

²⁶ DN Mahangila & MM Nchimbi *Income Tax in Tanzania* 1ed (2013) 192.

²⁷ Silke op cit (n15) 105.

²⁸ Ibid.

²⁹ Mahangila & Nchimbi op cit (n26) 192.

³⁰ Silke op cit (n15) 77.

³¹ Luoga op cit (n22) 42 to 43.

³² Silke op cit (n15) 77.

taxpayers or between taxpayers themselves³³ or sometimes between related parties, by changing their prices of products in order to avoid or pay less taxes.³⁴

Other methods include, sheltering of income, where a taxpayer shifts income to a tax haven country for the purpose of avoiding tax³⁵ or uses capital allowances;³⁶ capitalisation of income by changing income to capital in order to pay less taxes³⁷ or abuse of exemption opportunities³⁸ etc.

2.4 Tax Avoidance versus Tax Evasion

Most transactions done or ought to be done by a taxpayer have tax implications. The only thing that can differentiate them is that, some anticipate in minimising taxpayer's ability of paying tax which makes them legal and are termed as tax avoidance transactions while others anticipate on escaping the tax liability thus making them illegal and are termed as tax evasion transactions.³⁹

Tax evasion is therefore referred to as, 'all those activities deliberately undertaken by a taxpayer to free himself from tax which the law charges upon his income.'⁴⁰ Sometimes it reflects 'any illegal methods'⁴¹ used by a taxpayer on his activities which in turn leads him to have no tax liability.⁴²

Theoretically, tax avoidance can and is distinguished from tax evasion. Although they both deal with reduction of tax liability,⁴³ their difference can be drawn on the outcome of the act of minimising tax

³³ M James *The UK Tax System: An Introduction* 2ed (2009) 130.

³⁴ Mahangila & Nchimbi op cit (n26) 192.

³⁵ Luoga op cit (n22) 41.

³⁶ Mahangila & Nchimbi (n26) 192.

³⁷ Luoga op cit (n22) 41.

³⁸ Mahangila & Nchimbi op cit (n26) 193.

³⁹ *CIR v King* 1947 (2) SA 196 (A), 14 SATC 184 at 194.

⁴⁰ Silke op cit (n15) 1.

⁴¹ KK Agrawal *Direct Tax Planning and Management: Incorporating: Corporate Tax Planning, Business Tax Procedure and Management* 5ed (2006) 5.

⁴² Ibid.

⁴³ Luoga op cit (n22) 35.

liability.⁴⁴ As stated and explained earlier, tax avoidance is an act of avoiding payment of tax or taxes without breaking the law.⁴⁵ It is in fact acceptable by the law to avoid paying taxes as long as it is within the intent of it and that the act of avoiding or reducing tax liability does not result in any misuse or abuse of it.⁴⁶ On the other hand, tax evasion is the opposite of tax avoidance and it is considered a crime that tax officials and Legislatures intend to punish the taxpayer either by fine⁴⁷ or imprisonment.⁴⁸

A major distinction between tax avoidance and tax evasion was made and states by Watermeyer CJ that,

‘There was a real distinction between the case of one who so ordered his affairs that he had no income which would expose him to liability for income tax, and that of one who ordered his affairs in such a way that he escaped from liability for taxation which he ought to pay upon the income which in reality was his.’⁴⁹

Another, distinction between the two concepts was made and stated in a very simple manner, in my view, in *R v Mears*⁵⁰ by Gleeson CJ that,

‘The difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligation. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful.’⁵¹

2.5 Methods used to Evade Tax

There are various ways used by a taxpayer to evade tax liability. The following are a few methods that are commonly used.

- a) The falsifying of financial statements
- b) Not disclosing or misrepresenting relevant information in a tax return.

⁴⁴ Ibid.

⁴⁵ Agrawal op cit (n41) 5.

⁴⁶ Section 35(2) of the Income Tax Act 11 of 2004 and Section 80A of the Income Tax Act 58 of 1962.

⁴⁷ Section 105 of the Income Tax Act 11 of 2004 and Section 104(1) of the Income Tax Act 58 of 1962.

⁴⁸ Section 105 of the Income Tax Act 11 of 2004 and Section 104(1) of the Income Tax Act 58 of 1962.

⁴⁹ *CIR v King* supra (n39).

⁵⁰ (1997) 37 ATR 321.

⁵¹ *R v Mears* supra (n50) at 323.

- c) Deliberate failure by cash businesses to report the full amount of revenue received.⁵²

2.6 Tax Avoidance versus Tax Planning

Tax planning or as is sometimes referred to as tax mitigation,⁵³ is a way a taxpayer designs his arrangements for the purposes of having least tax liability. Under tax law, there is a very thin line between tax avoidance and tax planning. The two concepts are lawful in the eyes of the law and advantageous to a taxpayer; as they intend to make him enjoy the loopholes of the tax laws by making him pay less or have no tax liability.

The distinction between tax avoidance and tax planning was stated by Lord Nolan in *CIR v Willoughby*⁵⁴ that,

‘The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.’⁵⁵

It is therefore suggested by Prosser and Murray that, ‘tax planning is a form of tax avoidance’⁵⁶ but becomes tax avoidance in a scenario where the taxpayer seeks to obtain an advantage in question and in a manner that is contrary to the intention of the Legislature.⁵⁷ In other words, taxpayers are permitted to plan their tax affairs in a manner that may be described as tax planning. However, where in carrying out such planning, the taxpayer does so in a manner that is at variance with the intendment of the Legislature, this may result in tax avoidance.

⁵² SARS, Discussion paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) at 3, available at <http://www.sars.gov.za>, accessed on 19 August 2014.

⁵³ Murray & Prosser op cit (n6) 1.

⁵⁴ [1997] 4 All ER 65.

⁵⁵ *CIR v Willoughby* supra (n54) 73.

⁵⁶ Murray & Prosser op cit (n6) 1.

⁵⁷ Ibid.

The concept of tax planning is explained in *McDowell & Co. Ltd v CTO*⁵⁸ as it was stated that,

Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods.⁵⁹

It is therefore said, tax planning “is a choice of the most advantageous route consistent with normal business transactions among the various forms of tax relief and incentives”.⁶⁰ Additionally, tax planning is simply organisation of taxpayers’ affairs in a way that they give rise to minimum tax liability without resorting into tax avoidance.⁶¹

2.7 Advantages and Disadvantages of Tax Avoidance

Starting with the advantages, tax avoidance benefits the taxpayer alone and not otherwise. The benefits of it are that, taxpayers use the loopholes of tax law for their own advantages by arranging their business affairs in a way that reduces their tax liability or, have no liability at all.

Although it benefits the taxpayer, it also carries a lot of misfortune not only affecting the economy by contributing to massive loss of government revenue, but it also affects the welfare of the society at large. It is known to every citizen that, the source of government revenue among other sources are taxes used not only to meet government expenditures but also to provide social needs to its citizens such as education, supply of water and electricity and health services;⁶² and if the government lacks all these it can become problematic for the country. That is why, through the imposition of taxes as means of its revenue, it can fulfil its purposes. But where

⁵⁸ (1985) 3 SSC 230.

⁵⁹ *McDowell v CTO* supra (n58).

⁶⁰ R Eicke *Tax Planning with Holding Companies Repatriation of US Profits from Europe, Concepts, Strategies, Structure* (2009) 13.

⁶¹ SARS, Discussion paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) op cit (n52) 4.

⁶² Luoga op cit (n22) 5.

there are people within the society who try to abscond or reduce payments of taxes, none of the above would be possible to acquire.

2.8 Anti-Avoidance Rules

The term anti-avoidance means, prevention or the misuse or abuse of tax laws by the taxpayers⁶³ that has a direct effect on the economy and society in general. The disadvantages of tax avoidance have resulted in the establishment of anti-avoidance rules by both the South African tax system and the Tanzanian tax system in order to fight the phenomenal problem. These disadvantages will be discussed along with anti-avoidance measures.

The principles established by Lord Tomlin in *Duke of Westminster*⁶⁴ and Lord President Cullen in *Ayrshire Pullman* case,⁶⁵ that 'a man is entitled if he can to order his affairs in a way that it can diminish his tax liability...' have limitations. Not only the government that is determined to fight tax avoidance practices as they impede tax administrations but, it discourages tax compliance among other honest taxpayers. Tax officials together with Courts do not approve them and they have been regarded as,

'...an evil. Not only does it mean that a taxpayer escapes the obligation of making his proper contribution to the *fiscus*, but the effect must necessarily be to cast an additional burden on taxpayer who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set-up the necessary tax avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent argument that is only the rich, the astute and the ingenious who prosper in it and that 'good citizens' will always fare badly.'⁶⁶

Therefore, anti-avoidance measures are rules designed and introduced as measures of fighting against both tax avoidance and tax evasion.⁶⁷ The rules are traced back in the Roman law under the principle of *fraus legis* with an intention of not only examining

⁶³ Likhovski op cit (n8) 22.

⁶⁴ *Duke of Westminster v I.R.C* supra (n11).

⁶⁵ *Ayrshire Pullman Motors Services & D. M. Ritchie v I.R.C* supra (n4) at 763 to 764.

⁶⁶ Per MacDonald JP in *COT v Ferera* 1976 (2) SA 653 RAD, 38 SATC 66.

⁶⁷ Mo op cit (n5) 78.

taxpayer's activities but also preventing them so they may not lead to tax avoidance or tax evasion.⁶⁸ Additionally, anti-avoidance rules are used to prevent tax avoidance by way of 'preventing manipulation of tax incentives set out in the law.'⁶⁹ Consequently, their application gives a wide discretion to tax officials on disallowing tax avoidance arrangements.

Both the South African Income Tax Act and the Tanzanian Income Tax Act, provide for anti-avoidance rules. In both laws, the anti-avoidance rules are divided into two categories; specific anti-avoidance rules and the general anti-avoidance rules.

2.8.1 Specific Anti-Avoidance Rules

The specific anti-avoidance rules are contained in different provisions of the tax law, co-existing with the general anti-avoidance rules. Their aim is to prevent specific tax avoidance. Although they co-exist with the general anti-avoidance rules, their main purpose is to combat specific tax avoidance arrangements thus being the charging provisions that are not overruled by the general anti-avoidance rules which are a 'set of broad principles based rules within a country's tax code designed to counteract the perceived avoidance of tax.'⁷⁰

Under the South African Income Tax Act, the specific anti-avoidance rules are contained in the following provisions; section 103(2) dealing with assessed losses, section 103(5) that deals with cession or income swap, section 31 on transfer pricing and thin capitalisation rules to counter abuse practices, section 23B that prohibits double deduction when determining taxable income, section 24 on deferral of accruals

⁶⁸ T Grauberg 'Anti-tax-avoidance Measures and Their Compliance with Community Law' at 142, available at http://www.juridicainternational.eu/public/pdf/ji_2009_1_141.pdf, accessed on 19 August 2014.

⁶⁹ Grauberg op cit (n68) 142 to 143.

⁷⁰ GAAR rising, Mapping tax enforcement's evolution, February 2013, Ernst & Young at 2, available at [http://www.ey.com/Publication/vwLUAssets/GAA_rising/\\$FILE/GAAR_rising_1%20Feb_2013.pdf](http://www.ey.com/Publication/vwLUAssets/GAA_rising/$FILE/GAAR_rising_1%20Feb_2013.pdf), accessed on 19 August 2014.

and incurred expenditure on disposal of equity shares just to mention a few; while in Tanzania, the specific anti-avoidance rules existed before current general anti-avoidance rule under the Income Tax Act no.33 of 1973 that was repealed and replaced by the current Income Tax Act. The specific rules for anti-avoidance are provided for in the following provisions; section 33 dealing with transfer pricing and other arrangements, section 34 on income splitting, section 54 taxation of shareholders, section 57 dealing with income or dividend stripping, section 56 deals with change in control and section 19 of assessed losses, etc.

While the main purpose for specific anti-avoidance rules is 'progressively' curbing tax avoidance,⁷¹ the general anti-avoidance rules 'targets arrangements involving a course of action that would not have likely been taken other than for the reason of a tax advantage for the taxpayer.'⁷²

2.8.2 General Anti-Avoidance Rules

The general anti-avoidance rules, are rules used for the general application in denying tax benefit that occurs or ought to occur from tax avoidance arrangements.⁷³ The applications of these rules are conducted by both tax administrator and the judiciary⁷⁴ in a form of:

- i. The classification of contracts and related actions based on their true nature (disregarding simulated contracts)
- ii. The principle of the proper use of rights (prohibition of the abuse of law) and
- iii. The taxability of income from illegal acts.⁷⁵

⁷¹ Tooma op cit (n7) 26.

⁷² Tooma op cit (n7) 72.

⁷³ D Campbell *International Taxation of Low-Tax Transactions [2009] High-Tax Jurisdictions* (2009) 29.

⁷⁴ D Deák *Hungary in International Tax Planning* (2003) 331.

⁷⁵ Ibid.

2.9 Historical Background of the General Anti-Avoidance Rule

Historically, the general anti-avoidance rule existed in the South African Income Tax Act No. 31 of 1941 under section 90 which was not an effective provision on combating tax avoidance arrangements.

The interpretation of the section 90 had contradictions in Courts as it 'anticipated liability for tax, either in respect of a current tax year or in respect of future years, and not an existing liability for tax.'⁷⁶ Moreover, according to Schreiner JA, section 90: 'was intended to deal with cases in which the Commissioner was properly aggrieved by a transaction or operation designed to enable one of the parties thereto to escape tax.'⁷⁷ Furthermore, section 90 was elaborated to refer,

'...anticipated liabilities for tax, either in respect of a current tax year or in respect of future years. Liability for the payment of some expected tax can, in a wide general sense, be avoided by a taxpayer if he abstains from earning any income and acquires none in any other way. This abstention from earning an income can be brought about by many kinds of operations or transaction. A man can, for instance, simply close down his business or resign from employment, but it is absurd to suppose that the Legislature intended to impose a tax upon a man who enters into such a transaction or operation as if he had an income, which in fact he has not got, merely because his purpose was to avoid exposing himself to liability for taxation by having an income.

In a wide sense also the amount of a man's income tax can be reduced from what it was in previous years if he earns less income than in previous years, but here again it is absurd to suppose that the Legislature intended to impose a penalty upon a man who enters into a transaction which reduces the amount of his income from what it was in previous years merely because his purpose was to reduce the amount of his income and consequently of his tax. These two types of cases may be uncommon but there are many other ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have 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.'⁷⁸

The weaknesses and ineffective ability of section 90 in identifying what is purported to be a tax avoidance transaction, operation or scheme; as well as being limited to cases of which tax avoidance or reduction was the dominant motive of the transaction, operation or

⁷⁶ *CIR v King* supra (n39) at 206.

⁷⁷ *Ibid.*

⁷⁸ *CIR v King* supra (n39) at 207 to 208.

scheme, and the fact that its application could not be extended to situations where a taxpayer has disposed of his income producing asset either by way of sale, donation or by transfer to a company;⁷⁹ could not be hit by the section, as a result it was repealed and replaced by section 103 of the current South African Income Tax Act. Section 103 was introduced to fulfil the real intention of having the general anti-avoidance rule by ascertaining what section 90 could not fulfil. According to the section (section 103), for the Commissioner to invoke its application, four requirements were to be fulfilled:

- The existence of a transaction, operation or scheme
- That resulted in the avoidance, reduction or postponement of a taxpayer's tax liability
- That the transaction, operation or scheme was entered into or carried out in a manner not employed in a *bona fide* business
- The transaction, operation or scheme was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit.

It was later observed that, the provision lacked clarity and certainty that made it difficult for the Commissioner to determine key elements in establishing an avoidance arrangement.⁸⁰

Furthermore, the section also carried inherent weaknesses of section 90 and it was proved by both the Commissioner and the Court that its application was not different from its predecessor.

2.9.1 The following were the Weaknesses of Section 103

2.9.1.1 Abnormality Requirement

The abnormality requirement, is a test required to identify if an arrangement is designed in a manner that a normal business

⁷⁹ Silke op cit (n15) 11 to 13.

⁸⁰ SARS, Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) op cit (n52) 44.

transaction would not be entered into or carried out. In other words, not concluded in an arm's length.⁸¹

It was difficult for the Commissioner to establish abnormality of a particular transaction, operation or scheme entered into or carried out by a taxpayer for tax avoidance purposes.⁸² Consequently, the difficulty made it possible for taxpayers to argue in their favour that their arrangements were not abnormal especially where a particular transaction was used for tax avoidance purposes but also has commercial acceptability to an extent that its utilisation becomes normal.⁸³

Moreover, this became an issue for the Commissioner and Courts in establishing contrary rules that would contravene the freedom of taxpayers to structure and form their businesses in a manner that would result in minimising their tax liabilities.⁸⁴

2.9.1.2 Purpose Requirement

In order for purpose requirement to be met, the Commissioner was to prove that the arrangement was solely and mainly obtained for a tax benefit.⁸⁵ The major issue that section 103 failed to address, was the word 'mainly' that meant tax benefit was to be considered as a dominant motive. For example, where a transaction had both commercial and tax benefit elements, the Commissioner was under the obligation of proving that tax benefit was a predominant purpose of carrying out the transaction, but failed to do so because of the subjective test that required him to look at the taxpayer's intention and not the transaction itself.⁸⁶ Similarly, circumstantial evidence could not sustain Commissioner's allegations that the predominant

⁸¹ Section 80A(c)(i) of the Income Tax Act 58 of 1962.

⁸² SARS, Discussion Paper on Tax avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) op cit (n52) 39.

⁸³ Ibid.

⁸⁴ D Clegg & R Stretch *Income Tax in South Africa* (2012) Ch. 26.4.6.

⁸⁵ SARS, Discussion Paper on Tax avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) op cit (n52) 43 to 44.

⁸⁶ Ibid

purpose was to obtain a tax benefit. Furthermore, the Court rejected the application of section 103 where a dual purpose existed in a transaction for the purpose of obtaining a tax benefit.⁸⁷ The section gave more room to taxpayers' to abuse the law.

It was therefore noted that, section 103 had apparent weaknesses in its application as it was not certain, inconsistent and ineffective deterrent to tax avoidance arrangements.⁸⁸

The dissatisfaction of section 103 towards combating tax avoidance arrangements, led for its repeal and replacement to a new and the current general anti-avoidance of section 80A.

In Tanzania, as stated above, the general anti-avoidance rule was for the first time introduced under the current Tanzanian Income Tax Act with the aim of fighting not only tax avoidance but also tax evasion.

The establishment of the rule was led by the weaknesses of the specific anti-avoidance rules contained in the Income Tax Act 33 of 1973 left more room for taxpayer to take an advantage of the law since there was no general provision to cover the general tax avoidance practices, eg section 27 dealt with transactions to avoid tax liability. The section was used as one of the methods of preventing both tax avoidance and tax evasion on transactions only leaving out other possibilities that might have caused taxpayers to avoid taxes. Moreover, the section was a target to business deals that the government had with other country or foreign companies and not on individual taxpayers since the country was a socialist country by then.

Furthermore, the movement of the Tanzanian economic system from 'ujamaa policy' (Socialism) to capitalist, economic integrations, trade with other countries and interaction with foreign taxpayers led to the

⁸⁷ *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA), 61 SATC 391.

⁸⁸ SARS, Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962) op cit (n52) 1.

enactment of the new general anti-avoidance rule to counteract to all arrangements designed to result into tax avoidance.

Conclusion

The discussion in this chapter has shown insight of tax avoidance and the anti- avoidance concepts, by discussing both concepts in detailed manner. A distinction on the concept of tax avoidance is made from tax evasion and tax planning that are usually referred to as the same. Needless to say, the concept of anti-avoidance was discussed in order to show its evolvement and its fundamental purpose towards tax administration.

CHAPTER THREE

INTERPRETATION OF THE GENERAL ANTI-AVOIDANCE SECTION

3.1 Introduction

Courts are vested with powers to interpret statutes. Although there are many approaches used such as the mischief, literal and golden rule approach,⁸⁹ Courts are to interpret tax laws on the language used and by looking at the intention of the Legislature when making the law.⁹⁰ In other words, Courts are to interpret tax statutes in their literal meaning.

Under this chapter, the discussion is on how Courts interpret the general anti-avoidance section of the South African Income Tax Act and the Tanzanian Income Tax Act by making a comparison between the sections.

3.2 Interpretation of the Section 80A and Section 35

When fighting tax avoidance practices, Courts have adopted a strict approach when interpreting the general anti-avoidance section of the South African Income Tax Act and the Tanzanian Income Tax Act that was adopted as a principle from the case of *Partington v Attorney-General*⁹¹ where Lord Cairns stated,

‘If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the law the case might otherwise appear to be. In other words, if there be an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.’

Furthermore,

‘The limit within which this principle is to operate remain to be probed and determined judicially. Difficult though, the task maybe for Judges, it is one is beyond the power of the blunt instrument of the legislation. Whatever a

⁸⁹ VCRAC Crabbe *Understanding Statutes* (1994) 81 to 82.

⁹⁰ Luoga *op cit* (n22) 25.

⁹¹ 21 LT 370.

statute ay provide, it has to be interpreted and applied by the courts, and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found.⁹²

It is clear that, when interpreting section 80A and section 35, the language used in Courts is the plain meaning (literal rule approach) as stated by Rowlatt J that,

'In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.'⁹³

3.3 Requirements for Interpreting Section 80A and Section 35.

Under the South African Income Tax Act, section 80A of the Act reads as follows:

80A Impermissible tax avoidance arrangements

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

- (a) in the context of business-
 - (i) it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or
 - (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;
- (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or
- (c) in any context-
 - (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
 - (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).

While section 35 of the Tanzanian Income Tax Act reads:

35.-(1) Notwithstanding anything in this Act, where the Commissioner is of the opinion that an arrangement is a tax avoidance arrangement, he may by notice in writing make such adjustments as regards a person's or persons' liability to tax (or lack thereof) as the Commissioner thinks appropriate to counteract any avoidance or reduction of liability to tax that might result if the adjustments were not made.

⁹² *Furniss (Inspector of Taxes) v Dawson and related appeals* [1984] 1 All ER 530 (HL).

⁹³ *Cape Brandy Syndicate v IRC* (1921) 1 KB 64.

(2) A notice issued under subsection (1) shall specify the arrangement and the adjustments.

(3) For the purposes of this section, “tax avoidance arrangement” means any arrangement -

(a) one of the main purposes of which is the avoidance or reduction of liability to tax of any person for any year of income;

(b) one of the main purposes of which is prevention or obstruction in collecting tax; or

(c) where the main benefit that might be expected to accrue from the arrangement in the three years following completion of the arrangement is -

(i) an avoidance or reduction of liability to tax of any person for any year of income; or

(ii) prevention or obstruction in collecting tax,

but excludes an arrangement where it may reasonably be considered that the arrangement would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.

From the above stated provisions, four requirements are to be fulfilled in determining the application of the general anti-avoidance rule.

That is:

- i) there must be an arrangement
- ii) with the sole or main purpose of obtaining tax benefit
- iii) there must be a tax benefit resulting from the arrangement
- iv) Abnormality, lack of commercial substance and abuse or misuse of the provisions of the Act.

3.3.1 An Arrangement

According to Lord Denning,

‘the word arrangement is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons, a plan arranged between themselves may not be enforceable at law.’⁹⁴

From Lord Denning’s discussion, an arrangement could simply be an understanding of a preparation in the future between parties which is not necessarily binding before the law.

⁹⁴ *Newton v FCT* [1958] 2 All ER 759 (PC).

Under the South African Income Tax Act, an arrangement is defined under section 80L to mean:

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

The section does not provide the meaning of the terms comprised in the word ‘arrangement’. Therefore, since an arrangement means a transaction, operation, scheme whether enforceable by the law or not, that includes steps in or part in the said transaction, operation and scheme, Courts have established principles on how these terms are to be construed.

3.3.1.1 Transaction, Operation and Scheme

It was held by Watermeyer J that, ‘the word ‘scheme’ is a wide term and...sufficiently wide to cover a series of transactions...’⁹⁵ an interpretation is approved by Corbett JA while acknowledging the fact that a scheme can be ‘...wide enough to cover situations in which later steps in a course of an action were left unresolved at the outset.’⁹⁶ It was also observed in the case of *Ovenstone v CIR*⁹⁷ that, in order for a transaction, operation and a scheme to constitute a tax avoidance arrangement, the same must be ‘entered into and carried out than being formulated.’⁹⁸

In addition, any arrangement that consists of an agreement or understanding, in order for it to be termed as a tax avoidance arrangement, it does not have to be enforceable by law as long as its steps or part of its creation was entered with the sole or main purpose of obtaining a tax benefit.

Furthermore, if it involves alienation of property by covering the property from high prevalence of property-related transaction by

⁹⁵ *Meyerowitz v CIR* 1963 (3) SA, 25 SATC 287.

⁹⁶ *CIR v Louw* 1983 (3) SA 551 (A), 45 SATC 113.

⁹⁷ 1980 (2) SA 721 (A), SATC 55.

⁹⁸ *Ibid.*

involving tax aggressive techniques, then the said arrangement will constitute a tax avoidance arrangement.⁹⁹

Meanwhile, the Tanzanian Income Tax Act defines an arrangement to include,

‘an action, agreement, course of conduct, dealing, promise, transaction, understanding or undertaking. Whether express or implied, whether or not enforceable by legal proceedings and whether unilateral or involving more than one person.’¹⁰⁰

It is clear that, the treatment of ‘an arrangement’ under section 80A is not different from section 35; although it was held that, ‘methods used in formulating an arrangement that are unknown to the Tanzanian Income Tax Act, do not mean that an arrangement is a tax avoidance arrangement.’¹⁰¹

3.3.2 With the Sole or Main Purpose

Purpose, whether sole or main is another fundamental requirement for an arrangement to constitute an impermissible tax avoidance arrangement as stipulated under section 80A of the South African Income Tax Act or an avoidance arrangement under section 35 of the Tanzanian Income Tax Act.

In determining an avoidance arrangement, the Commissioner ought to know and understand the purpose of the said arrangement in order to ascertain whether or not it is for obtaining a tax benefit.

Although the requirement of sole or main purpose is to be present in establishing a tax avoidance arrangement, it should be noted that, the requirement is a rebuttable presumption and the onus of proof lies on the taxpayer for the case of the South African Income tax Act as stipulated under section 80G (1) that:

‘An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light

⁹⁹ Draft Comprehensive Guide to the General Anti-Avoidance Rule at 14 to 15, available at <http://www.sars.gov.za>, accessed on 20 July 2014.

¹⁰⁰ Section 3 of the Income Tax Act 11 of 2004.

¹⁰¹ *Tanga Cement Company Limited v Commissioner General* [2007] 1TTLR 71 at 103.

of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement'¹⁰²

Whereas, the burden of proof lies on the Commissioner under the Tanzanian Income Tax Act to show that the taxpayer has an intention of obtaining a tax benefit in one way or another.¹⁰³

The terms 'sole' or 'main purpose' are not expressly defined under the South African Income Tax Act nor the Tanzanian Income Tax Act, but according to *Chambers 20th Century Dictionary*, the word sole is defined as 'alone, without' while purpose means 'idea or aim kept before the mind as the end effort' or 'a definite intention'.

In Courts, the two terms were held that, subject to the underlined presumption under section 80G of the South African Income Tax Act, where a taxpayer has more than one purpose, then the dominant one is to be taken into consideration that is, the one that aims at obtaining a tax benefit as stated in *CIR v King*¹⁰⁴ "...purpose' meant dominant purpose." The same was confirmed in the case of *CIR v Bobat*¹⁰⁵ where it was stated that, '...a main purpose is obviously one which must be dominant over any other...'

Under the Tanzanian Income Tax Act, the word 'main purpose' under section 35, has not been precisely defined but Courts will look at the commercial substance of the arrangement and its outcome thereto in ascertaining the main purpose as it was seen in the case of *Tanzania Leaf Tobacco Company Ltd v The Commissioner General*¹⁰⁶ where it was held that:

'...the test to be used in order to determine whether or not there is an arrangement for tax avoidance is whether or not the same terms of... could be extended to any other company to which... is not related. Otherwise, where...conditions which cannot be extended to any other company which is not associated... such a transaction amount to...scheme planned to avoid or reduce tax liability.'

¹⁰² The Income Tax Act 58 of 1962.

¹⁰³ Tanzania Revenue Authority, *Handbook on the Application of the Income Tax Act, 2004* 1ed (2009) 105.

¹⁰⁴ *CIR v King* supra (n39) at 206.

¹⁰⁵ [2005] 67 SATC 47.

¹⁰⁶ VAT Appeal no.60 of 2012 (unreported) 11 to 15.

This was after the Commissioner General of Tanzania Revenue Authority (TRA) refused to allow deductions on a loss of foreign exchange suffered by the Tanzania Leaf Tobacco Company Ltd on the grounds that there was a tax avoidance arrangement between the company and its associates companies.

It has been suggested that, in order for the Commissioner to be certain that the sole or main purpose of the avoidance arrangement was or is to obtain a tax benefit, the said 'purpose' is subject to determination¹⁰⁷ though, a precise way of how it is to be determined has not yet been given;¹⁰⁸ but rather, it has been established that, the test to be used in evaluating the purpose is more subjective than objective. Below are cases supporting the subjective and objective test.

In *SIR v Gallagher*,¹⁰⁹ Corbett JA while distinguishing subjective and objective test, stated that:

'...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.'

A decision that was confirmed in the case of *SIR v Geustyn, Forsyth and Joubert*¹¹⁰ by Ogilvie Thompson CJ on his third holding. Whereas an objective test was suggested in the case of *Newton v FCT*¹¹¹ and stated,

'the word purpose used in the context of an arrangement, regard must be had to the objective effect of the arrangement. Purpose in this sense means not intention, but the effect with which it sought to achieve the end accomplished or achieved.'¹¹²

It was later observed by SARS that, the purpose test required under section 80A is objective as opposed to the subjective, as it looks at

¹⁰⁷ AD Koker & RC Williams *Silke on South African Income Tax* (2012) Ch.19.38.

¹⁰⁸ Clegg & Stretch op cit (n84) Ch. 26.3.4.

¹⁰⁹ 1978 (2) SA 463 (A), 40 SATC 39 at 48 to 49.

¹¹⁰ 1971 (3) SA 567 (A), 33 SATC 113.

¹¹¹ *Newton v FCT* supra (n94).

¹¹² Ibid.

the arrangement itself rather than the intention of the taxpayer. It was stated:

‘...that when determining the sole or main purpose of the avoidance arrangement, regards must be had to the relevant facts and circumstances of the arrangement and not to the subjective purpose or intention of a participating taxpayer, either at the time the arrangement is entered into or subsequently. The purpose of a party may be taken into account as one of the relevant facts, but this will not be the determining factor in making such objective determination.’¹¹³

As for section 35(3)(a) of the Tanzanian Income Tax Act, the Courts uses both subjective and objective tests in determining the main purpose of an avoidance arrangement. The intention is not only evaluating the arrangement, but also the intention of the taxpayer. This approach was seen in the case of *Tanga Cement Company Limited v Commissioner General*¹¹⁴ after the Board established that the true intention of the taxpayer was to pay a tax burden of its immediate withholding company as a result of a contractual obligation that it entered into after concluding two agreements. It was after the Commissioner General raised an issue of the intended purpose of the net tax agreement for the purpose of enhancing production and economic powers to be a tax avoidance. This position is again found in the case of *Tanzania Leaf Tobacco Company Ltd v The Commissioner General*.¹¹⁵

3.3.3 There must be a Tax Benefit resulting from the Arrangement

For an arrangement to be an avoidance arrangement, its sole or main purpose must be to obtain a tax benefit.¹¹⁶

Tax benefit is defined under section 1 of the South African Income Tax Act to ‘include any avoidance, postponement or reduction of any

¹¹³ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 21.

¹¹⁴ *Tanga Cement Company Limited v Commissioner General* supra (n101) at 102 to 103.

¹¹⁵ *Tanzania Leaf Tobacco Company Ltd v The Commissioner General* supra (n106) at 13.

¹¹⁶ Section 80A of the Income Tax Act 58 of 1962 and Section 35 of the Income Tax Act 11 of 2004.

liability for tax,' where tax is also defined to mean '...tax or a penalty imposed in terms of this Act'¹¹⁷ or 'any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner.'¹¹⁸

The meaning of 'tax benefit' has been judicially explained under the South African tax Courts and the following is a synopsis of cases giving the meaning of tax benefit.

In *CIR v King*¹¹⁹ stated:

'a tax benefit occurs when there are transactions and operations which if a tax payer carries them out would have the effect of reducing the amount of his income to something less than it was in the past or freeing himself from taxation from some part of his future income.'

In *Smith v CIR*¹²⁰ it was stated, 'to avoid liability in this sense is to get out of the way of escape or prevent an anticipated liability, GAAR will find application when a taxpayer enters in to an anticipated liability which will result in a tax benefit.'

The Tanzanian Income Tax Act, does not have a provision that directly defines the term tax benefit but one can argue based on the section 35(3) that, the act of avoiding, reducing, preventing and obstructing the collection of tax by a taxpayer is a tax benefit.

Moreover, the provision goes further in categorising the period when the said 'tax benefit' can be acquired, that is to say, it can either be a short term benefit or long term benefit. It also empowers the Commissioner to look at the current year of income of the taxpayer on any future expectation, eg, where the Commissioner is of the opinion that, the arrangement is a tax avoidance arrangement with one of its main purposes being to obtain a tax benefit from either avoiding, reducing, preventing or obstructing the collection of tax in the future, the said arrangement will be termed as a tax avoidance

¹¹⁷ Section 1 of the Income Tax Act 58 of 1962.

¹¹⁸ Section 80L of the Income Tax Act 58 of 1962.

¹¹⁹ *CIR v King* supra (n39) at 191

¹²⁰ 1964 (1) SA 324 (A), 26 SATC 1 at 12.

arrangement with the aim of having a tax benefit even though it is in the future.¹²¹

Once the tax benefit requirement has been established by the Commissioner, the challenge arises on how the said tax benefit can be determined. Both the South African income Tax Act and the Tanzanian Income Tax Act do not expressly provide for how the Commissioner whose ‘onus of proof lies on him’¹²² to determine how tax benefit is arrived.

Koker¹²³ and Clegg¹²⁴ agree and suggest that, since there is no test to determine the existence of a tax benefit, the same can be determined by looking at the income which a taxpayer was expecting to accrue. One could with their assumption but the question is left for the Court to decide.

Indeed the Court came up with the ‘but for’¹²⁵ test and it was stated by Wunsh J that,

‘The taxpayer would have suffered tax but for the transaction...if the transaction in issue had not been entered into the taxpayer would not have acquired the property, it would not have earned the income and it would not have incurred the interest expenditure.’¹²⁶

The decision was also confirmed in the *Louw’s* case.

3.3.4 Abnormality, Lack of Commercial Substance and Abuse or Misuse of the Provisions of the Act.

Abnormality, lack of commercial substance and abuse or misuse of the provisions of the Act, are the last requirements needing to be proved in order to implement the general anti-avoidance section.

¹²¹ Section 35(3)(c)(i) and (ii) of the Income Tax Act 11 of 2004.

¹²² *ITC 1625* 59 SATC 383.

¹²³ Koker & William op cit (n107) Ch.19.37.

¹²⁴ Clegg & Stretch op cit (n84) Ch. 26.3.3.

¹²⁵ *ITC 1625* supra (n122).

¹²⁶ *Ibid.*

In order for the Commissioner to apply the general anti-avoidance rule, the South African Income Tax Act under section 80A(a) has categorised the above requirement into three forms, ie, in context of a business, in a context other than business and in any context.

3.3.4.1 In Context of a Business

Section 80A(a) stipulates that, where a business is entered into or carried out in a manner which would not normally be employed in a *bona fide* business or it lacks commercial substance, then the said business will be said to have been entered into or carried out with a sole or main purpose of obtaining a tax benefit.

In order for the above to be established, two elements must be ascertained, ie,

- i) business purpose and
- ii) lack commercial substance.

3.3.4.1.1 Business Purpose Test

Under business purpose test, the way the business is carried out and the manner upon which it was entered into, are the key factors in evaluating whether the business was designed obtain a tax benefit. The test is used to identify the manner on which a business is entered into or carried out, and not on whether the business lacks commercial purposes.¹²⁷ In other words, the focus is on the abnormality of the business arrangement and not the business itself.¹²⁸

The term 'business' is not defined under the South African Income Tax Act but, according to section 3 of the Tanzanian Income Tax Act, 'business' is defined to include;

- (a) a trade, concern in the nature of trade, manufacture, profession, vocation or isolated arrangement with a business character; and
- (b) a past, present or prospective business, but excludes employment and any activity that, having regard to its nature and the principal

¹²⁷ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 24.

¹²⁸ Ibid.

occupation of its owners or underlying owners, is not carried on with a view to deriving profits.

With the help of case laws, a guideline is provided on what constitutes a 'business' or 'carrying on a business' on South African perspective for the sake of establishing tax avoidance in the context of business.

It was held by Wessels J that,

'To constitute a business there must either be a definite intention at the first act to carry on similar acts from time to time if opportunity offers, or the acts must be done not twice but successively, with the intention of carrying it on, so long as it is thought desirable.'¹²⁹

Taking this case into account, it is clear that, the essence of applying the business purpose test is to see if taxpayer's arrangement is entered into or carried out in a manner that would not normally be employed in a *bona fide* purposes.¹³⁰

In Tanzania, section 35 of the Tanzanian Income Tax Act have generalised what is categorised in section 80A(a), (b) and (c) of the South African Income Tax Act. In its generalised approach, the Commissioner is left with the burden of proving that an arrangement is a tax avoidance arrangement by looking at the way it is entered into or carried out and if it creates abnormal rights and obligations between the parties.

It is my submission that, abnormality requirement in the context of business is determined on the nature of the business itself because section 35 'excludes normal commercial transactions which taxpayers legitimately take advantage of it'¹³¹ and on the principles of arm's length as it was considered by Hon.P.M Kente that,

'...the test to be used in order to determine whether or not there is an arrangement for tax avoidance is whether or not the same terms of... could be extended to any other company to which... is not related. Otherwise, where...conditions which cannot be extended to any other company which is

¹²⁹ *Modderfontein Deep Levels Ltd v Feinstein* 1920 TPD 288 at 23.

¹³⁰ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 25.

¹³¹ Tanzania Revenue Authority, *Handbook on the Application of the Income Tax Act, 2004* op cit (n103) 106.

not associated... such a transaction amount to...scheme planned to avoid or reduce tax liability.¹³²

3.3.4.1.2 Lack of commercial substance

Section 80C(1) and (2) of the South African Income Tax Act, provides for rules to be used on determining lack of commercial substance. According to the provision, a presumptive and indicative tests are rules to be proved by the Commissioner when arguing lack of commercial substance in the arrangement in question.

The presumptive test questions whether or not a business entered into or carried out lacks commercial substance; by looking at the significant tax benefit results on the taxpayer and not the significant effects on either the business risks or net cash flows from any effect attributable to the tax benefit that would be obtained.¹³³ In that situation, the Commissioner will identify lack of commercial substance if the following are present in the arrangement:

- 'A disproportionate relationship between the actual economic expenditure or loss incurred by a party and the value of the tax benefit that would have been obtained by that party but for the provisions of the GAAR; or
- A loss claimed for tax purpose that significantly exceeds any measurable reduction in that party's net worth.¹³⁴

Furthermore, the indicative test suggests that, lack of commercial substance will be present if,

- 'the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or
- the inclusion or presence of-
 - (i) round trip financing as described in section 80D; or
 - (ii) an accommodating or tax indifferent party as described in section 80E; or
 - (iii) elements that have the effect of offsetting or cancelling each other.¹³⁵

¹³² *Tanzania Leaf Tobacco Company Ltd v The Commissioner General* supra (n106) at 13.

¹³³ Section 80C(1) of the Income Tax Act 58 of 1962.

¹³⁴ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 26.

¹³⁵ Section 80C(2)(a) and (b) of the Income Tax Act 58 of 1962.

Although section 80C outline the rules to be followed when determining lack of commercial substance, it is important to understand the Court established principle of substance over form that was introduced to determine the true nature of an arrangement for the purposes of establishing whether or not it was designed for tax benefit purposes thus an avoidance arrangement.¹³⁶

The principle or doctrine of substance over form was introduced by Courts to hit tax avoidance arrangements. According to the principle, Courts are required to look on the substance of a transaction rather than its form.¹³⁷ By looking at the substance, a true nature of a transaction could be determined.

It also elucidate that, where Courts noted any difference between the substance and legal form of a transaction, effect of legal substances is to be given to a transaction. And by legal substance, it means, a transaction is a disguised and dishonest transaction with the intention of concealing the real agreement between parties that was not necessarily created for tax avoidance purposes¹³⁸ but regarded as one if,

‘Parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subjected to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such transaction is said to be *in fraudem legis*, and is interpreted by the Courts in accordance with what is found to be the real agreement or transaction between the parties.’¹³⁹

The *Randles’* case outlined the difference between a simulated (sham) transaction and an impermissible transaction. From the case, the difference is drawn where ‘a transaction falling within the prohibitory or taxing provision of a statute but disguised to make it appear as if it does not...’¹⁴⁰ thus *in fraudem legis*. Therefore, legal substance is

¹³⁶ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 4.

¹³⁷ Ibid.

¹³⁸ *CCE v Randles Bro & Hudson Ltd* 1941 AD 369, 33 SATC 48 at 394.

¹³⁹ *CCE v Randles Bros & Hudson Ltd* supra (n138).

¹⁴⁰ *CCE v Randles Bros & Hudson Ltd* supra (n138) at 396.

used by Courts to identify a transaction that is simulated by giving it effect to what it really intend.

It is clear that, *Randles*' case used a subjective test to identify the legal substance of an arrangement that made it difficult for the Commissioner to argue that the true nature of the transaction was to avoid tax. Up until *CSARS v NWK Ltd*¹⁴¹ a new principle was formulated to determine whether the substance of an arrangement correlates with its legal form.

According to the *NWK* case, the principle of substance over form could not simply be whether there was an intention to give effect to an arrangement between parties but, there must be a commercial reason. In her judgment, Lewis JA stated that,

‘...the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that follows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.’¹⁴²

From the above cited case, a new principle is introduced to demonstrate lack of commercial reason on a taxpayers' transaction. Although the decision of the case have created confusion (to be discussed more in chapter 4) in interpreting section 80A, it has also increased the ability of the Commissioner to attack arrangements in terms of substance over form.

In identifying lack of commercial substance, section 35 concentrates on the business purpose that examines the true intention of entering into or carrying out a transaction. Where it is certain to the Commissioner that a transaction lacks commercial substance or being a sham, the same will be regarded as having no legal effect

¹⁴¹ [2011] (2) SA 67 (SCA), 73 SATC 55.

¹⁴² *CSARS v NWK Ltd* supra (n141) at 55.

thus being void.¹⁴³ Although there is no provision under the law that discusses the outcome of the law regarding simulated transaction, the discretion is vested upon the Commissioner to regard a sham or simulated transaction as void.¹⁴⁴

3.3.4.2 In a Context other than Business

Reference is provided under the context of business.

3.3.4.3 In any Context

A tax avoidance arrangement may occur in any other context if,

- (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
- (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).¹⁴⁵

The tests to be used under this aspect are tests of abnormal rights and conditions. Under these tests, an arrangement is evaluated on the rights and conditions that it provides for the parties thereto in relation to the concept of arm's length. It was stated by SARS that, the test 'is a factual inquiry, considered against only hypothetical normal transaction'¹⁴⁶ while the concept of arm's length was discussed in *Hicklin v SIR*¹⁴⁷ and was stated:

'For 'dealing at arm's length' is useful and often easily determinable premise from which to start the inquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself...Hence, in an at arm's length agreement the right and obligations it created are more likely to be regarded as normal than abnormal...'

¹⁴³ Tanzania Revenue Authority, *Handbook on the Application of Income Tax Act, 2004* op cit (n103) 106.

¹⁴⁴ Ibid.

¹⁴⁵ Section 80A(c) of the Income Tax Act 58 of 1962.

¹⁴⁶ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 37.

¹⁴⁷ 1980 (1) SA 481 (A); 41 SATC 179 at 195.

3.3.5 Abuse or Misuse of the Provision of the Act

In general, the intersection of the provision of not abusing or misusing the provisions of the Act, is with the aim of protecting both the South African Income Tax Act and the Tanzanian Income Tax Act. Though as for the case of the Tanzanian Income Tax Act, the Act will 'exclude normal commercial transactions which taxpayers legitimately take advantage of.'¹⁴⁸

¹⁴⁸ Ibid.

CHAPTER FOUR

General Conclusion and Recommendations

The purpose of the study was to make a comparative study of the general anti-avoidance provisions of two different tax jurisdictions, South Africa and Tanzania, and how the two provisions are interpreted by Courts. The two provisions that were compared were section 80A of the South African Income Tax Act and section 35 of the Tanzanian Income Tax Act. In the course of the comparison, the following observations were made.

4.1 Similarities:

The focus of the study was on the general anti-avoidance rule. In order to understand the provisions of these two sections, it is very important to recapitulate upon the reasons why the two provisions were introduced under their tax laws and how the Court interprets the two sections.

Both of the provisions seek to fight against tax avoidance practices of taxpayers that are a problem not only to the government but also to society in general. On the government side, they reduce government revenue by causing losses which result in taxpayers either reducing the amount of tax payable or having no liability at all. And for society, they create a gap between the rich, middle class and the poor by shifting the burden mostly to the middle class and the poor while demoralising the spirit of taxpaying community.

In interpreting section 80A and section 35, Courts have been using the approach of plain meaning (literal rule) in order to divine the true intention of the Legislature when making the rule. As it was stated in *Vesteys's Executors v IRC*¹⁴⁹ where Lord Normand stated:

¹⁴⁹ [1949] All ER 1108 (HL).

‘Parliament in its attempts to keep pace with the ingenuity devoted to tax avoidance may fall short of its purpose. That is a misfortune for the taxpayers who do not try to avoid their share of the burden and it is disappointing to the Inland Revenue. But the Court will not stretch the terms of taxing Acts in order to impose on the efforts of parliament and to stop gaps which are left open by statutes. Tax avoidance is an evil, but it would be the beginning of much greater evil if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.’

Therefore, the rules of interpreting the two provisions are the same.

Turning to the issue of tax benefit, both sections treat the issue similarly, that, for an arrangement to be termed as a tax avoidance arrangement or an impermissible tax avoidance arrangement, its sole, or one of its main purposes must be, to obtain a tax benefit and even where it not expected on the current year of income but in the future. The difference is that, section 35 went further in giving the exact limit of time that the benefit can be anticipated in future.

4.2 Differences:

Although the provisions address the same issues (prohibiting tax avoidance activities), the construction of the same is slightly different on the overview when interpreting the wording of the two sections.

1. Overview of the sections.

Section 35 has a general and narrow scope of application as compared to section 80A which is categorical and extensive in terms of applying the general anti-avoidance rule and thus, makes it easier for implementation. Section 35 therefore, falls short in covering the entire application of the general anti-avoidance rule which apparently is its limiting factor.

2. Construing of the word ‘arrangement’.

Under section 35, the definition of the word ‘arrangement’ is exhaustive as compared to the way it has been defined under section 80A. This gives a clear outset on how an arrangement should be defined under the Tanzanian Income Tax Act.

3. Sole or Main purpose test.

In determining the 'sole or main purpose' of a presumed tax avoidance arrangement, section 80A requires a subjective test to be used rather than an objective test. From the subjective test, Courts will concentrate on analysing taxpayer's intention when entering into or carrying out the said arrangement in order to ascertain the 'sole or main purpose' requirement.

This poses a danger on implementation of the general anti-avoidance in a way that, taxpayers can easily exonerate themselves by claiming to have no intention of acquiring a tax benefit from their transaction, operation or schemes making the benefit therefrom to be incidental.

Although there is some debate that the test for 'sole or main purpose' ought to be objective, section 80A has not yet given a clear path because its yet to be tested before the Court. According to SARS,¹⁵⁰ the test to be used should be an objective test as it focuses on the arrangement itself and the reason for its existence.

Section 35 requires the test to be both subjective and objective, when interpreting the provision. Courts will not only look at the intention of the taxpayer, but also the intention of creating the arrangement itself in order to ascertain the true purpose of the arrangement because some arrangement may result in taxpayers taking advantage of the law.

4. Onus of proof.

Section 35 of the Tanzanian Income Tax Act, requires the Commissioner to prove not only the existence of a tax avoidance arrangement, but that the arrangement falls under the requirements of the provision while with section 80A together with section 80L of the South African Income Tax Act, the onus lies on the taxpayer.

¹⁵⁰ Draft Comprehensive Guide to the General Anti-Avoidance Rule op cit (n99) 21.

5.0 General Conclusion

Based on the general study, the comparison was on the interpretation and application of section 80A of the South African Income Tax Act and section 35 of the Tanzanian Income Tax Act. Many factors were taken into consideration when conducting the study, eg the level of economic development between the two countries, the time when the two provisions were introduced etc.

Despite the significant differences, section 80A has shown to have a wide application in fighting tax avoidance arrangements as compared to section 35 as it leaves less chance for creation of tax avoidance arrangements. Additionally, it is designed in way that enables tax administrators to easily identify an arrangement designed for the purpose of either avoiding taxes or misusing or abusing of the Act.

Although the design of section 80A is superior to section 35, it is a complex provision that is difficult to apply in real practice. The complexity of the section has led to uncertainty in determining the interpretation of key requirements of what is or might constitute a tax avoidance arrangement. For example, when determining the purpose of an avoidance arrangement, Courts still debate on whether a subjective test or objective test should be used. Is because the section has not been tested and the principles that Courts follows on determining a tax avoidance arrangement were established under the old anti-avoidance sections?

Similarly, although the new rule on substance over form in ascertaining commercial substance introduced in the *NWK* case, has made it easy for the Commissioner to attack any simulated transaction, the rule have created confusion on interpreting section 80A thus making the section more complicated also has contravene SARS practice on treatment of legitimate tax avoidance arrangements;¹⁵¹ eg,

¹⁵¹ E Broomberg 'NWK and Founders Hill' (2011) 60 *Taxpayer Journal* 199.

- The words ‘avoidance’ and ‘evasion’ were used interchangeably. The Court did not differentiate between tax avoidance for tax evasion or giving a reason as to why it used the term evasion when identifying a simulated transaction.¹⁵²
- The fact that an objective test was introduced that examines the commercial sense of a transaction, does that mean, any transaction without commercial purpose is or will be regarded as a simulated transaction? As the Courts will ignore the rights and obligations created by parties in a genuine transaction.¹⁵³

In general, section 80A also needs redrafting in order to remove its complexity.

Nevertheless, regardless of its complexity, section 80A stands to be clearer and more comprehensive as it leaves little room for tax avoidance arrangements.

Needless to say, although section 35 is suitable for the Tanzanian tax jurisdiction, more changes are required on the provision. It is recommended by the researcher that, since the provision still leaves some loopholes on the GAAR, the following are recommended:

- There is a need of redrafting the section by categorising situation where tax avoidance might occur like who section 80A is designed. It is in opinion that, the provision concentrates more on the occurrence of tax avoidance on a business level leaving out the fact that it can occur outside a business scope. A good example is shown under section 80A.
- Subsection 3(c) of section 35 provides for the period upon which tax benefit is expected to be accrued. According to the provision, an arrangement is a tax avoidance arrangement if

¹⁵² Broomberg op cit (n151)198.

¹⁵³ Broomberg op cit (n151) 199.

tax benefit is expected to be accrued in three years after its completion. A question comes, does that mean, an arrangement that is expected to obtain tax benefit within the period of either less or more than three years will not be a tax avoidance arrangement? If not, then what is the true intention of the subsection? Because it is likely for the taxpayers to use the uncertainty and create arrangements that would not fall under that requirement of the provision.

- Although it is imperative to use the doctrine of substance over form on identifying a simulate (sham) transaction because taxpayers enters into arrangements that do not convey their true agreement therefore leading to tax avoidance, TRA are to be careful on the application of the doctrine because it is easy to create a legal façade.

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