

## Masters' Dissertation

Submitted by **Robert Frank Driman** (DRMROB003) in partial fulfilment of the requirements of the degree **Master of Commerce Specialising in Taxation** in the Field of South African Law (FTX5031W) – **University of Cape Town** Faculty of Commerce **Department of Finance and Tax**.

Supervisor Professor Peter Surtees

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**1. Title**

“The usefulness (or otherwise) of the concept of “abnormality” as a test in general anti-avoidance rules”.

## 2. Acknowledgements<sup>1</sup>

To those who came before; and for those who follow after.

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<sup>1</sup>I wish to acknowledge the considerable role of Professor Peter Surtees (a remarkable man) – the degree course lecturer-in-main, who taught us to teach ourselves, and supervised my writing of this paper. All of the lecturers on the course added greatly to my understanding of the area. I acknowledge the financial assistance of my firm, Norton Rose Fulbright South Africa (incorporated as Deneys Reitz Inc.). Although it no doubt gets tax relief for contributing to its employees' further education, on a light note in the context of this paper, saving tax is not the *sole or main purpose* for its support. I acknowledge my classmates, who also taught me a great deal. In particular I also wish to thank Clare Hollands, Rauen Venter, Georgios Michaelides and Donald Pearce-Crump for support, advice and input. This paper is my sole responsibility.

### 3. Abstract

The paper discusses and traces the history of tax policy which creates the basis for the difference between illegal tax evasion, and tax avoidance (which may also be illegal). The discussion reveals the cause of ambiguities in judicial interpretation (and through this the effect of avoidance legislation) of schemes which cause tax to be avoided – which is found in policy considerations. The South African anti-avoidance common law and legislation is described. A spotlight is placed on the most subjective policy factor which is used to test for impermissible avoidance – the concept of abnormality. The *NWK*<sup>2</sup> decision is examined in some detail as a useful illustrator of how the policy by which the court approaches anti-avoidance matters affects the outcome of the case – and just how subjective are policy-based tests for what is permissible or not. There is an examination of the obverse of using subjective concepts by removing them from the law. The paper finds that subjective factors – while having some use - lead to uncertainty in tax planning, and states why this is undesirable. The paper does not examine in detail whether courts have a pre-judgmental approach to tax matters, but recommends that as far as possible tests in anti-avoidance measures should avoid subjective elements. A recommendation is proposed of how this may be achieved in relation to the concept of abnormality.

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<sup>2</sup> See footnote 93 below.

4. **Abbreviations**

A –Appellate Division

AD – Appellate Division

RAD – Rhodesian Appellate Division

SATC – South African Tax Cases

SCA – South African Supreme Court of Appeal

TC – Tax Court

## 5. Table of Contents

i	Title
ii	Acknowledgements
iii	Abstract
iv	Abbreviations
v	Table of Contents
vi	Chapter 1 - introduction
vii	Chapter 2 - tax policy
viii	Chapter 3 - South African general anti-avoidance measures
ix	Chapter 4 – the <i>NWK</i> decision and “abnormality”
x	Chapter 5 – is “abnormality” necessary?
xi	Chapter 6 – conclusions
xii	Chapter 7 – recommendations

## 6. Chapter 1 - introduction

### 6.1 Introduction

This paper examines tax policy, which has its roots in the ancient enforcement (or extraction) of revenue to fill state coffers (called the *fiscus*<sup>3</sup>), from the viewpoint of tax payer and tax enforcer.

Because of the powers of the tax enforcer (derived – as is most law – originally from coercion and therefore less easily felt as part of a social contract), some tax payers have a natural predilection to avoid paying more in tax than is absolutely necessary. In turn, the tax enforcer comes to see as immoral the efforts of the tax payer in avoiding paying tax which would otherwise be due.

The cat-and-mouse game is played out in a heavily-regulated environment<sup>4</sup>.

The aim of this paper is to examine one aspect of the tax regulation in anti-avoidance provisions, to determine how useful that aspect is, and to recommend changes which would be to the benefit of all role players.

This chapter examines the history of taxation in order to understand the context of policy issues<sup>5</sup> at play.

### 6.2 Background

“Tax-gatherers dislike people who get the better of them. They see themselves as the custodians of the fiscal morals of the nation. Tax avoiders, they say, are bad citizens who dodge the column and put part of their burden on to others. While the small fry get up to minor tricks, the big boys employ specialists to launch tax-avoidance rackets on a scale which makes bank robbers envious. The picture is one of the hapless tax-gatherer constantly following his astute quarry through a revolving door and never coming out in front. The tax avoider keeps one move ahead and all the complicated anti-avoidance legislation fails to stop him. In desperation the tax-gatherer is driven to the conclusion that to administer and construe the Income Tax and Finance Acts is

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<sup>3</sup> Literally, the “basket”.

<sup>4</sup> Some countries are more regulated than others – Germany accounts for about 75% of the fiscal regulation in the world.

<sup>5</sup> See chapter 3 below.

not enough. He must have the power to search the taxpayer's conscience and compel him to bare his soul. Was he up to something? To protect innocence is not enough; there must be proof of it."

These are the words<sup>6</sup> of Lord Houghton of Sowerby, quoted in the journal of the trade union for those working in tax collection. Lord Houghton had himself worked in tax collection and for 38 years he was the general secretary of the Inland Revenue staff federation. During that time he ceaselessly worked to improve the training of tax officials, and he had a life-long disdain of pettiness<sup>7</sup>. Lord Houghton's article was meant as a kindly re-assurance to tax-collectors, but at the same time as a cautionary tale. Their job is an important one – and much-derided: but the tax-collector must stay within the bounds of the law.

Perhaps Lord Houghton would have his reader believe that tax avoidance was neither an art nor a science: rather, it was a sport played in an endless revolving door. Whatever his reasoning, his words form a very useful backdrop for this paper.

Lord Houghton's questioning words (which he answers in the same article) can be broken down into constituent parts –

- Tax collectors believe they have a moral (rather than purely legal) role.

As will be discussed in this paper, the tax collector is a functionary of the executive, who (in our constitutional democracy) carries out the will of parliament (the legislature) acting subject to the Constitution<sup>8</sup> : no more, and no less<sup>9</sup>. In this context, the role of the courts is to do no more nor any less than to ensure that this was done within the bounds of what the fiscal laws permit<sup>10</sup>;

- The collectors believe that persons who outwit them in their gathering of taxes are bad.

The tax collector has a duty to collect such taxes as may be due by a taxpayer. If a taxpayer does not meet the obligation to report and pay tax on income, then that

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<sup>6</sup> Lord Houghton (Douglas Houghton) in *Taxes, the journal of the Inland Revenue Staff Federation*, England, January 1978, quoted in Huxham and Haupt *Notes on South African Income Tax* H&H Publications 2010 page 458. The writer sourced a copy of the entire note as well.

<sup>7</sup> Tam Dalyell Obituary: Lord Houghton of Sowerby *The Independent* 3 May 1996.

<sup>8</sup> See Chapter 2, footnote 16 below.

<sup>9</sup> Lord Houghton foot note 6 above says in his article at page 5 – "Taxation is an act of Parliament, not an act of God".

<sup>10</sup> There is an interesting debate regarding the role of the legislature, executive and judiciary in *CIR v King* – see footnote 59 below.

constitutes tax evasion with criminal sanctions. If the taxpayer escapes the obligation by arranging affairs accordingly – in other words, adjusting affairs so that no or less tax is payable – then that is permissible. There is no room for any other judgement;

- This is particularly so of wealthier persons, who use their economic might to employ experts to find gaps in the tax legislation, and who unfairly shift the tax burden to other (poorer) persons<sup>11</sup>.

Lord Houghton stated that at the time he wrote his article moonlighting was the most prevalent form of tax evasion, and that tax collectors should be comprehensive and impartial in looking to stop tax evasion<sup>12</sup>. In contrast, the Economist newspaper warned that in Italy it was likely to be “pensioners” and “housewives” who would feel the heat of revised regulations against tax avoidance<sup>13</sup>.

### 6.3 Research problem

The research problem is whether a subjective factor (in particular the inexact and subjective concept of “abnormality”) is useful as a test in legislation designed by the fiscus to limit permissible tax avoidance measures, or not. In this context, “usefulness” means utility – whether the choice of legislator in using the concept of “abnormality” as a test is valuable to the revenue official, the fiscus and to the taxpayer.

### 6.4 Value

Since a considerable amount of time and expense is spent structuring the affairs of tax payers, and similarly a considerable amount of time and expense for the fiscus and the courts is spent in determining whether the structures employed by taxpayers are lawful, assessing the usefulness or otherwise of subjective tests such as “abnormality” is important to taxpayers, the fiscal authorities<sup>14</sup>, the Treasury and the courts alike.

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<sup>11</sup> For a discussion on this see footnote 29 below.

<sup>12</sup> Lord Houghton footnote 6 at page 5.

<sup>13</sup> See footnote 39 below. *The Economist* wrote : “Most honest Italians, however, welcome the new weapon in the fight against tax evasion. But few are betting that tax authorities will advance smoothly to victory. Italy’s bureaucracy has an ample capacity for cock-up. Many expect the unhappy recipients of the authorities’ attention to be impoverished pensioners and harassed housewives, rather than habitual tax dodgers.”

<sup>14</sup> A disputed but nonetheless useful suggestion is that the US federal fiscal codes are now 9 million words long, yet (or, maybe, therefore) tax avoidance is pervasive. The longer the code, the more room for ambiguity - [http://en.wikipedia.org/wiki/Flat\\_tax](http://en.wikipedia.org/wiki/Flat_tax).

If a preferable manner of testing is found, it would make budgeting by taxpayers and the Treasury, tax planning and enforcement alike more efficient.

## **6.5 Limitations to scope**

The scope of this paper is limited to anti-avoidance measures employed by persons who are subject to the anti-avoidance rules found in the common law and the *Income Tax Act, 1962* (and its predecessors – see chapter 3 below). Natural and legal persons are included. Only South African domestic tax is examined. International tax is excluded (although global policy issues are examined). This paper looks only at general anti-avoidance measures. Specific anti-avoidance measures are excluded.

## **6.6 Structure**

The structure of this paper consists in looking at the background and history to taxation and tax avoidance, who the role-players are, the policy which grew from that history, an examination of general South African anti-avoidance provisions, an analysis of case law, and a conclusion on the usefulness of abnormality, with a recommendation on a better way to examine the lawfulness of such schemes.

## Body Chapters

### 7. Chapter 2 – tax policy

#### 7.1 Introduction

The issue in this chapter is to describe policy considerations on tax evasion and tax avoidance, together with the contrasting views relating to tax avoidance.

#### 7.2 Sub issue

The word “tax” comes from the Latin *taxo* which means “I estimate” – an imprecise term, which pre-supposes a process of adjustment. Although an estimation of what was due in tax was no doubt what was intended in the politically fluid times when tax was so named, for reasons set out hereunder, in reality in modern times, tax and its permissible avoidance is now more aptly an estimation of the respective power positions in the balancing act between the rights of the taxpayer and the tax levying authority<sup>15</sup>. In this playing field, there is another variable – the state, or the executive, which levies funds into the fiscus in order to carry out its political will and obligations<sup>16</sup>.

This paper seeks to discuss how tax policy has evolved over time from when “tax” was essentially the spoils of conquest, to modern times when tax – while still a grudge payment - is both something for which benefits may be expected in return, and in respect of which the taxpayer can structure its affairs using tax legislation to minimise tax payments that would otherwise be due.

As a concept, tax avoidance is premised on taxation being levied. Tax is something which is with us from birth (potentially even before<sup>17</sup>) to after death<sup>18</sup>. So much for Twain’s statement that “the only two certainties in life are death and taxes”<sup>19</sup> – since tax survives even death. Once tax is so pervasively part of human life, tax avoidance is a natural temptation (and, most would argue, a right). The application of human

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<sup>15</sup> The fiscus.

<sup>16</sup> In South Africa, Chapter 13 of the *Constitution*, 1996, deals with state revenue, its being collected into a revenue fund and its equitable distribution between the provinces, as well as the rights of different parts of government (regionally and locally) to raise taxes. Treasury (which manages revenue) falls into the executive branch of government under the political Ministry of Finance. There are many revenue laws ranging from those dealing with imports and export (excise) to those dealing with income and other forms of tax.

<sup>17</sup> The benefit which may inure to an as-yet unborn beneficiary of a trust would still be taxed.

<sup>18</sup> Death duties are not paid by the deceased but by his or her estate. Both the fact that in this example and the example immediately above that others would pay the taxes, ignores that the overall tax paid emanates from the fact of the life which came about and which later ended.

<sup>19</sup> The controversy of who in fact came up with the saying is of no consequence for present purposes.

ingenuity to avoid paying more tax than is strictly necessary and the power of the taxing authority to resist that is well documented and is discussed below. The state takes a second bite at revenue collection by targeting tax avoidance schemes in legislation and drawing a finer line<sup>20</sup> in legislation as to what may legitimately be avoided and what may not be<sup>21</sup>.

Unfortunately, tax is also the subject of many illegal stratagems to evade lawful efforts to collect revenue by the state by falsifying or understating details of taxable income or overstating deductions<sup>22</sup>. This paper proceeds on the basis that illegality should not be countenanced and is legitimately criminalised.

Within the context of taxpayers' embarking on the lawful reduction of taxes levied which are owed on the face of it, this paper considers whether one of the key definitions used in general anti-avoidance rules – that is the abnormality of a scheme – is useful or efficient as a test of the lawfulness of tax avoidance schemes for all parties concerned. Put differently, this paper will attempt to analyse whether the “estimation” of tax payable can be made more precise if the test of abnormality is found to be imprecise.

The underlying concept in relation to planning for lawful tax avoidance arises from policy considerations.

Taxation has its roots in the history of humanity. At a penumbral level, in its first iterations taxation was no more than plunder by the powerful, who extracted possessions from the vanquished for their own benefit. Avoidance of such a tax was obviously desirable, but had little finesse – it meant fleeing, defeating the challenger or paying them off<sup>23</sup>.

At an umbral level, taxation in ancient (including biblical) times saw the ruler extracting tax against the will of the taxpayer, but in return being obliged to offer those being ruled protection and later also other benefits in return – with tax revenue being used as the glue binding growing and prosperous societies by creating infrastructure from which

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<sup>20</sup> Specific anti-avoidance provisions are precise; general anti-avoidance regulations are general in nature – Huxham and Haupt (see footnote 6 above) Chapter 17 *Tax Avoidance* par 17.1 p 485.

<sup>21</sup> There are many specific anti-avoidance provisions (not within the scope of this paper), and also general anti-avoidance rules: see sections 80A - L of the *Income Tax Act, 1962*.

<sup>22</sup> There is no tax which is not evaded – customs, income tax, death duties, VAT and other add-on taxes.

<sup>23</sup> An ancient tax was danegeld – literally paying money to the northern raiders so they would leave.

economies could develop<sup>24</sup>. Withholding the expected benefits from taxpayers led some to refuse to pay tax<sup>25</sup>. In time, even the rulers became taxed<sup>26</sup>, and in turn they resorted to tax avoidance<sup>27</sup>. Voluntary payments to the fiscus in the stead of tax are practically unheard of<sup>28</sup>.

The balancing act between taxing authority, ruler and taxpayer is therefore nuanced. In modern times, that nuance has found expression in judicial utterances on tax and tax avoidance. There are many examples, but three selected for this paper have particular resonance in what is stated in this paper.

In *IRC v Duke of Westminster*<sup>29</sup> Lord Tomlin said succinctly –

“every man is entitled to order his affairs so that the tax attaching under the appropriate Acts is less than it would otherwise be”.

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<sup>24</sup> Roman society at the turn of the so-called Christian era is a good example. Rome was governed by emperor Caesar Augustus: “In addition to establishing a basic administrative structure, Augustus also had to monitor the everyday issues of taxation and local services. As a result of the civil war, the state treasury was empty. Augustus, after his conquest of Egypt, had personally received the accumulated treasure of the Egyptian queen Cleopatra and her predecessors as well as a vast ongoing income from Egyptian production, trade, and taxes. He contributed large amounts of this income to the treasury, which he carefully recorded in his public memoirs. He also replaced the corrupt private tax collectors with state employees and managed to balance Rome's budget. For the first time, he established public police and fire protection for Rome and kept close control over grain distribution and the water supply. People in the provinces outside of Rome welcomed the new regime of Augustus with enthusiasm. Augustus planned to integrate the Italians into all aspects of Roman life. When he came to power, the people of Italy remained a mixture of different cultures. Many southern Italians still used Greek, people in the mountain areas spoke different Italic languages, and the Etruscan language had only recently died out. The economic growth that followed the long period of civil war enriched the towns and drew Italy together, but Augustus truly unified ancient Italy culturally, politically, and economically. Under his rule the provinces fared better than they had under the corrupt governors and greedy tax collectors of the republic.” This extract from *Encarta Bible History* refers to the reign of Octavian – Augustus Caesar as he became – the conqueror of the wealth of Cleopatra, and the creator of a viable, economically powerful and tax-efficient state where tax was efficiently collected and generally distributed to provide resources to citizens: “The first Roman emperor, reigning at Christ's birth (Luke 2:1, etc.). His decree that all the world should be taxed, each going to his own city, was the divinely ordered (Micah 5:2) occasion of Jesus' birth taking place at Bethlehem. Born 63 B.C. Also called Octavius and Octavianus from his father, who died while he was young. Educated by his great uncle Julius Caesar, triumvir with Antony and Lepidus. Dissension having arisen, Octavianus overcame Antony, and gained supreme power at the battle of Actium, 31 B.C. Saluted emperor (imperator, military commander in chief originally), and surnamed Augustus Caesar, "majestic." Fausset's *Bible Dictionary*.

<sup>25</sup> “taxation without representation” - noun *American History* a phrase, generally attributed to James Otis about 1761, that reflected the resentment of American colonists at being taxed by a British Parliament to which they elected no representatives and became an anti-British slogan before the American Revolution; in full, “Taxation without representation is tyranny.” Dictionary.com Unabridged Based on the *Random House Dictionary*, © Random House, Inc. 2011.

<sup>26</sup> Queen Elizabeth II agreed that her income would be taxed from 1993 onwards – a reversal of fortunes which played out over centuries back to a time when there was no distinction between the monarch and the treasury.

<sup>27</sup> Queen Elizabeth saved £20m in death duty on her mother's death by virtue of an arrangement with the British Treasury, and deducts the amounts she pays to other royals for their keep from her taxable income.

<sup>28</sup> Even the call by one of the world's richest men, Warren Buffett, to increase fiscal revenue in the United States to reduce the unprecedented federal government borrowing deficit (“Stop Coddling the Super Rich”, op-ed *The New York Times* 16 August 2011) is a call to increase tax rates and not to call for voluntary payments to the state.

<sup>29</sup> [1936] 19 TC 490 at 520.

In this case, the expression “every man” included the 2<sup>nd</sup> Duke of Westminster – a title created by Queen Victoria in a very wealthy English family. At issue was an arrangement made by the Duke with his staff to pay them in a manner which should not alter their income drastically, but admittedly would reduce the Duke’s taxes. This arrangement was permitted as lawful tax avoidance. The reports of the case do not focus on the tax benefit (if any) to the employees.

This expression of tax policy – which is supported in contemporary South African tax jurisprudence<sup>30</sup> - was not followed by MacDonald JP in a 1976 decision<sup>31</sup>, when by contrast he held that –

“... the avoidance of tax is an evil. ...[T]he effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility<sup>32</sup>, 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.”

The judge-president went as far as to call tax avoidance a “nefarious<sup>33</sup>” practice which armed “opponents of our capitalist society with potent arguments that it is only the rich, the astute, and the ingenious who prosper in it”<sup>34 35</sup>.

To this mix must be added the ever-wise words of Justice Learned Hand of the United States of America Supreme Court. He wrote –

“... there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich and poor, and all do right, for nobody owes any

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<sup>30</sup> *Michau v Maize Board* 2003 6 SA 459 SCA where the Court affirmed that “...parties are free to arrange their affairs so as to remain outside the provisions of a particular [taxing] statute.”

<sup>31</sup> *COT v Ferera* 1976 2 SA 653 RAD.

<sup>32</sup> It will be remembered that in 1976 the then Rhodesia was in a precarious financial state – it was heavily reliant on loans from South Africa, and by 1979 was requesting a further loan of R1 billion – *Pik Botha and his Times* Theresa Papenfus 1<sup>st</sup> edition 2010 page 278 – 282.

<sup>33</sup> A view echoed by Lord Houghton, who referred to tax-gatherers considering tax avoiders as “bad citizens” using specialists to outsmart the fiscus, which eventually wishes to search the tax avoider’s conscience: Lord Houghton in *Taxes, the journal of the Inland Revenue Staff Federation*, England, January 1978, quoted in Huxham and Haupt Chapter 17 *Tax Avoidance* par 17.2.1 page 458.

<sup>34</sup> 38 SATC 66 at 70.

<sup>35</sup> In the United Kingdom there is an activist group which targets companies considered to be avoiding tax – [www.ukuncut.org.uk](http://www.ukuncut.org.uk) (which has been followed in the US and Portugal). Church and charitable organisations also target tax avoidance – Christian Aid (a church organisation which has revenue of GBP104m per annum – focuses continually on tax avoidance – see <http://www.christianaid.org.uk/ActNow/blog/aug11/vodafone-enter-public-debate-country-by-country.aspx>. The targets are large retailers, mobile phone companies and banks).

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.”<sup>36</sup>

It seems self-evident that the policy battle shown between the permissive view of tax avoidance in the *Duke of Westminster* case and the harsh disapproving words of MacDonald JP is between the need to fill state treasuries, and taxpayer fatigue in paying taxes. In the United Kingdom, the revenue, customs and treasury estimated that in 2011 about £9 billion was lost due to tax evasion and avoidance – about 2% of their estimate of the total tax due<sup>37</sup> for the fiscal year of 2010 - 2011. At the same time, the United Kingdom has moved to introduce a general anti-avoidance regulation. While the reason for this may have more to do with European Union parity<sup>38</sup> for such rules than because of a change in tax policy in general, it cannot be lost on any observer that (while 2% is a remarkably small percentage) a gap of £9 billion which was estimated to be due to the treasury but not collected is a substantial sum in post-2008 financial crisis times<sup>39</sup>. The treasury – with massive deficits - needs to be filled from wherever possible, and anti-avoidance legislation, or taxes on the wealthy, are a well-recognised place to start<sup>40</sup>. This means that those collecting and paying taxes will look more closely and critically at those who do not either by evasion or avoidance<sup>41</sup>. In turn, courts interpreting anti-avoidance legislation will be influenced at least to some extent by economic considerations when interpreting subjective terms.

It is neither the purpose, nor the aim, of this paper to choose sides in regard to the merits or demerits of the avoidance of tax – or whether it is moral to avoid tax or not. The issues are spelt out so that what is at stake is clear – tax deals with the very commercial existence of modern society where infrastructure must be provided so that an economy can thrive. Its avoidance is in the same way therefore an important corollary which permits those who legitimately avoid tax the opportunity of a pressure release valve –

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<sup>36</sup> *Commissioner v Newman* 159 F 2d 848 (CCA-2 1947).

<sup>37</sup> <https://www.gov.uk/government/policies/reducing-tax-evasion-and-avoidance>.

<sup>38</sup> G Sinfield “The *Halifax* principle as a universal GAAR for tax in the EU” in [2011] *British Tax Review* No.3 Thomson Reuters (Professional) UK Limited.

<sup>39</sup> The position is far worse in Italy in relation both to tax shortfalls and the economy, where a staggering €285 billion (about 18% of GDP) went uncollected in 2012 – see <http://www.economist.com/blogs/schumpeter/2013/01/tax-evasion-italy?fsrc=scn/tw/te/bl/biggovernmentmeetsbigdata>.

<sup>40</sup> The British Labour Party plans to raise the top rate of income tax from 45% to 50% if elected, which would bring in £100m in extra tax revenue (enough to build a half-dozen schools) but it would not make a dent in the British government’s £100 billion deficit – see “Tax rates in Britain”, in *The Economist* The Economist Newspaper February 1<sup>st</sup> 2014.

<sup>41</sup> See footnote 37.

which in itself greases the wheels of commerce. The merits or morality of tax avoidance is not in issue in this paper.

What this paper attempts to confront is the fluid definition of tax as an “estimate”. Given the coercive nature of taxation, the benefits which may flow in efficient societies, and the rights which have accrued to taxpayers over time in return for the payment of tax - for those who choose to (be they leaders or led, the rich or poor, knowledgeable about or laity in tax matters), does the test of abnormality permit all participants to efficiently and optimally determine with precision whether a particular general tax avoidance scheme is likely to be upheld or not. Added to this complication is the impossibility of completely legislating with accuracy in a way which removes the opportunity to find loopholes to reduce tax<sup>42</sup>.

The utility of the exercise is because tax litigation to resolve disputes has considerable downsides. It takes an inordinate amount of time, creates significant expense, and permits uncertainty in the entire process of budgeting for, and collecting or paying tax. None of the downside issues is desirable for any participant<sup>43</sup>.

### 7.3 Conclusion

It is not possible to conclusively determine that the policy which a court adopts will determine the outcome on such a limited sample. However, given the very emphatic language used in the examples from the *Duke of Westminster* and *Newman* decisions, compared with the equally emphatic but opposite view expressed by MacDonald JP, this chapter concludes that the policy which a court adopts in relation to tax avoidance is an important indicator of how a court will apply subjective legal concepts. At the very least, it creates uncertainty for all of the role players in that the subjective policy adopted by a judge may affect the judge’s view on an avoidance measure chosen by the taxpayer – and that can only be known at the time of a trial. It also increases the risk (and cost and time) of an appeal.

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<sup>42</sup> See for example "Pasternak M., and Rico C., *Tax Interpretation, Planning, and Avoidance: Some Linguistic Analysis*, 23 *Akron Tax Journal*, 33 (2008)."

<sup>43</sup> See Vern Krishna "Tax litigation beyond the reach of most people" Legal Post in *Financial Post Canada* 19 April 2011: "The high costs of legal services in tax law — a function of market economics, complexity of the subject, professional malpractice risk and escalating overhead costs — put the resolution of tax disputes beyond the reach of most people. Thus, increasing numbers of individuals must represent themselves before the Tax Court of Canada and in the Federal Court of Appeal. These self-represented litigants impose substantial indirect costs on the judicial system — courts, judges, administrative staff and Crown counsel."

Using subjective terms in anti-avoidance legislation dramatically increases the risk of uncertainty in outcome already introduced by policy.

## 8. Chapter 3 – South African general anti-avoidance measures

### 8.1 Introduction

This chapter describes the history and development of general anti-avoidance measures in South Africa.

### 8.2 Sub issue

South Africa has a long-developed and broad set of anti-avoidance measures<sup>44</sup>. Some arise from the common law, and others from statute. The sub-issue of this chapter is, given the history and content of general anti-avoidance measures, whether “long-developed” anti-avoidance measures also mean that the measures are “well-developed”. It is hypothesised that the measures are developed but that they include subjective measures which create uncertainty.

Before considering a transaction against anti-avoidance measures, both the common law and statute point to looking to the substance, and not only the form, of a transaction being considered for anti-avoidance.

In illustration of the difference between substantive, rather than mere formal, examination of a transaction, in *Erf 3183/1 Ladysmith (Pty) Limited v CIR*<sup>45</sup> the court stated a court must have recourse not only to a written memorial of how the parties to the transaction in question had recorded their intentions, but in addition “[t]he real question is, however, whether they actually intended that each agreement would *inter partes* have effect according to its tenor. If not, effect must be given to *what the transaction really is*”<sup>46</sup>[my emphasis].

In other words, it was insufficient to merely look to the words of the agreement or agreements proffered to explain what the taxpayer had intended – the court must go further and ascertain what the transaction really achieved<sup>47</sup>.

Once the true nature of the arrangement has been determined, in the common law the general principles applicable to any arrangement mean that if the substance of the

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<sup>44</sup> Silke *Income Tax* 2010 Service par19.2 p 19-6-1 describes a long process of judicial striving.

<sup>45</sup> 1996 3 SA 942 A.

<sup>46</sup> The full discussion is found at *Erf 3183/1* 953 A – F.

<sup>47</sup> This is a transcending theme – see for instance *King* footnote 59 below.

arrangement – whatever its form – are misleading, fraudulent or a sham or an abuse of a right<sup>48</sup> then the arrangement may either be set aside or ignored.

The same approach is taken in legislation<sup>49</sup>. The two approaches in the common law and general anti-avoidance legislation therefore look to the facts of the transaction, and then apply the law. The facts are objectively determinable, but only if the facts are as they appear.

This is illustrated in *Zandberg v van Zyl*<sup>50</sup> where the judgment reads –

*“Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived, They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is: not what in form it purports to be. The maxim then applies plus valet quod agitur quam quod simulate concipitur<sup>51</sup>. But the words of the rule indicate its limitations. The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention.”<sup>52</sup>*

The *plus valet* maxim is a powerful tool of the common law in order that a Court may determine objectively what the parties intended - which is subjective. In the context of this paper, the tax collector would be asking the Court to invoke the maxim in order that the true intention of a taxpayer be laid bare, rather than to rest with what the taxpayer says it intended subjectively.

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<sup>48</sup> For a useful summary of the common law position see Cassidy, J “Tainted elements or nugatory directive? The role of the general anti-avoidance provisions (“GAAR”) in fiscal interpretation” *Stell LR* 2012 2 319

<sup>49</sup> Which therefore can be said to supplement the common law. See the discussion in relation to *CIR v King* below, and also Chapter 3.

<sup>50</sup> 1910 AD 302.

<sup>51</sup> The famous axiom of the Roman lawyer Ulpian: *plus valet quod agitur quam quod simulate concipitur*.<sup>51</sup> “What it says is that truth and not simulation will win the day” – a loose-hand but apt translation by Professor Kobus van Rooyen referring to *Zandberg*, in a talk marking the 90<sup>th</sup> anniversary of the law faculty at the University of Pretoria.

<sup>52</sup> *Zandberg* 309.

The first point of departure lies in examining the difference between subjective and objective measures.

Subjective questions are those which are classically answered by stating an opinion of the person asked the question. This should be contrasted with an objective question, which is described as one answered with a “yes” or “no” response – or where the answer is one with which a reasonable person<sup>53</sup> would respond<sup>54</sup>.

Not content with the benefits of the common law, the legislature has enacted several general anti-avoidance measures, as will be explained. Legislation is introduced in the context of tax avoidance for a number of reasons – its proponents say that such legislation, particularly when similar terms are used in different countries (such as in the EU), creates certainty (again, particularly for businesses operating across those borders)<sup>55</sup>. It introduces specificity and removes omnibus sections and generalities<sup>56</sup>. It increases the reach of the anti-avoidance provision and provides a deterrent against improper anti-avoidance provisions<sup>57</sup>. It is not clear to this writer from reading the proponents’ view how it is that the *plus valet* rule was less certain or filled with generalities, or how the enactment of the legislation set out below has changed the ease with which tax avoidance is measured.

During recent history, there have been three overall sets of general anti-avoidance measures. Section 103<sup>58</sup> was introduced by the legislator following the decision in *CIR v King*<sup>59</sup> which dealt with the legislation as it was in 1941<sup>60</sup>, and which cut down much of the effectiveness it was hoped section 90 would have against tax avoidance. Section 90 of the 1941 Act inserted the first general anti-avoidance provision into South African

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<sup>53</sup> The so-called “reasonable man” test.

<sup>54</sup> The way that National Treasury sees things sums the legislation up well – “If it were possible for the Legislature, through an ideal medium of communication to precisely define the exact ambit, scope and intended effect of each and every provision of a tax statute with absolute clarity and certainty with regard to all possible factual situations (both past, present and in future), then the taxpayer’s factual situations would, when viewed objectively and with a complete understanding thereof, simply fall within or beyond the clearly discernible parameters of the potentially applicable provision of the relevant tax provision. Unfortunately such an ideal medium of communication is not available to the Legislature and hence disputes between the fiscus and taxpayers are a part of our lives...” – text of speech by J Moleketi, Deputy Minister of Finance – 9 June 2005.

<sup>55</sup> See footnote 38 above, at page 236.

<sup>56</sup> Lord Houghton – see footnote 6 above, page 6.

<sup>57</sup> According to the South African Revenue Services – see footnote 62 below.

<sup>58</sup> Section 103(1) of the *Income Tax Act*, introduced in 1962.

<sup>59</sup> 1947 2 SA 196 AD, 14 SATC 184.

<sup>60</sup> Section 90 of the *Income Tax Act*, 1941 – “Whenever the Commissioner is satisfied that any transaction or operation has been entered into or carried out for the purpose of avoiding liability for the payment of any tax imposed by this Act, or reducing any such tax, any liability for any such tax, and the amount thereof, may be determined, and the payment of the tax may be required and enforced, as if the transaction or operation had not been entered into or enforced....”.

tax legislation. It provided that when the commissioner was satisfied that any transaction or operation was entered into or carried out to avoid or reduce liability under the Act, then the commissioner may determine liability for tax to be paid and enforced as if the arrangement or operation had not taken place<sup>61</sup>.

The main elements of the section are therefore that there be an arrangement, a tax benefit attributable to the arrangement, and a tax avoidance or reduction<sup>62</sup>.

*King* is a fascinating insight into a judicial approach on general anti-avoidance provisions. In fact, there were two appeals which were dealt with, on similar facts, apparently in relation to members of the same King family. Shares (and the right to receive dividends due on them) were sold and transferred prior to the end of a tax year, meaning that the purchaser and not the seller was obliged to pay tax on the dividend income earned<sup>63</sup>. The purchase price was lent to the purchaser by a family business, and the seller was credited in the companies' books with the purchase price lent. The shares were pledged to the company as security, and the company was entitled to use them as security for its own debts. The purchaser was entitled to only a portion of the dividends received, although was credited with the full amount of such dividends against the outstanding loans.

The court was unanimous that the subjective terms "avoiding liability" or "reducing any such tax" were ambiguous in regard to the tax period involved, and should be read to refer to anticipated liabilities for tax<sup>64</sup>. In this regard, if a taxpayer closed a business or resigned a job, the court said, this avoided liability for tax or reduced the amount of tax payable. So too the taxpayer could contract expenses against which deductions from tax could be sought. To establish in these circumstances what tax the taxpayer should have been subject to would be "insoluble" and involve "countless possibilities" of what might otherwise have been done by the taxpayer<sup>65</sup>.

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<sup>61</sup> The terms are set out more fully in footnote 60 above.

<sup>62</sup> I am borrowing from an analysis by SARS Legal and Policy Division in relation to section 103 (see footnote 58 above) "*Tax Avoidance and Section 103 of the Income Tax Act, 1962 – Revised Proposals*" paragraph 4 ("Tainted Elements") page 5 September 2006.

<sup>63</sup> The judgment is not entirely clear on what the Commissioner was dissatisfied with, since the purchaser would then be liable for tax on the income. Only the question of the seller's tax liability was in issue. It is assumed that the seller's marginal tax rate was higher than the purchaser's – super tax (see *King* page 206). The judgment assumes that the sale price of the shares was lower than the market price – *King* at 204 - 205.

<sup>64</sup> *King* 207.

<sup>65</sup> *King* 208.

Counsel for the commissioner had argued that under section 90 the commissioner had a discretion whether or not to use its provisions - section 90 said that the commissioner “may” determine and charge tax. The Court held that this did not save section 90 from absurdity – the legislation was imposed by the legislature and not by the commissioner, and was legislation passed in the public interest in which regard the commissioner would be acting by applying it, or declining to do so. “[I]f a transaction is covered by the terms of the section its provisions come into operation, if it is not then its provisions cannot be applied”<sup>66</sup>. (The intention is to ensure the fisc is properly funded as parliament intended it should be, and not in the discretion of the commissioner.)

It was an absurdity to assume that the hypothetical examples<sup>67</sup> the court had given were the mischief which the legislature intended to prevent. The court said:

*“... it should be realised that there is a real difference between the case of a man who so orders his affairs that he has no income which would expose him to liability for income tax, and the case of a man who so orders his affairs that he escapes from liability for taxation which he ought to pay upon the income which is in reality his”*<sup>68</sup> [my emphasis].

The transactions which the legislator had enacted section 90 to prevent were those orderings of his affairs which caused a taxpayer to escape from liability for taxation which he ought to pay upon the income which in reality was his. The same applied to a reduction in liability for tax, the court said.

In the two *King* cases, the court concluded<sup>69</sup> that the tax event – the right to receive the taxable dividend income – had clearly passed from the seller to the purchaser with the sale of the shares. The taxpayer was entitled to do precisely that, and to avoid liability for taxation on the dividend amount.

Both the main judgment<sup>70</sup> and the supplementary but concurring judgment<sup>71</sup> dealt at some length with the effect of the disposition of dividends – in other words, the factual and legal consequences of the transaction which the commissioner wished to impugn.

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<sup>66</sup> *King* 209.

<sup>67</sup> See footnotes 64 and 65 above.

<sup>68</sup> *King* 210.

<sup>69</sup> *King* 213.

<sup>70</sup> *King* 213 – 215.

<sup>71</sup> *King* 217 – 218.

The facts are important in determining the legal consequence (see the discussion in relation to *NWK* below<sup>72</sup>).

The supplementary but concurring judgment<sup>73</sup> contains further useful analysis. In regard to the findings in the main judgment of over-breadth and absurdity the supplementary judgment agreed<sup>74</sup>. It was fundamentally difficult however to avoid throwing the baby out with the bathwater – “giving [section 90] a meaning which, because of its absurd, and indeed revolutionary, consequences the Legislature could not have intended, and, on the other hand, giving it no meaning at all”<sup>75</sup>.

The supplementary judgment did not view section 90 as a penalty section – “It was intended, I think, to deal with cases in which the Commissioner, as representing the *fiscus*, is properly aggrieved by a transaction or operation designed to enable one of the parties thereto to escape tax”<sup>76</sup>. And further – “it is designed to meet the Commissioner’s objections to the creation of abnormal and unnatural situations, to the detriment of the *fiscus*”<sup>77</sup>. That was the situation the Commissioner was legitimately entitled to object to using the provisions of section 90:

*“In such cases, and in my view in such cases alone, it can be said that the Commissioner is seeking to tax the taxpayer on what is “in reality his income” ... [using the expression of the main judgment]. It is in reality his income because it should have accrued to him and it can only be said that it should have accrued to him if it was the fruit of his capital or of his labour or of both”*<sup>78</sup>.

What *King* adeptly answered was that where an element of the subjective existed, confusion, uncertainty or absurdity entered the picture.

Intriguingly it offered a simple subjective test – the taxpayer escaping liability for tax which was in fact owed by that taxpayer – which has been in turn ignored in successive legislation.

The decision in *King* therefore came to a similar conclusion to that in the *Duke of Westminster* decision, and it became necessary in the view of the Commissioner for

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<sup>72</sup> Footnote 93.

<sup>73</sup> *King* 215.

<sup>74</sup> *King* 215 – 216.

<sup>75</sup> *King* 215.

<sup>76</sup> *King* 216.

<sup>77</sup> *King* 216.

<sup>78</sup> *King* 216.

Inland Revenue that the legislator tighten up the legislation. With the march of time and the expertise of taxpayers and their advisors<sup>79</sup>, this measure too became outmoded<sup>80</sup> and in 2006 Sections 80A and following were inserted into the Income Tax Act.

Abnormality was the concept imported by section 103<sup>81</sup>. Section 103 sought (in a similar structure to section 90, but with additional armour<sup>82</sup>) to permit the secretary to disregard any transaction, operation or scheme which was entered into or carried out, and which has the effect of avoiding, postponing or reducing tax liability which – in the opinion of the secretary, having regard to the circumstances under which the transaction, operation or scheme was carried out<sup>83</sup> – was done in a manner which would not normally be employed in dealings of that nature<sup>84</sup>, or between persons dealing at arm's length<sup>85</sup>. The additions introduced by Section 103(1) compared with Section 90 were to include the concepts of a scheme, the postponement of any liability for tax, regard being had to the circumstances, abnormality, and an arm's length transaction.

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<sup>79</sup> As foreseen in *King* when the court said that an "ingenious person" may avoid or reduce liability for tax, but that the mischief was in avoiding or reducing such tax which was "in reality his income" – *King* 210.

<sup>80</sup> The *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006* [WP2-06] reports that the "increasingly sophisticated forms of impermissible tax avoidance" rendered the law ineffective, and made the change to the law necessary. This was presaged by Minister Moleketi's comments in his speech (footnote 54 above) – "The truth is that ordinary everyday language remains the vehicle of the Legislature's communication with the taxpaying public regarding the individual's tax obligations. A further reality is that fiscal legislation is often directed at highly complicated transactions found in the modern commercial world."

<sup>81</sup> See footnote 58 above.

<sup>82</sup> The general section – subsection 1) was deleted in 2006 when S80A was inserted. The remaining part reads : (2) Whenever the Commissioner is satisfied that—

- (a) any agreement affecting any company or trust; or
- (b) any change in—

- (i) the shareholding in any company; or
- (ii) the members' interests in any company which is a close corporation; or
- (iii) the trustees or beneficiaries of any trust,

as a direct or indirect result of which—

- (A) income has been received by or has accrued to that company or trust during any year of assessment; or
- (B) any proceeds received by or accrued to or deemed to have been received by or to have accrued to that company or trust in consequence of the disposal of any asset, as contemplated in the Eighth Schedule, result in a capital gain during any year of assessment,

has at any time been entered into or effected by any person solely or mainly for the purpose of utilizing any assessed loss, any balance of assessed loss, any capital loss or any assessed capital loss, as the case may be, incurred by the company or trust, in order to avoid liability on the part of that company or trust or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof—

- (aa) the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed;
- (bb) the set-off of any such assessed loss or balance of assessed loss against any taxable capital gain, to the extent that such taxable capital gain takes into account such capital gain, shall be disallowed; or
- (cc) the set off of such capital loss or assessed capital loss against such capital gain shall be disallowed.

<sup>83</sup> Section 103(2).

<sup>84</sup> Section 103(2)(i).

<sup>85</sup> Section 103(2)(ii).

From a substantive viewpoint, what was added was the requirement for a “tainted element”<sup>86</sup> – being a combination of abnormality and the absence of a proverbial arm’s-length between the transactors.

At the end of 2005, the tax authorities together with the Minister of Finance invited a discussion on section 103 and the role of the anti-avoidance provisions<sup>87</sup>, together with proposals on how to amend section 103. As the legislation and debates around it progressed, SARS indicated that it would not alter the approach taken in section 103<sup>88</sup> but that it would buttress the “tainted elements” (which in section 103 were abnormality and the absence of an arm’s length), but would add two additional tainted elements – that there be commercial substance to and the elevation of the purpose of the statute<sup>89</sup>. Ironically, SARS observed that the extensive public input into the draft legislation had resulted in an increase in the length and complexity of the proposed wording<sup>90</sup>. Ultimately the provisions were enacted in sections 80A and following inserted in to the 1962 Act, which focussed on transactions where the sole or main purpose was to avoid or reduce tax<sup>91</sup>, or which were lacking commercial substance<sup>92</sup>.

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<sup>86</sup> See footnote 62 above.

<sup>87</sup> See footnote 62 above – page 1.

<sup>88</sup> See footnote 62 above.

<sup>89</sup> See footnote 62 above – pages 5-6.

<sup>90</sup> See footnote 62 above – page 1.

<sup>91</sup> Section 80A which reads : **80A. Impermissible tax avoidance arrangements.**—An avoidance arrangement is an impermissible 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).

<sup>92</sup> Section 80C which reads : **80C. Lack of commercial substance.**—

- (1) For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.
- (2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to—
  - (a) 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

[Para. (a) substituted by s. 40 (1) of Act No. 8 of 2007 deemed to have come into operation on 2 November, 2006 and applicable in respect of any arrangement (or any step therein or parts thereof) entered into on or after that date.]

Wording of Sections

### 8.3 Conclusion

The chapter tentatively concludes that South Africa has a long-developed set of general anti-avoidance measures, but that the extent of purely subjective tests in such measures unduly clouds judicial examination of the measures, creating uncertainty for taxpayers and revenue officials. This will be addressed in the following chapters. Complex subjective tests are unnecessary.

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- (b) 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.

## 9. Chapter 4 – the *NWK* decision and “abnormality”

### 9.1 Introduction

The issue in this chapter is an examination of the *NWK* decision<sup>93</sup>, testing that decision against the preliminary conclusions in chapter 3, and looks at the concept of “abnormality” more closely: forming a basis for further analysis.

### 9.2 Sub issue

The facts which gave rise to the *NWK* decision are bizarre<sup>94</sup>. As best summarised for these purposes, a written agreement of loan was concluded between a bank and its customer lending R96 415 776 to the customer – the taxpayer. In fact only R50m was advanced under the loan. However, a complex matrix of agreements, some with third parties, appeared to give the customer the right to claim a deduction against income for the purposes of calculating what tax was due based on interest calculated on the higher amount of R96 415 776 – with reference to promissory notes issued by the taxpayer. Rather like in the *King* case<sup>95</sup>, security was given and taken, and it appeared that the repayment of the debt (in the form of a commodity which the taxpayer regularly sold) was hedged to avoid the possibility of a non-payment of the debt.

The Court held that the loan for R96 415 776 “was a transaction designed to disguise the real agreement between the parties – a loan of R50m”<sup>96</sup>. It accordingly did not need to look at the general anti-avoidance legislation, but the Court concluded that : “There appears to me to be no reason why an invalid transaction [the consequence at common law of the transaction being disguised] cannot also be abnormal [the test in s 103 of the *Income Tax Act, 1962*]”<sup>97</sup>.

Until this point, the analysis of *NWK* appears to be little removed from the shorthand test devised in *King*<sup>98</sup>. The transaction was admittedly unusual, and no good reason for it appeared to exist in the form in which it was transacted.

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<sup>93</sup> *Commissioner for the South African Revenue Service v NWK Limited* 2011 2 SA 67 SCA.

<sup>94</sup> Lewis JA who wrote the judgment thought that the words “What a charade” adequately described them - *NWK* at 72E.

<sup>95</sup> See footnote 59 below.

<sup>96</sup> At 87J – 88A.

<sup>97</sup> At 88G – H.

<sup>98</sup> See footnote 68 above – in that the taxpayer had resisted reporting correctly what the true quantum of the deduction against income should have been.

The evidence showed that the borrower needed - and was advanced - R50m. Its financial resources were such that the purported loan amount of some R96 million was not required by the borrower. Security - a normal requirement for a bank loan - was not given for the R50m actually advanced, particularly strange since the advance was made from a subsidiary of the bank whose financial position would by implication be less strong than that of the bank, and therefore more likely to require security. It also made the other elements of the transaction - forward sales etc - seem out of proportion in regard to their complexity. And, crucially, there was no need for the agreement to have been concluded in this convoluted form<sup>99</sup>.

The judgment compared this position with the facts giving rise to the decision in *Commissioner for Inland Revenue v Conhage*<sup>100</sup> dealing with the same taxation principles, where there had been a sale of an asset owned by the taxpayer, which it then leased back since it "permitted the manufacturer [taxpayer] to retain possession of the equipment"<sup>101</sup>. There was a commercial rationale for the transaction which - had the purchaser not paid for the equipment - meant it would not have become owner, and there was therefore a genuine passing of ownership. In *NWK* there was neither a commercial rationale nor did ownership of the maize (which formed a backdrop to the transaction) pass in reality<sup>102</sup>.

Since it is not within the scope of this paper to analyse whether the finding of the court in *NWK* was correct or not, the facts and findings will not be carefully dissected, but it would not have been surprising if once this conclusion was reached the court simply concluded that the transaction was simulated, either under the *plus valet* rule or in terms of the then-applicable section 103<sup>103</sup>.

The judgment however seemed constrained to carry on further - :

*"In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the*

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<sup>99</sup> At 80G and following.

<sup>100</sup> 1999 4 SA 1149 SCA .

<sup>101</sup> At 80D.

<sup>102</sup> At 80D.

<sup>103</sup> Broomberg – see footnote 113 below.

*commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion [it has been observed in several places that the court must have meant "avoidance", since evasion is always unlawful] 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."*<sup>104</sup>

It is suggested that the *NWK* decision could have been decided without the need for this construct of the test of simulation - after all, the agreement was on the face of it for a loan of some R96m when in fact only R50m was lent and advanced, and only R50m plus the interest and other charges needed to be repaid. There was no pretence at lending and advancing the amount of R96m. It is difficult to see why it was necessary to add "something more" to what a court required in order to determine the outcome, since the *plus valet* rule, or the interpretation of what the court was required to do in *King* would have presumably yielded an intellectually-satisfactory answer. But the court did do so, and the proverbial cat was set amongst the pigeons.

In finding as it did, and possibly upsetting years of established law, *NWK* appeared to have missed the benefit of the careful analysis of *King*<sup>105</sup> or Lord Houghton<sup>106</sup> - that the common law wished to punish the mischief of things not being as they appeared, and statute went only as far as parliament had expressed itself. In this sense, *NWK* may be read as fiscus-minded<sup>107</sup>, rather than an impartial analysis of whether the taxpayer had to pay tax without the benefit (to adapt *King* to the facts of *NWK*) of being spared with deductions from income which were not rightfully its to claim. This may be discerned from its incorrect reference to evasion in the place of avoidance. Policy may therefore have played a hand in the court's analysis, but this was based on the fact that the court found the transaction abnormal<sup>108</sup>

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<sup>104</sup> At 80E – F.

<sup>105</sup> See footnote 59 above.

<sup>106</sup> See footnote 6 above.

<sup>107</sup> "One can understand, of course, that Lewis JA evidently considers it to be unacceptable that members of the public should be permitted to enter into transactions which create binding rights and obligations. For the sole purpose of avoiding tax; and many may agree with that sentiment. That, however, does not justify the Court in overriding the basic common law principle, and in creating a new common law rule to counter such tax-avoidance." – Broomberg page 199 par 18 – see footnote 113 below.

<sup>108</sup> See footnote 94 above.

The supplementary judgment in *Bosch and McClelland v CSARS*<sup>109</sup>, which concurred in the finding in the main judgment, provides an instructive overview of the concerns which arose after *NWK*. Noting that the main judgment had found nothing in the "careful" judgment in *NWK* showed that *NWK* was intended to alter the basic principles for determining simulation in a contract<sup>110</sup>, the supplementary judgment recorded that:

*"NWK is a dramatic reversal of what has been a consistent view of what constitutes a simulated transaction. NWK, considered in its entirety, not by extraction of words and phrases out of their real context, does in fact lay down the rule that any transaction which has as its aim tax avoidance will be regarded as a simulated transaction irrespective of the fact that the transaction is for all purposes a genuine transaction"*<sup>111</sup>.

It was important, the supplementary judgment said, to avoid the "confusion" caused by *NWK* (illustrated by the main judgment in *Bosch* saying that *NWK* did not intend to depart from long-standing precedent, while the pre-eminent tax practitioner and author Broomberg<sup>112</sup> said it did so intend). This was especially so if the *NWK* judgment should be read as referring to tax avoidance (rather than evasion, as it did), since it then went "... against the accepted practice in our Income Tax Law which permits transactions aimed at tax avoidance".

So where did *NWK* go wrong? In *Bosch*, both judgments refer to the critique of *NWK* by E Broomberg<sup>113</sup>.

Broomberg thought *NWK* made a number of wrong findings or assertions. The finding that: "If the purpose of the transaction is only to achieve an object that allows the evasion [avoidance?] of tax, or of a peremptory law, then that will be regarded as simulated" recognised, wrote Broomberg, a new class of simulated transaction<sup>114</sup>: a deemed simulation even if the underlying transaction was genuine, but sought only to avoid tax.

Broomberg pointed to a number of what he thought were flaws in the reasoning in *NWK*. Firstly, he criticized the suggestion that even if the parties intended to be

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<sup>109</sup> 2013 5 SA 130 WCC.

<sup>110</sup> At 151G.

<sup>111</sup> At 158G.

<sup>112</sup> See footnote 113 below.

<sup>113</sup> Broomberg, E "NWK and Founders Hill" in 2012 *The Taxpayer* (60) page 187.

<sup>114</sup> Broomberg page 203 par 35.

genuinely and legally bound, the transaction would be deemed simulation if their sole purpose was to avoid tax (remembering that *NWK* was decided on the common law, and not under section 103)<sup>115</sup>. Second, he referred to the use of the word evasion when it seems plain that avoidance was intended<sup>116</sup>. But, he wrote, even if the judgment had intended avoidance rather than evasion, the rule it postulated was difficult to make sense of<sup>117</sup>. And, it departed from a long line of established precedent<sup>118</sup>. In doing so, *NWK* must have contemplated that there were compelling reasons to overturn the established position, that prior judgments on simulated transactions were wrong<sup>119</sup>, and that the new formulation of the rule would eliminate the mischief aimed at<sup>120</sup>. In each instance, Broomberg wrote, *NWK* was misguided and misleading and introduced something unnecessary. In addition, the departure from precedent damaged a vital component for giving certainty both to the law and how it is interpreted<sup>121</sup>.

Although much of the detail of Broomberg's analysis is not within the bounds of this paper, there is one area of the detail which requires attention. Notwithstanding that *NWK* was determined on the common law principles, or whether the decision did change the common law in fact (as the main judgment in *Bosch* said it had not<sup>122</sup>), Broomberg analyzed the summary of the case law over the years which had been dissected for the purposes of that court reaching its decision in *NWK*<sup>123</sup>. Broomberg points out that in none of the authorities cited did the *facts* so patently support the argument that the transaction was simulated. "Indeed, in some respects, the arrangement in the *NWK* case were so bizarre, that the learned judge, in the midst of her recording of the plain facts, was prompted to make the rather odd interpolation : "The reader might well say 'What a charade'". And later : "... the conclusion of the Court in the *NWK* case, that the transaction in question was simulated, seems to have been based on the actual facts found, not on a deemed simulation pursuant to the application of the rule".

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<sup>115</sup> Broomberg page 203 par 35.

<sup>116</sup> Broomberg page 198 par 7.

<sup>117</sup> Broomberg page 198 par 8 – 9.

<sup>118</sup> Broomberg page 198 par 7.

<sup>119</sup> Broomberg page 198 par 11.

<sup>120</sup> Broomberg pag 201 par 26.

<sup>121</sup> Broomberg page 199 par 17.

<sup>122</sup> See footnote 110 above.

<sup>123</sup> Broomberg page 203 par 41 and following.

With this in mind, it is useful<sup>124</sup> to examine the approach taken in the majority judgment in *Randles Brothers*<sup>125</sup> (a leading authority<sup>126</sup>), where the court said that four steps had to be taken by a court in examining a simulated transaction. First, to look at the words of the legislation, and to find their meaning. This is a legal enquiry. Second, to look at the words used in the contract in question, and to see how the legislation impacted on such an agreement. This, too, is a legal enquiry. Third, to decide - as a matter of fact - whether the contract (duly interpreted and placed in a legislative context) represented the genuine intentions of the parties. The final step - a legal enquiry - was to determine whether the rights and obligations so ascertained, were within or outside of the legislation<sup>127</sup>.

While explaining that there were indeed differences on each question by the judges in the authorities which *NWK* examined, Broomberg makes this important point: the judges differed on issues of law, and because the learned judges had placed different interpretations on the contracts, not surprisingly, they arrived at different answers<sup>128</sup>. Broomberg concludes that the judgments were not - as suggested in *NWK*<sup>129</sup> - inconsistent, but rather the different judges' conclusions followed automatically from their contrasting views on the law<sup>130</sup>.

There was therefore no reason to create a new rule for dealing with the interpretation of simulated contracts in fiscal matters - but more importantly for the purposes of this paper the different conclusions reached by the highly respected judges referred to in *NWK* shows just how important it is for legislation (and in turn contracts) to be clear and easily ascertainable. It follows axiomatically that the more complex, uncertain or unwieldy any term is that is used in legislation the greater the degree of risk that an unpredictable or divided judgment will be arrived at.

And, it is submitted, the term "abnormal" must rank pretty high up in the digest of complex, uncertain or unwieldy terms<sup>131</sup>. Quirkily, the term does not refer to the

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<sup>124</sup> In regard to this formulation of reasoning I am indebted to an earlier, unpublished draft of his article, by Broomberg.

<sup>125</sup> *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* 1941AD 369.

<sup>126</sup> In *NWK* it is referred to as having "classic" statements - at 77C.

<sup>127</sup> *Randles Brothers* at 394.

<sup>128</sup> Broomberg page 204 par 45, par 45 - 46.

<sup>129</sup> See for instance the reference to a "divergence in application" between principles in *NWK* at 78B.

<sup>130</sup> Broomberg page 204 par 46.

<sup>131</sup> *Abnormal* *adj* 1. Not normal; deviating from the usual or typical; extraordinary. 2. *Informal*. odd in behaviour or appearance; strange - *Collins English Dictionary* 3<sup>rd</sup> edition HarperCollins Publishers Glasgow.

opposite of normal in the way of antonyms<sup>132</sup>, suggesting that it is not an antonym. Assuming that what is intended is therefore a movement “from<sup>133</sup>” normal, there are a number of issues which arise.

The first question which is begged is to whom the definition of normality belongs. In the fiscal legislation, the luxury of this and the onus of proving otherwise are settled – the tax authorities decide what is abnormal, and the taxpayer has the onus of proving otherwise<sup>134</sup>. But that does not stop the moving target of what is normal, and what is not. Ultimately, that is for the court to decide, and an analysis of *NWK* shows that questions of legal interpretation in anti-avoidance cases (no matter what the stature of the judgment in the legal arena) are seldom without controversy<sup>135</sup>.

An analysis of the tidy reasoning in a tidy case such as *Conhage*<sup>136</sup> shows that certainty in relation to policy and interpretation of the common law and statute is not an unattainable abstract. In *Conhage*, at issue was the true nature and substance of two agreements which in form comprised sales and leasebacks of equipment<sup>137</sup>. The taxpayer had sought to deduct rentals which resulted from the leaseback as expenditure<sup>138</sup>. Many of the legal issues already dealt with in this paper were raised by the parties<sup>139</sup>. The court affirmed that the onus lay on the taxpayer to show that the transactions were authentic<sup>140</sup>, and recorded that the taxpayer had led evidence that had been accepted by the Special Court<sup>141</sup>, and then wrote as follows:

*“The fact of the matter is that the evidence that the parties had every intention of entering into agreements of sale and leaseback and of putting the agreements into effect was not contradicted. The result was that the Special Court had no option but to accept it unless the witnesses were not reliable, or all the available*

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<sup>132</sup> “unnatural”, or “not normal”.

<sup>133</sup> “Ab” in Latin means “from”.

<sup>134</sup> In the *Income Tax Act*, 1962, for instance the consequences for “impermissible tax avoidance” lie in the hands of the commissioner (sections 80B and 80H), and the onus lies on the party claiming the tax benefit to prove another purpose than solely a tax benefit (section 80G).

<sup>135</sup> It would be difficult to imagine many cases where a subsequent court of final appeal critically supplements the finding of an earlier one – especially where the earlier court’s judgment is considered a “classic”, as was the case in *NWK*’s reference to *Randles Brothers* - which the court in *NWK* said showed “divergent” views: *NWK* at 78B. Indeed, Broomberg described it as a “daunting responsibility of overturning the century-old common law principle which lies at the heart of our legal system...” – Broomberg page 198 par 7.

<sup>136</sup> See footnote 100 above.

<sup>137</sup> *Conhage* at 1155I.

<sup>138</sup> at 1156A.

<sup>139</sup> For instance form over substance, the true nature of the agreement, disguised transactions – at 1155G – 1156G.

<sup>140</sup> At 1157G.

<sup>141</sup> See *Income Tax Case No 10229 1998 6 JTTLR 139 E*.

*information and such inferences as might reasonably be drawn, were cogent enough to cast sufficient doubt thereon.”<sup>142</sup>*

It is therefore incumbent on the party in such litigation to discharge the onus or evidential burden on it<sup>143</sup>, and not to muddy the waters created through interpretation of legislation and contracts by failing to give the court deciding the matter a full and thorough exposition of the facts which will apply.

### **9.3 Conclusion**

The purely subjective concept of “abnormality” or other similar terms is a poor predictor of the lawfulness or otherwise of a scheme for the avoidance of tax, and tends to introduce uncertainty for both tax collector and tax payer.

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<sup>142</sup> At 1158E. The court found that the special court had not erred – at 1158F.

<sup>143</sup> The third step in *Randles Brothers* – see footnote 127 above.

## 10. Chapter 5 – is “abnormality” necessary?

### 10.1 Introduction

This paper has already tentatively concluded that policy<sup>144</sup> and uncertainty created through the introduction of subjective and uncertain terms<sup>145</sup> muddy the waters for tax-collectors and taxpayers alike. Policy is a pervasive factor, impossible to remove. The issue in this chapter is to consider the benefit of subjective concepts such as “abnormality” introduced into South African general anti-avoidance legislation, and whether such terms can be avoided entirely.

### 10.2 Sub issue

It would be difficult to find a serious writer who would contend that no tax should be paid<sup>146</sup>. It is much easier to find a source arguing that more tax should be paid<sup>147</sup>, or that the common law rules are insufficient in preventing tax leakage<sup>148</sup>.

This chapter starts from the premise that tax has to be collected for the public good, and that it should be collected in a fair and equitable way. This is however affected also by policy<sup>149</sup>. The problems with the application of the general anti-avoidance rules themselves identified in the preceding chapters start with the way that the courts interpret the law (see the formulation in *Randles Brothers*). Interestingly, although it is well beyond the scope of this paper, at face value the difference of interpretation of the facts between the special court in *NWK* and on appeal seems unusual – normally the facts are common cause. Rather it is in understanding what the law says and interpreting the agreements which the taxpayer has interposed which creates the greatest divergence<sup>150</sup>.

If the premise is that tax has to be collected, and further that the general anti-avoidance rules are a necessary part of that, then one has to test whether the common law is sufficient. Most commentators concede that the common law is limited in its extent in

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<sup>144</sup> See chapter 2.

<sup>145</sup> See chapter 4.

<sup>146</sup> In South Africa there is an Abolition of Income Tax and Usury Party which does have the view that taxes should be abolished - [http://www.abolishtax.org.za/#TAXATION POLICY](http://www.abolishtax.org.za/#TAXATION%20POLICY).

<sup>147</sup> That is the reason for general and specific anti-avoidance legislation – see for instance footnotes 13, 40 and 54 above.

<sup>148</sup> “It is concluded that because of, *inter alia*, the limited scope of the[se] common-law principles they are not sufficient to combat tax avoidance” – Cassidy at 320: see footnote 48 above.

<sup>149</sup> See for instance chapter 2.

<sup>150</sup> For instance see the analysis of the law in *NWK* and the critical analysis of that by Broomberg.

relation to general anti-avoidance<sup>151</sup>. The present general anti-avoidance rules are wider than the common law<sup>152</sup>. However, some argue that the way that the courts interpret such legislation in South Africa is too literal<sup>153</sup> thus inhibiting the effectiveness of anti-avoidance legislation, and that courts should be more purposive<sup>154</sup> in interpreting the legislation (which means that the court should determine the purpose or mischief which parliament had intended to stop). It is difficult to advance such a proposition though (especially after *NWK* – which widened the common law rules), since the purpose of the legislation in the anti-avoidance context is to delineate what is permissible avoidance and what is not – and not, as the critics seem to suggest, to move that line in favour of the fiscus.

Also, the legislature has free rein and authority to alter the common law through legislation, or to amend statutes to take into account the effect of court judgments which are adverse to it, or to close loopholes taxpayers have found. That it does not do so, and since legislation in fact encourages some forms of avoidance (for instance, allowing the deduction of donations<sup>155</sup>), suggests that it is not the legislation or how it is interpreted – but rather its content – which is at the root of the problem facing enforcement of general anti-avoidance rules. There are enough checks and balances (including the placing of the onus) which permit of confidence that the way courts interpret the legislation is not at the root of how uncertain the application of the anti-avoidance rules are.

But the question of the role of amorphous policy and uncertain language in general anti-avoidance legislation also has a more sombre place in our law. Any law (whether at common law or in statute) which is uncertain offends against the rule of law<sup>156</sup>. The rule of law requires relative certainty<sup>157</sup> and that laws must be effective<sup>158</sup>. However,

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<sup>151</sup> See chapter 3, or for instance Cassidy footnote 148 above.

<sup>152</sup> Cassidy (footnote 48 above) - page 342 par 5.2.

<sup>153</sup> Cassidy page 346 – “The South African courts’ use of an excessive literal interpretation to tax statutes, including anti-tax avoidance measures themselves, has allowed quite blatant tax schemes to be effective [in this context Cassidy relies on SARS Revised Proposals regarding the new rules.] Importantly in the context of this article, the courts’ excessive use of the literal rule even emasculated section 103 of the Income Tax Act and its predecessors. This was particularly so through the decision *CIR v Conhage (Pty) Ltd*. This case essentially re-inforced the *Duke of Westminster* principle that taxpayers are allowed to order their affairs to minimise their tax. As a consequence, the deterrent effect of section 103 had greatly diminished”.

<sup>154</sup> Cassidy page 347.

<sup>155</sup> See footnote 156 below – at 22.

<sup>156</sup> See for instance Prebble A & Prebble R “Does the use of general anti-avoidance rules to combat tax avoidance breach principles of the rule of law? A comparative study” in *Saint Louis University Law Journal* Vol 55:21 2010 Saint Louis University at page 21.

<sup>157</sup> Prebble footnote 156 above at 22.

<sup>158</sup> Prebble footnote 156 above at 33.

general anti-avoidance rules (including those of South Africa<sup>159</sup>) do not give certainty<sup>160</sup> and they risk being ineffective because courts will find it impossible to enforce them<sup>161</sup>. There is by definition<sup>162</sup> uncertainty as to whether a transaction falls within or outside of the general anti-avoidance rule<sup>163</sup> and attempts to enforce the law will constantly fail<sup>164</sup>.

Apart from policy differences which draw judges into being pro<sup>165</sup>- or anti-fiscus<sup>166</sup> there is the risk that “judges will not know what to make of them”<sup>167</sup>.

This is a systemic problem in general anti-avoidance legislation, because there can be fewer laws of more serious effect (as opposed to “traffic offences” in some countries) which people try to circumvent, and because of the complex nature of tax legislation which allows for the possibility of loopholes<sup>168</sup>.

The answer is however not to drop the general anti-avoidance rules<sup>169</sup> or to make them more specific<sup>170</sup>. The reality is that the general rules are “an aberration: It is their very vagueness that makes them effective.”<sup>171</sup> While the general anti-avoidance rules may breach the rule of law, they do so for the public good<sup>172</sup> which demonstrates that even the rule of law is – for some – “not an unqualified good”<sup>173</sup>.

### 10.3 Conclusion

The element of subjectivity creates significant inroads into the rights of taxpayers and the whole process of the collection of taxes. It creates uncertainty. Yet, most would

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<sup>159</sup> Prebble footnote 156 above at 26.

<sup>160</sup> Prebble footnote 156 above at 25.

<sup>161</sup> Prebble footnote 156 above at 33.

<sup>162</sup> Prebble footnote 156 above at page 29 – “... all legislation is vague to some extent. The most specific of rules will always have borderline cases.... The difference is that general anti-avoidance rules have far larger penumbras than most laws.... (30) The fact that general anti-avoidance rules exist at all is evidence that policy-makers and legislators themselves cannot predict what structures taxpayers will eventually contrive”.

<sup>163</sup> Prebble footnote 156 above at 28.

<sup>164</sup> Prebble footnote 156 above at 33.

<sup>165</sup> See for instance footnote 107 above.

<sup>166</sup> Prebble footnote 156 above at page 34 – the example is cited of an Australian chief justice who “felt very strongly that “[i]t is for Parliament to specify, ... with unambiguous clarity, the circumstances which will attract an obligation on the part of a citizen to pay tax”. The Chief Justice had little time for the vagueness of the general anti-avoidance rule and tended to find for the taxpayer even in cases of the most blatant tax avoidance.”

<sup>167</sup> Prebble footnote 156 above at 33.

<sup>168</sup> Prebble footnote 156 above at 38.

<sup>169</sup> Prebble footnote 156 above at page 38 – which would remove an element of equity in the way taxes are applied, and (39) make them less neutral.

<sup>170</sup> Prebble footnote 156 above at page 38 “Unfortunately, however, the more specific and detailed a system’s rules become, the more ways people find to circumvent them”.

<sup>171</sup> Prebble footnote 156 above at 41.

<sup>172</sup> Prebble footnote 156 above at 40 – tax revenue keeps a state functioning.

<sup>173</sup> Prebble footnote 156 above at 45.

agree that because of the unique nature and place of taxes, some degree of subjectivity is inevitable in the general anti-avoidance rules, which cannot be done away with. However, simplicity of formulation does dictate a more acceptable outcome for both the rule of law and certainty in how a court will interpret anti-avoidance rules.

## **11. Chapter 6 - conclusions**

### **11.1 Introduction**

This paper set out to discuss and trace the history of tax policy which separates illegal tax evasion from tax avoidance (although it may also be illegal). The South African anti-avoidance common law and legislation was also described. The *NWK* decision was examined in some detail to consider how policy can influence the outcome where subjective terms are used as a test. The concept of abnormality was also considered. After considering whether subjective terms such as abnormality should be removed from the law, it was shown that – while undesirable – the concept of general anti-avoidance rules is necessary, but the subjective terms used in them should be limited, precise and transparent.

The paper found that, as they are presently applied, subjective factors – while having some use - lead to uncertainty in tax planning, which is undesirable. The discussion reveals that the cause of ambiguities in judicial interpretation of schemes which cause tax to be avoided (and through this the effect of avoidance legislation) is found primarily in policy considerations, which then play out in interpretation of subjective terms.

### **11.2 Conclusion**

In Chapters 1 and 2, the paper considered the history of taxation, and the policy considerations which applied. Tax is levied based on the payer's estimation of what is due, and collected based on receiver's adjustment thereof. This is the result of what rights to tax the state has to collect tax, usually set out in legislation. It is necessary to collect tax in order for a state to be properly funded in order to fulfil its functions and to benefit the people who reside in it. When times are tough economically, politicians seek to increase the amount of tax collected, often focussing on grey areas, in order to bolster the national treasury. Added to this, taxpayers are mostly allowed to organise their affairs in order to pay as little tax as is legally required. Courts find themselves in the middle, realising the public good effected through tax collection by giving tax legislation meaning, but also protecting the rights of taxpayers when their liability is uncertain or the legislation is unclear.

This may give rise to a temptation for taxpayers to test the boundaries of tax liability due to their fatigue at high levels of taxation or their disagreement with how the public

purse is spent. At some level, there is inevitably a competition between taxpayers and collectors in the grey area between what tax is due, and what can be avoided. Tax collectors tend (wrongly) to believe that they have a moral role, and that taxpayers are there to outwit them. Tax avoidance can be carried out by the rich and powerful, but also by the masses avoiding tax in small, almost undetectable ways. The courts therefore play an important role in ensuring that tax planning and avoidance is done within the bounds of the law, fairly and equitably.

The chapters found that policy within which a court operates is therefore a strong determinant of whether the taxpayer will successfully avoid tax liability or not.

Chapter 3 considered the history and extent of the general anti-avoidance rules at common law and in statute. Courts look at both the substance and form of transactions when applying the law. To supplement the common law, which was considered deficient by the government in preventing what it considered to be undesirable tax avoidance, legislation was introduced successively to curb such schemes. Legislation is seen as a benefit to both taxpayer and collector since it intends to create certainty, specificity and provides a deterrent against the improper use of the rules. The first two legislative attempts did not stand the test of court scrutiny generally. The first attempt - section 90 - was done considerable damage by the *King* case. However, the tests which originate in it remain useful – what, despite planning - the taxpayer was in reality found to be liable for. The legislation was shown to be too subjective for the purposes which the tax collector believed parliament had enacted it. Section 103 – which introduced the concept of abnormality - suffered a similar demise. The legislation was supplemented with new provisions which increased the complexity of the legal provisions, and added significantly to their verbiage.

The chapter concluded that South Africa has a long-developed set of general anti-avoidance measures, but that the use of a “tainted” element such as abnormality was a purely subjective test which created lack of clarity in judicial examination. This resulted in uncertainty for tax payers and collectors.

Chapter 4 used the somewhat controversial *NWK* decision to test the earlier findings in this paper. The facts of *NWK* were bizarre and - having regard to its substance - the transaction was clearly contrived and a charade. The court apparently needed do no more than make that finding in order for the tax collector to have succeeded. The court

however went further and asserted that if the only purpose of a transaction was to be evasive of a peremptory law (such as fiscal laws), then the transaction would be regarded as simulated. This conclusion seems to have been policy-driven but, because of the particularly stark facts, clearly married policy with abnormality. The *NWK* decision is therefore important in every aspect of this paper – it applied a pro-fiscus policy, looking at what it perceived to be deficiencies in both the common law and statute, and considered the transaction sufficiently abnormal to require the court to bolster the common law. This is starkly at odds with the role of the court set out in chapters one and two – which was not to be activist, but a fair arbiter of the fine line in the grey area of tax avoidance within the bounds of the common law or the way in which parliament expressed itself. For this, the *NWK* decision has been criticised and distinguished by subsequent courts.

The chapter concluded that abnormality was an illusive and elusive subjective term, which - despite the benefit a taxpayer may have in leading evidence to discharge the onus of showing the transaction was not abnormal – led to uncertainty and jurisprudential discord.

In chapter 5, this paper considered if abnormality could be done away with. It found that there were competing arguments: some wished to supplement even more into what was considered abnormal, while others thought that subjective tests such as abnormality in anti-avoidance legislation offended against the rule of law because they created uncertainty and potentially the impossibility of the enforcement of the law. In considering this, the chapter found that legislation such as anti-avoidance rules were an aberration, but served a necessary role in organised society, and therefore should not be dropped.

The chapter concluded that simplicity – and not the temptation for greater complexity – was at the cornerstone of finding an acceptable form of test for abnormality.

The paper therefore found that abnormality was not in itself a useful concept in dealing with competing policy and judicial issues in interpreting the law. However, (because something was needed to test the grey area of anti-avoidance) if what was intended by the concept of abnormality was itself made clearer and simpler, then it could still have some utility in the anti-avoidance rules.

## 12. Chapter 7 - recommendations

### 12.1 Recommendation

In order to be most certain, effective and fair, the general anti-avoidance rules should comply with the following requirements.

Form should still give way to substance.

The onus should remain with the taxpayer to show that all income has been declared and that deductions have been properly obtained.

The rules should retain the principle in *Duke of Westminster* that a taxpayer may order affairs in order to pay the least tax possible.

The principle flowing from *King* that a taxpayer remains liable to pay tax on income which in reality is that of the taxpayer should be followed.

As regards abnormality, the test in *King* should be adapted so that the taxpayer remains liable to pay tax on income which in the circumstances would normally accrue to the taxpayer.

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