

**DOES THE SOUTH AFRICAN GAAR CRITERIA OF THE “MISUSE OR ABUSE” OF A
PROVISION INCLUDED IN SECTION 80A(c)(ii) OF THE INCOME TAX ACT ADD ANY
VALUE?**

by

ALLEENDA GLYNN LANGENHOVEN

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Supervisor: Professor Jennifer Roeleveld

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Abstract

Tax planning, where taxpayers arrange their affairs so as to minimize the resulting tax liability, has evolved over the last couple of decades as a result of the change in the way business is conducted by virtue of globalisation and the development in technology. It appears to have become more and more aggressive as taxpayers have the opportunity to access tax benefits not only through utilising loopholes in domestic legislation, but also through international tax loopholes. Revenue Authorities have to respond to this by employing mitigating anti-avoidance mechanisms. One such mechanism employed in South Africa (“SA”) is the use of General anti-avoidance Rules (“GAAR”) found in s80A-L of the Income Tax Act No. 58 of 1962 (“ITA”). To combat certain shortcomings in this GAAR’s predecessor and to stay abreast of international trends, for the first time ever, a Statutory Purpose Element has been included in GAAR. This Statutory Purpose Element, as included in s80A(c)(ii) of the ITA, evaluates the misuse or abuse of the provisions of the ITA as a means to identify impermissible tax avoidance arrangements. Essentially, this calls for the application of the modern approach to statutory interpretation, where the purpose and context of the provisions of the ITA are first identified, before the misuse or abuse of these provisions can be proven. This study evaluates whether the inclusion of this Statutory Purpose Element in GAAR, adds any value or provides any additional powers to SARS when applying GAAR, especially in light of s39(2) included in the Bill of Rights of the Constitution, of 1996, (“Constitution”). The Constitution, the supreme law in SA, already calls for the modern approach to be applied to any statutory interpretation and the findings of this study indicate that s80A(c)(ii) appears to be completely superfluous as it does not award any additional powers to SARS, which were not already granted by the Constitution. If anything, s80A(c)(ii) broadens the scope of GAAR to such an extent, that it most likely will only cause further confusion for taxpayers wanting to engage in tax planning.

List of Abbreviations and Glossary

BEPS	Base Erosion and Profit Shifting
Commissioner	Commissioner of SARS
Constitution	South African Constitution, of 1996
CIR	Commission of Inland Revenue
CITA	Canadian Federal Income Tax Act
DTA	Double Taxation Agreement
GAAR	General Anti-Avoidance rules
GDP	Gross Domestic Product
ITA	Income Tax Act No 58 of 1962
ITAA	Income Tax Assessment Act 1936 (Australia)
JA	Justice of Appeal
MNE	Multinational Enterprises
NZITA	New Zealand Income Tax Act
OECD	Organisation for Economic Cooperation and Development
SA	South Africa
SARS	South Africa Revenue Service
SAAR	Specific Anti-Avoidance rules
UK	United Kingdom
US	United States of America

Table of Contents

Declaration	ii
Acknowledgements.....	iii
Abstract	iv
List of Abbreviations and Glossary	v
CHAPTER I: INTRODUCTION	1
1.1 BACKGROUND AND RATIONALE	1
1.2 RESEARCH TOPIC AND MAIN QUESTION	6
1.3 RESEARCH METHOD	7
1.4 SCOPE OF THE STUDY	7
1.5 LITERATURE REVIEW/MAJOR SOURCES	8
1.6 OUTLINE OF THE STUDY	8
CHAPTER 2: WHY THE NEED FOR GAAR?	10
2.1 WHAT IS THE PROBLEM GIVING RISE TO THE NEED FOR GAAR?	10
2.2 RESPONSES TO INCREASED TAX AVOIDANCE: GAAR VS SPECIFIC ANTI-AVOIDANCE	16
2.3 SUMMARY	23
CHAPTER 3: GAAR IN SOUTH AFRICA	24
3.1 DEVELOPMENT OF GAAR IN SA	24
3.2 GAAR TODAY – SECTION 80A TO 80L OF THE ITA.....	28
3.2.1 Section 80A	29
3.2.1.1 Arrangement & Avoidance arrangement	31
3.2.1.2 Tax Benefit.....	33
3.2.1.3 Sole or main purpose	35
3.2.1.4 Tainted Element	38
3.3 CONCLUSION	47
CHAPTER 4 – MISUSE or ABUSE OF PROVISIONS OF THE ITA	48
4.1 ORIGINS OF THE “MISUSE OR ABUSE OF PROVISIONS” INCLUSION IN SA GAAR	48
4.2 CANADIAN GAAR – MISUSE OF TAX PROVISIONS AND STATUTORY INTERPRETATION.....	53
4.3 SA GAAR – MISUSE OF TAX PROVISIONS AND STATUTORY INTERPRETATION.....	55
4.3.1 Traditional approach	56
4.3.2 Modern Approach	57
4.4 CONCLUSION	58
CHAPTER 5 – SA GAAR v COMMON LAW IN SA	60

5.1	THE MODERN APPROACH – THE CONSTITUTION.....	60
5.2	STATUTORY INTERPRETATION – THE EFFECT OF “MISUSE OR ABUSE OF PROVISIONS” IN GAAR.....	63
5.3	CONCLUSION	64
CHAPTER 6 – CONCLUSION		66
6.1	OVERALL SUMMARY	66
6.2	FINAL CONCLUSION AND RECOMMENDATIONS.....	69
BIBLIOGRAPHY.....		70

CHAPTER I: INTRODUCTION

1.1 BACKGROUND AND RATIONALE

Over the last couple of decades, traditional tax planning has changed drastically as a result of globalisation and the development of technology. In today's world, tax planning is no longer limited to accessing tax benefits through apparent loopholes in domestic tax legislation, but now also extends to finding tax benefit opportunities on an international scale, for example, moving profits to jurisdictions with lower effective tax rates. In South Africa "Tax benefit" is defined in section 1 of the Income Tax Act (ITA)¹ to "include any avoidance, postponement or reduction of any liability of tax."

The approach to tax planning appears to have become more and more aggressive, drawing attention to the distinction between tax evasion, impermissible tax avoidance and legitimate tax planning. The OECD has defined the following terms as follows²:

- "Tax avoidance" includes "the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow";
- "Tax evasion" includes "illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities"; and
- "Tax planning" includes the "arrangement of a person's business and /or private affairs in order to minimize tax liability".

The difference between tax avoidance and tax planning is a fine one as both concepts share the objective of minimising one's tax liability. Tax planning however, speaks to the legitimate application of tax legislation to achieve tax benefits intended by lawmakers, while tax avoidance

¹ 58 of 1962

² *Glossary of Tax Terms, OECD, Centre of Tax Policy and Administration - <http://www.oecd.org/ctp/glossaryoftaxterms.htm> (date accessed March 2016)*

leans towards the “stretching” of tax legislation to obtain tax benefits beyond the intended scope put in place by legislators. Tax evasion then goes one step further and is the ultimate breaching of tax legislation provisions to obtain tax benefits, crossing the threshold to becoming an illegal activity. Chris Evans in one of his papers³ states that *“The distinction between tax evasion and tax avoidance is well recognized. It is the difference between working outside the law and working within the law (though against its spirit).”*⁴

The taxpayers’ right to structure their affairs in the most tax efficient manner is a concept that is well cemented in the tax arena. One of the judgements in South African case law indicating this comes from *CIR v Conhage (Pty) Ltd*⁵, where Judge Hefer JA states:

“Within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If e.g. the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax. (Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue 1996 (3) SA 942 (A) at 950I-952C).187”

This right afforded to taxpayers therefore means that there are permissible tax avoidance arrangements, being tax efficient arrangements that are *“permitted in terms of the letter and spirit of the tax law. Terms like tax planning and tax mitigation can all be said to be synonymous with permissible tax avoidance”*⁶

The distinction between permissible and impermissible tax avoidance therefore becomes key, however *“Impermissible tax avoidance is difficult to define because it is unpredictable and ever-changing. Broadly speaking, it consists of the avoidance of tax that is inconsistent with the spirit of the tax laws.”*⁷ The South African Revenue Service (“SARS”) in its discussion paper on Tax Avoidance attaches the following general meaning to impermissible tax avoidance – *“refer(s) to artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually*

³ C. Evans, [March 2007], *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, UNSW Law Research Paper No. 2007-12, Hong Kong Law Journal, Vol. 37, p 4

⁴ R. Woellner, S. Barkoczy, S. Murphy, and C. Evans, [2006], *Australian Taxation Law Select: legislation and commentary*, Australian Taxation Law, (16th Edition), Sydney, CCH, at 1544-1545

⁵ *CIR v Conhage (Pty) Ltd* [1999], SCA, 61 SATC 391, p 393

⁶ B. T. Kujinga, [March 2012], *Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada*, The Comparative and International Law Journal of Southern Africa Vol. 45, No. 1, Institute of Foreign and Comparative Law, p 43

⁷ *Ibid*

designed to manipulate or exploit perceived “loopholes” in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament.”⁸

The effects of impermissible tax avoidance are far reaching and include an adverse impact on the ability of Revenue Authorities to collect tax revenues due to them, which ultimately are used to develop countries and their economies. SARS in its Discussion paper lists the following harms of impermissible tax avoidance to “...include short-term revenue loss, growing disrespect for the tax system and the law, increasingly complex tax legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden, and a weakening of the ability of Parliament and National Treasury to set and implement economic policy.”⁹ Revenue Authorities across the globe therefore have to seek mechanisms to curb impermissible tax avoidance that could adversely impact the country’s tax base.

Such mechanisms include anti-avoidance rules which are incorporated into tax legislation. Anti-avoidance rules can either be specific (“SAAR”), i.e. applicable to a specific transaction or arrangement, or general (“GAAR”), i.e. applicable to any transaction or arrangement. Various countries use different strategies to employ either only SAAR or GAAR, or a combination of both in the fight against revenue loss through impermissible tax avoidance arrangements. “*The primary purpose of a GAAR is that it must target only impermissible tax avoidance and allow permissible tax avoidance by drawing a clear distinction between the two.*”¹⁰ SARS has indicated that “*While the application of the GAAR to impermissible tax avoidance may help to stem the tide of short-term revenue loss, the GAAR itself is not a revenue raising measure. It is intended to protect the tax base established by Parliament, not to expand it.*”¹¹

GAAR was first introduced into South African tax legislation in 1941 in terms of section 90 of the Income Tax Act of 1941¹² and has since undergone a number of changes, with the most recent changes being the introduction of section 80A-L of the Income Tax Act (“ITA”), applicable to

⁸ SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p 4

⁹ *Ibid*

¹⁰ R. Woellner *et al* See Note 4, p 43

¹¹ B. T. Kujinga See Note 6, p6

¹² *Ibid*, p 38

transactions coming into effect on or after 02 November 2006.¹³ The evolution of GAAR in South Africa will be further elaborated upon in this study. However, the most recent changes to South African GAAR came about after SARS had identified certain shortcomings in the previous GAAR and includes concepts that are completely new in the South African tax arena. One of these new concepts to be included in GAAR is that of an *“impermissible avoidance arrangement... arising directly or indirectly from the misuse or abuse of the provisions of the Act”*¹⁴

*“The concept of misuse or abuse works to deny tax benefits obtained in a manner that conforms to the letter of the law but not to the purpose of the Act. It is based on a view of impermissible tax avoidance as an abuse of the provisions it uses to obtain tax benefits.”*¹⁵ This concept calls for the interpretation of the purpose of the provisions of the ITA and in South Africa, the interpretation of statutes either follow a modern approach or a traditional approach. The traditional approach only considers the literal meaning assigned to the words appearing in legislation, whereas the modern approach looks deeper to the intention of the provision itself and then in relation to the other provisions of the ITA. Judgements from South African case law have developed statutory interpretation principles, indicating when it is considered appropriate to look beyond the literal meaning of the words used in legislation and refer to the intention or purpose behind the provisions of the Act.

The traditional approach is characterised by looking to the literal meaning and intention of the provision and in this regard, it was held by Innes CJ in *Venter v Rex*,

*“when to give the plain words of the statute their ordinary meaning would lead to absurdity so glaring that it could never have been contemplated by the legislature or where it would lead to a result contrary to the intention of the legislature, as shown by the context or by such other considerations as the court is justified in taking into account, the court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and to give effect to the true intention of the legislature.”*¹⁶

¹³ B. T. Kujinga, See Note 6, p44

¹⁴ Section 80A of the ITA

¹⁵ B. T. Kujinga, See Note 6, p 45

¹⁶ *Venter v Rex* [1907] TS 910, Supreme Court of Transvaal, p 914

When considering the Interpretation of tax statutes, the textbook SILKE on South African taxation states the following when discussing instances where the literal meaning of tax legislation gives rise to absurdities:

“Looking beyond the ordinary, grammatical meaning of a word to establish the intention of the legislature in interpreting legislation overlaps, to a limited degree, with the purposive approach to the interpretation of fiscal legislation.”¹⁷

The modern approach is then characterised by looking to the purpose of the provision itself and then in the context of the other provisions of the ITA. SARS indicates that the reason behind the introduction of the misuse or abuse provision was to reinforce the modern approach to the interpretation of tax statutes.¹⁸ The development of these approaches to statutory interpretation and the link to the rights afforded to the Commissioner by the inclusion of the misuse or abuse characteristic in South African (SA) GAAR will be further explored in this study.

This concept of misuse or abuse of a tax provision seems to have been borrowed from the Canadian GAAR, although the application of the concept is not identical to that of the Canadian GAAR. In the Canadian GAAR, this concept acts as a limiting provision in that Revenue Canada first has to prove the misuse or abuse of a provision of the Canadian Income Tax Act (“CITA”) before it can apply GAAR to any arrangement.¹⁹ In SA however, the misuse or abuse concept is included in GAAR as one of the characteristics of an impermissible avoidance arrangement applicable in any context. *“It is, however, clear that the misuse or abuse concept works to expand the scope of the GAAR to address as many forms of impermissible tax avoidance as possible. The concept broadens the application of the GAAR because it increases the scope of the tainted elements.”²⁰* The misuse or abuse concept is therefore incorporated into SA legislation to extend the scope of GAAR and not as a limiting provision as in the Canadian GAAR. The potential impact of the different application of the misuse or abuse of a provision in SA and Canadian GAAR will be further investigated in this study.

¹⁷ A.P. de Koker, R.C. Williams, [2016], *Interpretation of statutes – intention of legislation, Literal meaning giving rise to absurdity*, SILKE on South African Income Tax, Lexis Nexis, Chapter 25.1B

¹⁸ SARS, [September 2006], *Revised Proposals on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962 (Revised Proposals)*, Law Administration, p 16

¹⁹ Section 245(4) of CITA, R.S.C., 1985, c. 1 (5th Supp)

²⁰ B. T. Kujinga, See Note 6, p 47

In South Africa, the most supreme legislation is the Constitution, of 1996 (“Constitution”) and there is a school of thought that the Constitution already calls for the modern approach to be applied when interpreting legislation. *“Further evidence of the dominance of the modern approach in the interpretation of tax legislation, and indeed all legislation, can be seen in the South African Constitution. In terms of sections 1, 2 and 8 of the Constitution, the Constitution is superior to all law in the country.”*²¹

Subsections 39(1) and (2) of the Constitution state:

(1) When interpreting the Bill of Rights, a court, tribunal or forum –

(a) Must promote the values that underlie an open and democratic society based on human dignity, equality and freedom;

(b) Must consider international law; and

(c) May consider foreign law.

(2) When interpreting any legislation and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.

This study will therefore evaluate whether there was a need in the first place to include the misuse or abuse of provisions in the ITA to SA GAAR, and whether the seemingly increased scope of GAAR by the inclusion of this characteristic could be viewed as superfluous.

1.2 RESEARCH TOPIC AND MAIN QUESTION

The latest amendment to the SA GAAR includes section 80A(c)(ii) relating to the misuse or abuse of provisions of the ITA. The purpose of this study is to answer the question: whether the inclusion of such a provision in the SA GAAR adds any value, and/or whether the Constitution already covers the extended scope in SA GAAR that SARS envisaged when adding this criterion.

In order to answer the research question, this study will include:

- An analysis of the development of general anti-avoidance rules in South Africa and the inclusion of section 80A(c)(ii) relating to the ‘misuse and abuse’ of provisions of the Income

²¹ B. T. Kujinga, See Note 6, p46

Tax Act will be performed. The analysis will include an evaluation of the need for anti-avoidance provisions, the different anti-avoidance mechanisms applied by different countries, the evolution of GAAR in SA including a comparison of the previous GAAR (section 103(1) of the ITA) with the latest GAAR (section 80A-L of the ITA);

- A comparison of section 80A(c)(ii) with the apparent origin of this provision found in the Canadian GAAR; and
- An evaluation of the already existing status provided by the Constitution in the context of section 80A(c)(ii) to the SA GAAR, to assess whether this inclusion might be superfluous.

1.3 RESEARCH METHOD

A legal interpretative research methodology will be used to investigate the evolution of GAAR and assess whether the inclusion of section 80A(c)(ii) in SA GAAR was really necessary. A doctrinal research approach will be executed to evaluate GAAR legislation, from a South African perspective, as well as the intended scope of such legislation. A comparative analysis will be conducted to assess differences in Canadian and SA GAAR, with a specific focus on the misuse or abuse of provisions criteria included in both.

This study will follow the structure of reform oriented research, where the adequacy of old and newer SA GAAR is evaluated through documentary evidence and findings. The perceived success of addressing the shortcomings of the old SA GAAR with the new section 80A-L of the ITA will also be evaluated. Existing literature and comparative studies will be used to determine whether there was any increase in scope available to legislators when the decision was made to change SA GAAR and include a borrowed “misuse or abuse of provisions” criteria from the Canadian GAAR.

1.4 SCOPE OF THE STUDY

The scope of the study is limited to an overview of the intended purpose of GAAR and changes of the SA GAAR from the previous GAAR included in section 103(1) of the ITA to GAAR that is currently in effect by virtue of section 80A-L. A general overview will be conducted of Spain, the United Kingdom (UK) (even though the UK employs other anti-avoidance mechanisms such as GAAR in

conjunction with SAAR) and the United States (US), being countries adopting SAAR and Australia, Canada and SA, being countries using GAAR, in conjunction with SAAR. This overview is to evaluate the various anti-avoidance mechanisms employed in certain countries against the GAAR used in South Africa. An in depth analysis of section 80A(c)(ii) will be conducted, with reference to the origins of the sections found in Canadian GAAR. Finally, the provisions of the SA Constitution relating to interpretation approaches will be analysed in the context of section 80A(c)(ii) to ascertain whether SARS actually extended the scope of GAAR as intended with the inclusion of the misuse or abuse of provisions concept.

1.5 LITERATURE REVIEW/MAJOR SOURCES

The main sources of information for this study includes publications (journal articles, articles, or published studies) on topics that fall within the scope of the research question. The SA legislation and that of the other countries within the scope of this study are used as sources for the analysis of GAAR in this study. Discussion papers and explanatory memorandums issued by the SA Revenue Authorities of other countries within the scope of this study are also used as a major source of information. Any comparative studies which have been published and have been sourced from the public domain on areas falling within the scope of this study are used and referred to in the analysis conducted.

Internet based searches were conducted on key words like “GAAR” and “misuse or abuse of provisions”, with relevant hits used as a source of information for this study. The SARS website is used as a key source of information, as well as the SA National Treasury website. The University of Cape Town online library resources (Google Scholar and online Thesis and Dissertations) and databases (such as IBFD and Nexis Lexis) are key tools used to source information.

1.6 OUTLINE OF THE STUDY

Chapter 2 assesses the need for GAAR in general by looking at the intended objectives, requirements and effectiveness of having a GAAR. A summary of countries applying GAAR is presented along with details of countries that do not rely on GAAR, but rather on specific anti-

avoidance provisions, drawing distinctions between the two approaches of curbing impermissible avoidance transactions.

Chapter 3 focuses on GAAR in SA by looking at the development of GAAR and the need, as expressed by SARS, to revamp GAAR to what it looks like today based on the shortcomings of the previous GAAR legislation. This Chapter also includes a detailed analysis of section 80A-L of the ITA and analyses whether the purpose of GAAR has been extended with the introduction of this legislation in 2006. This analysis includes, where applicable, the current objectives, scope and limitations of GAAR.

Chapter 4 specifically looks at the ‘misuse or abuse of provisions’ concept included in SA GAAR for the first time and looks at the effectiveness of borrowed concepts included in the SA GAAR as compared to the original use in comparative legislation. This comparative analysis is of Canadian GAAR and the SA GAAR, considering Canada Revenue Authorities intended objectives and their application to SARS’ objectives and application. The effect on statutory interpretation in Canada versus SA is then assessed and compared. The analysis then turns to why SARS thought it appropriate to include such a provision in SA GAAR, considering the intended objectives and application, the meaning of the words “misuse or abuse of the provisions of the Act” and the intended scope of SA GAAR once such a provision is included. The effects on taxpayers’ rights to conduct tax planning are then also considered.

Chapter 5 evaluates any interaction between civil law in SA and SA GAAR, by assessing the scope of the provisions of the Constitution specifically dealing with interpretation approaches as compared to the scope provided by the inclusion of the misuse or abuse of provisions of the Act in SA GAAR. SARS intended application is compared to the rights already granted under SA civil law to ascertain whether or not the inclusion of section 80A(c)(ii) adds any value.

Chapter 6 ends off the study with a conclusion of the findings and indicates any recommendations arising from these findings.

CHAPTER 2: WHY THE NEED FOR GAAR?

Introduction

This Chapter will first explore identified problems calling for the need of anti-avoidance mechanisms. The responses to these problems will then be discussed, including the implementation and use of specific anti-avoidance rules, GAAR and a combination of both specific and general anti-avoidance rules.

2.1 WHAT IS THE PROBLEM GIVING RISE TO THE NEED FOR GAAR?

Loss in revenue collected by Revenue Authorities

The landscape of doing business has changed drastically over the last couple of decades. There are many articles and opinions expressed on the impact this change has on the taxpayer's behaviour and attitudes. The effect of globalisation and the development of the technology industry create opportunities for individuals to access most financial markets or economies, where previously these individuals might have been limited to only their own country's markets. In the SARS Discussion Paper on Tax Avoidance, it was noted that "... *advances in computer and telecommunication technology have radically transformed the way in which multinational firms, particularly multinational accounting firms, can share and exchange information*".²² The Chapter "Tax Avoidance and Tax Evasion" by Anne Michèle Bardopoulos²³ points out that a significant aspect of eCommerce is that it transacts across borders and a single transaction can engage diverse jurisdictions.

The Tax Avoidance and Tax Evasion Chapter by Bardopoulos further identify the critical point that "*the Internet facilities increased double non-taxation transactions consequently potentially expediting tax avoidance schemes. The discussion [in this Chapter] also highlights the comment that*

²² SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration p. 8 & 9

²³ A. M. Bardopoulos, [2015], *Tax Avoidance and Tax Evasion*, eCommerce and the Effects of Technology on Taxation Part VII, Volume 22 of the series Law, Governance and Technology Series, Springer, p. 337-341

tax evasion may be intensified by rapid globalisation and may, furthermore, find a perfect zone in the virtual world."²⁴

As business transactions are now crossing geographical divides between countries, factors such as differences between various jurisdictions tax rates play an important role. The taxes imposed on any company's operations, whether it is domestic taxes imposed on business profits in the company's resident country, or taxes imposed on offshore operations, these are taken into consideration as a "cost" of doing business. More and more companies are deciding to minimise operating costs by entering into cross border transactions and moving certain business functions offshore to take advantage of the differences in tax rates. SARS indicates in its Discussion Paper on Tax Avoidance that the "OECD has repeatedly expressed concern about harmful tax competition being driven, in part, by various tax havens around the world".²⁵

An Organisation for Economic Co-operation and Development ("OECD") publication notes that Multinational Enterprises ("MNEs") now represent a large proportion of global GDP²⁶. This report further note that, although globalisation has boosted trade, increased foreign direct investments have encouraged the free movement of capital and labour and it has also resulted in the shift of manufacturing bases from high-cost to low-cost locations.²⁷ This shift of where business is conducted, is one of the reasons for the increase in base erosion and profit shifting ("BEPS"), a very topical issue, as business profits are being shifted to low tax jurisdictions, even if no real economic activity takes place in that low tax jurisdiction.

The report by the Davis Tax Committee on BEPS has found that this development has led to MNEs taking advantage of legal arbitrage and asymmetries in the various countries' domestic tax law with the objective of minimising their tax burdens.²⁸ This movement in the way business is conducted therefore has a direct, and sometime adverse, impact on these countries' ability to collect corporate

²⁴ A. M. Bardopoulos, See note 2 above

²⁵ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 7

²⁶ OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing <http://dx.doi.org/10.1787/9789264202719-en>, p 7 (accessed May 2016)

²⁷ *Ibid*, p 7

²⁸ Davis Tax Committee, [December 2015], *The Introductory Report*, BEPS First Interim Report for public comment, http://www.taxcom.org.za/docs/New_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf (accessed April 2016), p 9

income tax as MNEs are structuring tax efficient transactions by channelling profits to specific desired jurisdictions. Countries therefore find themselves in a position where measures need to be put in place to curb such activities, which are ultimately eroding their tax bases. Payne *et al.* indicates in a paper titled “Aggressive Tax Avoidance: A Conundrum for Stakeholders, Governments and Morality” that one of the consequences of BEPS is that governments have been harmed by having access to less revenue while bearing higher costs to ensure tax compliance; governments have also seen critically harmful underfunding of public investments that could stimulate economic growth.²⁹

Ethical deterioration in tax planning

SARS, in its Discussion Paper³⁰ on Tax Avoidance has this to say about the cause and effect of changes experienced in markets:

“Changing attitudes and market forces also play a role. Thus, for example, the United States Department of the Treasury has noted that “[s]ome commentators explain the growth in corporate tax shelters as a reflection of more accepting attitudes of tax advisers and corporate executives toward aggressive tax planning.”³¹ At the same time, the lucrative market for tax avoidance schemes and “tax optimisation” plans has led to an increase in the resources and talent being devoted to those areas by professional firms in many countries.”

Tax planning is a known business practice, where taxpayers/professional firms identify and implement tax efficient structures and arrangements. Tax planning therefore involves utilising loopholes often included in the way tax legislation and codes are written to reduce the tax burden of doing business. Tax avoidance, being the “process of using legal means to reduce the amount of tax that is owed based on enumerated provision in the tax law”³² is thus a crucial part of tax planning. Tax avoidance is said to be “an accepted and expected element in a corporate entity’s tax

²⁹ D. M. Payne and C. A. Raiborn, [December 2015], *Aggressive Tax Avoidance: A Conundrum for Stakeholders, Governments and Morality*, Journal of Business Ethics, Springer, p 4

³⁰ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 7

³¹ US Treasury, [1999], *The Problem of Corporate Tax Shelters*, Discussion, Analysis and Legislative Proposals, Washington, D.C.: United States Treasury Department, at p 19

³² D. M. Payne *et al.*, See note 8 above, p 2

planning function and arranging affairs so as to make the tax burden as efficiently reduced as possible is therefore reasonable.”³³

It is once tax avoidance becomes aggressive that a problem arises, which could ultimately lead to tax evasion or impermissible tax avoidance – tax avoidance but with an element of deception and illegality. The array of considerations which need to be taken into account when actively performing tax planning thus extends beyond the legitimate limitations of tax legislation. Dinah *et al.* states that “Tax evasion is any dishonest or dubious action taken “outside the legal framework” to reduce or conceal taxable income amounts or increase deductions so as to reduce the true tax liability to less than the obligated amount under the legal tax framework “(Sikka 2010)³⁴ Tax evasion therefore has an element of unethical behaviour on the taxpayer’s part and more and more, taxpayers are faced with ethical dilemmas while navigating through business activities.

Why would the increase in tax avoidance be of concern, one could ask? As Evans points out in his article; “*It may be unpalatable to some to confront the stark sentiment expressed by a South African judge, in the Ferera case*³⁵ that “...the avoidance of tax is an evil”, but there is little doubt that tax avoidance activity has harmful consequences in a number of ways.”³⁶ As already pointed out earlier in this Chapter, one of these harmful consequences takes the form of losses in revenue that could have been collected by Revenue Authorities to better the state of their economies. An estimate of such losses disclosed by SARS in its Discussion Paper is that “*total assets, held in tax haven jurisdictions have ranged from four to eight trillion US dollars, with annual revenue losses to other countries in excess of 50 billion US dollars (R312,5 billion).*”³⁷

Evans states in his article that it can “*safely be concluded that the growth in tax avoidance activity is a matter of grave concern, as it can reduce revenue collections, introduce economic inefficiencies by distorting economic behaviour, undermine the integrity of national tax systems and introduce a host of additional and unwanted complexities to those systems.*”³⁸

³³ D. M. Payne *et al.*, See note 8 above, p 2

³⁴ D. M. Payne *et al.*, See note 8 above, p 2

³⁵ J. P. MacDonald in *COT v Ferera* [1976] (2) SA 653, 38 SATC 66 at p. 70

³⁶ C. Evans, [March 2007], *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, UNSW Law Research Paper No. 2007-12, Hong Kong Law Journal, Vol. 37, p 15

³⁷ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 27

³⁸ C. Evans, See note 15 above, p 16 & 17

A worldwide concern

The action of pushing tax avoidance beyond an acceptable point towards being impermissible has been termed differently by various countries. SARS, in its discussion paper, refers to it as “impermissible or abusive tax avoidance”³⁹ and states that it has been a growing problem internationally during the past ten years.⁴⁰ Australia, on the other hand refers to it as “aggressive tax planning”⁴¹ and in New Zealand and the United Kingdom, such action is called “unacceptable tax avoidance”⁴².

According to the Discussion Paper by SARS, the scope of the increase in tax avoidance spans the globe and reports as follows⁴³:

- *“Australia has repeatedly expressed concerns over tax avoidance and evasion, particularly in respect of schemes involving offshore tax havens such as Vanautu and the Channel Island;*
- *In the United Kingdom, the 2005 Budget contained an array of new provisions designed to combat aggressive avoidance schemes, particularly in the cross-border context; and*
- *In the United States, a recent study by the General Accounting Office revealed that two-thirds of the companies operating in the US paid no federal income taxes on their profits between 1996 and 2000, and that for the year 2000, 94 per cent of all companies paid income taxes of less than five per cent of the profits they reported for financial accounting purposes”.*

A domestic concern

³⁹ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 4

⁴⁰ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 6

⁴¹ See, for example, Australian Tax Office, [2008], *Aggressive Tax Planning End-To-End Process*, ATO Practice Statement, Law Administration, PS LA 2008/15, <http://law.ato.gov.au/atolaw/view.htm?locid='PSR/PS200815/NAT/ATO'&PiT=99991231235958> (accessed April 2016)

⁴² See, for example, Lord Templeman’s judgment in the case of *CIR (NZ) v Challenge Corporation Ltd*, [1987] AC 155, and Lord Goff’s judgment in *Ensign Tankers (Leasing Ltd) v Stokes* [1992] 1 AC 655

⁴³ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 7

Sub-Saharan Africa consists of emerging economies facing economic, political and social issues that are different from those faced in developed countries. A Mail & Guardian article titled *“Tax-base erosion cripples Africa”* reports that a total of \$530-billion is estimated to have been lost to sub-Saharan Africa by the illicit flow of funds, which would include both tax avoidance and illegal activity, in the years 2003-2012, according to Global Financial Integrity, a nonprofit, research and advocacy organization.⁴⁴

An article in The Citizen reports that *“South African has lost R250 billion in the form of service payments over a three-year period, highlighting the significant risk base erosion and profit shifting (BEPS) is posing to the country’s tax base, a SARS official has said. Almost R80billion of this were management fees.... In an environment where there is constant pressure on government to improve service delivery and to build infrastructure, the erosion of the tax base is a significant concern, especially since economic growth has been under pressure and government is trying to balance its books while also keeping ratings agencies at bay.”*⁴⁵

In the 2016 National South African budget delivered by the Minister of Finance in South Africa, Pravin Gordhan, the following was noted in relation to the loss of revenue due to tax avoidance activity:

*“We will continue to act aggressively against the evasion of tax through transfer pricing abuses, misuse of tax treaties and illegal money flows. Drawing on the work of the OECD, the G20 joint project on base erosion and profit shifting and independent bodies such as the Tax Justice Network, further measures will be taken to address such revenue losses, including inappropriate use of hybrid debt instruments.”*⁴⁶

It is therefore clear that the loss in revenue collections by SARS caused by tax avoidance, and at times impermissible tax avoidance, is a serious and pressing cause of concern in South Africa. SARS in its Discussion Paper on Tax Avoidance notes the harms of impermissible tax avoidance activities:

⁴⁴ L. Steyn, [24 April 2015], *“Tax-base erosion cripples Africa”*, as reported in the Mail & Guardian newspaper

⁴⁵ I. Lamprecht, [05 November 2015], *“SA is bleeding billions”*, by as reported in The Citizen newspaper

⁴⁶ P. Gordhan – SA Minister of Finance, [26 February 2016], *National Budget Speech*, <http://www.treasury.gov.za/documents/national%20budget/2016/speech/speech.pdf> (accessed April 2016), p 16

“The harms caused by impermissible tax avoidance are varied and pervasive. They include short-term revenue loss, growing disrespect for the tax system and the law, increasingly complex tax legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden, and a weakening of the ability of Parliament and National Treasury to set and implement economic policy.”⁴⁷

2.2 RESPONSES TO INCREASED TAX AVOIDANCE: GAAR VS SPECIFIC ANTI-AVOIDANCE

When Evan’s article turns to what the response has been to the problem identified, he states that *“while tax avoidance activity may have grown significantly in recent years, so too has the armoury available to those who would counter such activity.”⁴⁸* He proposes that the barriers which have been erected to curb tax avoidance can be grouped into the following 3 categories: legislative, judicial and administrative. It is the legislative barrier that will be explored further in this section of the Chapter.

Various countries have explored and implemented different avenues of utilising legislation to impede tax avoidance in their respective jurisdictions. Legislation, with this objective, is not limited to tax legislation, but could also include the application of common law. The opportunities that common law presents in facilitating the hindrance of tax avoidance will be discussed later in this study. Tax legislation adopted in response to the threats brought about by avoidance activity, can include specific anti-avoidance measures, general anti-avoidance rules, a combination of both and disclosure incentives/penalty programs. It is therefore up to the revenue authorities of each jurisdiction to determine what the objectives of its tax regime are and then decide on the most appropriate measures to adopt to curb detrimental tax avoidance.

Specific anti-avoidance legislation

Such legislation targets a specifically identified problem or loophole which is causing adverse effects on the tax base of a country by hindering the revenue authorities’ ability to collect taxes. The advantage of such provisions in legislation is that it prevents or mitigates specific tax avoidance

⁴⁷ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 7

⁴⁸ C. Evans, See note 15 above, p 24

activities and therefore offers a very precise and direct measure. There are, however, also limitations in using specific anti-avoidance rules, as opposed to GAAR, as the impact might be deflected by tax planners who can arrange their scheme in such a way that it circumvents the specific anti-avoidance rules, i.e. incorporate new characteristics into the scheme to remove it from the ambit of the specific anti-avoidance rules. The SARS Discussion paper provides an example of where it is difficult to rely on specific anti-avoidance legislation to combat tax avoidance as *“The tremendous flexibility of derivatives, together with the ease with which they may be combined with, or substituted for, other financial instruments or arrangements, makes it extraordinarily difficult to combat these products through specific anti-avoidance legislation.”*⁴⁹

It is thus imperative that those drafting such specific anti-avoidance legislation are careful not to leave wiggling room for taxpayers to easily circumvent the rules, whether intentionally, or otherwise. There is a rise in the recognition of the fact that GAAR shouldn't be too specific or precise if it is to be effective. The Carter Commission in Canada has *“warned that drafters cannot foresee all the possible avoidance transactions and that specific rules might create roadmaps for new tax planning”*⁵⁰

SARS in its Discussion paper states the following in relation to adequacy of specific anti-avoidance legislation being used in isolation:

*“The GAAR nevertheless reflects a fundamental recognition that even the best drafted, best designed tax legislation cannot anticipate every possible nuance and circumstance that may arise, let alone every scheme that may later be devised in response to it.”*⁵¹

*“No country has yet succeeded or is likely to succeed, in framing its tax laws in such a way that it is clear how the tax liability will be calculated on any conceivable set of facts. Even the most accurate draftsman of a law will not be able to find precise language to convey his meaning and the wisest legislator cannot foresee every possible set of circumstances that may arise.”*⁵²

⁴⁹ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 1

⁵⁰ G. S. Cooper, [1997], *Tax Avoidance and the Rule of Law*, Amsterdam: IBFD Publications, p33

⁵¹ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 6

⁵² G. S. Cooper, See note 29 above, p 13

Evans illustrates the danger of using specific anti-avoidance rules with the following example⁵³:

“The Australian experience with the introduction of specific anti-avoidance measures designed to clamp-down on the alienation of personal services income through the use of interposed entities, introduced to operate with effect from 1 July 2000, is a classic example of where the initial legislation was well-intentioned but poorly conceived, and it is only after a number of refinements and amendments have passed through Parliament over the ensuing years that the measures have begun to operate as intended.”

Types of specific anti-avoidance legislation in South Africa

In South Africa, a combination of specific anti-avoidance legislation and GAAR is used to combat aggressive tax avoidance. The use of GAAR in South Africa will be explored later in this Chapter. Examples of specific anti-avoidance rules include the following:

- The shift from source based taxation to resident based taxation - this could be viewed as a specific anti-avoidance rule as the resident based tax regime specifically includes all income of a SA resident taxpayer in the tax net, whereas before such SA resident taxpayers could exclude income generated from a source outside of SA from their taxable income in SA);
- The enactment of controlled foreign company rules, where foreign income is imputed as taxable income of the resident shareholder in certain instances;
- Reportable arrangement reporting;
- The limitation of interest deductions;
- Transfer Pricing and thin capitalisation rules; and
- Corporate rules governing intra-group transactions.

Certain countries choose to only make use of specific anti-avoidance rules and mechanisms to combat aggressive tax avoidance. Below is a summary of countries that initially employed only specific anti-avoidance rules, and then in recent years introduced a GAAR as well:

United Kingdom (“UK”)

⁵³ C. Evans, See note 15 above, p. 26 & 27

The UK is an example of a common law jurisdiction that initially only used specific anti-avoidance rules, with no GAAR legislation to attack aggressive tax avoidance (The UK enacted GAAR in 2013⁵⁴, which is applied in conjunction with specific anti-avoidance principles already in existence.) A disclosure regime is in place, and continues to be used, by tax authorities, where the details of the potentially abusive tax avoidance scheme had to be provided before the scheme was implemented. This was to identify instances of aggressive tax avoidance which were used to influence specific anti-avoidance rules. Evans, in his article provides examples of such specific anti-avoidance rules that have been introduced and implemented in the UK:

“A number of the financial avoidance schemes being targeted were apparently identified through the UK’s new disclosure regime, which shows that such a regime can work in practice. The United Kingdom has continued to battle new avoidance schemes through specific anti-avoidance provisions. In the 2005 Budget, for example, three new sets of broad anti-avoidance rules were introduced targeting avoidance through arbitrage, double tax relief avoidance, and financial avoidance. Separate specific provisions were also announced to address various abusive film schemes.”⁵⁵

United States of America (“US”)

The US also initially did not rely on GAAR, but instead applied judicially developed principles when attacking tax avoidance. (The US enacted GAAR in 2010⁵⁶ and therefore today, uses a combination of GAAR and judicially developed principles.)

SARS Discussion Paper points out that *“the courts in the United States have developed a variety of robust judicial doctrines to counter abusive avoidance schemes. These doctrines include the business purpose doctrine, the substance over form doctrine, the step transaction doctrine, the assignment of income doctrine and the economic substance doctrine.”⁵⁷* An example of such principles can be found in *Gregory v Helvering*, where Judge Learned Hand attributed a decision

⁵⁴Finance Act [2013] Part 5, General Anti-Abuse Rule, ss 206 - 215

⁵⁵SARS, [November 2005], *Discussion Paper*, See note 1 above, p. 36

⁵⁶United States Internal Revenue Code §7701(o), enacted March [2010]

⁵⁷SARS, [November 2005], *Discussion Paper*, See note 1 above, p. 37

to the “economic substance doctrine, the business purpose doctrine and the step transaction doctrine”.⁵⁸

A study by David A. Weisbach from the University of Chicago Law School indicates that doctrines such as the “business purpose doctrine” and the “economic substance doctrine” are not intended to fill gaps in or get rid of inconsistency in the US tax law. *“Instead, they attempt to address the problem of avoidance directly by identifying avoidance behaviour and limiting the resulting tax benefits. To do this they weigh tax and nontax elements in a transaction and, if the nontax elements are sufficiently large, they disallow the results.”*⁵⁹

GAAR legislation

This type of legislation aims to hinder those tax avoidance activities having adverse effects, by formulating rules and criteria that could be applied to any arrangement or scheme. It is thus a set of general rules used to fight against what is understood to be abusive avoidance activities. Such rules have long histories in many jurisdictions and have had to undergo revamps and refinements over time.

It has been said that *“quite possibly no other feature of tax law provides a better insight into a nation’s tax psyche than its anti-avoidance rules. There appears to be no universal understanding of what constitutes a GAAR, or for that matter, what constitutes “tax avoidance”, the notional target of GAAR. In most countries the GAAR takes the form of a statutory rule, albeit with an extremely large range of constructions. The most commonly cited drawbacks are uncertainty for taxpayers and unfairness resulting from selective application. A GAAR applies to each case separately and its elements, including the taxpayer’s purpose must be considered separately for each case. Equal application to all tax payers of a rule that looks at the totality of circumstances in each case – including, as it does in most instances, the motives of each particular taxpayer – is not possible. Jurisdictions reluctant to adopt GAARs delegate to the courts the task of identifying cases where the taxpayer’s characterisation of transactions could be rejected, or rely on specific legislative responses*

⁵⁸ *Gregory v Helvering* 69 F 2d 809 (2d Cir.) [1934] case referred to in written piece by “B. T. Kujinga, [March 2012], *Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada*, The Comparative and International Law Journal of Southern Africa Vol. 45, No. 1, Institute of Foreign and Comparative Law, p 43

⁵⁹ D. A. Weisbach, [2002], *“An Economic Analysis of Anti-Tax-Avoidance Doctrines”*, University of Chicago Law School, *American Law and Economics Review*, p 1 & 2

where the courts decline to look beyond legal form even where transactions were carried out in a particular manner with the clear objective of tax avoidance. All tax jurisdictions have Specific anti-avoidance rules (SAAR) that can operate alongside GAAR. Where a SAAR applies to the particular facts of an arrangement, it will be used in preference to the GAAR as a matter of practice in one case.”⁶⁰

In terms of the interaction between GAAR and the Specific anti-avoidance rules, In *Canada v ImperiaOil Ltd*⁶¹ it was stated that “[t]he purpose of GAAR is to prevent abusive tax avoidance to which more specific anti-avoidance rules do not apply. Thus if a taxpayer does not satisfy the statutory requirements of a provision on which the taxpayer relies, the Minister need not resort to GAAR. Similarly, GAAR is not needed if a more specific anti-avoidance rule applies. In other words, GAAR is the anti-avoidance provision of last resort. It purports to provide a framework to distinguish between legitimate tax minimization and abusive tax avoidance.”

Below is a summary of some countries that employ GAAR against abusive tax avoidance:

Australia

GAAR has been part of Australia’s tax legislation for a very long time and has been amended a few times over time to overcome identified shortfalls or limitations that may exist. The Explanatory Memorandum on the introduction of Part IVA of the Income Tax Assessment Act of Australia (“ITAA”) in 1981, said to have replaced the GAAR previously contained in section 260 of the ITAA, indicates that the intended change was made to “*overcome the difficulties with the prior law and to provide “an effective general measure against the tax avoidance arrangements that – inexact though the words may in legal terms be – are blatant, artificial or contrived”*⁶²

Australia does however also have specific anti-avoidance measures, which are used in conjunction with GAAR. SARS discussion paper makes reference to “*the introduction of the*

⁶⁰ R. Krever, [December 2015], “*Chapter 1: General Report: GAARs*”, GAARs – A key Element of Tax Systems in the Post – BEPS Tax World, Volume 3, Institute for Austrian and International Tax Law, Europe and International Tax Law & Policy series – Online Books, IBFD Tax Research platform (accessed June 2016)

⁶¹ *Canada v ImperiaOil Ltd* [2004] FCA 36 at par 30 – 31

⁶² ATO, [1981], *Explanatory Memorandum to Income Tax Laws Amendment Bill (No 2) 1981*, Canberra: AGPS 1981, at p. 2

direct and indirect value shifting provisions in Australia in response to the circumstances highlighted by the Peabody⁶³ case⁶⁴ as an example of where such specific anti-avoidance measures have been enacted.

New Zealand

New Zealand has had GAAR included in its tax legislation from 1954 which was amended in 1976 and 1994 per the New Zealand Income Tax Act (“NZITA”).⁶⁵ A Wirtscharfts University research paper titled “*Kelsen, the Principle of Exclusion of Contradictions, and General Anti-Avoidance Rules in Tax Law*” indicates that “*the first statutory GAAR appears to have been section 29 of the New Zealand Property Assessment Act 1879, carried forward into section 40 of the Land and Income Assessment Act 1891. Since 2007 the New Zealand GAAR has appeared as section BG 1 of the NZITA 2007*”⁶⁶

“Section BG 1 generally provides that a tax avoidance arrangement is void against the Commissioner and authorises the Commissioner to counteract any “tax advantage” obtained by a person from such an arrangement.”⁶⁷

Evans notes in his paper that “*The Canadian and New Zealand general anti-avoidance rules have some similarities, but are – in substance – quite different from each other.*”⁶⁸

South Africa

As mentioned before, South Africa uses a combination of specific anti-avoidance rules and GAAR. The South African GAAR was introduced in 1941 as section 90 of the ITA of 1941⁶⁹ and has subsequently been amended on numerous occasions, with the most recent change being the introduction of section 80A to 80L into the ITA, applicable to transactions on or after 02 November 2006.

⁶³ *FC of T v Peabody* [1994] 181 CLR 359; 94 ATC 4663.

⁶⁴ C. Evans, See note 15 above, p 25

⁶⁵ SARS, [November 2005], *Discussion Paper*, See note 1 above, p 32

⁶⁶ J. Prebble, [2015], “*Kelsen, the Principle of Exclusion of Contradictions, and General Anti-Avoidance Rules in Tax Law*”, WU International Taxation Research Paper Series No. 2015 – 23, p 2

⁶⁷ SARS, [November 2005], *Discussion Paper*, See note 1 above, p. 33

⁶⁸ C. Evans, See note 15 above p. 44

⁶⁹ SARS, [November 2005], *Discussion Paper*, See note 1 above, p. 38

A detailed review of the development of GAAR in South Africa will be performed in Chapter 3 of this study.

2.3SUMMARY

The main problems identified, giving rise to the need for anti-avoidance mechanisms and rules, are the loss in revenue collection due to aggressive or abusive tax avoidance arrangements and the deterioration of ethical behaviour in tax planning. Anti-avoidance mechanisms include specific anti-avoidance rules, targeting transactions that have been explicitly described and identified, and GAAR, a set of rules targeting any transaction with specified characteristics. Different countries have chosen different approaches to combat the adverse effects of aggressive tax avoidance, with some countries relying more heavily on specific anti-avoidance rules and others using a combination of GAAR and specific anti-avoidance measures.

South Africa is one of those countries that employ a combination of GAAR and specific anti-avoidance rules, with GAAR having undergone a number of changes since it was first included in South African tax legislation. Chapter 3 will explore, in detail from a South African perspective, the intended purpose of GAAR, the development of GAAR and the need, as expressed by SARS, to revamp GAAR to what it looks like today based on the shortcomings of the previous GAAR legislation.

CHAPTER 3: GAAR IN SOUTH AFRICA

Introduction

This Chapter assesses the development of GAAR in South Africa since it was first introduced in 1941. A detailed analysis of the most recent change to GAAR, being the introduction of section 80A – 80L of the ITA is also performed. Where applicable, a comparative analysis is conducted between the wording incorporated into section 80A -80L, and the words used in the GAAR's predecessor, section 103(1), which was repealed. Consideration is also given to the identified shortcomings of section 103(1) of the ITA, whilst evaluating whether GAAR as it stands today, has overcome such shortcomings.

3.1 DEVELOPMENT OF GAAR IN SA

GAAR legislation was first enacted in SA in 1941 with the introduction of section 90 of the Income Tax Act 31 of 1941. Where it was found that the taxpayer entered into arrangements with the result of avoiding tax liabilities, this GAAR aimed to hold taxpayers liable for the avoided taxes by applying definitions and limitations to the impermissible tax avoidance arrangement. This provision is however understood to have caused confusion, result in certain absurdities and have a restrictive interpretation as indicated in the case of *CIR v King*⁷⁰,

“The fundamental difficulty, in dealing with sec 90 is to avoid, on the one hand, giving it 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 effect at all, in view of the already existing power of the Court to strip disguises from transactions and declare what the real act was. A sphere of operation, reasonable and at the same time effective, must, if possible, be discovered for the section.”

In an attempt to overcome the shortcomings identified with section 90 of Income Tax Act 31 of 1941, it was substituted with section 103 of the Income Tax Act 58 of 1962. Interestingly, when these GAAR provisions were enacted, it was applicable to all arrangements prior to and subsequent

⁷⁰ *CIR v King* [1947] (2) ALL SA 155 (A) 14 SATC 184 at p 168.

to the effective date. Judge Harms, JA in the *Conshu (Pty) Ltd v CIR*⁷¹ case heard by the Appellate Division, indicated this in his judgement saying,

“The precursor of sec 103(2) was introduced by way of amendment (by s 90(1)(b)) to the Income Tax Act 31 of 1941 by the Income Tax Act 55 of 1946. It has since been the subject of a number of textual alterations, none presently material. It should, however, be pointed out that the 1946 provision, like s 103(2), applied to any agreement entered into "at any time before or after the commencement of the Income Tax Act, 1946". This meant, at the time, that the Commissioner was entitled to apply, say during 1947, this provision in relation to an agreement entered into during 1945. The 1962 Act came into operation on 1 July 1962 and on the plain wording of the section, the Commissioner was entitled to apply s 103(2) thereafter to an agreement entered into before that date.”

Section 103(1), read as follows:

“103. Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amount of taxes on income. –

- (1) Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)—*
- a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof; and*
 - b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out—*
 - 1. was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or*

⁷¹ *Conshu (Pty) Ltd v Commissioner for Inland Revenue* (437/92) [1994] ZASCA 104; 1994 (4) SA 603 (AD)

2. *has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and*
- (c) *was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax, duty or levy (whether imposed by this Act or any previous Income Tax Act or any other law administered by the Commissioner) or the reduction of the amount of such liability,*
- the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out or in such a manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction."*

When evaluating the need to again address shortcomings of section 103(1) of the ITA, SARS in its Discussion Paper in 2005 includes a description of the characteristics of section 103(1). For the Commissioner to successfully apply section 103(1), four elements have to have been found to exist. These requirements are summarised in the Discussion Paper to be as follows⁷²:

1. *"There must be a "transaction, operation or scheme" (the scheme requirement);*
2. *The transaction must result in the avoidance, reduction or postponement of a tax (the tax effect Requirement);*
3. *The transaction must have been entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit, having regard to the circumstances (the abnormality requirement); and*
4. *The transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (the purpose requirement)."*

⁷² SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p. 38

The mechanics of section 103(1) of the ITA allowed there to be a rebuttable presumption that the purpose requirement is met once the tax effect requirement was found to be satisfied. For SARS to apply GAAR, as included in section 103(1), the onus initially fell on SARS to prove that the tax effect requirement was satisfied, after which the onus shifted to the taxpayer to prove that the main or sole purpose of the transaction was not to obtain that tax benefit. All of the above 4 requirements had to be met simultaneously for GAAR to have been successfully applied to any transaction, operation or scheme.

This version of GAAR, however, received quite a bit of criticism for deficiencies identified. The Margo Commission (a Commission of inquiry appointed by the Minister of Finance) issued a report in 1986 highlighting some of these deficiencies saying that *“The test of abnormality presents difficulties. If a particular form of transaction is widely used for tax avoidance purposes, it may gain a commercial acceptability to the extent that its utilization becomes normal.”* The report proposed that *“The concept of abnormality must therefore be qualified to this extent.”*⁷³

In 1995, the Katz Commission also issued a report on the efficiency and effectiveness of GAAR as contained in section 103 of the ITA. This report also commented on the abnormality requirement saying that *“the test of abnormality presents difficulties for revenue in that if a particular form of transaction is widely used for tax avoidance purposes, it may gain a commercial acceptability to the extent that its utilisation becomes normal”*.⁷⁴ The proposal suggested that the abnormality requirement be split into characterising transactions in a business context and then in all other instances.

In reaction to the report issued by the Katz Commission, Parliament enacted amendments to section 103 in an attempt to address the shortcomings identified. The reaction to these changes were however not favourable, with commentators arguing that certain ambiguities still remained in the amended section 103, despite the changes effected. One commentator, L Olivier states that *“the purpose in amending section 103(1) of the act was to clarify some of the issues. The legislator did not*

⁷³ Margo Commission Report of 1986 cited in the SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p 39

⁷⁴ Katz Commission, [28 November 1995], *Katz Commission Third Interim Report of the Commission into certain aspects of the Tax Structure of South Africa*, para. 11.2.2

*succeed in this. Instead of addressing some of the existing problems, the amendment created even more problems and this is regrettable.*⁷⁵

SARS proposed changes to this GAAR in 2005, and revised proposals were issued in October 2006, with the aim of enhancing the effectiveness of GAAR on impermissible tax avoidance transactions.⁷⁶ Section 103(1) was thus repealed by section 36(1)(a) of the Revenue Laws Amendment Act 2006 and replaced with the new GAAR provisions (section 80A – 80L). According to SARS, section 103(1) was repealed due to the follow reason:

*“it has proven to be an inconsistent and at the times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance and because it has not kept up with international developments”.*⁷⁷

As mentioned in Chapter 1 of this study, the way business is conducted both domestically and internationally, has changed over the last couple of decades and continues to do so. Therefore, to maintain the effectiveness of a GAAR, the requirements of the anti-avoidance rules have to change accordingly so as to be available to Revenue Authorities as an effective tool which can be used to curb impermissible tax avoidance. SARS stipulated that section 103(1) could not be regarded as an effective deterrent as things were changing and the Act was not being modified so as to cater for the more sophisticated forms of impermissible tax avoidance agreements.⁷⁸ Furthermore, SARS stated that section 103(1) could not keep up with international developments and hence there was a need to repeal it.⁷⁹

3.2 GAAR TODAY – SECTION 80A TO 80L OF THE ITA

The GAAR currently in effect can be found in Part IIA of Chapter III of the ITA: section 80A - 80L. This GAAR applies to any arrangement entered into on or after 02 November 2006. To better understand and evaluate why these provisions are worded the way they are, a comparison is made with any similar requirements contained in its predecessor, section 103(1). For ease of reference the GAAR

⁷⁵ L. Olivier, [1997], *Tax Avoidance: Options Available to the Commissioner for Inland Revenue*, TSAR Vol. 4, p. 744

⁷⁶ SARS. [2006]. *Tax Avoidance and Section 103 of the Income Tax Act, 1962: Revised Proposals*, Tax Administration, p 2

⁷⁷ SARS, [2006], *Explanatory Memorandum on the Revenue Laws Amendment Bill*, Tax Administration, [WP2-06], p 62

⁷⁸ *Ibid*, p 62

⁷⁹ *Ibid*

contained in section 80A – 80L will be referred to as “new GAAR” and the GAAR previously contained in section 103(1) as “old GAAR” for this section of the study.

A detailed analysis of each section of GAAR is presented below, following the order in which the provisions appear in the ITA, as far as possible. It is important to note that to date there has not been any case law on the new GAAR, and therefore, where applicable, reliance has to be placed on the judgements made by Courts based on the old GAAR to identify any precedent that may have been set.

3.2.1 Section 80A

Section 80A of the ITA provides the framework of what constitutes an impermissible arrangement and reads as follows:

“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).*⁸⁰

By defining impermissible tax avoidance arrangement, it confirms the notion that not all tax avoidance arrangements are impermissible and that GAAR is only aimed at situations where the tax avoidance is so severe that it falls within the definition set out above. There are essentially 4 requirements in this section that ALL need to be met for an arrangement to qualify as an impermissible arrangement. These 4 requirements are as follows and are further explored in detail below:

1. There has to be an arrangement, which is also an avoidance arrangement;
2. The arrangement has to result in a tax benefit;
3. The sole or main purpose of the arrangement must be the tax benefit;
4. Characteristics of avoidance arrangement to be met – tainted elements (only one requirement has to be met):
 - In a business context, the arrangement has to
 - Not be normally employed for *bona fide* business purposes, or
 - Lack commercial substance, or
 - Create rights and obligations not normally created, or
 - Result in the misuse or abuse of the provisions of the ITA.
 - In a context other than business, the arrangement has to
 - Not normally be employed for a bona fide purpose, or
 - Create rights and obligations not normally created, or
 - Result in the misuse or abuse of the provisions of the ITA.

The SARS Response document indicates that the basic four pronged approach is maintained from the old GAAR to the new GAAR.⁸¹ Each of these 4 requirements, as listed above, will be evaluated in detail below.

⁸⁰ Section 80A of the ITA

⁸¹ SARS, [2006], *Response Document Revised Proposal Tax Avoidance section 103*, Law Administration, South African Revenue Services 2006-03, p 5

3.2.1.1 Arrangement & Avoidance arrangement

Arrangement is defined in section 80L of the ITA as being ‘Any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property.’⁸²

“Arrangement” vs “Transaction, operation or scheme”

The old GAAR only referred to a “transaction, operation or scheme”, so it appears that the scope of GAAR has been extended with the definition of an “arrangement” found in the new GAAR now including the words ‘agreement’ and ‘understanding’.

The scope of the word ‘scheme’ has been discussed in past case law heard in SA Courts. Where there are a number of steps in a scheme, Judge Corbett had this to say about the scope of a scheme in *CIR v Louw* “If there is sufficient unity between this ultimate step and what has gone before, having regard to the ultimate objective, then together they may be regarded as being part and parcel of a single scheme.”⁸³ This judgement also found that the scope of the term “scheme” is wide enough to cover scenarios where later steps in a scheme remain incomplete at the outset.

The judgement of *Meyerowitz v CIR*⁸⁴ confirmed this principle that “scheme” is broad enough to cover a series of steps or transactions. The precedent for the meaning of the words ‘transaction’, ‘operation’ and ‘scheme’ set by case law therefore continues to be applicable to the new GAAR provisions. There is a school of thought though; that this extension of the scope of GAAR to apply to “arrangements” as identified, instead of “transactions, operations or schemes” as was the case in the old GAAR is unnecessary. Broomberg, in one of his articles, states that “there do not appear to be any reported cases in which it was even argued that the

⁸² Section 80L of ITA - Definitions

⁸³ [1983] (3) SA 551 (A) 45 SATC 113, p 135

⁸⁴ [1963] (3) SA 863 (A), 25 SATC 287, p 300

*Commissioner should fail on the ground that there was no transaction, operation or scheme. One may question, therefore, the desirability of introducing yet another elaboration in the form of a new definition being the definition of an 'arrangement'.*⁸⁵

“...whether enforceable or not...”

The “arrangement” definition, by the inclusion of the words “whether enforceable or not” indicates that the arrangement does not necessarily have to be legally enforceable for the new GAAR to be applied. These words were not included in the old GAAR and seem to allow SARS to attack even those arrangements that are not legally enforceable, which is an extension of the scope of the old GAAR. It appears that arrangements do not even have to be reduced to writing for it to fall within the “arrangement” definition included in the new GAAR. How useful this extended scope proves to be remains however to be seen, if anything it most likely saves SARS the trouble of proving that an arrangement is legally enforceable before seeking to apply the new GAAR.

“...including all steps therein or parts thereof...”

The “arrangement” definition includes both all steps in an arrangement or only parts of the arrangement. Silke on South Africa Income Tax suggests that this wording aims to “*connote a distinct transactional element of the whole.*”⁸⁶ Section 80H of the ITA explicitly allows the Commissioner to apply GAAR to “*steps in or parts of an arrangement*”⁸⁷, which is a new inclusion in the new GAAR. It is a differentiating characteristic of the new GAAR that appears to go against case law judgements on application of the old GAAR provisions. The *Conhage* judgement for example, where the Courts ruled that “*the courts would look at the whole of the transaction as opposed to reviewing individual steps to ascertain if tax avoidance has taken place*”⁸⁸ when the Court was considering a sale and leaseback arrangement. It is clear that the legislators intended

⁸⁵ E. B. Broomberg, [2007], *Tax Planning, Then and Now – II*, 21 Tax Planning, p131

⁸⁶ A. P. de Koker, R. C. Williams, [2012], *General Anti-avoidance*, SILKE on South African Income Tax, Lexis Nexis. Ch. 19.36 (online version – date accessed April 2016).

⁸⁷ Section 80H of ITA

⁸⁸ *CIR v Conhage* [1999] (4) SA 1149 (SCA), 61 SATC 391 at 393

to do away with this principle with the inclusion of section 80G(2) of the ITA, which reads as follows:

“The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole.”⁸⁹

The fact that SARS can now attack any step in an arrangement, by virtue of the powers granted in terms of section 80H, seems to also disregard judgements like the one in *Meyerowitz v CIR*⁹⁰, where the Courts held that the test to be applied in a scheme with different steps, is whether the steps appear to be so connected that they could ultimately lead to tax avoidance. It was also held in this case that it is of no significance whether the intention to avoid tax is only developed in later steps of a scheme.

This extension of the scope of GAAR still however leaves a number of unanswered questions. Broomberg mentions such questions in his article as follows; *“Can the Commissioner apply GAAR to only steps in an arrangement when the step or part so selected loses its commercial substance when considered in isolation?”*⁹¹

An avoidance arrangement is also defined in section 80L of the ITA, and includes any arrangement, but for Part IIA of the ITA, results in a tax benefit.⁹²

3.2.1.2 Tax Benefit

The term “tax benefit” is defined in section 1 of the ITA as being *“any avoidance, postponement or reduction of any liability for the payment of tax.”*⁹³ The determination of whether an arrangement has given rise to a tax benefit has been explored in a number of cases heard in SA Courts. In *Smith v CIR* the Court held that a tax benefit arises where a taxpayer “escape(s) a liability for tax which, but for such transaction or scheme, he would have been obliged to pay”.⁹⁴

⁸⁹ Section 80G(2) of ITA

⁹⁰ *Meyerowitz v CIR* [1963] (3) SA 863 (A), 25 SATC 287

⁹¹ E. B. Broomberg, [2007], *Tax Planning, Then and Now – II*, 21 Tax Planning, p131

⁹² Section 80L of ITA - Definitions

⁹³ Section 1 of the ITA - Definitions

⁹⁴ *Smith v CIR*, [1964] (1) SA 321(A), (SCA), at p 6 pf 26 SATC 1

As the term “tax benefit” also appeared in the old GAAR, principles previously established by the Courts would still apply to the new GAAR.

It appears that a tax benefit could relate to a current, future and past tax liability, which might cause some confusion. One must thus be mindful of this principle as judgements from past case law might create the impression that a tax benefit can only relate to a future tax liability when an arrangement is entered into. An example of this can be found in *CIR v King*, where the Court stated the following:

“There are many . . . ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income. For example, a man can sell investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in buying shares which produce no income but may increase in value ... He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation. If he is a professional man he may reduce his fees or work for nothing ... He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that Parliament intended by the provisions of section 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out”⁹⁵

There is no explicit test however to ascertain whether a tax benefit has been obtained through an avoidance arrangement. Here again, one has to rely on judgements from previous case law to provide guidance on a tax benefit “test” that could be applied. A test that appears to come through in a number of judgements is the “but for” test. This test basically assesses what the taxpayer’s position would have been, but for the avoidance arrangement in question.

⁹⁵ *CIR v King* [1947] (2) ALL SA 155 (A) at p 184, 14 SATC 184

Examples of where the Courts referred to this test can be found in *CIR v Louw*⁹⁶ and *ITC 1625*⁹⁷. This test can however become problematic in that it forces one to consider some sort of notional position the taxpayer would have found themselves in, had the avoidance arrangement not been entered into. This test is also based on a subjective analysis of what the taxpayer could have alternatively done; besides entering into the avoidance transaction.

Connected persons and accommodating or tax-indifferent parties

Section 80F of the ITA specifically deals with the treatment of connected persons and accommodating or tax-indifferent parties and provides the Commissioner with additional powers. In terms of this provision, the Commissioner may treat connected parties/accommodating or tax-indifferent parties and another party as one or disregard any accommodating or tax indifferent parties when determining whether a tax benefit has been obtained by virtue of an avoidance arrangement.⁹⁸ There was no such provision in the old GAAR.

3.2.1.3 Sole or main purpose

For an avoidance transaction to become an impermissible avoidance transaction, the main or sole purpose of the arrangement has to be the obtained tax benefit. There is however no definition or guidance on what is meant by the terms “mainly” and “solely”. This requirement was part of the old GAAR and therefore any principles established through case law would still apply to the new GAAR. The case *SBI v Lourens Erasmus (Edms) Bpk*, evaluated the meaning of the words “solely” and “mainly” and held that

*“... in the context under consideration, the word ‘mainly’ establishes a purely quantitative measure of more than 50% and the associated use of the word ‘solely’ or mainly is inserted, ex abundante cautela, to circumvent the possibility that what may be described as being ‘solely’ of a particular character would not qualify as being ‘mainly’ of that character”*⁹⁹

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

⁹⁷ *ITC 1625*, (1996) 59 SATC 383

⁹⁸ Section 80F of ITA

⁹⁹ *SBI v Lourens Erasmus (Eiendoms) Bpk* [1966] (4) SA 434 (A), 28 SATC 233

The Court, in *CIR v Bobat*, however held that “... a main purpose is obviously one which must be dominant over any other, because in ordinary language ‘mainly’ means for the most part, principally or chiefly.”¹⁰⁰ It is therefore safe to assume that the “sole” or “main” purpose of an arrangement does not have to be the only purpose of the arrangement, but it does have to be a dominant purpose of the entering into the arrangement.

The test of the purpose of an arrangement, in the old GAAR, was a subjective test in that it evaluated the purpose for which the transaction, operation or scheme was entered into, thus considering whether the taxpayer entered into the transaction, operation or scheme with the intention of obtaining a tax benefit. Query had to be made into the mind of the taxpayer who entered into the transaction, operation or scheme under this subjective test, which could be difficult in certain instances. The purpose test, as included in the new GAAR, appears now to be an objective test as it evaluates whether the purpose of the arrangement itself has the effect of a tax benefit. Corbett JA, in *SIR v Gallagher* explained the difference between a subjective and objective test and had the following to say:

*“By an objective test in this context is evidently meant a test which has regard rather to the effect of the scheme, objectively viewed, as opposed to a subjective test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme.”*¹⁰¹

SARS points out in their Response document that an objective test was included in the new GAAR, not to exclude the intention of the taxpayer entering into the arrangement, but to rather apply the test to the arrangement itself along with the taxpayers’ *ipse dixit*. The Response document indicates that *“It was never the intent of the original proposals to prevent a taxpayer’s explanation of the reasons for an arrangement from being taken into account. Rather, it was intended to ensure that a taxpayer’s statements of intent be rigorously tested against the relevant facts and circumstances.”*¹⁰²

¹⁰⁰ *CIR v Bobat & others* [2003] (N), 67 SATC 47

¹⁰¹ *SIR v Gallagher*, [1978] (2) 40 SATC 39, SA 463(A)

¹⁰² SARS, [2006], *Response Document Revised Proposal Tax Avoidance section 103*, Law Administration, South African Revenue Services 2006-03, p 21

SARS in its Discussion Paper on Anti-Avoidance¹⁰³ makes reference to the anomalous results identified by RC Williams that could potentially have arisen under section 103, as the reason for the change from a subjective test to an objective test. The anomalous results identified by RC Williams¹⁰⁴ are expressed as follows:

“...a taxpayer could with impunity enter into a transaction which was objectively ‘abnormal’ provided that he did not, subjectively, have the sole or main purpose of tax avoidance....”

The change to an objective test allows a uniform test to be applied to all arrangements, to ascertain whether the purpose of the arrangement itself is a tax benefit, instead of only applying to transactions, operations and schemes where the purpose of the taxpayer was to obtain a tax benefit. Section 80A of the ITA, by itself, however does not prove definitively that the new GAAR now includes an objective test, despite this being the intention of the legislators and SARS.

The shift from a subjective test to an objective test is supported by the wording included in Section 80G(1) of the ITA, which speaks to the presumption of purpose. Section 80G(1) reads as follows:

“An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit prove that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.”¹⁰⁵

Section 80G thus provides a rebuttable presumption that an “avoidance arrangement” has been entered into or carried out for the sole or main purpose of obtaining a tax benefit and Broomberg suggests that *“it is this wording that compelled courts abroad to conclude that the test of purpose was objective.”¹⁰⁶*

¹⁰³ SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p 56

¹⁰⁴ R. C. Williams, [1997]. *The 1996 Amendments to the General Anti Avoidance section of the Income Tax Act*, cited in SARS, [2010], *Draft Comprehensive Guide to the General Anti-Avoidance Rule*, Tax Administration, p 56

¹⁰⁵ Section 80G of ITA

¹⁰⁶ E. B. Broomberg, [2007], *Tax Planning, Then and Now – II*, 21 Tax Planning p132

The fact that the words, “*reasonably considered in light of the relevant facts and circumstances*”¹⁰⁷ is included in section 80G, however it appears that there is still a level of subjectivity to be applied under the new GAAR, this being as the taxpayers’ intention must still be considered in light of the facts and circumstances at hand. Until a Court hears a case on the application of the new GAAR, it is thus unclear whether only an objective test should be applied.

Broomberg indicates that with the old GAAR, “*the courts have ruled, the onus lay on the Commissioner to prove the presence of all the requirements for section 103(1), subject to the proviso that once the tax avoidance effect of the transaction had been proven by the Commissioner, the onus then shifted to the taxpayer to prove that his main or sole purpose was not the tax avoidance.*”

For new GAAR to apply, the onus initially rests on the Commissioner to prove that a tax benefit was obtained by virtue of an avoidance arrangement. Once this has been proven, the onus shifts onto the taxpayer to show that the tax benefit was not its sole purpose for entering into the transaction.

3.2.1.4 Tainted Element

In terms of the tainted elements, the old GAAR required there to be an “abnormal” transaction, operation or scheme with non-arm’s length rights and obligations, before it could be applied. These tainted elements are retained in the new GAAR, but additional elements are added, being a commercial substance element and a statutory purpose element.¹⁰⁸ Thus, as these tainted elements from the old GAAR were maintained in the new GAAR, any precedent set by the Courts from cases heard under the old GAAR, still apply. It should be noted though that there has been uncertainty regarding the meaning of “normal” when testing an arrangement under the old GAAR, which now continues to be an issue.¹⁰⁹

¹⁰⁷ Section 80G of ITA

¹⁰⁸ SARS, [2006], *Response Document Revised Proposal Tax Avoidance section 103*, Law Administration, South African Revenue Services 2006-03, p 5

¹⁰⁹ A. P. de Koker, R. C. Williams, [2012], *General Anti-avoidance*, SILKE on South African Income Tax, Lexis Nexis. Ch. 19.4. (online version – date accessed April 2016).

SARS in its Discussion Paper, states that the abnormality requirement, per the old GAAR suffered from two fundamental weaknesses.¹¹⁰ The first is that there is no clear distinction between “*bona fide*” business transactions and impermissible avoidance arrangements. It was often found that even where steps could be designed for *bona fide* business purposes, there were instances where these steps were “hijacked” by scheme promoters and included in impermissible avoidance arrangements. This first weakness leads into the second identified weakness, namely that these scheme promoters were found to quite easily “manufacture” plausible sounding “business purposes”.¹¹¹

The new GAAR expands and increases the scope of the abnormality requirement and now has to be considered either in the context of business, or in a context other than business. The details of the abnormality requirement as included in the new GAAR will be further evaluated by looking at each tainted element to be considered in either a business context or any other context.

In the context of business

As mentioned previously in this Chapter, the tainted elements to consider for an arrangement in a business context are as follows:

- Abnormality – *bona fide* business purposes (“the business purpose test”)

This business purpose test evaluates whether, in a business context, the arrangement has been entered into and/or executed in a manner that would not normally be employed for a *bona fide* business purpose, other than generating and obtaining a tax benefit. The test therefore aims to distinguish between how a specific business arrangement would normally have been entered into and executed versus what actually happened. As was the case in the old GAAR, it might prove difficult to establish what the “normal” manner should be when considering arrangements that have been entered into in good faith for business purposes.

¹¹⁰ SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p 42

¹¹¹ *Ibid*

De Koker in Silke¹¹², holds the view that by referring to “*bona fide business purpose*” again in the wording of section 80A(a), but in a different sense to the word “purpose”, appearing in the opening words of section 80A, might cause confusion. This confusion or the lack of guidance on the matter, might lead to SARS inappropriately applying GAAR based on discretion.

De Koker states the following in this regard:

“What s 80A(a) is really talking about, it is submitted, is not purpose (either subjective or objective) but method, that is to say, the overt means or manner by which the taxpayer has entered into or carried out the arrangement in question. If that means or manner was such as would not normally be employed in the context of business, then s 80A(a) component of an impermissible avoidance arrangement is present”¹¹³

- Lack of commercial substance test

The commercial substance test is made up of a general rule and then a non-exclusive list of characteristics that could indicate the lack of commercial substance. The general rule is contained in section 80C(1) of the ITA and reads as follows:

(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.”

This rule therefore considers the tax benefit obtained by the arrangement versus the commercial effect on business risks or net cash flow, other than that arising from the tax benefit. However, it is only where the tax benefit obtained is “significant”, without any significant impact on the business risk profile or cash flow status, that the arrangement can be said to lack commercial substance. There currently is no guidance available on what is meant by “significant tax benefit”, so it most likely would be difficult to apply GAAR on the basis of the commercial substance

¹¹² A. P. de Koker, R. C. Williams, [2012], *General Anti-avoidance*, SILKE on South African Income Tax, Lexis Nexis. Ch. 19.4., Chapter 19.39 (online version – date accessed April 2016)

¹¹³ *ibid*

general rule. Consideration should be given to whether the legislation should include some further definition or measurement criteria to determine whether this general rule could be applied.

Section 80C(2) contains a non-exhaustive list of indicators for the lack of commercial substance and reads as follows:

“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*
- 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.”¹¹⁴*

These 4 indicators are briefly discussed further below.

Legal substance over legal form

This indicator of a potential lack of commercial substance refers to arrangements where either the effect or legal substance of the arrangement as a whole is inconsistent or significantly different to the legal form of the individual steps of the arrangement. The legal substance of an arrangement is considered to be the actual or true rights and obligations created by an arrangement and thus constitute the real arrangement in place. The legal form would then be what the parties actually do.

This principle should not be confused with the traditional “legal substance over form test” established through common law and applicable to simulated transactions, where the substance of an arrangement is given effect over the legal form. The test in section 80C(2)(a) refers to where the parties have acted in good faith, but the rights and obligations, assigned by the

¹¹⁴ Section 80C(2) of the ITA

supporting legal documentation, are not aligned with the parties' actions; whereas the "legal substance over form test" challenges sham arrangements where the parties have deliberately disguised the true nature of the arrangement.

Important principles arise from the *NWK v SARS*¹¹⁵ case relating to legal substance over form. In this case the court stated that:

"... the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. The test should go further and require an examination of the commercial sense of the transaction i.e. its real substance and purpose."

If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated.'

Based on these words by the court, it would seem that an objective test has to be applied to a transaction, operating or scheme to test the commercial sense against any tax benefit obtained.

This test therefore looks beyond the parties' *ipse dixit* of what their intentions are. SARS has found it difficult in the past to argue legal substance over form where the legal form and legal substance are consistent, i.e. the parties act in accordance with the legal rights assigned. The objective test provided in *NWK* may therefore make it easier to prove that an arrangement lacks commercial sense, instead of considering the intentions of the parties to prove that the substance of an arrangement is inconsistent with the form.

EB Broomberg states in an article, that the legal substance over legal form test as included in section 80C(2)(a) and the other provisions of GAAR may only be applied to the *true rights and obligations that have been identified after all substance-versus-form issues have been resolved*.¹¹⁶ It is clearly suggested that the common law principles should first be applied to any arrangement, before the legal substance over legal form test can be applied.

¹¹⁵ *CSARS v NWK* [2010] (27/10), ZASCA 168, p 19

¹¹⁶ E. B. Broomberg, [2007], *Then and Now - VI*, 22 Tax Planning, p74

Round trip financing

Section 80D¹¹⁷ of the ITA defines round trip financing and states that it refers to avoidance arrangements in which:

- *“Funds are transferred between or among parties; and*
- *The transfer would*
 - *Result in a direct or indirect tax benefit; and*
 - *Significantly reduce, offset or eliminate any business risk by any connected party.”*

The scope of this test appears to be too wide as SARS could potentially apply it in any instances where funds (defined to mean cash, cash equivalents, or any right or obligation to receive or pay the same)¹¹⁸ are transferred between parties.

Also, the inclusion of the terms ‘tax benefit’ and the reduction of ‘business risk’ in the test for round trip financing, creates a duplication of the test laid out in section 80C(1) for the determination of a tax benefit. This also has the potential to create confusion.¹¹⁹

Accommodating or tax-indifferent parties

Section 80E provides as follows:

- “(1) A party to an avoidance arrangement is an accommodating or tax indifferent party if -*
- (a) Any amount derived by the party in connection with the avoidance arrangement is either:*
- (i) Not subject to normal tax; or*

¹¹⁷ Section 80D of the ITA

¹¹⁸ Section 80D(3) of ITA

¹¹⁹ Y. Haffejee, [2009], *A critical Analysis of South African General Anti Avoidance Provisions in Income Tax Legislation*, (LLM dissertation, 2009 NMMU), p 27

- (ii) Significantly offset by either any expenditure or loss incurred by the party in connection with the avoidance arrangement or any assessed loss of the party; and
- (b) Either
- (i) As a direct or indirect result of the participation of that party involves an amount that would have:
- (aa) been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts and accruals of a capital nature of that party;
- (bb) constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party;
- (cc) constituted revenue in the hands of another party would be treated as capital by that other party; or
- (dd) given rise to taxable income to another party would either be not included in gross income or be exempt from normal tax; or
- (ii) the participation of that party directly or indirectly involves a prepayment by any other party.¹²⁰

Section 80E(2) then goes on to explicitly state that accommodating or tax-indifferent parties do not need to be connected parties and Section 80E(3) provides certain circumstances where the accommodating or tax-indifferent parties rule will not apply. In conjunction with this rule, it is important to note section 80F¹²¹ as well, which provides the Commissioner the right to treat connected parties and accommodating or tax-indifferent parties as one and the same person and disregard any identified accommodating or tax-indifferent parties.

Offsetting or cancelling elements

This rule essentially states that where an avoidance arrangement includes elements that effectively cancel each other out or offset each other, it will constitute an impermissible avoidance arrangement where it was entered into or executed in a business context, a tax

¹²⁰ Section 80E of ITA

¹²¹ Section 80F of ITA

benefit was obtained, which was the sole or main purpose of the arrangement. This indicator of a potential lack of commercial substance is new to GAAR and there is thus no guidance on how this section should be applied or interpreted.

From the SARS Discussion Paper it appears that this indicator was included in the new GAAR to cover abusive avoidance schemes which are often mind-numbingly complex to disguise the true nature of a scheme and more cynically, where promoters deliberately add complexity in order to justify higher professional fees.¹²²

- Create rights and obligations not normally created

This provision was also contained in the old GAAR provisions, however the following wording has been removed from the inclusion in the new GAAR: *“under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question”, and of “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out”*.¹²³ The removal of such wording therefore removes the benchmark that would have to be applied per the old GAAR provisions and appears to make this test an objective one.

The new GAAR thus calls for a factual inquiry to test whether an avoidance arrangement has created rights or obligations not normally created between parties dealing at arm’s length, considered against the hypothetical normal transaction.¹²⁴ It should be noted that this provision is applicable in any context and not only in a business context and therefore has a very wide scope.

- Misuse or abuse of the provisions of the ITA

This provision also applies in any context, and not only a business context. The concept of ‘misuse or abuse’ is new to the South African GAAR and the rationale behind this insertion was to reinforce the modern approach to the interpretation of tax statutes “in order to find the meaning that harmonizes the wording, object, spirit and purpose of the provisions of the

¹²² SARS, [November 2005], *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)*, Law Administration, p 21 & 22

¹²³ Previous Section 103(1) of ITA – now repealed.

¹²⁴ R. Garg, [2012], *Removing the fences: Looking through GAAR*, PriceWaterHouse Cooper publication, at 47 (accessed online <https://www.pwc.in/assets/pdfs/publications-2012/pwc-white-paper-on-gaar.pdf> in April 2016)

Income Tax Act”.¹²⁵ The Explanatory Memorandum to the Revenue Laws Amendment Bill of 2006¹²⁶ states that this legislature has relied on, amongst others, a Canadian precedent in introducing the misuse or abuse of the Act test.¹²⁷

A detailed analysis of the inclusion of this provision in the new GAAR will be conducted in Chapter 4 of this study where consideration will be given to the supposed origin of the provision, the desired objectives of the inclusion of this provision and a comparison to the rights granted by the provision to the Commissioner versus any similar rights already provided by the Common Law of South Africa.

In the context other than business

As previously indicated, the tainted elements in a context other than business which could indicate an impermissible avoidance arrangement are as follows:

- *Abnormality – bona fide purposes*

The same discussion above on abnormality in a business context applies equally to this tainted element, except that any *bona fide* purpose will suffice as it does not refer to a “business” purpose. There is no enquiry into a ‘lack of commercial substance’ as this would be inappropriate in a non-business context but the use of ‘normal’ in the provision indicates it entails a comparison with a hypothetical scenario.¹²⁸

- *Create rights and obligations not normally created*

As mentioned above, this tainted element applies in any context and the discussion under “in the context of business” would therefore equally apply here.

¹²⁵ SARS, [September 2006], *Revised Proposals on Tax Avoidance and Section 103 of the Income Tax Act 58 of 1962 (Revised Proposals)*, Law Administration, cited from Canada Trustco Mortgage Company v Canada 2005 SCC 54.

¹²⁶ SARS, [2006], *Explanatory Memorandum on the Revenue Laws Amendment Bill*, Tax Administration, [WP2-06], p 3

¹²⁷ E. B. Broomberg, [2007], *Then and Now – IV*, 22 Tax Planning, p31

¹²⁸ A. P. de Koker, R. C. Williams, [2012], *General Anti-avoidance*, SILKE on South African Income Tax, Lexis Nexis. Ch. 19.39, Chapter 19.39 (online version – date accessed April 2016)

- Misuse or abuse of the provisions of the ITA

As mentioned above, this tainted element applies in any context and the discussion under “in the context of business” would therefore equally apply here. Further detailed discussions on this new provision included in the new GAAR can be found in Chapter 4.

3.3 CONCLUSION

This Chapter focussed on the development of GAAR in South Africa from the first time it was introduced in 1941 per section 90 of the Income Tax Act 31 of 1941. As weaknesses have been identified, GAAR has undergone a number of changes to try and overcome these weaknesses.

The predecessor to GAAR, was section 103(1) of the ITA (a section repealed by section 36(1)(a) of the Revenue Laws Amendment Act 2006). Many of the principles included in the previous section 103(1) have been retained in section 80A – 80L, but it appears that the new GAAR has increased the scope of potential instances where it may be applied.

Certain tests included in the old GAAR, for example the purpose test, were previously thought to be subjective tests, considering the intentions of the parties entering into and executing an arrangement, but are now potentially considered to be objective tests. The principles as proposed by SARS, in the new GAAR, still however have to be considered by the Courts, before taxpayers can have certainty of the application thereof.

One of the additions to the new GAAR, which came about when the rules became effective to transactions on or after 2 November 2006, is the inclusion of the tainted element which speaks to the misuse or abuse of the provisions of the ITA, which will be considered in detail in Chapter 4.

CHAPTER 4 – MISUSE or ABUSE OF PROVISIONS OF THE ITA

Introduction

As previously mentioned in Chapter 3, the GAAR currently in effect includes, for the first time, a provision referring to the misuse or abuse of provisions of the Act as one of the tainted elements, applicable in any context. An arrangement may therefore be set aside as an impermissible avoidance arrangement where it results in the misuse or abuse of the provisions of the Act. This Chapter takes a detailed look at this provision of GAAR, evaluating the origins of the provision, being Canadian GAAR, the objectives and meaning of including such a provision in GAAR, as well as the appropriateness of such a provision in the ITA, by looking at the effects on statutory interpretation principles. Finally, the effects of such a provision being included in GAAR on the rights of taxpayers, as established through case law in SA are considered.

4.1 ORIGINS OF THE “MISUSE OR ABUSE OF PROVISIONS” INCLUSION IN SA GAAR

For the first time, since the existence of GAAR, has the notion been introduced that an impermissible avoidance arrangement may arise from the misuse or abuse of a provision of the Act. This is therefore a new concept that needs to be explored in an attempt to better understand the effects of such an element in GAAR. The concept was however already proposed in 1995 as part of the recommendations of the Katz Report, where it was suggested that the following proviso be inserted at the end of section 103(1):

"provided that the provisions of this section shall not apply where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act, read as a whole."¹²⁹

This recommendation was however never effected and so the proviso was never included in section 103(1) of the Act, a repealed section of the Act. Instead the concept of the misuse or abuse of the

¹²⁹ Katz Commission, [28 November 1995], *Katz Commission Third Interim Report of the Commission into certain aspects of the Tax Structure of South Africa*, para. 11.5.8

provisions of the Act was introduced only much later with the GAAR that is currently in effect by virtue of section 80A(c)(ii) of the Act.

Section 80A(c)(ii) of the ITA states the following:

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

(c) in any context—

...

(ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).”¹³⁰

Based on the wording of this provision, where an arrangement is regarded as having abused, or misused a provision of the Act, it may be put aside as an impermissible avoidance arrangement for tax purposes. The provision is included in GAAR as a tainted element, applicable in any context, which could be indicative of an impermissible avoidance arrangement. The other tainted element, applicable in any context, as mentioned in Chapter 3, includes the creation of rights and obligations not normally created and therefore it is not a requirement that a specific tainted element is present for an arrangement to constitute an impermissible avoidance arrangement.

A similar provision is included in Canadian GAAR and is found in s245 of the Canadian Federal Income Tax Act (CITA). The SARS Discussion Paper provides a brief summary of the history of GAAR in Canada and states the following¹³¹:

“For many years, Canada possessed a rudimentary anti-avoidance provision in the form of section 137 of the Canadian Income Tax Act (CITA). A 1984 decision by the Canadian Supreme Court expressly rejecting the adoption of a judicially developed business purpose test¹³², together with a subsequent announcement by Revenue Canada that it would issue advance rulings in respect of transactions lacking any business purpose, encouraged “taxpayers and their advisers [to become] increasingly aggressive”. A serious shortfall in

¹³⁰ Section 80A of ITA

¹³¹ SARS, [November 2005], Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962), Law Administration p. 30

¹³² *Stubart Investments Ltd v the Queen* [1984] CTC 294; 84 DTC 6305 (SCC)

corporate revenues ensued and ultimately led to the enactment of a new GAAR, the current section 245 of the CITA.”

A journal article in the Bulletin for International Taxation¹³³ indicates that “*The Supreme Court of Canada released the first decision on 19 October 2005 in which it considered the GAAR in section 245 of the CITA. Effective for transactions entered into on or after 13 September 1988, this rule was enacted as a deliberate response to the Supreme Court of Canada decision in Stubar Investments Ltd. v. The Queen*¹³⁴ and was intended to reduce what the Court had described as “*the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally guided and equally specialized taxpayer reaction*”¹³⁵

Section 245 subsection (1) to (4), includes the scope and application of Canadian GAAR and reads as follows¹³⁶:

“Definitions

245 (1) *In this section,*

tax benefit means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty; (*avantage fiscal*)

tax consequences to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount; (*attribut fiscal*)

transaction includes an arrangement or event. (*opération*)

General anti-avoidance provision

(2) *Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but*

¹³³ D. G. Duff, [February 2006], *The Supreme Court of Canada and the General Anti-Avoidance Rule: Canada Trustco and Mathew*, Bulletin for International Taxation, Vol. 60, No. 54, Social Science Research Network, p 54

¹³⁴ *Stubar Investments Ltd v the Queen* [1984] CTC 294; 84 DTC 6305 (SCC)

¹³⁵ *Stubar Investments*, supra note 4, Para. 66, cited in Canada, Department of Finance, Tax Reform 1987: Economic and Fiscal Outlook (Ottawa: Department of Finance, 18 June 1987), reproduced in White Paper on Tax Reform (Don Mills, Ontario: CCH, 1987), p211

¹³⁶ Section 245 of Income Tax Act (R.S.C., 1985, c. 1 (5th Supp.)), <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/section-245.html>, accessed May 2016

for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

Avoidance transaction

(3) *An avoidance transaction means any transaction*

(a) *that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or*

(b) *that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.*

Application of subsection

(4) *Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction*

(a) *would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of*

(i) *this Act,*

(ii) *the Income Tax Regulations,*

(iii) *the Income Tax Application Rules,*

(iv) *a tax treaty, or*

(v) *any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or*

(b) *would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.”*

Based on the wording of section 245 (4) the tax benefits derived from an avoidance transaction may only be disregarded or set aside if the transaction results in the misuse of the provisions of the CITA. It is important to note the distinction of how the misuse or abuse provision is included in Canadian versus SA GAAR. As mentioned with Canadian GAAR, unless the transaction has resulted in a misuse of the provisions in the CITA, Canadian GAAR cannot be applied, whereas with SA GAAR, the misuse or abuse of the provision of the Act is only one of the tainted elements that may indicate an impermissible arrangement and therefore does not necessarily have to be present for SA GAAR to be applied.

The misuse provision included in Canadian GAAR therefore acts as a limiting provision, and taxpayers are able to argue and defend their arrangements on this basis, whereas in SA GAAR the misuse provision is only a tainted element, and taxpayers would need to address the other criteria of an impermissible arrangement when defending their arrangement. The other criteria of an impermissible arrangement, as described in Chapter 3, is that there is an avoidance arrangement, which results in a tax benefit, where the main or sole purpose of the arrangement is to obtain this tax benefit.

Broomberg says the following about this limiting feature of the Canadian GAAR as compared to how the misuse of a provision is included in SA GAAR:

“The significance of this feature in the Canadian Act should not be overlooked. It is an acknowledgement of the multiple dangers inherent in framing a general anti-avoidance measure too widely:

- *In the first place, a general anti-avoidance rule empowers the Commissioner to override the specific and unambiguous provisions of an Income Tax Act, as laid down by an elected parliament. This is an undesirable state of affairs to say the least.*
- *In addition, it creates an atmosphere of uncertainty that may act as a disincentive to economic activity in the country.*
- *Finally, if the anti-avoidance legislation is too broad it starts to hit at transactions that the legislature could never have intended to attack. This, in turn, tends to provoke the courts into placing an unduly restrictive interpretation on the legislation.”¹³⁷*

The manner in which the drafters of legislation chose to include the misuse or abuse provision in SA GAAR may thus cause confusion as to the powers provided to the Commissioner when seeking to set aside arrangements by the application of SA GAAR.

SARS notes in its Response Document that *“at times, the traditional “literal” approach to the interpretation of tax statutes has exacerbated this problem. As a result, there has been a broad movement towards the so-called “modern” approach to interpretation which requires a “contextual and purposive approach . . . in order to find the meaning that harmonizes the wording, object, spirit*

¹³⁷ E. B. Broomberg, [2007], *Tax Planning, Then and Now – IV*, 22 *Tax Planning*, p31

and purpose of the provisions of the [tax laws]”.¹³⁸ This is the stated reason for introducing a new “Statutory Purpose Element” to GAAR in SA which reinforces the modern approach to the interpretation of the tax legislation by searching for the meaning that mends together the object, spirit and purpose of the statutes of the Act. It therefore becomes important to establish how to determine whether there has been a misuse of the provisions, which essentially considers statutory interpretation principles applied to find the purpose of these provisions. Arrangements which may conform to the letter of the law, but not necessarily to the intended purpose of the legislation may be considered to have misused or abused the provisions of the Act. The concept of misuse or abuse of a provision found in GAAR therefore aims to deny the tax benefits derived from such arrangements.

The definition of misuse per the Oxford dictionary is to “use (something) in the wrong way for the wrong purpose”¹³⁹ and of abuse is to “use (something) to bad effect or for a bad purpose”.¹⁴⁰ Both definitions refer to the purpose of something not being adhered to and it therefore follows that the purpose of provisions of an Income Tax Act first needs to be established, through statutory interpretation principles, before any misuse or abuse of these provisions can be argued.

4.2 CANADIAN GAAR – MISUSE OF TAX PROVISIONS AND STATUTORY INTERPRETATION

As indicated before, the misuse provision of the Canadian GAAR criterion has to be met for Canadian GAAR to successfully be applied and a tax benefit set aside. It is therefore important that taxpayers are able to understand and determine whether a transaction might fall foul of the intended meaning of the provisions of the CITA, Income Tax Regulations, Income tax application rules or tax treaties. In *Trustco Mortgage*¹⁴¹, the court relied on the reasons in *OSFC Holdings Ltd v Canada*¹⁴² judgement in which the court set out a two-stage analysis for abuse under GAAR. The first is to “identify ... the relevant policy of the provisions or the Act as a whole” and the second “to assess ... the facts to

¹³⁸ SARS, [2006], *Response Document Revised Proposal Tax Avoidance section 103*, Law Administration, South African Revenue Services 2006-03, p 14

¹³⁹ Definition of “misuse” from Electronic Oxford Dictionary - <http://www.oxforddictionaries.com/definition/english/misuse> (accessed May 2016)

¹⁴⁰ Definition of “abuse” from Electronic Oxford Dictionary - <http://www.oxforddictionaries.com/definition/english/misuse> (accessed May 2016)

¹⁴¹ *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54

¹⁴² *OSFC Holdings Ltd. v. Canada*, [2002] 2 F.C. 288, 2001 FCA 260 (“OSFC”)

determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy”.

This analysis provided by the Canadian Courts asks that the relevant policy of the provisions of the CITA, Income Tax Regulations, Income tax application rules or tax treaties first be identified, which calls for an interpretation of the legislation before misuse can be established. The principles of statutory interpretation in Canada are best described by the E.A. Driedger’s “modern rule” according to which *“the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament”*¹⁴³ In *Trustco*, the Court explained that *“there is no doubt today that all statutes, including the [Income Tax] Act, must be interpreted in a textual, contextual and purposive way”*¹⁴⁴ The Court also emphasised that the CITA *“must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently”*.¹⁴⁵ Thus *“[w]hen the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process”*¹⁴⁶ The Judge went further in the *Trustco* judgement¹⁴⁷ to quote the following from *Principles of Canadian Income Tax Law*¹⁴⁸:

“Even where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities. “After all, language can never be interpreted independently of its context, and legislative purpose is part of the context. It would seem to follow that consideration of legislative purpose may not only resolve patent ambiguity, but may, on occasion, reveal ambiguity in apparently plain language.”

When considering statutory interpretation principles, it has to be evaluated against the established rights of the taxpayer. The Court in *Trustco* reaffirmed the long standing principle established in *Duke of Westminster*, that taxpayers may *“manage their affairs”* to minimize the tax payable¹⁴⁹. The Court then went further to observe the Explanatory Memorandum accompanying the Canadian GAAR legislation and affirmed that *“tax planning – arranging one’s affairs so as to attract the least*

¹⁴³ E. A. Driedger, [1983], *Construction of Statutes*, Toronto: Butterworths, 2nd ed., p 87

¹⁴⁴ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 11

¹⁴⁵ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 12

¹⁴⁶ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 10

¹⁴⁷ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 47

¹⁴⁸ P. W. Hogg, J. E. Magee and J. Li, [2002], *Principles of Canadian Income Tax Law*, Scarborough: Carswell, 4th ed., p 563

¹⁴⁹ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 12

*amount of tax – is a legitimate and accepted part of Canadian tax law*¹⁵⁰ and that *“the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between protection of the tax base and the need for certainty for taxpayers in planning their affairs”*.¹⁵¹

Therefore, when determining whether the misuse of a provision has given rise to a tax benefit, a purposive interpretation approach has to firstly be applied to identify the object, spirit and purpose of the provision in question. Only once the purpose of the relevant provision of the CITA has been determined, may enquiry be made into whether this purpose has been frustrated or defeated leading to the misuse of the object, spirit or purpose of the provision.

In terms of the burden of proof of establishing the purpose of provisions included in the provisions of the CITA, Income Tax Regulations, Income tax application rules or tax treaties, the majority of the Court of Appeal in *OSFC Holdings* held that neither party has a formal onus to establish the relevant policy of the provisions, but that the Minister has a “practical” burden to explain the policy, while the taxpayer has *“the onus.... to prove the necessary facts to refute the Minister’s assumptions of fact that the avoidance transaction in question results in a misuse or abuse.”*¹⁵² However, according to the Court in *Trustco*, the presiding Judge held that the taxpayer only has the onus of proof to show compliance with the wording of a provision and should not be required to disprove the accused violation of the purpose of the provision¹⁵³, and said the following about the onus that rests on the Minister:

*“It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner.”*¹⁵⁴

4.3SA GAAR – MISUSE OF TAX PROVISIONS AND STATUTORY INTERPRETATION

¹⁵⁰ *Ibid*, para 31 cited the *Explanatory Notes to Legislation Relating to Income Tax*, [June 1988], p 464

¹⁵¹ *Ibid*, para 15 cited the *Explanatory Notes to Legislation Relating to Income Tax*, [June 1988], p 461

¹⁵² *OSFC Holdings Ltd. v. Canada*, [2002] 2 F.C. 288, 2001 FCA 260 (“OSFC”)

¹⁵³ *Canada Trustco Mortgage Co. v. Canada*, See note 13, para 65

¹⁵⁴ *Ibid*, para 65

Although the “Statutory Purpose Element” is a new concept to SA GAAR, it is not a new concept to the statutory interpretation principles in SA. By way of example, Judge Botha JA in *Glen Anil Development Corporation Ltd v SIR* promoted a wide interpretation approach which includes an evaluation of the purpose of tax legislation in question.¹⁵⁵ It is generally understood that there are two approaches to the interpretation of statutes, namely the traditional approach and the modern approach. The traditional approach focuses on the literal meaning of words, while considering the intention of lawmakers, whereas the modern approach looks at the purpose of legislation, while considering the context in which the legislation falls.

4.3.1 Traditional approach

The literal rule provides that only the strict, literal meaning of the words included in the provisions of the Act, should be taken into account when evaluating the interpretation of the legislation. In *Coopers & Lybrand v Bryant*, the Appellate Division said the following:

*“According to the “golden rule” of interpretation the language in the document is to be given its grammatical and ordinary meaning, unless this would result in some absurdity, or some repugnancy or inconsistency with the rest of the instrument.”*¹⁵⁶

Another passage that is often referred to is from Judge Rowlatt J in *Cape Brandy Syndicate v IRC*, where the following was said:

*“It simply means that in a taxing Act one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.”*¹⁵⁷

Therefore, under the traditional approach, where the words included in a statute are clear, precise and result in an unambiguous meaning, the Court is not allowed to do anything else but apply the literal meaning. However, when the literal meaning of words included in a statute result in an absurdity or more than one meaning could be assumed, the true intention of the legislation may be

¹⁵⁵ *Glen Anil Development Corporation Ltd v SIR*, [1975] (4) SA 715 (A)

¹⁵⁶ *Coopers & Lybrand v Bryant*, [1995], (3) SA 761 (A) at 767, p 9

¹⁵⁷ *Cape Brandy Syndicate v IRC* [1921], 1 KB 64, p 71

sought and applied. This principle was referred to by Judge Innes CJ in *Venter v Rex*¹⁵⁸, when the following was stated:

“when to give the plain words of the statute their ordinary meaning would lead to absurdity so glaring that it could never have been contemplated by the legislature or where it would lead to a result contrary to the intention of the legislature, as shown by the context or by such other considerations as the court is justified in taking into account, the court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and to give effect to the true intention of the legislature.”

Silke refers to the objective of establishing the intention of legislation as being “to canvass the legislature’s policy in enacting the provision and interpreting it in a manner so as not to defeat the policy.”¹⁵⁹ Seeking the intention of legislation could therefore result in both a wider or narrower meaning being ascribed to the words used by the lawmakers, based on the circumstances of each case and the respective policy of the legislature.

4.3.2 Modern Approach

The modern approach to interpretation of legislation seeks the general underlying purpose underlying the statutory provision. Silke refers to legislative purpose as being “*the light that should guide statutory interpretation.*”¹⁶⁰ This approach does not call for there first to be an ambiguity or and absurd result if the literal meaning of the word used in a statute is applied before the purpose of the legislations is sought. Silke however warns that “*Applying a purposive construction to a statute does not, however, imply neglect of the language used, which must be understood in its popular sense as utilized in ordinary parlance, yet balanced by the context in which it is used*”¹⁶¹

The purposive approach is something that has been applied by the Courts in SA not only from a tax perspective, but by virtue of the Constitution. The Constitutional Court has held “*that legislation must be interpreted purposively to promote the spirit, purport and objects of the Bill of Rights; courts are under a duty to examine the objects and purport of an Act and to read the provisions of*

¹⁵⁸ *Venter v Rex*, [1907] TS 910, p 915 & 916

¹⁵⁹ A. P. de Koker, RC Williams, [2012], *Interpretation – The intention of the legislature*, SILKE on South African Income Tax, Lexis Nexis. Ch. 25.1C (online version – date accessed May 2016)

¹⁶⁰ Silke, See Note 31, Chapter 25.1D – *The purposive approach*

¹⁶¹ *Ibid*

legislation, so far as is possible, in conformity with the Constitution.”¹⁶² A more detailed evaluation of the Constitution and the interpretation principles established will be conducted in Chapter 5 of this study, when it is compared to the Statutory Purpose Element of SA GAAR.

The modern approach goes further and not only considers the purpose of statutes itself, but also the context in which the statute is found. This is similar to the concept established by the Canadian Courts where the overall policy of statutes has to be identified and considered when trying to establish whether there has been a misuse of provisions. The words used by lawmakers have to be considered within the context it has been placed, in determining how the legislation should be interpreted.

It is a well-established principle in SA as well, that taxpayers have the right to arrange their affairs in a tax efficient manner. One must therefore bear in mind, that within the bounds of the anti-avoidance provisions, a taxpayer is entitled to minimize his tax liability by arranging his affairs in a suitable manner, a principle referred to in *CIR V Conhage*¹⁶³. However, the Judge in *CIR V KING*¹⁶⁴ warned that one must distinguish between a taxpayer who orders his affairs so that he has no income from one who orders his affairs to escape tax liability on income which in reality is his. The powers provided to the Commissioner by the misuse or abuse provision included in SA GAAR, should therefore not hinder the taxpayers right to enter into arrangements in the most tax efficient manner. The interaction between the powers granted to the Commissioner in terms of section 80A(c)(ii) of the Act and the taxpayers right to arrange their affairs so as to minimize the resulting tax liability will have to be evaluated by SA Courts, before any definitive conclusion can be made.

4.4 CONCLUSION

As previously mentioned, the inclusion of the misuse or abuse provision in SA GAAR, as understood from SARS’ publications, is to reinforce the modern approach to the interpretation of the tax legislation.¹⁶⁵ It is important to note that this Statutory Purpose Element of SA GAAR extends to even the provisions contained in GAAR itself and it would thus be possible for the Commissioner to

¹⁶² *Ibid*

¹⁶³ *CIR v Conhage* [1999] (4) SA 1149 (SCA), 61 SATC 391

¹⁶⁴ *CIR v King*, [1947] (2) SA 196 (A), 14 SATC 184

¹⁶⁵ SARS, [2006], *Response Document Revised Proposal Tax Avoidance section 103*, Law Administration, South African Revenue Services 2006-03, p 16

argue that an arrangement is impermissible by virtue of it defeating the purpose of the provisions included in GAAR itself.

As this Statutory Purpose Element has not yet been tested by the Courts in SA, it is very difficult for taxpayers to definitively know how the element will be applied when setting aside an impermissible arrangement due to it resulting in the misuse or abuse of a provision of the Act. One should be weary of assuming that the SA Courts will use the same approach as those applied by the Canadian Supreme Court in *Trustco Mortgage Company v Canada*¹⁶⁶, especially since the effect of the manner in which the misuse GAAR provision is included in SA GAAR versus Canadian GAAR is so different. The inclusion of this misuse or abuse provision in SA GAAR therefore appears to create more confusion and uncertainty for taxpayers and until this principle has been tested in a SA Court, one can only speculate about the mechanics of this part of SA GAAR.

¹⁶⁶ *Canada Trustco Mortgage Co. v. Canada*, See note 13

CHAPTER 5 – SA GAAR v COMMON LAW IN SA

Introduction

The modern approach to statutory interpretation involves an enquiry into the purpose of the legislation and the context in which the legislation is found. SARS stated that the reason for the inclusion of the misuse or abuse provision in GAAR was to reinforce this modern approach, so as to follow what appears to be an international trend to combating impermissible tax avoidance (see discussion in Chapter 4, section 4.1. In SA, the modern approach is however already well established through judgements delivered in tax cases heard by the Courts, but more importantly, it is an approach that is already in effect by virtue of the South African Constitution, of 1996. (“Constitution”).

This Chapter seeks to investigate the modern approach to statutory interpretation as provided for by the Constitution. A comparison is then made between the scope of the Constitution and that of GAAR by virtue of the newly included misuse or abuse of provisions. The interaction between these two pieces of legislation will then be evaluated, so as to ascertain whether the inclusion of the misuse or abuse of provisions in GAAR results in any additional powers granted to the Commissioner when dealing with impermissible avoidance arrangements.

5.1 THE MODERN APPROACH – THE CONSTITUTION

The Constitution is the most superior law to all other laws of the country. This is by virtue of the following wording found in the Constitution as pointed out on the Parliament of South Africa’s website¹⁶⁷ *“Chapter 1 of the Constitution states that the “Republic of South Africa is one, sovereign, democratic state”, founded on a number of values. Section 1(c) provides for “Supremacy of the Constitution and the rule of law” and section 2 states that “This Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled”.*

The Constitution provides a general approach to the interpretation of the legislation domestically in SA. A dictum from the Constitutional Court in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* indicates that *“the emerging trend in statutory construction is to have regard to the context*

¹⁶⁷ Parliament of the Republic of South Africa, *A PEOPLE’S GOVERNMENT, THE PEOPLE’S VOICE*, Publications – Business Publications - http://www.parliament.gov.za/live/content.php?Item_ID=299 (accessed June 2016)

*in which the words occur, even where the words to be construed are clear and unambiguous*¹⁶⁸.

The Constitution construes the common law in SA and serves the function of promoting public interest.

Subsections 39(1) and (2) of the Constitution states¹⁶⁹:

“(1) When interpreting the Bill of Rights, a court, tribunal or forum –

(a) Must promote the values that underlie an open and democratic society based on human dignity, equality and freedom;

(b) Must consider international law; and

(c) May consider foreign law.

(2) When interpreting any legislation and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.”

From the above the Constitution directs that the interpretation of any other legislation should follow constitutional standards and thus effectively promotes the modern approach to statutory interpretation. Van Schalkwyk and Geldenhuys found in their study on section 80a(c)(ii) that *“By directing the interpretation of any other legislation to follow constitutional standards, the Constitution effectively requires legislation to be interpreted with reference to the modern approach.”*¹⁷⁰

Applying the modern approach to statutory interpretation as called for by the Constitution is a concept that has been written about extensively in the past and the views taken are quite often similar. As an example of such congruencies, *“Goldswain concludes that if the judiciary interprets a provision without attempting to establish the intention or purpose of the legislature, such an omission would constitute grounds for a constitutional challenge to the decision. He then reiterates that the purposive theory to the interpretation of tax statutes incorporates the essential values underpinning the Constitution. Goldswain, it is submitted, thus indicates that the Constitution requires a modern approach to the interpretation of statutes.”*¹⁷¹ De Ville also adopts a similar view by indicating *“that the Constitution requires statutes to be interpreted by following a broad*

¹⁶⁸ *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* 2004 (4) SA 490 (CC)

¹⁶⁹ South African Constitution of 1996, Chapter 2 – Bill of Rights

¹⁷⁰ L. van Schalkwyk and B. Geldenhuys, [2009] *‘Section 80A(c)(ii) of the Income Tax Act and the interpretation of Tax Statutes in South Africa’*, Merditari Accountancy Research, Vol 17 No. 2 2009, p178

¹⁷¹ G. K. Goldswain, [2008], *The purposive approach to the interpretation of fiscal legislation: the winds of change*. Merditari Accountancy Research, 16(2):107-121 as quoted in Van Schalkwyk and Geldenhuys – See note 4.

*contextual approach. The context in which the statute is interpreted should include the constitutional values, the statute's background and purpose (viewed in the light of the aims of the Constitution), other statutes as well as the social, political and economic context and (where relevant) comparative and international law.*¹⁷²

As the Constitution is the sovereign law in SA, the principles established by this legislation have to be followed in all instances. Therefore, as the Constitution prescribes that the modern approach should be followed when dealing with matters of statutory interpretation, this approach would also have had to be followed by Courts hearing tax related cases.

There have been tax related Court cases where the constitutionality of tax principles has been challenged in the Constitutional Court of South Africa. One such recent example is the “pay now, argue later” principle for tax debts to SARS which was dealt with in *Metcash Trading Ltd v CSARS*¹⁷³ where the legality of the “pay now, argue later” concept for VAT survived the scrutiny of the Constitutional Court when the taxpayer sought to contend that the VAT legislation governing this principle is incompatible with section 34 of the Bill of Rights.

It was then held in *Capstone 556 (Pty) Ltd v CSARS*¹⁷⁴ that “*the considerations underpinning the “pay now, argue later” concept include the public interest in obtaining full and speedy settlement of tax debts and the need to limit the ability of recalcitrant taxpayers to use objection and appeal procedures strategically to defer payment of their taxes*”. The Court then went further to say the following:

“There are material differences distinguishing the position of self-regulating vendors under the value-added tax system and taxpayers under the entirely revenue authority-regulated income tax dispensation. Thus the considerations which persuaded the Constitutional Court to reject the attack on the aforementioned provisions of the VAT Act in Metcash might not apply altogether equally in any scrutiny of the constitutionality of the equivalent provisions in the [Income Tax] Act”.

¹⁷² J. R. De Ville, [2000]. *Constitutional and statutory interpretation*, Cape Town: Interdoc Consultants.

¹⁷³ *Metcash Trading Ltd v CSARS*, [2006], 63 SATC 13

¹⁷⁴ *Capstone 556 (Pty) Ltd v Commissioner, South African Revenue Services and Another, Kluh Investments (Pty) Ltd v Commissioner, South African Revenue Services and Another* (26078/2010, 8274/2011) [2011] ZAWCHC 297; 2011 (6) SA 65 (WCC) (22 June 2011)

It is clear from these two cases that the concepts and principles established by the Constitution extends to tax related matters, and therefore both the taxpayer and SARS have the obligation to uphold the Constitution at all times. The modern approach to statutory interpretation, as prescribed by the Constitution, therefore would have to be upheld by both the taxpayer and SARS.

5.2 STATUTORY INTERPRETATION – THE EFFECT OF “MISUSE OR ABUSE OF PROVISIONS” IN GAAR

SARS’ stated reason for the inclusion of the “misuse or abuse of provisions” in GAAR as a Statutory purpose element, has already been found to be to reinforce the modern approach to statutory interpretation. By including this statutory purpose element in GAAR for the first time, the scope of the application of GAAR appears to have been extended as an avoidance arrangement may be classified as impermissible on grounds that it abused or misused the provisions of the Act. To establish whether the provisions of the Act have been misused or abused, the purpose of the provision has to be identified and the context in which the provision is found has to be considered. It is only then that the argument may be put forward of whether the spirit and objective of the legislation has been frustrated.

These considerations are however called for by virtue of the Constitution, and so even without the inclusion of the misuse or abuse of provisions in GAAR, the modern approach to statutory interpretation would have to be applied. A criticism that could thus be levied against the misuse or abuse provision of GAAR is the fact that it is evidently clear that in SA the purposive and contextual approach to interpretation is one that is already in use and therefore this provision in GAAR does not add anything new or provide the Commissioner with any additional powers. The misuse or abuse provision in GAAR therefore appears to address an issue that is already considered and governed by the Constitution and thus the question is whether any value is actually created with this inclusion in GAAR.

Haffejee states *“that if the provisions of the statute are applied contextually and purposively, as in the case of South Africa, the obvious implication is that there appears to be no relevance to having a misuse and abuse provision in the Income Tax Act.”*¹⁷⁵ Cilliers also criticizes this section by stating

¹⁷⁵ Y. Haffejee, [2009], *A critical analysis of South Africa’s general anti avoidance provisions in Income Tax Legislation*, Dissertation in Faculty of Business and Economic Sciences at Nelson Mandela Metropolitan University. p 39

*“that the proposed GAAR does not need a provision like section 80A(c)(ii).”*¹⁷⁶ He states that *“the rest of the GAAR is robust enough to survive without it. Furthermore, common law principles already make provision for the interpretation of statutes purposively and contextually.”*¹⁷⁷ One can therefore safely conclude that the misuse or abuse provision of GAAR is simply a reinforcement of the common law interpretation principles and it was therefore unnecessary to include this in GAAR in the first place.

In *Glen Anil* it was said that *“there seems little reason why the interpretation of fiscal legislation should be subjected to special treatment which is not applicable in the interpretation of other legislation.”*¹⁷⁸ This appears to indicate that tax statutes have always been required to be interpreted using the purposive and contextual approach and that the misuse or abuse provision included in GAAR could be superfluous. The only true effect of the inclusion of the misuse or abuse provision in GAAR is that it has broadened the potential application of GAAR.

The fact that the misuse or abuse provision in GAAR is phrased in positive language, instead of being included as a limiting factor, as is the case in section 245(4) of the CITA, it has stripped GAAR of any limitations and could result in a potential excessively broad application of GAAR. If anything, the inclusion of this provision in GAAR could result in a *“disturbance of the equilibrium between the power of the fiscus and a taxpayer conducting his business. This section could therefore place GAAR in a predicament where the ambit is considered to be too wide.”*¹⁷⁹ EB Broomberg states that *“the new misuse and abuse test will only affect limited transactions, particularly transactions that qualify for tax benefits in terms of a provision of the Act, and that the broad ambit of the section could result in a narrow and restricted interpretation of the GAAR when considered by the Courts.”*¹⁸⁰

5.3 CONCLUSION

The Constitution is the sovereign law and principles established through the Constitution have to be upheld by all other pieces of legislation in effect in South Africa. The Constitution clearly establishes the modern approach to statutory interpretation by prescribing that the interpretation of any other

¹⁷⁶ C. Cilliers, [2006], *The Proposed sec80A(c)(ii) of the Income Tax Act: should it be enacted?* The Taxpayer, vol. 55, no. 10, p 182

¹⁷⁷ *Ibid*, p 187

¹⁷⁸ *Glen Anil Development Corporation Ltd v SIR*, 1975 4 SA 715 (A) 727

¹⁷⁹ ASA, [01 July 2009], Section 80A(c)(ii) of the Income Tax Act and the scope of part IIA, accessed online at <http://www.accountancysa.org.za/section-80ac-ii-of-the-income-tax-act/> (July 2016)

¹⁸⁰ E.B. Broomberg, [2008], *Misuse or abuse, Then and Now – IV*, 22 Tax Planning p32

legislation should follow constitutional standards. Tax statutes thus always had to be interpreted with the purpose and context in mind, even before the inclusion of the misuse or abuse provision in GAAR.

It appears therefore that the stated reason for the inclusion of the misuse or abuse provision in GAAR, being to reiterate the modern approach to statutory interpretation so as to keep up to date with international trends, does not take into consideration that the modern approach already has to be followed by virtue of the statutory interpretation principles established by the Constitution. It seems thus that the addition of this provision to GAAR does not provide any additional powers to SARS when looking to attack an impermissible avoidance arrangement. There has not been any case law heard by the South African courts on this matter, so taxpayers are left with uncertainty around how the misuse or abuse provision of GAAR will be implemented.

CHAPTER 6 – CONCLUSION

Introduction

This final Chapter includes an overall summary of the aspects discussed throughout the study, collates the conclusions made in each Chapter and ends off with a final conclusion of the findings of the study and any recommendations to be taken into consideration going forward.

6.1 OVERALL SUMMARY

Tax planning, where taxpayers arrange their affairs so as to minimize the resulting tax liability, has evolved over the last couple of decades as a result of the change in the way business is conducted by virtue of globalisation and the development in technology. It appears to have become more and more aggressive as taxpayers have the opportunity to access tax benefits not only through utilising loopholes in domestic legislation, but also through international tax loopholes. Tax avoidance, a legitimate manner of arranging one's tax affairs so as to reduce the tax liability, has to be distinguished from tax evasion, which are illegal arrangements resulting in the impermissible avoidance of tax obligations. It is an established principle that taxpayers are allowed to structure their affairs in a tax efficient manner; however it should be within the scope of tax benefits intended by legislators.

One of the categories of impermissible tax avoidance is the avoidance of tax that is inconsistent with the spirit of tax laws and results in harmful effects, such as the loss of revenue collection and the deterioration of ethical behaviour in tax planning. To mitigate these adverse effects, Revenue Authorities have to make use of anti-avoidance mechanisms. These anti-avoidance mechanisms include SAAR, where specific arrangements are targeted, and GAAR, a general set of rules targeting any arrangement that contravenes these rules. Various countries use different strategies to employ either only SAAR or GAAR, or a combination of both in the fight against revenue loss through impermissible tax avoidance arrangements. SA is a country that employs both SAAR and GAAR as anti-avoidance mechanisms. This study however focuses on GAAR in SA, from when it was first introduced in 1941 to the anti-avoidance provisions currently included in section 80A-L of the ITA.

The predecessor of the current GAAR, section 103(1) of the ITA, now repealed, is understood to have caused confusion as a result of certain ambiguities found in the abnormality test included in that GAAR. In an attempt to address these shortcomings, proposed changes were made by SARS in an attempt to enhance the effectiveness and efficiency of GAAR. Section 103(1) was thus repealed by section 36(1)(a) of the Revenue Laws Amendment Act 2006 and replaced with the current GAAR provisions (section 80A – 80L), which is effective to transactions on or after 2 November 2006. According to SARS, section 103(1) was repealed due to the follow reason:

“it has proven to be an inconsistent and at the times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance and because it has not kept up with international developments”¹⁸¹

A detailed analysis of the GAAR found in section 80A – 80L of the ITA can be found in Chapter 3.2 of this study. SARS aim of keeping up with anti-avoidance international developments, has been met with the inclusion of a tainted element indicating a potential impermissible arrangement by virtue of the inclusion of the misuse or abuse provision in section 80A(c)(ii) of the ITA. This tainted element is a new concept to SA GAAR and allows for an avoidance arrangement to be classified as an impermissible avoidance arrangement by virtue of the fact that the arrangement contravenes the object, spirit and purpose of the provisions of the ITA.

This misuse or abuse provision of GAAR appears to be a borrowed concept from the Canadian GAAR found in section 245 of the CITA. Even though the misuse or abuse provision found in Canadian GAAR is similar to the provision included in section 80A(c)(ii) of the ITA, it is included as a limiting factor in Canadian GAAR, as GAAR may not be applied unless there has been a misuse or abuse of a provision found in certain Canadian legislation, whereas in SA GAAR, the misuse or abuse provision is simply included as one of the tainted elements that could apply to an impermissible avoidance arrangement, and thus effectively extends the scope of SA GAAR. The effect of the way in which the misuse or abuse provision is included in Canadian GAAR versus SA GAAR is therefore vastly different and may create more confusion and uncertainty for taxpayers in SA.

¹⁸¹ SARS, [2006], *Explanatory Memorandum on the Revenue Laws Amendment Bill*, Tax Administration, [WP2-06], p 62

The misuse or abuse tainted element included in SA GAAR is referred to as the Statutory Purpose Element of GAAR as it calls for an investigation into what the purpose and context of the provisions of the ITA are, before the misuse or abuse test may be applied. SARS considers the Statutory Purpose Element of GAAR to be a reinforcement of the modern approach to statutory interpretation. This is because the modern approach to statutory interpretation seeks the general purpose of provisions included in legislation, as well as the context in which the provision is found. It is a completely new concept to SA GAAR and is yet to be tested in a SA Court. The fine balance between the taxpayer's right to order their affairs in a tax efficient manner and the Revenue Authority's entitlement to collect tax revenues should not be impeded by the inclusion of this tainted element in GAAR. At this stage, the inclusion of the misuse or abuse provision in GAAR appears to create more uncertainty for taxpayers and one can only speculate on the actual mechanics of this part of GAAR as no precedent has been set as yet by the SA Courts.

The modern approach to statutory interpretation is a concept that is however already established by virtue of the South African Constitution, of 1996. The Constitution is the supreme law of the country and therefore all other pieces of legislation and any interpretation principles established thereby, have to be within the bounds of the Bill of Rights found in the Constitution. Subsection 39(2) of the Constitution¹⁸² says the following:

“(2) When interpreting any legislation and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights”.

The considerations called for by the Statutory Purpose Element of GAAR therefore already appear to be a requirement of the modern approach to statutory interpretation called for by the Constitution. Tax statutes always had to be interpreted with the purpose and context in mind, even before the inclusion of the misuse or abuse provision in GAAR and it is thus difficult to argue that this inclusion to GAAR adds any value.

¹⁸² South African Constitution of 1996, Chapter 2 – Bill of Rights

6.2 FINAL CONCLUSION AND RECOMMENDATIONS

It is very difficult to imagine an all-encompassing criterion that could be used in GAAR to identify impermissible tax avoidance arrangements. The broadening of the scope of GAAR with the inclusion of the misuse or abuse of provisions tainted element most likely will result in more uncertainty than in the successful application of GAAR in mitigating the adverse effects of impermissible tax avoidance.

Determining whether a provision of the ITA has been misused or abused is not an easy task, which is evidenced in *Canada Trustco*¹⁸³ heard by the Canadian Court and discussed in Chapter 4.2. There is always the possibility that arrangements which SARS consider to be abusive, may be found to be within the spirit, purpose and context of the provisions of the ITA. It should therefore be cautioned that principles and issues identified through cases heard by Courts in other jurisdictions, be considered by SARS before this tainted element of GAAR is applied in SA. A recommendation for when this tainted element is tested in a South African Court is that similar standards should be set, as have already been set by other jurisdiction's Courts, so as to avoid further dispute of the effectiveness of GAAR. This especially since the inclusion of the misuse or abuse of provisions of the ITA in GAAR does not appear to add any value or grant any further powers to SARS that are not already available by virtue of the Constitution. It is also probable that the difficulties and uncertainties surrounding the misuse or abuse provisions are hindering the application of GAAR by SARS to any potentially abusive schemes, evidenced by the lack of case law. While it can be said that having a GAAR is in itself a deterrent, the fact that it is never applied should be of concern.

¹⁸³ *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54

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