

TAX PLANNING IN THE LIGHT OF TAX AVOIDANCE
PROVISIONS IN THE SOUTH AFRICAN INCOME TAX ACT:
SECTION 103 - AS AMENDED IN THE INCOME TAX ACT NO
36 OF 1996

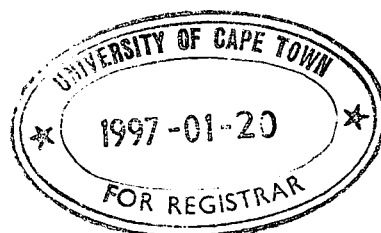
“Research dissertation presented for the approval of Senate in fulfillment of part of the requirements for the degree of Master of Laws in approved courses and a minor dissertation. The other part of the requirement for this degree was the completion of a programme of courses.”

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**THIS PIECE OF WORK IS DEDICATED TO MY DEAR PARENTS
EUGINIE AND PRINCE LETETE AND TO ALL THE MEMBERS OF
THE LETETE FAMILY WHO INSPIRED AND SUPPORTED ME TO
THE END OF THIS RESEARCH PAPER.**

PART ONE

1. INTRODUCTION

"Anybody has a right to evade taxes if he can get away with it. No citizen has a moral obligation to assist in maintaining the Government." -J. Pierpont Morgan.

"Taxation is the price we pay for civilisation." - Oliver Wendell Holmes.

"Tax is a matter of law not of morality,..." - Divaris

The first question that comes to one's mind, in dealing with question of tax planning and tax avoidance is, what is tax planning? What is its significance in the economy of each particular country? How does it affect every taxpayer and what consequences does it have for the Receiver of Revenue? Every country has got its own system of taxation, depending on the prevailing socio-economic factors. For example, one would not expect that the system of tax existing in the Republic of South Africa would be similar to the one existing in the Kingdom of Lesotho. This difference is brought by the fact that South Africa is a bigger country, with a larger economy. Therefore, the system of tax would be more complex than the one existing in Lesotho. However, one is not suggesting that the size of the country is the determining factor. The determining factor might be related to the economy of each country.

What is tax? Tax can be viewed as a contribution of every subject of state towards the economic support of the government, in proportion to their income. Taxation therefore, is the system of taxing. Emslie, in referring to tax in general says,

*"...tax is an everyday reality of life and there is scarcely an economic act devoid of tax consequences....fiscal policy has a critical impact on the political economy of any country, and plainly there are many variables to be taken into account when it comes to the pursuit of an efficient, equitable and politically acceptable system of taxation."*¹

Tax law, on the other hand has been viewed as, "a body of rules under which the public authority has a claim on taxpayers requiring them to transfer to the public authority part of their income or their property." In general, tax law is concerned only with the legal aspects of taxation, not with its financial, economic or other aspects.²

The present paper attempts to examine the notion of tax planning in the light of the amended anti-avoidance provisions in the South African Income Tax Act, that, is. section 103 of Act 36 of 1996. The discussion will focus on the South African anti-avoidance provisions, however, comparisons will be drawn from other jurisdictions, such as the United Kingdom and Australia. This problem will be looked at from different perspectives, thus, from the taxpayer's point of view and from the point of view of the Receiver of Revenue. The other argument that will also be pursued is that tax avoidance as long as it is well planned and done within the law is a legitimate exercise, whereas on the other hand it can impinge on the fiscus and the economy of a country.

Every person has a right to reduce his tax burden as long as that is done in a legal and reasonable manner. However, the receiver of revenue will try as much as possible to bring a taxpayer within the ambits of the law to be liable to pay tax. What is tax planning? Tax planning being a day to day phenomenon to every taxpayer who wants to reduce his tax liability, has been defined by Spitz as thus;

*"[T]ax planning is the process of taking into consideration all relevant tax factors, in the light of the material non-tax factors, for the purpose of determining: whether; and if so-when; how; and with whom, to enter into and conduct transactions, operations and relationships, with the object of keeping the tax burden falling on taxable events and persons as low as possible while attaining the desired business and other objectives."*³

Mitchell, on the other hand, sets out the objectives of tax planning, which might help to clarify what this concept means:

*"-[T]he accurate assessment by the taxpayer of his or her present and future liability to tax,
-[T]he development of an ability on the part of the taxpayer in appropriate circumstances to challenge the tax collector's assessment of his or her present or past liability to tax,
-[T]he minimisation - by legal means - by the taxpayer of his or her future tax liability,
-[T]he certainty that any particular transaction will not give rise to unnecessary taxation."*⁴

Tax planning merely helps one to plan in advance and anticipate the outcome of taxation on his or her cash resources. Therefore, tax planning might result in tax avoidance. This will be to the benefit of the taxpayer and to the prejudice of the receiver of revenue, who always wants to collect as much tax as possible.

Tax avoidance, on the other hand, presupposes legal means, but for some special provision contained in the Act, employed by a taxpayer to reduce or avoid his tax liability. This however, should be within reasonable limits. Tax avoidance should be contrasted with tax evasion, which refers to all illegal acts employed by the taxpayer to reduce his tax liability. These include, rendering false returns, false books and accounts and sham transactions. It has been stated that no person is under any obligation legally or morally, so to arrange his affairs as to pay the largest possible amount of tax.

Tax by itself is an important phenomenon, as the budget of each state depends on what the taxpayer contributes in the form of tax. Adam Smith formulated four maxims with regard to taxes in general: Firstly, he said,

“the subjects of every state ought to contribute towards the support of the government as nearly as possible, in proportion to their respective abilities. Secondly, the tax which each individual is bound to pay ought to be certain, and not arbitrary. Thirdly, every tax ought to be levied at the time, or in a manner in which it is most likely to be convenient for a contributor to pay it; and lastly, every tax ought to be so contrived as to both take out, and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.”⁵

It is upon the State, one would believe to conscientise the people about the whole spectrum of tax, so as to develop the society which is willing to pay tax as opposed to avoiding tax.

This paper is divided into Five Parts. Part 1 is the Introduction. Part 2 introduces the notion of tax planning in general and its effects both to the taxpayer and to the receiver of tax. Part 3 focuses on the concept of tax avoidance and tax evasion, the relationship of tax-avoidance with morality and public attitude towards tax-avoidance. Part 4 deals with the anti-tax avoidance provisions embodied in the amended Income

Tax Act No.58 of 1962 and the new Act No. 36 of 1996 of South Africa. The implications of Section 103, therefore are discussed prior to its amendment and after the amendment in July, 1996. Examples from other jurisdictions will be drawn for purposes of comparison.

Lastly, Part 5 is the conclusion whereby the previous discussions and arguments will be brought together to round up the problems which can be brought about by tax avoidance and in particular the problems related to section 103 of the Act. Moreover, suggestions on prospects of reform in future to the Legislation for the benefit of both the taxpayer and the receiver of tax will be made.

PART TWO

2. TAX PLANNING

*"It is both lawful and sensible to arrange business and personal affairs in such a way as to attract the lowest possible incidence of tax. The widening scope of tax laws, the complexity of their provisions and high tax rates make it more necessary than ever for business enterprises and individuals alike to plan their taxable events with considerable care."*⁶

Tax planning basically, is the process of arranging and planning one's tax liabilities, in in order to reduce such liabilities. A good tax planning, done well in advance results into less tax payment. The taxpayer is usually on the outlook to watch whatever, loopholes are imminent in the Income Tax legislation, as to reduce his tax burden. As already shown above, tax planning has been defined as the process of taking into consideration all relevant tax factors for the purpose of determining how to enter conduct transactions with the object of keeping the tax burden as low as possible.⁷

On the other hand, the Collector, usually termed the Commissioner of Income Tax always wants to deduct as much tax as possible from the taxpayer. The Commissioner will try all means to bring the taxpayer within the ambits of the law, in order to collect as much revenue as possible. Tax planning no doubt can lead to tax avoidance, which is what the Commissioner disapproves. It is clear, therefore, that it

is not only by illegal evasion that much revenue is lost to the fiscus. Moreover, a good tax planning requires knowledge of the tax law and specifically the entire provisions of the Income Tax legislation. Some commentators, on developments in taxation in South Africa wrote the following about tax planning;

*"Tax planning in any event encompasses much more than the avoidance or reduction of liability. This point is worth some elaboration, since the full parameters of tax planning are seldom appreciated. Not every 'user' or applier of tax planning will be interested in the full range of tax planning, but, somewhere, there will be an application for every one of its facets."*⁸

There is no doubt that tax planning starts with a knowledge of the tax law. Even tax lawyers do still experience problems with tax planning, as the Legislature always comes to the rescue of the Commissioner by closing loopholes of the planned tax strategy. To understand what is tax planning, the starting point should be to examine the various aspects of tax planning as enunciated by Divaris and Stein in Tax Planning;

*"Tax planning establishes liability for tax. It draws up a cash flow for the projected incurring and settlement of that liability. It assesses risks: the risk of misunderstanding the law;.... It accommodates not only the law but also the peculiarities of the practical administration of that law. It attempts to minimise liability. It informs decisions with a knowledge of their tax consequences. It plays a role in any bargaining between independent parties. It attempts to predict the likely development of tax law. It demands a development of tax law. It demands a say in or at least an opportunity to criticise or comment upon that development. It assesses the social / economic / political roots, significance, thrust and impact of tax. It mobilises political and quasi-political forces. It places taxation in perspective in national affairs. And it ponders upon the underlying philosophical basis of tax."*⁹

The above captured features of tax planning exhausts almost all facets of tax planning. Tax planning is a broad phenomenon and complicated. If done in a brilliant way as not to offend or attract the attention of the Revenue, it can reduce the taxpayer's liability to tax. It seems that even in other jurisdictions, tax planning is regarded as necessary as long as it does not result into tax evasion. For example, looking at the English legal system and the attitude towards tax planning, the position becomes apparent.

In the case of Leverne V IRC Viscount Summer stated:

*"It is trite 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

Similarly, Lord President Clyde in Pullman Motor Services and DM Ritchie V IRC stated:

*"No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow - and quite rightly -- 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."*¹¹

Furthermore, Lord Tomlin in the most famous case of Duke of Westminster V IRC said the following in regard to tax planning:

*"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

Although these three dicta arose in English law, the principles arising therefrom have been accepted in South African law. These principles basically are that; firstly, there is no obligation on the taxpayer to pay greater tax than is legally due and secondly, that a taxpayer is not debarred from entering into a bona fide transaction which has the effect of ensuring a tax liability does not arise.

An important task of planning is to warn taxpayers against illegal or vulnerable schemes and discourage their wider dispersion.¹³ Moreover, another task of tax planning is to determine exactly what the law as laid down by the authorities themselves actually says. Tax planning in any event encompasses much more than the avoidance or reduction of liability.

PART THREE

3. TAX AVOIDANCE AND TAX EVASION

Tax avoidance must be distinguished from tax evasion. Tax avoidance is a legal means to reduce one's liability to pay tax to the Revenue, whereas on the other hand tax evasion involves a defrauding of the Fiscus. Tax evasion consists of acts such as rendering false statements, concealing income and like. This action is a criminal offence and bears a penalty of either a fine or imprisonment or both, under the provisions of the Income Tax Act. CIR V Da Costa,¹⁴ is an example of cases of tax evasion and where the Court imposed a fine. In this case, the taxpayer, a semi-literate immigrant cafe owner, had entrusted the bookkeeping of his business and the handling of his tax affairs to an apparently reputable firm of accountants who had employed a "short-cut" method of bookkeeping which drastically reduced the true revenue of the business, resulting in the income being understated in his income tax returns. It was accepted by the Commissioner that no intention to deceive could be imputed to the taxpayer and that these facts constituted extenuating circumstances, but he took the view that the respondent should be penalised for the deceit of his agents. The Commissioner in terms of s76 imposed a penalty, which was reduced by the Special Court to R3 000. The decision of the Special Court was upheld by the Appellate Division.

Tax evasion should, therefore, be contrasted with tax avoidance which legitimate, and it is recognised as such in various jurisdictions. For example, in the United States of America, the principle was eloquently and forcefully expressed by Hand J in Helvering V Gregory when he said;

"[Every taxpayer is entitled to] arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury."¹⁵

The taxpayer is entitled to take advantage of the so-called "loopholes" in the Income Tax legislation in order to reduce or avoid the liability to pay tax. As the dictum by Lord Cairns, in Partington V Attorney General goes,

“[A]s I understand the principle of all fiscal legislation, it is this: 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 letters of the law, the subject is free, however apparently within the law the construction might appear to be, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.”¹⁶

Decided cases have laid down that the taxpayer is entitled to arrange his affairs so that he pays least amount of tax. However, according to Matuson and teGroen,

“ [A]t the same time, the Receiver’s responsibility is to collect sufficient revenue to finance the nation’s expenditure. If tax avoidance practices subvert this object, it is natural that steps must be taken to counter the position.”¹⁷

The basis of tax is to make sure that every citizen contributes so much to the development of his country from which he earns the resources. The collected tax is used by the Receiver to finance public services, such as health services, schools, to build roads, to mention a few. Therefore, it is in the national interest that people who are capable of being taxed, should indeed be taxed.

It is a fundamental principle of taxation that the burden of income tax should be spread as fairly and equitably as possible among all the taxpayers. In this respect one must keep in mind that important maxim of Adam Smith in his famous work *Wealth of Nations*:

“[T]he subjects of every state ought to contribute towards the supports of the Government, as nearly as possible, in proportion to their respective abilities; that is in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation, is like the expense of management to the joint tenants of a great estate, who are all obliged, to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation....”¹⁸

The principle that ‘every man is entitled if he can to order his affairs so as to diminish the burden of tax’, has got some limitations, set-up by the law and judicial precedents. Enunciating the same view, Lord Scarman in Furniss V Dawson says,

“The limits within which this principle is to operate remain to be probed and determined judicially. Difficult though the task may be for judges, it is one is beyond the power of the blunt instrument of legislation. Whatever a

statute may 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."¹⁹

It is clear therefore, that courts do not approve of tax avoidance regardless how perfectly it is done within the law. There are a number of dicta which illustrate the apparent disapproval by the courts of this practice of tax avoidance. This disapproval is well illustrated in the following quote by Lord Normand in the House of Lords in the English case of Vesteys's (Lord) Executors & Another V Inland Revenue Commissioners:

*"[P]arliament 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 improve on the efforts of Parliament and to stop gaps which are left open by the statutes. Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved."*²⁰

In the Rhodesian case of COT V Ferera Macdonald JP agreed with the opinion of Lord Normand as far as tax avoidance was concerned. After quoting the extract of Lord Normand above, Macdonald JP went on to say:

*"I endorse the opinion expressed that the avoidance of tax is 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 taxpayers 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 arguments that it is only the rich, the astute and the ingenious who prosper in it and that 'good citizens' will always fare badly."*²¹

Fair enough, poor people or middle - earning citizens are mostly not exposed to the opportunities of engaging the services of tax lawyers or accountants to assist in the tax planning. Therefore, they would not have the opportunity to know about the loopholes in the Income Tax legislation, which they could utilise to curb their tax liability. If on the other hand, people could have a 'substantial amount' of income, no one would ever even think of mitigating tax liability.

The courts have gone further and made a distinction between tax mitigation and tax avoidance. In the New Zealand case of CIR V Challenge Corporation Ltd, which dealt with the interpretation of s.99 of their Income Tax Act 1976, (which is their anti-avoidance provision) Lord Templeman, in delivering his judgement to the courts, said the following: “[T]he material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the often quoted words of Lord Tomlin in CIR V Duke of Westminster [1936] AC 1 : the distinction between tax mitigation and tax avoidance was neither considered or applied.”²²

Lord Templeman then went on to draw the necessary distinction, between tax mitigation and tax avoidance, saying that income tax is mitigated where a taxpayer reduces his income or incurs expenditure in circumstances which reduce his assessable income or which entitle him to a reduction in his tax liability, while income tax is avoided and a tax advantage derived where an arrangement by the taxpayer reduces his liability to tax avoidance which entitles him to the necessary reduction. The taxpayer ‘s engagement in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.

It is clear from the above discussion that, courts are very strict on the concept of tax avoidance. It would seem that the courts are now adopting the strict interpretation of the provisions on tax avoidance. The Courts seem to playing the role of the Legislature, instead of just interpreting the words of the statute as they are. This will therefore, lead taxpayers more into practices of tax evasion.

Furthermore, courts could be justified to stretch the provisions so far, because once taxpayers’ are left to exercise their discretion on tax avoidance, the fiscus will indeed suffer a lot. Therefore, English courts have prescribed a level of tolerance beyond which taxpayers may not venture in their efforts to reduce tax. This is evident in the

following passage from Lord Goff of Chiveley in Ensign Tankers Ltd V Stokes (Inspector of Taxes) where he emphatically said,

“Like my noble and learned friend Lord Templeman I approach this case on the basis that there is a fundamental difference between tax mitigation and unacceptable tax avoidance. Examples of the former have been given in the speech of my noble and learned friend. There are cases in which the taxpayer takes advantage of the law to plan his affairs so as to minimise the incidence of tax. Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it maybe, which otherwise would never have existed. These structures are designed to achieve an adventitious tax benefit for the taxpayer, but in truth are no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable.”²³

The above mentioned cases have been accepted in South African law and have been cited by the courts in the following cases: CIR V Estate Kohler and Hicklin V CIR, which will be dealt with in detail later in the discussion.

3.1: TAX, MORALITY AND PUBLIC ATTITUDE

“Tax avoiders are bad citizens, their critics allege. They are dodging the column, taking a free ride, pushing the burden onto their fellows. They get up to all manner of tricks, and the tax authorities need a hundred eyes to defend the public purse from their depredations. Indeed, the avoiders are generally one jump ahead of the game, so that the authorities need extensive or even unlimited powers in order to check abuse.”²⁴

Moreover, this paper examines briefly the impact of tax on the public and how people view the whole notion of tax. The above captured quotation, shows how some people have reacted to the whole notion of tax avoidance. As mentioned earlier, it is a fundamental principle of taxation that the burden of income tax should be spread as fairly and equitable as possible among all the taxpayers. In this way every citizen has a duty to contribute towards the support of their Government in proportion to their abilities and income. It is clear therefore, that if a person does not have any income, he cannot be expected to pay any tax. However, the Legislature is against the taxpayer who engages in schemes which will divert income not to accrue which would have under normal circumstances accrued to him. On the other hand the

Revenue would not be able to attack the taxpayer who arranges his affairs in such a way that no income accrues to him at all.

Tax avoidance, therefore, should not be looked only from the statutory point of view, but also from the morality point of view. While trying to utilise the provisions of the statute to tax an individual, the moral obligation that every citizen should fulfil his obligation of paying tax. Silke, is of the opinion that,

*"if the tax laws are such that certain taxpayers are free to arrange their affairs and reduce their fiscal obligations, they secure an unfair advantage over other taxpayers who are not in a position to take advantage of the 'loopholes'."*²⁵

Some Tax commentators on the moral aspect of tax avoidance have expressed their view in the following manner;

*"...the undelying assumption of those who call tax avoidance (not tax evasion) an evil is that there is some norm or other representing a taxpayers's fair share of, or proper contribution towards, tax. The truth of the matter is that there is no such norm. A fair shar or proper contribution is what the taxing statute says it is. No more, no less. And tax avoidance cannot occur except in the circumstances there cannot be tax avoidance in the legal sense and that is the only sense that can be applied in the court."*²⁶

It has been argued that as far as legal avoidance is concerned, morality should not enter the picture. Lord Houghton sharing similar sentiments said the following:

*"Taxation has no more to do with morals than the Rating and Valuation Act, or the Community Land Act, or even the dog licence. Taxation is an act of Parliament, not an act of God. It is what Parliament says it should be, no more and no less. Not only has taxation no morals, it may not even claim to be fair. While we all have a public duty to comply with the law..., this does not extend to complying with the 'spirit' of the law, still less the supposed 'intentions of Parliament'. The law is what the Act says, or, in case of doubt, what the Courts construe its words to mean."*²⁷

There is no doubt that a lot of revenue is lost to the fiscus not only by illegal evasion of tax but also through the legal tax avoidance. However, as long the Revenue fails to bring the taxpayer within the limits of the law to be able to collect as much revenue as possible, then the taxpayer is a free man.

According to Silke, if the tax laws are such that certain taxpayers are free to arrange their affairs and reduce their fiscal obligations, they secure an unfair advantage over other taxpayers who are not in a position to take advantage of the 'loopholes'.²⁸ The most controversial issue as far as tax avoidance is concerned, is whether failure by other taxpayers to pay tax, shifts the burden to other good citizens who pay tax? There have been conflicting views as far as this aspect is concerned: One view is that the rich tax avoider, like the illegal tax avoider, shifts his burden on to the shoulders of others and frequently poorer taxpayers.²⁹ Another view is that it is not self-evident that the avoider is harming his fellows. There is no doubt that tax avoidance shifts the burden of tax to other taxpayers. Since tax is used by the fiscus to finance the Governments' expenditure, regardless of whether one taxpayer has not paid tax, the Revenue will make sure that he collects the amount already anticipated and required for the Governments' expenditure.

Some writers are so much opposed to tax avoidance, and have said thus:

*"There is no doubt that a system of taxation, the effect of which is that a taxpayer pays more or less tax than his fellow-countryman, according to his knowledge of loopholes in the law or the skill of his adviser or the dictates of his conscience, is bad and requires reform."*³⁰

One is inclined to submit that the above view is too harsh against the legislature. It is impossible to enact a legislation which will be succeed to close down all the loopholes which taxpayers take advantage of. There is indeed nobody who wants to pay high taxes, if there is a legal way to escape such liability.

From the above discussion, it is clear that it is the duty of every citizen to pay tax, but on the other hand the Revenue should be reasonable enough to impose a minimum tax liability upon the taxpayer, so that the taxpayer should not be tempted to engage in tax avoidance schemes. This will also enable the Revenue to collect more tax rather than having to deal with tax avoiders.

PART FOUR

4. TAX-AVOIDANCE IN SOUTH AFRICA:

The position in South Africa as far as tax-avoidance is concerned, is that the legislature has interfered by enacting both specific and general anti-avoidance provisions in the South African Income Tax Act No.58 of 1962, which has been amended several times. The general anti-avoidance provision, section 103, was amended in July 1996. The operating legislation in South Africa at present is the Income Tax Act 36 of 1996. Therefore, for purposes of this paper, the discussion will encompass both the old version and the new version of section 103.

Under South African legal system the true definition of tax avoidance was, given in CIR V King, namely,

*"where a man for the purpose of saving tax so orders his affairs that he escapes from a liability for taxation on income which is in reality his, that is, income which is the product of his capital or his labour or both."*³¹

4.1: THE SPECIFIC ANTI-AVOIDANCE PROVISIONS IN THE INCOME TAX ACT

Since this paper is focused on the general anti-avoidance provision, the specific anti-avoidance provisions will be discussed briefly. Some of the common specific anti-avoidance provisions in the Income Tax legislation are the following:

SECTION 1 para (c) (ii)

Section 1 dealing with Gross Income definition paragraph (c) (ii) on Cession of income includes in the gross income of any person any amount received by or accrued to or for the benefit of any other person in respect of services rendered or to be rendered by the former person. This prevents cases where income is ceded in order that it be taxed in the hands of someone in a lower tax bracket.

According to Commissioner's Practice Note No.4, 2 September, 1985, the provisions will not be applied where a natural person is nominated by his employer to act as a director of a company in which the employer is a shareholder directorship are payable either directly to the employer or to the director subject to a condition requiring him to pay the fees over to and for the benefit of the employer.

SECTION 7 (1)

The section deems income to accrue to a person notwithstanding the fact that such income has not been received by him. This section has been said to do no more than confirm the principle of accrual in the gross income definition as laid down by the case of CIR V Peoples Stores³²

SECTION 7 (2)

The aim of the section was to introduce the changes of separate taxation of married women, which was not the case up until 1991. The section aims at preventing tax avoidance whereby one spouse's income is taxed in the hands of the other in order that it be taxed at lower marginal rates. The section deems income to accrue to the donor spouse if:

- (a) Such income was derived in consequence of a donation, settlement, other disposition, transaction, operation or scheme entered into for the purposes of avoiding tax. The "abnormality" element of s103(1) is not required, enabling the Commissioner to attack a commercial transaction between spouses. The onus would be on the taxpayer prove that the purpose of the transaction was for reasons other than the avoidance of tax.
- (b) The income received by the recipient (husband or wife as the case may be) from a connected trade is unreasonably excessive in relation to the services rendered.
- (c) A married woman may elect to include her income with her husband's income if his gross income does not exceed R10 000.

SECTION 7(3)

This section prevents a parent from obtaining a lower average tax rate by splitting his income with his minor children. Any income received by a minor child by reason of a donation, settlement or other disposition made by the parent of the child will be deemed to be the income of the parent.

SECTION 7(4)

This section prevents the possible of avoidance of tax envisaged in s7(3) by means of cross donations between parents.

SECTION 7(5)

Income received by a trust, as a result of a donation, which is not distributed to the beneficiaries because of a stipulation in the trust deed is taxed in the hands of the donor.

SECTION 7(6)

Like section 7(5) this section is most frequently found in the context of trusts and estate planning. The section deems income which accrues to a beneficiary resulting from a donation to be the income of the person who retains the power to distribute the income at his discretion. This is to prevent a person from obtaining a lower average tax rate by distributing income to beneficiaries with the lowest marginal tax rates.

SECTION 7(7)

The section was introduced to prevent tax avoidance which involved the cession of income - found in donations to charities, while retaining or regaining ownership of the asset which produces the income.

SECTION 8E

This section was introduced to counter tax-avoidance brought about by the use of the so called preference share financing schemes. The scheme operated in the following

way; instead of borrowing money and paying interest on the loan, a company would issue preference shares to the "lender" and pay dividends on the shares. The result would be that the investor (lender) would receive the dividend free of normal tax, whereas had it received interest the interest would have been liable for tax.

SECTION 103(5)

This is an anti-avoidance provision aimed at transactions, operations or schemes where a taxpayer has ceded his rights to receive interest in exchange for dividends. The section requires the Commissioner to determine the normal tax liability of the taxpayer or any other party to the transaction as if the cession had not been effected. This section applies where a taxpayer has ceded his right to receive interest and not when a taxpayer cedes income which may be interest.

4.2: SECTION 103 - PRIOR TO 1996 AMENDMENT

Section 103(1) was the main anti-avoidance provision in the 1958 Income Tax Act, which the Revenue invoked in order to attack anti-avoidance practices by the taxpayer. For the Revenue to invoke the Section the following four requirements had to be met:

1. There had to be a transaction, operation or scheme
2. Which had the effect of avoiding, postponing or reducing the liability for tax
3. Which having regard to the circumstances under which the transaction, operation or scheme was carried out or entered into;
 - (a) was done by means or in a manner not normally employed in carrying out a transaction of the nature of the one in question or;
 - (b) has created rights and obligations that would not be created in a similar arm's length transaction;
4. was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of tax.

4.2.1. FIRST REQUIREMENT: TRANSACTION, OPERATION OR SCHEME

As to what constitutes a transaction, operation or scheme is a subjective test, depending on the circumstances of each case. It would be helpful to find out how decided cases have defined the terms.

The courts tend to focus on the interpretation of the words in assessing each particular transaction, operation or scheme as provided by the section. The issue has actually been whether to give a wide or narrow interpretation to the words. In Hicklin V CIR³³ the court opted for a restrictive interpretation of the word 'scheme'. What becomes clear in this case is that the court dismissed the Commissioner's argument that the series of transactions in question should be seen as being part of a comprehensive scheme, that is why such a restrictive interpretation was adopted by the court, hence it is clear from the facts that such an interpretation was not anticipated. The court went further to lay a guideline for subsequent cases:

*"Indeed, Section 103(1) itself enjoins the Respondent, and hence any Court seized with the problem, to have regard to 'the circumstances under which the transaction, operation or scheme was entered into or carried out'."*³⁴

In Ovenstone V SIR³⁵ the Court was again asked to consider the scope of the words transaction, operation or scheme. In this case a 'scheme' to reduce estate duty payable was conceived in 1966 but only implemented three years later in 1969. Furthermore, the 'scheme' which was finally implemented in 1969 differed markedly from the one which was envisaged in 1966. The Court a quo had held that the 'scheme' embarked upon in 1969 was in fact a different 'scheme' to the one conceived in 1966. The Appellate Division however overruled this interpretation and in holding that there were not two 'schemes' in existence but in fact only one, had the following to say:

*"Be that as it may, the evidence as a whole does, I think, establish that the original scheme was never abandoned by Appellant. That the control and benefit of Scotia shares were in fact ultimately vested in the trust confirms that. It also tends to show that the original scheme was in substance carried out in 1969, the deviations just mentioned being merely 'refinements' thereof. All that negatives any suggestion that the transactions or operations in 1969 constituted a new scheme."*³⁶

From this decision, it is clear that the court opted for a wide approach in interpreting the word 'scheme'.

Furthermore, on the same issue of interpretation of the words, 'transaction, operation or scheme', the case of Meyerowitz V CIR³⁷ can be referred to. The facts of the case were that; the well-known tax author received profits from the sales of various of his books and journals. For no consideration he ceded his interest to a company jointly owned by his wife and himself. The author's father then formed a trust for the benefit of Meyerowitz's children to which the company ceded its interest to profits from the sale of the books. Thereafter followed a series of transactions involving the trust, the company, a second company and a partnership comprising the trust. The net upshot of all these arrangements was that Meyerowitz limited his income from the books and journals to a nominal editorial fee, while a substantial portion of the income, being the profits derived from the sale of the books and journals, flowed to the trust for the benefit of Meyerowitz's children. Commenting on the meaning of the word 'scheme', the Appellate Division held as follows:

*"Otherwise, I think that there is sufficient unity about the whole matter to justify its being called an arrangement for this purpose, because the ultimate object is to secure for somebody money free from what would otherwise be the burden or the full burden of surtax. Merely because the final step to secure this object is left unresolved at the outset, and decided on later, does not seem to me to rob the scheme of the necessary unity to justify it being called an 'arrangement'.... The word 'scheme' is a wide term and I think there can be little doubt that it is sufficiently wide to cover a series of transactions such as those mentioned above."*³⁸

4.2 2 SECOND REQUIREMENT: EFFECT OF AVOIDING, POSTPONING OR REDUCING THE LIABILITY FOR TAX

Not only must the transaction, operation or scheme be entered into, but it must also have the effect of avoiding, postponing or reducing liability to pay tax. The Courts have held that the test for whether effect of transaction is to avoid liability for tax is an objective one.³⁹ The test is that the effect of the transaction at the time of carrying it out is what must be looked at.

This second requirement was dealt with in the case of Smith V CIR.⁴⁰ The facts of the case are as follows: Smith was a shareholder in Tellurometer (Pty) Ltd., a company with large undistributed reserves which was about to declare a dividend. By a series of transactions, and exchanges of shares, Smith became the sole shareholder in a company in South West Africa, which held all the shares in a Rhodesian Company, which held all the shares in a South African Company, which held the shares in a firm known as IMC, whose shares had been swapped for shares in Tellurometer (Pty) Ltd. Smith contended that the transactions had the effect of avoiding liability for tax, and argued that the Commissioner had interpreted the phrase incorrectly.

The court held that “avoiding liability” within the meaning of the section is to get out of the way of, to escape or prevent an anticipated liability. In this regard, Steyn CJ said the following:

“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....The Afrikaans rendering of the phrase is ‘wat die uitwerking het dat dit aanspreeklikheid vir die betaling van ‘n belasting...op inkomste vermy’. The ordinary meaning of ‘vermy’ is ‘owntwyk’ or ‘voorkom’. That wider meaning is the meaning to be ascribed to the phrase, unless it is clear that a different meaning is intended.”⁴¹

Smith was held to fall within the provisions of the phrase “avoiding liability for tax” in that the effect of his transaction was to escape liability and therefore, he was hit by the provision. It follows from this judgement that the alienation of any asset, or any other transaction, operation or scheme, by involving the taxpayer by which income, which otherwise would have accrued to the taxpayer, accrues to another can be regarded as having the effect of avoiding, postponing or reducing liability to tax, although the taxpayer has no right to and will receive no benefit from the income.

In CIR V Louw,⁴² where the directors, who were shareholders had borrowed money from the company, the court held that had the loans not been made the directors or shareholders would probably have received the equivalent in salary or dividends and that this was sufficient to show that the effect of the loans was to avoid or postpone liability for tax.

Another case dealing with the meaning of “anticipated liability to tax” is Hicklin’s case.⁴³ The facts can be summarised as follows: Hicklin and his two co-shareholders sold their dormant company (called Recklame) which had appreciable accumulated distributable reserves to a dividend stripping company, (called Ryan Nigel Limited (RN)) for the net asset value of the company less 10% of the distributable reserves. The only assets in the company at the time were the loan levy and loans to the shareholders. Once the dividend-stripper had obtained control of the company, it declared out all its reserves as dividends and then deregistered the company.

At the time this transaction took place, dividends were taxable in the hands of individuals (today dividends are exempt in terms of s.10(1)(k) of the Income Tax Act and not taxable in the hands of companies). Consequently, the Commissioner applied s103(1) and taxed Hicklin and his co-shareholders on the dividends. On the issue of “anticipated liability to tax”, the Court held that it was unnecessary and even inadvisable to decide whether a vertical line should be drawn along that wide range of meanings in order to delimit the connotation of ‘anticipated liability’.

The Court went further to say, that although the taxpayers liability was contingent upon the dividend stripping company declaring a dividend, the liability was clearly an anticipated liability. Trollip JA, in delivering the judgement of the Court, said the following:

“After all, they were always mindful that something unforeseen might occur that would compel them to declare dividends and incur the ensuing tax liability and the possibility of some such contingency occurring was sufficiently proximate and pressing to induce them to sell their shares under the RN Agreement in order to “get out of the way of”, escape or prevent such liability from falling upon them.”⁴⁴

The RN Agreement was held to have the effect of avoiding that anticipated tax liability and therefore, the provisions of S103(1)(b) were applicable. It is clear from the above decision as to how far Courts can go in interpreting the phrase ‘anticipated liability’, to include not only an existing liability, but a contingent liability as well.

In relation to the same issue of ‘anticipated liability’, Clegg had the following to say:

“Anticipation of tax presupposes a pre-existing source of income whether proximate or remote, for without income there can be no liability and where there is no source of income, Section 103 cannot be invoked.”⁴⁵

In order to determine such tax avoidance by the taxpayer, the Commissioner, in practice, compares how much tax would have been payable had the transaction not been carried out at all, with that payable if the transaction is accepted at face value. The Commissioner will try to show that the former exceeds the latter. In applying the test the Commissioner takes into account the amount of tax payable by all the parties involved, their children, any company or close corporations or Trusts in which the taxpayers have an interest.

4.2.3. THIRD REQUIREMENT: ABNORMALITY OF THE TRANSACTION, OPERATION OR SCHEME

The abnormality requirement falls into two parts, namely: the transaction, operation or scheme was not ‘normal’ having regard to, firstly, the means by which or manner in which it was entered into or carried out and secondly, the rights or obligations created by it by persons dealing at arm’s length. The question as to whether a transaction can be regarded as “normal” is not always easy to determine. What is considered as “normal” in one case need not necessarily be in another case. Therefore, a normality test has to be applied to the actual transaction in question.

The case of Hicklin V SIR, is also relevant in relation to the normality test, and it lays out some guidelines as what is meant by “abnormality” and dealing at “arms length” in the following manner:

“When the transaction, operation or scheme is an agreement, as in the present case, it is important, I think, to determine first whether it was one concluded at arms length. That is the criterion postulated in para (ii). For ‘dealing at arm’s length’ is a 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 rights and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by para (ii). And the means or manner employed in entering into or carrying it out are also more likely to be normal than abnormal in the sense envisaged by para(i). The next observation is that, when considering the normality of the rights and obligations so created or of the means or manner so employed, due regard

has to be paid to the surrounding circumstances. As already pointed out s103(1) itself postulates that. Thus, what may be normal because of the presence of circumstances surrounding the entering into or carrying out of an agreement in one case may be abnormal in an agreement of the same nature in another case because of such circumstances. The last observation is that the problem of normality or abnormality of such matters is mainly a factual one. The Court hearing the case may resolve it by taking judicial notice of the relevant norms or standards or by means of the expert or other evidence adduced thereant by either party....”⁴⁶

The Court, finding in favour of the taxpayer, held that the agreement between the sellers and the dividend-stripper was an at arm’s length transaction in which each party was striving to obtain the maximum possible advantage for himself, and therefore s103(1) was not applicable. In an arms length transaction there is a rebuttable presumption that the rights and obligations created thereof are normal and the means and manner employed are also likely to be normal.

The parties to a transaction are not always at arm’s length, for example, they may be relatives, or partners, or shareholders and company. Is this fact one of the circumstances to which regard must be had in determining the normality of the transaction? The difficulty is reflected in the case of SIR V Geustyn, Forsyth and Joubert.⁴⁷ In that case a professional partnership had converted into an unlimited liability company with the partners as shareholders. They were credited with R240 000 goodwill on which interest was payable, but took no security for payment; they each received a salary and directors’ fees which together with interest on their loan accounts was less than they would have earned as partners. They had no service contract with the company. The Commissioner contended that the cumulative effect of these facts revealed that the transaction had not been carried out in a normal manner and created rights and obligations which would not normally be created between persons dealing at arm’s length.

On this issue the Court said the following:

“Section 103(1) is couched in very comprehensive terms but in forming his opinion t in relation to sub-paras (i) and (ii) of the section, the Secretary is required to have regard:’ to the circumstances under which the transaction, operation or scheme was entered into or carried out’. The criterion of ‘persons dealing at arm’s length’ mentioned in s103(1)(ii) is, however, not

*easy of application in a case such as the present. For the section enjoins the application of that criterion in relation to a transaction, operation or scheme 'of the nature of the transaction, operation or scheme in question'. Yet the Court is in the present case ex hypothesis concerned with partners who have, in the circumstances outlined above, made over their practice, not to an independent third party with whom they would ordinarily deal 'at arm's length', but to an unlimited company of which they are the sole shareholders and directors and whereof they have full and complete control. However, inasmuch as it is not essential for the decision of this case to pronounce upon this particular aspect of the matter (which was not exhaustively argued before us) I prefer to express no conclusion upon the point...."*⁴⁸

Furthermore, Silke submits that normality and abnormality requirements should not be judged solely by the question of whether the parties dealt at arms length. He suggests that this should be one of the important factors which the court must take into account but not necessarily be conclusive as the Commissioner could look into the circumstances under which the transaction was entered into. This would assist in cases such as Geusteyns' case where parties who were not independent adopted means to enter into a contract which were normal for that particular transaction but which would be considered abnormal for parties dealing at arms length.⁴⁹

The Court was faced with the same difficulty in Louw's case. The issue before the court was whether the court in applying the normality yardstick should take account of the special relationship between the partners in the company they had formed or ignore it and apply the yardstick as if the company were a stranger. Corbett JA in dealing with the issue, held as follows:

*"I do not see how the Court can ignore this special relationship and give credence to the concluding words of Section 103(1)(b). For it is of the very nature of the incorporation scheme that the company to which the practice is sold by the partners will have as its shareholders and directors the self same partners and will be controlled by them. These are the realities of the situation. Moreover, it must be borne in mind that the transaction is a multi-partite one to which all the partners and the company are parties; and each partner contracts with the company and its fellow partners and seeks to extract from the transaction the best possible transaction for himself."*⁵⁰

4.2.4 FOURTH REQUIREMENT: PURPOSE OF THE TRANSACTION, OPERATION OR SCHEME

The fourth and final requirement which must be met before the Commissioner can apply s103(1) is that he must be satisfied that the transaction, operation or scheme was entered into or carried out solely or mainly for the purpose of the avoidance or the postponement of liability for the payment of any tax, duty or levy or the reduction of the amount of such liability.

In SIR V Gallagher,⁵¹ the taxpayer argued that s103(1) was not applicable because his sole or main purpose informing the trusts had been estate planning and not tax avoidance. The Court held that “purpose” is used in the sense of the intention of which transaction is entered into and is therefore, clearly a subjective test aimed at determining the intention of the taxpayer in entering into or carrying out a transaction.

The term “purpose” as used in s103(1)(c) has to be distinguished from the term “effect” as used in s103(1)(a). While the transaction may have the effect of avoiding tax, it does not follow that the purpose of entering into the transaction was to avoid, postpone or reduce liability for tax.⁵²

Moreover, on the same issue of purpose, the case of Ovenstone V SIR⁵³ held, that purpose must be determined at the time that the scheme or transaction “is implemented or carried out not at the time it was formulated”. Another aspect of the requirement is that tax avoidance should be the sole or main purpose of the transaction. In CIR V King⁵⁴ the Court interpreted the phrase “sole or main purpose” to mean the dominant purpose. If the taxpayer can show that tax avoidance is merely one of a number of purposes for entering into or carrying out a transaction, the Commissioner will not be able to invoke the provisions of s103(1).

The Commissioner in terms of s103(1) has a double difficulty of having to prove purpose as well as the fact that the transaction was entered into mainly for the purpose of avoiding tax. Section 103(4)(a) raises a rebuttable presumption against the

taxpayer, that where tax avoidance's the result of a transaction, it is presumed until proven otherwise, that the tax avoidance was the sole or main purpose. The onus is on the taxpayer to rebut the presumption.

However, despite the onus which s103(4) places on the taxpayer, taxpayers have been relatively successfully defeating the Commissioner by proving the absence of the tax-avoidance motive. SIR V Gallagher is an example of a taxpayer who invoked this particular provision to successfully avoid liability. Another example is the case of SIR V Geustyn, Forsyth and Jourbert, where the taxpayer successfully argued that the conversion of the partnership into a company was not a tax avoidance scheme but to achieve the following advantages: "the facility of participation in consortiums of engineers engaged upon large projects, the ability to increase the participation in profits by qualified engineer-employees while, at the same time, eliminating the necessity to restrict the number of partners to the legal limit of twenty."

Basically, this notion of "purpose" and "effect", is summarised very clearly by Meyerowitz on Income Tax thus;

*" [W]hether or not a transaction is hit by section 103(1) must be answered by reference to the effect and purpose of the transaction and the circumstances surrounding it at the time it is implemented or carried out and not at the time it was formulated, ie conceived, decided or agreed upon, or otherwise involved. Therefore even if the purpose or effect of the 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 carried it out. "*⁵⁵

4.2 5. DETERMINING THE LIABILITY FOR THE PAYMENT OF TAX

If a particular transaction or scheme falls within the conditions of s103(1), the Act requires the Commissioner to tax as if the transaction or scheme has not been entered into from the onset or in such a manner as in the circumstances of the case he deems appropriate for the prevention of the avoidance, postponement or reduction of liability for tax.

4.2.6. SECTION 103(4) ONUS

In terms of s82 of the Act, the onus of proving that an amount is not subject to tax lies with the taxpayer, and in any appeal to the Special Court, the onus is upon the taxpayer to prove that the assessment in question is incorrect. However, in contrast, s103(4) deals with onus, in relation to the provisions of that entire Section, which subjects any decision of the Commissioner under s103 to objection and appeal. The Section provides that whenever in proceedings relating to an appeal under s103 it is proved that the transaction, operation, scheme, agreement or change in shareholding or members' interests would result in the avoidance or the postponement of liability for payment of any tax duty or levy imposed by the Act or any previous Income Tax Act or any other law administered by the Commissioner or in reduction of the amount thereof it shall be presumed, until the contrary is proved that-

- (a) in the case of a transaction, operation or scheme it was entered into or carried out solely or mainly for the purpose of such avoidance, postponement or reduction;
- (b) in the case of any agreement or change in shareholding or members' interests it was effected solely or mainly for the purpose of utilising the assessed loss in order to avoid, postpone or reduce the liability for tax.

The question that arises from this Section, is who has the onus of proof in terms of that proviso? There has been different opinions on this issue. According to Meyerowitz and Spiro,

*"as the presumption only arises whenever it is proved that the avoidance, postponement or reduction of tax would result, it is considered that the onus of proving this lies upon the Commissioner."*⁵⁶

Whereas, in contrast, Huxham & Haupt submit that the onus lies upon the taxpayer to prove that the transaction, operation or scheme was not entered into solely or mainly to avoid, postpone or reduce such tax.⁵⁷

One is inclined to support the view that since Section 103 contains its own provision dealing with onus, then the general section as to onus does not apply to s103, otherwise, there would not have been a need to have an express proviso in s103.

Meyerowitz concludes that in the absence of provisions in s103 casting the burden of proof on the taxpayer in regard to the abnormality test, then, the only reasonable conclusion is that the onus of establishing abnormality lies on the Commissioner.⁵⁸

4.3. THE AMENDED VERSION OF SECTION 103(1): JULY, 1996 - INCOME TAX ACT 36 OF 1996

As a result of the difficulties which the Commissioner came across in proving the abnormality test under s103(1), specifically in the cases of Hicklin and Geustyn, the provision was amended in July, 1996 to improve its efficacy. It has been said the aim of amending this section is twofold: "first, to reshape the 'abnormality' test, and, secondly, to penalise taxpayers whose machinations are successfully attacked under s103." The amended version reads thus:

"Whenever the Commissioner is satisfied that any transaction, operation or scheme-

- (a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act, or of reducing the amount thereof; and
- (b) having regard to the circumstances under which the transaction, operation was entered into or carried out-
 - (i) was entered into or carried out-
 - (aa) in the case of a transaction, operation or scheme in the context of business in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and
 - (bb) in the case of any other transaction, operation or scheme, being a transaction, operation or scheme not falling within the provisions of item (aa), by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or
 - (ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a trans-

action, operation or scheme in question; and
 (c) was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit,
 the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.”

The new version s103(1) now makes a distinction between a transaction, operation or a scheme employed for a business and a non-business purpose, and this is where the difference lies between the new version and the old one. What is the effect of this distinction? For schemes in the context of business, the Commissioner may act when they were entered into or carried out ‘in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit’. Whereas, on the other hand, for other schemes, the Commissioner may act when they were entered into or carried out ‘in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question’.

The next question that arises is whether the amended version achieve any clarity both to the taxpayer and the Revenue, and whether it will make the task of the Commissioner any easier in proving the normality test? The issue is, does the ‘business test’ makes any significant change to the provision? Several views have been expressed on the new s103(1), for example some commentators wrote the following;

“...our present view of it is that there is not much practical difference between the two versions of section 103(1). Possible the change may complicate the construction of section 103(1), because the new version refers to two purposes, namely a scheme which would not be employed for a bona fide business purpose other than the obtaining of a tax benefit, yet where this is the case, the taxpayer’s sole or main purpose must be the avoidance of tax. Conceivably and not at all outside the realm of practicality, a scheme may be entered into or be carried out solely or mainly for a commercial or economic

purpose, and at the same time in a manner not normally employed for bona fide business purposes because of the tax benefit".⁵⁹

The new version does not seem to shift the burden of proof in relation to the test of normality from the Commissioner. In this way, one would submit that the Commissioner is still faced with this difficulty especially in relation to the so-called 'other schemes'. It is arguable therefore, that the new provision, will not be able to cover transactions entered into for business purpose and at the same time in the manner that is not normally employed in bona fide business transactions because of obtaining tax benefit, and yet the taxpayer's sole or main purpose is not to avoid tax. The Commissioner still has the burden of proving that whatever transaction the taxpayer entered into was for purposes of avoiding tax. Moreover, there is no definition of the term 'in the context of business', and it may be difficult in practice to establish which schemes fall into this category.

Furthermore, 'purpose test' has been changed. Commenting about this change some commentators have said;

" While the 'obtaining of a tax benefit' is built into the normality test for schemes in the context of business, it is also now the basis of the overall purpose test in s103(1)(c), which has been redrawn. No longer will a scheme be objectionable if entered into solely or mainly for the purposes of the avoidance of the postponement of liability for the payment of any tax, duty or levy imposed by the Act or any previous Income Tax Act or any other law administered by the Commissioner or of reducing the amount of that liability. It will now be assailable if entered into or carried out solely or mainly for the purposes of 'obtaining a tax benefit'. "⁶⁰

Another important amendment of the section, is by addition of a new s103(7), which defines a 'tax benefit' as including, 'any avoidance, postponement or reduction of liability for payment of any tax, duty or levy imposed by the Act or by any other law administered by the Commissioner'. It remains to be seen how the Courts will interpret the new version of s103(1), in a case. One is inclined to submit that taxpayers will still be able to manoeuvre their arrangements under the new section.

4.4: COMPARABLE INTERNATIONAL LEGISLATION AND CASE LAW ON ANTI-AVOIDANCE

Tax Avoidance is not unique to South African law. In order to find out how other jurisdictions deal with tax avoidance, a brief discussion of the relevant legislation and case law in the United Kingdom and Australia is necessary. It is important to mention that there is no general anti-avoidance provision in the United Kingdom. However, their case law on tax avoidance is so developed, that the South African courts tend to refer to the precedents thereof. In contrast Australia has a general anti-avoidance provision which will also be looked at in the course of the discussion.

4.4 1: AUSTRALIAN GENERAL ANTI-AVOIDANCE PROVISIONS AND CASE LAW

It would be relevant to discuss the Australian general anti-avoidance provisions for purposes of comparison with their South African counterpart. The general anti-avoidance provision of the Australian Income Tax Assessment, 1936, is Part IVA, comprising sections 177A to 177G. Part IVA was inserted to replace section 260. This Part governs the tax-avoidance practices, which the taxpayer may enter into and as a result has obtained a tax benefit. This tax benefit being either the omission of assessable income or the obtaining of an allowable deduction. Once this is established, consideration is paid to the eight criteria specified in section 177D, to establish whether the sole or dominant purpose of entering into the scheme was to enable the taxpayer to obtain the tax benefit as defined in section 177C. Where the Part applies, the Commissioner is empowered to cancel the tax benefit arising from the scheme.

The important provision is s177D, which contains eight tests in para (b) which the Commissioner can consider in deciding whether the scheme was entered into for the dominant purpose of enabling the taxpayer to obtain a tax benefit. The eight tests will be looked into in detail:

- (i) The manner in which the scheme was entered into or carried out; this test would examine the background of the scheme and the alternative purposes which could be attributed to the taxpayer in entering into it.
- (ii) The form and substance of the scheme; this would be examining both the legal form and the eventual effect of the scheme.
- (iii) The time at which the scheme was entered into and the period of time during which the scheme was carried out.
- (iv) The result (i.e. tax effect) which would be achieved by the scheme.
- (v) Any change in the financial position of the relevant taxpayer arising out of the scheme.
- (vi) Any change in the financial position of any other person; this test would review financial position of any other person who benefits from the scheme vis-à-vis the taxpayer.
- (vii) Any other consequences for the relevant taxpayer or any other person connected with him; this test would consider whether any benefits, not of a financial form were obtained.
- (viii) The nature of any connection between the relevant taxpayer and a person contemplated by para (vi) above.

For the Commissioner to attack a particular scheme or arrangement, reference is made to the above tests in order to establish whether the dominant purpose of a scheme or arrangement is tax avoidance.

Two of the important cases in Australian legal system, which are usually referred to in tax avoidance schemes are the following: The first case is Federal Commissioner of Taxation V Lau.⁶¹ In this case the taxpayer, a medical practitioner engaged in full-time practice, considered acquiring a long-term investment. He consulted his accountant with a view to investing in pine trees, wishing to make provision for the years when the income from his professional practice might be expected to diminish but not unmindful of the advantage of having a substantial tax deduction for the year ended 30 June 1981.

He then entered into a series of arrangements in which he participated with several other parties in a forest-management scheme for the purpose of establishing and maintaining a pine plantation. The Court held that although the tax benefits were not overlooked in this case, on the evidence presented the transactions were negotiated in a genuine commercial setting and had an essentially commercial nature. The Court concluded that the scheme was “no sham and that the dealings between the parties were actuated by genuine commercial considerations....”

In another Australian case, Anderson V Federal Commissioner of Taxation,⁶² the Court held, on the facts of that case, that all the expenditure incurred by the taxpayer, as a member of a partnership to make films, was incurred for the purpose of earning a tax deduction only and therefore not deductible. The judge held that the answers received from the taxpayer suggested a perception from the latter that the scheme “...would never make a commercial profit. So the only financial attraction in the project was its perceived tax advantages”. The judge, considering the facts, ruled that the taxpayer was not “genuinely interested in the possibility of making money by the exploitation of the rights over the films to be made under the agreement and... that the whole of the expenditure...was incurred for the purpose of earning a taxation deduction.”

Furthermore, the judge held that, “for an expenditure incurred in the carrying on of a business to be deductible, it must be incurred for the purpose of gaining or producing assessable income.” In this case, however, the expenditure was incurred merely for the purpose of generating tax losses and was therefore not deductible.

4.4.2: THE NEW ENGLISH SUBSTANCE APPROACH

The new English Substance approach towards schemes entered into to postpone liability for tax is laid in W.T. Ramsay Ltd V IRC, IRC V Burmah Oil Co. Ltd and Furniss V Dawson. In South African Law, this is what is referred to as tax-avoidance which falls under s103 - the general anti-avoidance provision. Ramsay’s case concerned a complex ‘circular’ avoidance scheme at the end of which the financial

position of the parties was little changed but it was claimed that a large capital gains tax loss had been created. It was held that where a preconceived series of transactions is entered into to avoid tax and with the clear intention to proceed through all stages to completion, once set in motion, the Duke of Westminster principle (laid down earlier) does not compel a consideration of the individual transactions and of the fiscal consequences of such transactions in isolation.

In delivering judgement, in Furniss V Dawson, Lord Brightman took the liberty to describe the rationale of the new approach in this way:

*"In a preplanned tax saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step seriatim. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results...Ramsay says that the fiscal result is to be no different if the several steps are preordained rather than precontracted."*⁶³

The Ramsay principle was accepted thereafter, as marking a significant change towards tax avoidance in subsequent English cases. For example, in IRC V Burmah Oil Co. Ltd., Lord Diplock said:

*"It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that Ramsay's case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach. It does not necessitate the overruling of any earlier decisions of this House; but it does involve recognising that Lord Tomlin's oft-quoted dictum in IRC V Duke of Westminster. 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be', tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straightforward way."*⁶⁴

The three English cases summarised above show clearly, that motive with which the taxpayer enters into a transaction is irrelevant, instead what is important is the effect

of such transaction. This is because it is possible to have a situation in which a taxpayer, whose sole motive is the saving of tax, invests with others in an ordinary trading activity conducted by them for a commercial purpose and with a view to making a profit.

However, the principle is still subject to limitations as expressed by Lord Brightman in *Furniss's* case as thus: "First, there must be a preordained series of transactions, or, if one likes,, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end.... Second, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax, not 'no business *effect*'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied."⁶⁵

From the above cases, an important principle which is emphasised is the necessity for the schemes to be based on sound or legitimate commercial grounds other than the mere attainment of a significant fiscal advantage. It is clear therefore, that a 'commercial purpose' test is what the English and Australian jurisdictions uphold, in schemes attacked for postponing or reducing liability for tax. The new version of the South African law on anti-avoidance, was trying to incorporate similar principles as the ones enunciated above from the discussed English and Australian cases. However, the new legislation still leaves the heavy task in relation to the abnormality test with the Commissioner in relation to the so-called 'other schemes' as opposed to 'schemes in the context of business'.

PART FIVE

5. CONCLUSION

Tax planning is a very important exercise. The only way a taxpayer can be able to safe his income, is through an exercise of tax planning. Since, tax legislation keeps on

change time and again, it is necessary for the taxpayer to stay on the outlook to be able to plan his finances and know clearly how the Commissioner impose any kind of tax or duty.

On the other hand, it is very important for a taxpayer to be conversant with the anti-avoidance provisions, so that he can be able to plan his affairs before hand. Tax avoidance, as already mentioned, is legitimate, as Learned Hand J, in Commissioner of Internal Revenue V Newman said:

*"Over an over again Courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."*⁶⁶

The amended s103(1) aims at combating practices and schemes by taxpayers which have the effect of postponing or avoiding liability for payment of tax. The Commissioner is always on the outlook to attack arrangements which are entered into or carried out that have the effect of avoiding or postponing liability for the payment of tax. But, as it has already been shown, the new 'business' test introduced does not really make things any easier for the Commissioner. On the other hand the amendment is a step forward in the field of tax in the South African legal system.

In practice, it is a difficult task for the Commissioner to formulate and enact a general anti-avoidance provision which will close totally close all the loopholes to discourage the taxpayer to engage in such tax-avoidance schemes. We await to see the efficacy of the new section when cases to that effect arise.

It is the duty of the Commissioner to bring the taxpayer within the ambits of the law to pay tax, so the dictum run, 'everyman is entitled to arrange his affairs within the framework of the law as to attract upon himself the least amount of tax.' It is submitted, therefore, that the more the Revenue closes the loopholes in the tax

legislation, the more the taxpayers will find means of avoiding tax, whereas if the legislation can be more relaxed, the Revenue would collect more tax.

Perhaps, one would suggest that the better approach to amend s103 (1), which is the general anti-avoidance provision, it should be made drafted in a broad manner. This means that the scope of the provision would be wide enough to try to pin down the taxpayer in whatever transaction or scheme which aims at avoiding or postponing any liability for tax. In drafting the provision, perhaps reference should be made to existing provisions in other jurisdictions, such as Australia, which has laid down broad tests to examine whether a transaction is one which avoids tax.

The present South African provision enables taxpayers to manoeuvre around and be able to reduce their liability to pay tax. However, the Commissioner has no ground of complaint as long as he still fails to bring the taxpayer within the ambit of the law.

ENDNOTES

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ACTS AND STATUTES

Australian Income Tax Act 1936

Income Tax Act of South Africa Act No. 58 of 1962 and Act No. 36 of 1996

held from such remuneration under the provisions of the said Schedule unless the claim therefor is made within the period referred to in paragraph (b). 35.32

Treatment of certain small tax claims and refunds

102A Notwithstanding anything to the contrary in this Act, if in the case of any person (other than a company)—

- (a) whose taxable income for the year of assessment consists entirely of remuneration (as defined in paragraph 1 of the Fourth Schedule) the amount of which does not exceed the amount referred to in section 66 (1) (b) (i), as applicable in respect of the said year; and
- (b) who was not in terms of section 66 (1) required to furnish a return for the assessment of tax in respect of the said year (whether or not he did in fact furnish such a return),

the amount of his liability for normal tax for the said year either exceeds or falls short of the aggregate of the amounts of employees tax deducted or withheld from the said remuneration under the provisions of the Fourth Schedule, such excess shall not be recoverable by the Commissioner from the said person if the amount thereof is less than R10 or such shortfall shall not be refundable by the Commissioner to the said person if the amount thereof is less than R2. 35.20

Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income

103 (1) Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)—

- (a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof; and
- (b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out—
 - (i) was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or
 - (ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and
- (c) was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax, duty or levy (whether imposed by this Act or any previous Income Tax Act or any other law administered by the Commissioner) or the reduction of the amount of such liability,

the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction. 29.2

(2) Whenever the Commissioner is satisfied that any agreement affecting any company or any change in the shareholding in any company or in the members' interests in any company which is a close corporation, as a direct or indirect result of which income has been received by or has accrued to that company during any year of assessment, has at any time before or after the commencement of the Income Tax Act, 1946, been entered into or effected by any person solely or mainly for the purpose of utilizing any assessed loss or any balance of assessed loss incurred by the company, in order to avoid liability on the part of that company or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof, the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed. 29.10

(2) Subsection (1) shall come into operation on the date of promulgation of this Act and shall apply to any excess arising on or after that date.

Amendment of section 103 of Act 58 of 1962, as amended by section 14 of Act 101 of 1978, section 37 of Act 121 of 1984 and section 19 of Act 70 of 1989

29. Section 103 of the principal Act is hereby amended—

(a) by the substitution for subparagraph (i) of paragraph (b) of subsection (1) of the following subparagraph:

"(i) was entered into or carried out—

(aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and

(bb) in the case of any other transaction, operation or scheme, being a transaction, operation or scheme not falling within the provisions of item (aa), by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or";

(b) by the substitution for paragraph (c) of subsection (1) of the following paragraph:

"(c) was entered into or carried out solely or mainly for the purposes of (the avoidance or the postponement of liability for the payment of any tax, duty or levy (whether imposed by this Act or any previous Income Tax Act or any other law administered by the Commissioner) or the reduction of the amount of such liability) obtaining a tax benefit"; and

(c) by the addition of the following subsections:

"(6) Where the Commissioner has applied the provisions of this section in the determination of any taxpayer's liability for any tax, duty or levy imposed in terms of this Act, the Commissioner shall not exercise his discretion in terms of the provisions of section 89 *quat*(3) or (3A) so as to direct that interest shall not be payable in respect of that portion of any tax which is attributable to the application of this section.

(7) For the purposes of subsection (1) 'tax benefit' includes any avoidance, postponement or reduction of liability for payment of any tax, duty or levy imposed by this Act or by any other law administered by the Commissioner."

(2) Subsection (1) shall come into operation on the date of promulgation of this Act and shall apply to any transaction, operation or scheme entered into or carried out on or after that date. Provided that the provisions of section 103 of the principal Act shall, in relation to any transaction, operation or scheme entered into or carried out before that date, continue to apply as if subsection (1) had not been enacted.

Amendment of paragraph 4 of First Schedule to Act 58 of 1962, as amended by section 17 of Act 72 of 1963, section 41 of Act 89 of 1969, section 42 of Act 94 of 1983 and section 43 of Act 113 of 1993

30. Paragraph 4 of the First Schedule to the principal Act is hereby amended by the deletion of subparagraph (2).

Amendment of paragraph 5 of First Schedule to Act 58 of 1962, as substituted by section 18 of Act 72 of 1963 and amended by section 23 of Act 52 of 1970, section 30 of Act 88 of 1971, section 28 of Act 103 of 1976, section 23 of Act 104 of 1980 and section 26 of Act 96 of 1981

31. Paragraph 5 of the First Schedule to the principal Act is hereby amended—

(a) by the substitution for subparagraph (1) of the following subparagraph: