

The General Anti Avoidance Provisions, as amended

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I Nomagugu Mvuyana(MVYNOM001) hereby declare that the work included in this thesis is my original work. It is being submitted as part of the Post graduate diploma in tax. It has not been submitted at any other university.

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Date

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Smith v CIR

Introduction:

The basis of any well-functioning economy rests on the effectiveness of the taxation system in place. One of the biggest threats to this is those taxpayers who seek to cheat the system and pay lower taxes than that actually due by them.

The General Anti Avoidance rules (GAAR) have been put in place in South Africa as a means to combat impermissible avoidance arrangements and collect what is actually due to the South African Revenue Service (SARS). The crux of GAAR thus rests on the fact that the taxpayer has engaged in an avoidance arrangement, where the sole or the main purpose was to obtain a tax benefit thus rendering the arrangement an impermissible avoidance arrangement.¹

The general anti avoidance rules seek to grant the Commissioner the authority to set aside the tax benefit obtained in avoidance arrangements which are proven to be impermissible as defined by s80A and treat the arrangement as if it had not been entered into other than in the manner the Commissioner would deem to be appropriate.²

As of 2 November 2006 a new GAAR regime came into effect. This saw s103(1) which previously bore the GAAR provisions being replaced by 12 new provisions found in S80A-L, these provisions must be read in conjunction with s80M-S80T which deals with reportable arrangements. This paper seeks to analyse the new provisions enacted by the Commissioner and tries to assess the effect that they will have on the taxpayer and the Commissioner. It will further attempt to establish whether or not the taxpayer's position was better under the old GAAR or under the new GAAR.

GAAR is only applicable if it has been established by the Commissioner that the taxpayer has entered into an arrangement which as defined by the new S80A is considered to be an impermissible avoidance arrangement.

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1. S80A of the income tax act of 1964
 2. S80B of the income tax act
 3. K Jordaan, A Koekemoer, M Stiglingh, L van Schalkwyk, M Wassermann, J Wilcocks Silke: South African Income Tax (2008) at §25.1..

Although the Income tax act has specific and general avoidance provisions, the taxpayer is not prohibited from arranging his transactions in the most advantageous manner. The Commissioner seeks only to tax those transactions which have been ordered in such a manner so as to defraud SARS. It is thus of great importance to understand the difference tax avoidance and tax evasion which is achieved through legitimate tax planning.

Tax Evasion

Tax evasion involves the use of illegal or dishonest means in order to reduce the tax liability due or as recognised by SARS it may also refer either to *those transactions, operations or schemes that clearly run afoul of a specific or general anti-avoidance provision*³.

Examples as provided by the *SARS Draft Comprehensive guide to anti avoidance provisions*⁴ include *the falsifying of financial statements; not disclosing or misrepresenting relevant information in a tax return; or [The] deliberate failure by a [] cash [] business to report the full amount of revenue received.*

The taxpayer seeks to evade tax through the exploitation of the loopholes that exist within the Income tax act and goes against what the legislature's initial intention when that specific provision was put in place. Such efforts by the taxpayer usually include illegal behaviour such as *fraud and falsifying of financial statements*, as was discussed above.

Evasion is an issue that plagues many societies, as this involves the intentional disguise by the taxpayer of income which in all respects is due to him and is taxable as such. The evasion of tax constitutes a criminal offence for which the Commissioner does not require statutory law to prosecute⁵.

3. K Jordaan, A Koekemoer, M Stiglingh, L van Schalkwyk, M Wassermann, J Wilcocks Silke: South African Income Tax (2008) at §25.1.

4. Tax avoidance and s103 of the Income Tax Act of 1962 Interim response SARS(2005). *Tax Evasion, Impermissible Avoidance and Legitimate Tax Planning*.pg5

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The introduction of the new Tax administration Act (TAA) has seen the implementation of a much harsher regime to deal with those taxpayers who understate their tax liabilities or fail to comply with the administrative laws⁶. Taxpayers who evade tax would be subject to the stipulations of this Act.

Tax Avoidance

Tax avoidance on the inverse is a form of tax planning which involves the use of legal means to reduce tax liability i.e. seek to pay minimum tax as in accordance with the provisions of act⁷.

SARS has also made use of the term tax planning which in essence realises that taxpayer's right to arrange his affairs in such a manner so as to reduce his tax liability⁸. This was further supported by Hefer JA in CIR v Conhage (pty) Ltd⁹:

□ 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.

In an article by E.Brinker¹⁰ it was explained as

"Legitimate tax planning entails a transaction where a taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and generally suffers the economic consequences that the legislature intended to be suffered by those taking advantage of the option"

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6. Tax and legal publications. Overview of SARS new penalty regime. Available <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/tax-and-legal-publications/pages/overview-of-sars-new-penalty-regime.aspx> (online)
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 10. Brinker,E. *The new General anti avoidance provisions for South Africa?* .Business law (online).

It is clear that the Commissioner has provided for specific benefits to be reaped by the taxpayer by entering into specific types of arrangements, this is done to encourage certain behaviour from the taxpayer which will benefit both the taxpayer and the country as a whole.

An example found in *tax avoidance* by Murray.R¹¹ discusses a situation where the taxpayer has acquired property, plant or equipment in order to gain the capital allowances allowed by the Commissioner. As stated above the creation of such an allowance would suggest that this is behaviour that the Commissioner sought to encourage and the country as a whole would benefit from increased capital expenditure.

The difference between tax avoidance and evasion is a very conscientious issue which common law as sort to distinguish. This is evident in the ruling provided in the R v Mears case¹²

"....the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using illegal means to escape payment of tax."

In the CIR v King case¹³ the courts held that:

There [is] a real distinction between the case of one who so [orders] his affairs that he had no income which would expose him to liability for income tax, and that of one who [orders] his affairs in such a way that he escaped from liability for taxation which he ought to pay upon the income which in reality is his. Similarly there [is] a distinction between reducing the amount of tax from what it would have been had the transaction been entered into and reducing the amount of tax from what it ought to have been in that year of assessment

The judgement as set out above sought to determine the differences that exist between tax avoidance and evasion. It is clear that there exists a very thin line between tax avoidance and evasion which may at times be difficult for the courts to distinguish.

¹¹. Murray.R, Kevin.J, Prosser. *Tax avoidance*. (2012) Sweet and Maxwell.

¹². 1947(2) SA 196 14 SATC 184

¹³. (1997) 37 ATR 321

The Commissioner would agree with such sentiment, of a taxpayer ordering his affairs in the most advantageous manner so as to reduce his tax liability, as long as the taxpayer does not seek to intentionally deprive the fiscus of what is rightfully due to it. Thus it should stand to reason that such a line should not, at any time be crossed. I would at this point seek to argue that it should be the taxpayer's intention for entering into the transaction that should be assessed in determining whether or not he has *crossed the Rubicon*¹⁴ from tax avoidance to tax evasion.

The anti-avoidance provisions seek to tax arrangements which are considered to be impermissible tax avoidance arrangements as per the criterion set out by S80A. The sole or main purpose of such arrangements is to obtain a tax benefit¹⁵. The Commissioner only seeks to tax that which is due to him as outlined by the South African Income tax act.

*No obligation rests upon a taxpayer to pay a greater tax than is legally due under the tax Act*¹⁶.

The general anti avoidance provisions seeks to cover all types of tax avoidance schemes which are not captured by the other specific anti avoidance provisions¹⁷. The aim of the legislature when the amendment was passed was to create provisions such that the line between tax avoidance and evasion was clearly drawn and defined in the Act and to clarify the ambiguity that existed between s103 and case law that had been established.¹⁸

The revised GAAR is expressed in part IIA of the income tax act under S80A-L. The basis on which the amended anti avoidance provisions rest on the issue that first and for most there must be an avoidance transaction which was entered into for the sole or main purpose of obtaining a tax benefit¹⁹ in order for the rest of the sections to apply.

14. Natal Estates v CIR 1975 SA 177 (A), 37 SATC 193, 1975 Taxpayer 161.

15. S80 A of Income tax Act

16. CIR v Conhage 1999(4) 1149 (SCA), 61 SATC 391

17. De korker,A.P (2011).Silke on south Africa income Tax.Chapter 19(online version)

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19. S80 A-L of the income tax Act of 1962

The new GAAR was put into effect in order to adequately address the limitations that were inherent in the previous GAAR regime.²⁰ Upon assessing the need for a new, more effective GAAR the Commissioner identified the following to be the main weaknesses in the previous regime

- Not an effective deterrent.
It became clear to the Commissioner due to the increasingly sophisticated schemes taxpayers were engaging in, in order to exploit the provisions of the GAAR. Furthermore the time and resources required in order to detect the transactions proved too onerous for the Commissioner²¹
- Abnormality requirement.
Taxpayers and promoters of illegal schemes were usually able to provide valid business purposes for having entered into certain agreements²² thus rendering the abnormality requirement less effective.
- The purpose requirement
The onus rested on the Commissioner to disprove the fact that the sole or main purpose of the taxpayer entering into the arrangement was to obtain a tax benefit.
- Procedural and administration issues
This related to the uncertainty around to what extent the GAAR could be applied to the individual steps of a transaction within a larger transaction²³. The other issue related to whether the provisions of the GAAR could be applied where another provision was in dispute²⁴.

It is evident that the success of the new GAAR rests on the provisions being able to effectively tackle the weaknesses that were inherent in previous GAAR.

²⁰ .Engel, K., Chief Director, Tax Legislation – National Treasury, □The GAAR proposal: A National Treasury Perspective(2005)

²¹ . SARS.(2005). Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Pretoria:SARS.

²² . SARS.(2005). Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Pretoria:SARS.

²³ . CIR v Louw 1983 (3) SA 551 (A), 45 SATC 113.

²⁴ . SARS.(2005). Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Pretoria:SARS.

Conclusion

The new GAAR has been put in to effect for all arrangements entered into on or after 2 November 2006 should they satisfy all the requirements where are:

1. There must be an arrangement
2. Which was entered into in order to obtain a tax benefit
3. The sole or main purpose of the avoidance arrangement was to obtain a tax benefit
4. The arrangement consists of one of four tainted elements for arrangements, I the context of business; in the context other than business it must include one of three tainted elements, in order to be considered impermissible tax avoidance arrangement.

As stated earlier the remedies grated by GAAR under s80B to the commissioner may only be applied should it be proven that an impermissible avoidance arrangement exists. Given the much wider scope of transactions that may now be subject to GAAR, the onus will rest on the courts to redefine these parameters so that both the Commissioner and the taxpayers do not feel aggrieved and an equitable balance is achieved.

The new GAAR seeks to remedy many of weaknesses inherent in s103(1), however the new GAAR also falls short in drawing a clear line between tax evasion and avoidance. How much under the new GAAR is considered too much before the taxpayer is considered to be evading tax? On the inverse it must also be questioned has the Commissioner gone too far and the GAAR effectively infringed on the taxpayers right to so order his affairs in such a manner as to pay the least amount of tax as allowed by the Act.

The chapters to follow will seek to analyse each of these requirements and determine how they differ from the now repealed s103 (1). I will further aim to assess whether or not the new GAAR has the desired effect the Commissioner had envisioned with the new legislation, which is that all arrangements entered into by taxpayers to be taxed in the appropriate manner.

Chapter 2

There must be an avoidance arrangement

The General anti avoidance provisions as amended in 2006 are all encompassed in s80A-L of the income tax Act of 1962. This serves the purpose of replacing s103 (1) and s103 (4). The scope or rather the reach of GAAR has been widened as the section now includes twelve provisos as opposed to four which were encompassed in the prior GAAR.

Although the aim of GAAR was to widen the scope, the new provisions have been argued to be difficult enough to perplex even the most impressive minds ²⁵.

The aim of this chapter is to take a look at the type of arrangements covered by the revised GAAR, whether or not this establishes a more favourable position for the Commissioner, with reference to a widened scope of what is considered to be an avoidance arrangement and the overall effect is on the taxpayer.

80A. Impermissible tax avoidance arrangements.—an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and—²⁶.

The General anti avoidance provisions were put in place to govern impermissible tax avoidance arrangements. It is thus of great importance that an appropriate definition be attached to impermissible tax avoidance arrangements as well as permissible tax avoidance transactions.

Permissible avoidance are unaffected by the provisions of s80A-L as these represent bona fide transactions which when carried out have the effect of avoiding or reducing the tax liability²⁷. This was further affirmed in the Duke of Westminster vs IRC case²⁸.

Everyman is entitled if he can to so order his affairs that the attaching tax under the appropriate act is less than it would have otherwise be if he succeeds in ordering them so as to securer this result, then, however unappreciative the commissioner of Revenue or his fellow tax payers may be to his ingenuity, he cannot be compelled to pay a increased tax.

²⁵.Drummod,B(2006).A purposive approach to drafting tax legislation.British tax Review

²⁶.S80A Income tax act of 1962

²⁷.De korker,A.P (2011).Silke on south Africa income Tax.Chapter 19(online version)

²⁸.51 TLR 467, 19 TC 490 at 520.

In as much as the taxpayer is permitted to order his affairs in such a manner as to decrease his tax liability, it should be noted that a very thin line exists between a permissible and impermissible arrangements. Should this line be crossed and the taxpayer is deemed to be part of an impermissible avoidance arrangement as defined by the Act and the transaction is deemed to be within the reach of GAAR and the taxpayer would thus be liable to pay the related tax liability as S80B.

An arrangement

Avoidance arrangements form the basis of which GAAR seeks to implement the provisions laid out in an s80A-L provided it is further proven that such arrangements are impermissible. Avoidance tax arrangements as defined by the Act are arrangements entered into in order to obtain a tax benefit²⁹.

The amended GAAR is still subject to the four requirements that were previously accounted for in s103 with a new addition namely the misuse or the abuse of the provisions of the Act. The effectiveness of the new addition is yet to be tested in South African courts³⁰

The first requirement of S80A states that there must be an arrangement; both the old and new anti-avoidance provisos provided a definition for this term. The courts have also sought to provide a definition for this term

S103 had defined an arrangement as ³¹:

- (1) Where 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) has been entered into or carried out which has the effect of avoiding or postponing liability for any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act), or of reducing the amount thereof, and which in the opinion of the secretary, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out-*

²⁹. S80A of the income tax act

³⁰. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

³¹. S103(1) of the Income Tax Act 58 of 1962.

- i) *Was entered into or carried out by means or In a manner which would it be normally be employed In the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme In question; or*
- ii) *Has created rights or obligations, which would not normally be created between persons acting In an arm's length under a transaction , operation or scheme of the nature of the transaction ,operation , or scheme In question,*

And the secretary is of the opinion that the avoidance or the postponement of such liability or the reduction of the amount of such liability was the sole or main purpose of the transaction, operation or scheme, the Secretary shall determine the liability for any tax, duty or levy on income and the amount thereof as if the transaction , operation or scheme had it been entered into or carried out or In such manner as In the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance , postponement or reduction.

In summary the old GAAR stated that an arrangement was any transaction, operation, or scheme has been entered into or carried out and which has the effect of avoiding or postponing liability for any tax, duty or levy on income³².

In several cases the meaning of arrangements has been established. In Meyerowitz v CIR³³ a definition for a scheme was established for a scheme

□The word □scheme' is a wide term and I think that there can be little doubt that it is sufficiently wide to cover a series of transactions...

The ruling in CIR v Louw³⁴ came to a similar conclusion citing that the meaning of the term *scheme* is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset

It should be noted that the issue with regards to the transaction will not rest on the related amounts in the affected transaction but rather the reason the transaction was entered into.

³². Ibid

³³. 1963 (3) SA 863 (A), 25 SATC 287, 1963 Taxpayer 126

³⁴. 1983 (3) SA 551 (A), 45 SATC 113, 1983 Taxpayer 14

As per the amended GAAR an arrangement is now defined in s80L as:

.....any transaction, operation, scheme agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing of the alienation of property³⁵.

There are two major changes provided by the amendment firstly, the Commissioner is granted the right to attack the arrangement in steps or parts thereof or as a whole. Secondly the arrangement now includes transactions, operations or schemes or an understanding whether enforceable or not. As stated by SARS it is not necessary for an arrangement to be legally enforceable in order for GAAR to be applied³⁶. It was further established that the agreement may be reduced to writing or made orally³⁷ tacit agreements are also included.

The change in new GAAR enables the Commissioner to implement the GAAR provisions to any part or step of an avoidance arrangement which satisfies the definition of an impermissible avoidance arrangement. This seeks to address the procedural and administration issues that were inherent in the previous GAAR with particular reference to the application of the GAAR to the individual steps of a large transaction.

Steps or part constituting an arrangement

The ability of the Commissioner to assess the arrangement in steps or parts is one of the new provisions included in the new GAAR. The aim was to enable the Commissioner to apply GAAR to steps or parts of an arrangement if they result in a tax benefit, as legislated by s80H. This amendment has had the effect of giving the Commissioner greater powers as all that is required is that part of the arrangement must be deemed to have been entered into in order to obtain the tax benefit In order for s80A –S80L to apply.

35. S80L of Income tax act

36. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

37. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

This amendment has been met with some criticism; this is mainly due to the fact that SARS reserves the right to take part of the transaction to which GAAR may be applied. The problem here rests in the fact that where part of the transaction is viewed in isolation, it may be seen as being entered into in order to gain a tax advantage; this may differ from the original intention of the taxpayer for entering into the transaction as a whole.

At this point it seems necessary to question the impact on the taxpayer's position, if this does in fact result in the taxpayer being put in a fairer position? This new provision has the potential to unfairly prejudice the taxpayer as this could lead to bona fide business transactions being viewed in isolation, from the transaction as a whole, and being treated by the Commissioner in an unjust manner. It is important to be mindful of the fact that the purpose of the GAAR is not to unfairly prejudice the taxpayer but rather to punish those who attempt to cheat the system.

SARS position is further strengthened by s80G (2) and s80H, S80G (2) states:

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.^{38.}

This implies that the intention for entering into the arrangement as a whole may differ from that of the individual parts, and it is for this reason that the Commissioner is granted the right to attach GAAR to individual parts of an arrangement. The issue to be considered would be that of a tax benefit obtained in part the arrangement, being inappropriately viewed as an impermissible avoidance arrangement. Even if the sole or main purpose of that of arrangement was not to obtain a tax benefit but arose in the ordinary course of business.

The court's ruling in the CIR vs Cohage³⁹ was one of the contributing factors which led to the amendment of GAAR, and thus effectively resulted in introduction of a more effective section of legislation⁴⁰. Many argued that the courts in this particular instance emasculated s103 (1) it and as a result ceased to be the deterrent it once was⁴¹. This remedy was rendered ineffective in the hands of the commissioner as result. This was as results of the courts deciding that SARS may only review the whole transaction and not individual steps of an arrangement

³⁸. s80G (2) Income tax Act of 1962

³⁹. 1999 (4) SA 1149 (SCA), 61 SATC 391.

⁴⁰. The taxpayer (2007). General anti avoidance rule 56.3.March 2007.pg 41

⁴¹. Mazansky, E "The discussion paper on tax avoidance" Werksmans News – Item [71419](8 November 2005).

The inclusion of this provision in the new GAAR will in future prove to be very problematic for the Commissioner, as it may result in many taxpayers being assessed incorrectly. Should the Commissioner elect to attack part of an agreement, the onus rests on the Commissioner to prove that the specific part of the arrangement in question was entered into in order to obtain the tax benefit. This may in the end prove to be too onerous on the Commissioner as it would be a waste of valuable resources, and have an adverse effect on decreasing the procedural and administrative issues that rendered the previous GAAR ineffective.

An agreement which includes a understanding, which may be legally enforceable or not

This represents a new inclusion in the definition of an arrangement-

Understanding, (whether enforceable or not)⁴².

The term understanding has not been defined in the act it would appear that the best point of reference would be to refer to the SARS Comprehensive guide to GAAR⁴³. Certain examples were given in order to provide the general public with what SARS considered to be an understanding (legally enforceable or not). These include

- *an agreement between parties to agree in future on reasonable terms and conditions to effect a merger;*
- *the so-called gentleman's agreement;*
- *heads of agreement between parties which sets out the intended result the parties wish to achieve but which is not necessarily legally binding at the time;*
- *an agreement binding in honour only, binding only in conscience, letter of intent and the like.*

The scope of what is considered to be an arrangement has been widened to the point that certain transactions which may not yet be legally enforceable have been given a wider definition. In an attempt to include all possible arrangements which may later be proven to be impermissible avoidance arrangement in the new provision, some arrangements may be inappropriately attacked which would result in a waste of resources for both the Commissioner and taxpayer. The widened scope of the GAAR would prove to create greater confusion around the meaning of an arrangement and thus nullify the effectiveness of this provision.

⁴². S80L Income tax Act of 1964

⁴³. SARS.(2005). Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Pretoria:SARS.

Conclusion

The first requirement of the new GAAR is that there must be an avoidance arrangement; to which s80 L has provided a definition which differs from that previously provided by s103(1) on two accounts.

The first being the Commissioner is now given the authority to assess steps or parts thereof of an arrangement. This had previously been cited as one the reasons the previous GAAR became ineffective. In some parts of arrangements it was clear that the sole or main purpose of that particular step was to obtain the tax benefit, but because the previous GAAR assessed the avoidance arrangements as a whole many guilty parties were not prosecuted.

In order for the new GAAR to be more effective a drastic provision such as this maybe what is required. Although this maybe unfavourable to those taxpayers that may be assessed incorrectly this may be one of the needed in order to make the South African the effective deterrent it once was. However the success of this provision rests on the Commissioner successfully applying the GAAR to individual steps of the arrangement. Should the taxpayer be assessed incorrectly this will result in a lot of time and money being wasted while the matter is being decided by the courts.

The second being the arrangement need not necessarily be legally enforceable. The results in a much broader scope for arrangements the success of which is yet to be tested and thus increase the number of avoidance arrangement that maybe considered to be impermissible.

The burden of proof rests with the commissioner to prove the existence of an impermissible avoidance arrangement, subject to the other provisions in S80A-L, should a step or part of the arrangement be attacked.

Chapter 3

A tax benefit attributable to the arrangement must exist

This chapter serves to discuss the second and third requirements of the new GAAR which states that there must be a tax benefit attributable to the avoidance arrangement and it must further be proven that pursuit of this tax benefit was the sole or main purpose of the taxpayer pursuing the arrangement.

In order for s80A to apply it must be proven that an impermissible tax arrangements exists⁴⁴ which is defined as an arrangement that is firstly an avoidance arrangement and secondly is entered into for the sole or main purpose of obtaining a tax benefit.⁴⁵ It must then be proven that the sole or main purpose of further occurrence of the arrangement was the pursuance of said tax benefit⁴⁶.

The first requirement requires that there be an arrangement, which was discussed in detail in the previous chapter, secondly the arrangement must contain a tax benefit In order to be considered an avoidance arrangement as provided for by s80L⁴⁷.

S80A requires that an impermissible tax avoidance arrangement exist before it may be applied. The intention of the tax payer at this point is to be taken into account so as to ascertain if obtaining the tax benefit was the sole or main reason for entering into the arrangement. Should this be the case the avoidance arrangement is considered to be impermissible and is thus subject to the provision laid out in s80A-L.

For this requirement to be satisfied it must be proven that a favourable tax effect was inherent in the manner in which the avoidance arrangement was structured, when the arrangement was entered into.

⁴⁴. s80A income act of 1962

⁴⁵. ibid

⁴⁶. ibid

⁴⁷.Income Tax Act of 1962

The meaning of sole or main purpose has not been defined by the act but the courts have attached a meaning to the phrase.

Solely was deemed to mean a purely qualitative measure, more than 50%⁴⁸. When determining the purpose of an arrangement, the time of implementation thereof is crucial and not the time of conceptualisation.⁴⁹

Tax Benefit

*Any avoidance, postponement or reduction of any liability for*⁵⁰. This is the definition that has remained unchanged in the new GAAR. In addition to the statutory definition the courts have also sought to provide their own meaning.

In *Smith v CIR*⁵¹ the courts held:

□The ordinary natural meaning of avoiding liability for a tax on income is to get out of the way of, escape or prevent an anticipated liabilityGAAR will find application when a taxpayer enters into an arrangement which has the effect avoiding liability or anticipated liability which will result in a tax benefit

S80L has defined tax as any, levy or duty imposed by this act or any other tax administered by the commissioner. GAAR seeks to attach itself to the anticipated tax liability rather than existing liability this was established as a result of the findings of the *CIR v King* case⁵²

The role of S80F has been put in place to help determine if a tax benefit exists in the arrangement in question so as to determine if an arrangement is an impermissible tax avoidance arrangement. It also seeks to determine whether or not the arrangement lacks commercial substance with particular reference to connected parties.

The new GAAR seems to concentrate on the relationship between connected parties. This would indicate that many taxpayers have in the past managed to obtain unlawful tax benefits through the connected party status. This new provision grants the Commissioner the right to treat connected parties as a single party⁵³. An overriding provision to be considered would be the rebuttable presumption found in S80G which seeks to disprove the onus that rests with the Commissioner of proving that the tax benefit was inherent in the avoidance arrangement.

⁴⁸. *SBI v Lourens Erasmus (Edms) Bpk* 1966 (4) SA 434 (A), 28 SATC 233.

⁴⁹. *Ovenstone v CIR* 1980 (2) SA 721 (A), 42 SATC 55.

⁵⁰. Income tax act of 1962

⁵¹. 1964 (1) SA 324 (A), upheld in *Hicklin* at 193

⁵². 1947 (2) SA 196 (A), 14 SATC 184.

⁵³. *Ibid*

Onus of proof

It was established In ITC 1625 that the onus of proving that the arrangement did in fact contain a tax benefit rests with the Commissioner⁵⁴. This would appear to detrimental to the Commissioner in terms of being able to prove that the sole or main purpose of the avoidance arrangement was to utilise the tax benefit. However the inclusion of the rebuttable presumption in S80G that forms part of the new GAAR more than offsets this risk.

The Purpose Requirement

The third requirement states that the sole or main purpose of entering into the avoidance arrangement was to obtain a tax benefit. The issue to be considered at this point would seem to be the tax payer's intention upon entering into the arrangement. Was the resultant tax benefit simply a result of the manner in which the operation of the act, or was this benefit intentionally pursued and thus proven to be the motivating factor behind the arrangement?

The purpose of the arrangement is fundamental in determining whether or not arrangement in question constitutes an impermissible avoidance arrangement .⁵⁵The purpose requirement featured in the new GAAR deviates from that previously found in s103.⁵⁶

The new GAAR seeks to alter the purpose requirement by moving away from relying on the taxpayers stated intention to assessing the substance of the transaction. This will see the purpose requirement becoming a more objective test than that seen in the previous GAAR. The purpose behind this would be to include all those arrangements that in the previous GAAR which were argued by the taxpayers to have plausible business purposes by fitting in with the previous subjective requirements.⁵⁷

⁵⁴. 1983 (3) SA 551, 45 SATC 133

⁵⁵ SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

⁵⁶. Ibid

⁵⁷. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

Purpose requirement under s103

S103(1):

Whenever the Commissioner is satisfied that any transaction, operation or scheme...(c) was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit...⁵⁸

The purpose requirement remains the heart of GAAR as was the case in s103. It is the purpose of solely entering into the avoidance arrangement as a means of obtaining the tax benefit that will render the avoidance arrangement impermissible and thus attract the consequences set out by s80A-L.

As was held in *SIR v Geustyn, Forsyth and Joubert*⁵⁹
...as soon as it is determined that the transaction was entered into other than to obtain a tax benefit s103 is not applicable.

It is clear from this judgment that the previous general anti avoidance provisions relied heavily on the purpose for having entered into the transaction in order to determine whether the provisions should be applied against the taxpayer. This case further highlights the differences that now exist between s103 and s80A. S103 required the tax benefit purpose apply to the whole avoidance arrangement.

The prior purpose requirement relates to any arrangement, transaction, operation or scheme that was entered into. This in essence sends out a different message than that of S80A which states that an avoidance arrangement becomes impermissible if the sole or main reason for its occurrence was the pursuit of a tax benefit.

The purpose test in past years was primarily a subjective test which relied heavily on the tax payer's *ipse dixit*. This was further confirmed by Corbett JA⁶⁰

□If the subjective approach be adopted (as it must) then it is obvious that of prime importance in determining the purpose of the scheme would be the evidence of respondent, the progenitor of the scheme, as to why it was carried out.

The Commissioner in this instance bore the burden of proof to prove that the sole intention of the taxpayer in the avoidance arrangement in question was to obtain a tax benefit.

⁵⁸. Income tax act of 1962(deleted)

⁵⁹.1971(3) SA 567 (A), 33 SATC 113, 1971 Taxpayer 148

⁶⁰. *SIR v Gallagher* 1978 (2) SA 463 (A) 40 SATC 39 at 48-49

The problem here was twofold firstly in order for GAAR to be successfully applied the Commissioner had to prove that the *whole* transaction, operation or scheme was entered into solely or mainly for the purpose of obtaining a tax benefit. Secondly the Commissioner had to try and disprove the taxpayers stated intention. The overall effect was that this provision seemed to be highly ineffective in tackling the real issue which was applying the general anti avoidance provisions to those avoidance arrangements which sort to deceive the law and obtain an unjust tax benefit.

Purpose requirements under s80A ad s80G

S80A seeks to redefine the purpose requirement by addressing the fact that it is the intention of the taxpayer that will turn an avoidance arrangement into an impermissible avoidance arrangement which will bring the provisions of GAAR into operation against the taxpayer in question.

The inclusion of S80G

*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 the tax benefit proves that, reasonably considered in the light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.*⁶¹

The effect of this new provision is that all taxpayers that have entered into avoidance arrangements will have to prove that the sole or main purpose for the arrangement was not to obtain a tax benefit. The purpose of the avoidance arrangement must be looked at as it relates to the whole arrangement and parts of the arrangement⁶². The effect of the introduction of this rebuttable presumption may lead to several legitimate avoidance arrangements being denied the tax benefit which is afforded to them as a result of specific provisions present in the act.

The purpose test states that the sole or main purpose must be to obtain the tax benefit. However SARS has altered the test from a subjective test to an objective one. This will place less emphasis on the taxpayer's *ipse dixit*⁶³ and relies more on the actual effect of the transaction.

⁶¹ Income tax Act of 1962

⁶²Hauxaum, k Haupt P (2012) Notes on Income tax South Africa. Cape Town: Hedron

⁶³. SARS.(2006). Revised Proposals on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Available: www.sars.gov.za

As provided by *Silke*⁶⁴ in order to discharge the rebuttable presumption stated by s80G that taxpayer has the obligation to prove that *reasonably considered in light of the relevant facts and circumstances that obtaining of a tax benefit was not the sole or main purpose*.

The fact that the purpose test is now an objective test coupled with s80G will once again unfairly prejudice the tax payer, who now also has the added burden of disproving the presumption that the arrangement was entered into purely to obtain a tax benefit.

Admittedly there was cause for an objective test to replace the subjective test as stated by RC Williams⁶⁵

□In essence...a taxpayer could with impunity enter into a transaction with the (subjectively) sole or main purpose of avoiding tax provided that there was no (objective) abnormality in the means or manner or in the rights and obligations which is created. Conversely, 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 new GAAR seeks to assess avoidance arrangements on a uniform basis by placing less reliance on the stated intention of the taxpayer, thus making the test an objective rather than subjective as was the previous GAAR. The sole or main purpose of the arrangement itself is the relevant purpose and no longer the subjective purpose of the taxpayer⁶⁶.

The shortcomings attributable to the previous GAAR were largely attributable to the reliance on the taxpayers stated intention. The change in the purpose test should provide a more standard test to be applied against all avoidance arrangements and the inclusion of S80 G however may prove to have unfairly positioned the taxpayer. the burden will prove to be too much because not only will the taxpayer be automatically assumed to have entered into the avoidance arrangement for the sole purpose of obtaining a tax benefit, the reasons provided for entering into the transaction shall no longer provide the same protection for the taxpayer.

Overstone v SIR⁶⁷ has identified the inherent weaknesses in S 80G

⁶⁴De koker, AP (2011). *Silke on South African income tax*. Durban : lexus Nexus.

⁶⁵. SIR vs Gallagher 1978(2) SA 463(A),

⁶⁶. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

⁶⁷. 1980 (2) SA 721, 42 SATC 55

The assumption established by section 80G places a heavy burden of proof on the taxpayer as the mere assertion that his sole or main purpose was not the avoidance arrangement will not discharge the onus resting upon

The purpose requirement and the much harsher provisions included in the new GAAR will prove to be an issue that will be problematic for many taxpayers as they will be unduly prejudiced, as proving that the sole or main purpose of entering into the avoidance arrangement was not to obtain the tax benefit will prove difficult if not impossible in some cases. The onus of proving that a tax benefit was inherent in the avoidance arrangement is more than discharged by S80G which contains the rebuttable presumption that the taxpayer's sole or main purpose of entering into the transaction was to obtain the tax benefit in question.

The overall effect would be that the taxpayer would struggle to prove that the sole or main purpose of the arrangement was not to obtain a tax benefit. In some instances, this would lead to an inaccurate assessment of the taxpayer.

Chapter 4 Tainted elements

The fourth and final requirement is twofold, and is applicable in both business and a non-business context. The onus of proving that one or more of the tainted elements exists in the avoidance arrangement in question rests on the Commissioner. However should the Commissioner be successful in proving the existence of the indicators set out in s80C to S80E of the income tax act the onus is successfully discharged⁶⁸.

In a business context the arrangement must satisfy one of four tainted elements tests in the business context as set out by s80 A(a)-(c)⁶⁹

- *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.*
- *It lacks commercial substance, in whole or in part, taking into account the provisions of section 80A.*
- *It would result directly or indirectly in the misuse of the abuse of the provisions of this Act*

The last two elements represent the new provisions included in the anti-avoidance provisions. The role that these elements seek to play in improving the quality of the South African GAAR will be discussed in detail.

The business purpose test/abnormality requirement

The test to establish whether the avoidance arrangement was entered for bona fide business purposes is known as the business purpose test. The new abnormality requirement still retains some of the principles which were found in 103(1)(b)(i). The essence of this test rests on the manner in which the avoidance arrangement was entered into and not the fact that the avoidance arrangement was actually entered into.

The business purpose test still remains an abnormality test that enquires whether the means and manner in which the arrangement was conducted would not be considered normal in a business context⁷⁰.

⁶⁸. Meyerowitz, D., □Meyerowitz on Income Tax□. (2008) 2007-2008 ed. Cape Town: The Taxpayer at 29-11.

⁶⁹. Income tax Act of 1962

⁷⁰. Williams,R.C. (1997).The 1996 Amendment to the General Anti avoidance Section of the Income tax Act,SALJ,vol 114

According to RC Williams⁷¹ the essence of the abnormality requirement rests on the fact

..... That it necessitates an enquiry into a hypothetical situation: whether the manner in which the transaction was entered into □would not normally be employed for bona fide business purposes.

The issue here is to determine what meaning the legislature had intended for bona fide business purpose as this term has also been left undefined in the act. The income tax act does provide a definition for trade as per s1⁷²:

every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or granting of permission to use certain other assets.

The carrying on of a □trade is clearly not the same thing as the carrying on of a □business⁷³.

The courts have established a meaning for bona fide to be that of good faith⁷⁴ in Silke the term bona fide was established as being:

.....even if the arrangement is entered into or carried in a bona fide manner the method employed may nevertheless be found to be abnormal⁷⁵.

It is clear that SARS seeks to attack the means and manner that such an avoidance arrangement was conducted and not its mere existence this was what still remains at the core of the business purpose test. The only change to be noted here from the previous GAAR is the test is now more objective one.

⁷¹. Williams,R.C. (1997).The 1996 Amendment to the General Anti avoidance Section of the Income tax Act,SALJ,vol 114

⁷². S1 of Income tax act.

⁷³. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

⁷⁴. Jarvis, J.(1996).Things are seldom what they scheme. Jutas Business law, vol4. Pg 147- 148

⁷⁵. De koker,AP (2011). Silke on South African income tax. Durban : lexis Nexus.

2. Commercial substance test

The second element of the possible four tainted elements is that the arrangement must lack commercial substance this condition applies only to in the context of business. The new tests are prescribed in s80C (1) and S80C (2)⁷⁶. This section aims to provide a general test for arrangements that will be considered to lack commercial substance

80C. (1) For purposes of this Part, an avoidance arrangement lacks

commercial substance if it fails to have a substantial effect upon a party's—

(a) business or commercial risks;

(b) net cash flows; or

(c) beneficial ownership of any asset involved in the avoidance arrangement,

apart from any effect attributable to the tax benefit that would be obtained but for the

provisions of this Part.

(2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to—

(a) a legal or economic effect resulting from the avoidance arrangement as a whole that is inconsistent with, or differs significantly from, the legal form of its individual steps;

(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

without a substantial change in the economic position of any one or

more of the parties; or

(c) an inconsistent characterisation of the avoidance arrangement for tax purposes

by the parties.

The general or presumptive test of commercial substance

The general test must be satisfied in order for the commissioner to prove that the arrangement lacks commercial substance.

S80 C(1) addresses a situation where the avoidance arrangement entered into and has had no substantial effect on either the cash flows, business risks or ownership of assets in the arrangement in question. If this is proven to be the case the Commissioner is well within his rights to use the remedies afforded to him under s80B. This is because the taxpayer in question would have received a tax benefit as defined by s80L.

S80 (2) has provided an inconclusive list of avoidance arrangements which may indicate a lack of commercial substance. Based on the wording of the act it is clear that only one of the conditions need to exist in the arrangement for S80C to apply.

The test for lack of commercial substance should be considered individually from that of abnormality even though they may overlap⁷⁷. It therefore stands to reason that should the arrangement contain abnormality characteristics it may well also lack commercial substance.

The SARS draft comprehensive guide to the general anti avoidance rule 2010⁷⁸ provides examples of instances where it would be clear the arrangement would lack commercial substance.

This includes arrangements where:

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

The presumption that the arrangement lacks commercial substance is stated in s80C(1), should it be proven that significant tax benefit has been gained by the taxpayer without a corresponding significant effect on business risks or net cash flows⁷⁹.

^{76.} S80 C Income tax act 1962

^{77.} SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

^{78.} SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

^{79.} Clegg, D, & Stretch, R. (2011). Income tax in South Africa. Chapter 26.

There is however an issue of the true definition of substantial tax benefit as this term has been left undefined. This will again create uncertainty for the taxpayer and will force the general public to rely again on the discretion of the courts. S82 has established that the burden of proof with regard to an avoidance arrangement does not lack commercial substance lies with the taxpayer. Although the Commissioner bears the burden of proof with regards to proving that one or tainted elements exists in the avoidance arrangement, the burden of proving that the arrangement does not lack commercial substance rests with the taxpayer. This will further increase the burden of proof that rests with the taxpayer.

It seems vital to assess all the factors that form part of the general test for lack of commercial substance in order to ascertain the role the Commissioner would need to satisfy in order to prove that one of the tainted elements exist thus the avoidance arrangement represents an impermissible avoidance arrangement.

B Indicative Commercial substance tests.

The Act in S80C(2) has provided the following as indicators although it is stipulated that this not an exhaustive list⁸⁰.

- *Legal substance differs from legal form*
 - *Inclusion or presence of round trip financing or (read with S80D)*
 - *Accommodating or tax indifferent parties or (read with S80E)*
 - *Elements that have the effect of offsetting or cancelling each other.*
-
- **Substance over form S80C(2)(a)**

The Legal or the economic effect is inconsistent with the legal form, or differs significantly from, the legal form, as a result of having entered into the avoidance arrangement. The substance over form test focuses on two elements legal and economic effects. The legal effect of the arrangement is compared to the legal form and if any discrepancies are identified it is considered to be indicative of a lack of commercial substance⁸¹.

⁸⁰. S80C of Income tax act

⁸¹. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

Furthermore the commercial substance shall also be compared to the legal form and if any discrepancies are identified it is considered to be indicative of a lack of commercial substance

Creating a legal façade that is contrary to the substance of the arrangement in particular individual steps in a broader arrangement, is a common tool used in tax avoidance schemes⁸²

SARS seeks to attach a different meaning to substance over form than that which has been established in common law. It is evident that the common law definition has failed to act as a successful deterrent to simulated or sham transactions

In Erf 3183/1 Ladysmith (Pty) Ltd v CIR⁸³ the court established that

One must distinguish the principle that one may arrange his affairs so as to remain outside the provisions of a particular statute, and the principle that a court will not be deceived by the form of a transaction, it will set aside the veil in which the transaction is wrapped and examine the true nature and substance.

This emphasises the notion that the Commissioner seeks to tax the actual effect on the taxpayer and in some instances shall not be satisfied with the appearance or rather the form of the arrangement.

Road Trip financing.

Road trip financing relates to any avoidance arrangement in which funds are transferred between or among the parties (round tripped amounts) and the transfer of the funds would –

- result, directly or indirectly, in a tax benefit but for the provisions of the GAAR; and
- Significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement.⁸⁴

S80D has defined funds as including any cash, cash equivalents or any right or obligation to receive or pay the same.

^{82.} SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

^{83.} 1996(3) SA 942 (A) at 950H-951D

^{84.} SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

80D. (1) Round trip financing includes any avoidance arrangement in which—
(a) funds are transferred between or among the parties (round tripped amounts);
and

(b) the round tripped amounts—

(i) would result, directly or indirectly, in a tax benefit but for the provisions of this Part; and

(ii) significantly reduce, offset or eliminate any credit or economic risk incurred by any party in connection with the avoidance arrangement.

(2) This section applies to any round tripped amounts without regard to—

(a) whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;

(b) the timing or sequence in which round tripped amounts are transferred or received; or

(c) the means by or manner in which round tripped amounts are transferred or received.

(3) For purposes of this section, the term 'funds' includes any cash, cash equivalents or any right or obligation to receive or pay the same.

The definition of Round trip Financing supplied in S80D shall not be considered to be exhaustive.

The essence of round trip financing rests on the fact that a tax benefit was obtained due to a transfer of funds between parties and as a result the business risk to the taxpayer was reduced or removed entirely.

^{85.} S80D of Income tax Act

Accommodating or tax indifferent parties or (read with S80E)⁸⁶

80E. (1) A party to an avoidance arrangement is an accommodating or tax indifferent

if—

(a) any amount derived by it in connection with the avoidance arrangement is either—

(i) not subject to normal tax; or

(ii) substantially offset either by any expenditure or loss incurred by it in connection with that avoidance arrangement or any assessed loss of that party; and

(b) the participation of that party would directly or indirectly involve or result in any of the following—

(including the recoupment of any amount) being shifted to another party;

(ii) the character of any amount being converted from—

(A) revenue to capital;

(B) one that would not have been deductible to one that would be deductible; or

(C) one that would have given rise to taxable income to one that would either not be included in gross income or would be exempt from normal tax; or

(iii) a prepayment of any expenditure by another party to that party.

(2) A person may be an accommodating or tax-indifferent party whether or not that person is a connected person in relation to any party.

(3) The provisions of this section do not apply if either—

(a) the amounts derived by the party in question are subject to tax in another country which is equal to at least two-thirds of the amount of normal tax

which would have been payable in connection with those amounts had they been subject to tax under this Act; or

(b) the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months: Provided these activities must be attributable to a business establishment, as defined in section 9D(1), whether or not the party is a controlled foreign company.

(4) For purposes of subsection (3)(a), the amount of tax imposed by another country must be determined after taking into account any assessed loss, credit, rebate

or other right of recovery to which that party or any connected person in relation to that party may be entitled.

The mere presence of an accommodating or tax-indifferent party in an avoidance arrangement is sufficient to render such arrangement impermissible, if the sole or main purpose of such arrangement was to derive a tax benefit⁸⁷. This would be due to the fact that the taxpayer would have failed to discharge the onus of proving that the avoidance arrangement does not lack commercial substance and is thus an impermissible avoidance arrangement. This would entitle the Commissioner to remedy this situation through the application of S80B. It should be noted that S80E does not require the parties in question to be connected.

^{86.} S80E of Income tax Act

^{87.} SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

S80E has also provided exclusions from the tax accommodating parties known as the safe harbour provisions. These safe harbours serve as broad indications that an accommodating or tax-indifferent party's participation in an arrangement does not indicate a lack of commercial substance⁸⁸.

A brief overview of the safe harbour provisions is sufficient to understand their impact on the new GAAR.

Parties subject to comparable foreign income tax.

This relates to transactions which is subject to foreign tax to the value of two thirds of that which would be payable under the income tax act. This is included in the safe harbour provisions because any tax benefit obtained by the parties in question in South Africa is offset by the foreign tax payable.

The second safe harbour provision relates to parties engaged in regular trading activities. The party in question must take part in substantive active trading activities in relation to the avoidance arrangements for at least 18 months

Offsetting and cancelling characteristics

This provision focuses on the elements of the avoidance arrangement that offset each other⁸⁹. The act however has not provided an exhaustive list of these elements, thus creating further uncertainty.

In order for an arrangement to be proven to be lacking in commercial substance, in a business context both the presumptive test and the presumptive tests must be satisfied. The lack of commercial substance test has been introduced to strengthen the Abnormality requirement.⁹⁰

⁸⁸. SARS (2010). Draft comprehensive guide to the GAAR. Available:
www.sars.gov.za

⁸⁹. S80 C of Income tax act.

⁹⁰. SARS.(2005). Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Pretoria:SARS.

Rights and obligations created would not exist in an arrangement concluded at arm's length

This third tainted element may exist in any context, business or otherwise. In order to determine such rights and obligations were created one must seek to look at arrangement concluded at arm's length and seek to contrast this with the arrangement in question.

Conceptually nothing seems to have changed between s103 (1) and that considered in the GAAR. The inquiry as to whether the arrangement was concluded at arm's length still remains a factual inquiry based on a hypothetical situation.

For the courts definition of an arm's length transaction the judgment passed in *Hicklin v CIR* still remains applicable.⁹¹

□ For □ dealing at arm's length is a useful and often easily determinable premise from which to start the inquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself. Indeed, in the Afrikaans text the corresponding phrase is □ die uiterste voorwaardes beding'. Hence, in an at arm's length agreement the rights and obligations it created are more likely to be regarded as normal than abnormal in the sense envisaged by para (ii). And the means and manner employed in entering into or carrying it out are also more likely to be normal than abnormal in the sense envisaged by para (i). □

Should it be determined that the arrangement was conducted in an arm's length manner it would stand to reason that the rights and obligation created by the arrangement should be considered to be normal and thus the arrangement is not lacking in commercial substance

^{91.} 1980 (1) SA 481 (A); 41 SATC 179 at 195

It should be noted that this section contains a fair amount of uncertainty due to the fact that the Commissioner has failed to supply an exhaustive list of lack of commercial substance indicators which can be referred to. A list of factors to be considered in the determination of whether the avoidance arrangement lacks commercial substance has also not been provided. This going forward will prove problematic for both the taxpayer and Commissioner and will affect the overall effectiveness of the new GAAR.

Conclusion

Paying taxes over to the Commissioner of the South Africa Revenue Services is a responsibility which rests with all working South Africans in order to help improve the living conditions for all. However this is a responsibility that many taxpayers try to avoid and many dubious schemes have been created as a result over the years.

Previously the General anti avoidance provisions were encompassed in s103 however it was later repealed in 2006. This is due to the fact that the Commissioner felt that the s103 had several shortcomings which were discussed at both the 1986 Margo and 1995 Katz commission⁹². The reasons cited for change acknowledged the shortcomings of s103 which include the inconsistent application by the courts and that it proved to be an *ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance*⁹³

The new GAAR has been put in to effect for all arrangements entered into on or after 2 November 2006 should they satisfy the following requirements:

1. There must be an arrangement
2. Which was entered into in order to obtain a tax benefit
3. The sole or main purpose of the avoidance arrangement was to obtain a tax benefit
4. The arrangement consists of one of four tainted elements for arrangements, in the context of business; in the context other than business it must include one of three tainted elements, in order to be considered impermissible tax avoidance arrangement.

The various requirements that need to be satisfied before the avoidance arrangement is considered impermissible have been discussed in detail in the prior chapters. It is however important to determine however whether the new GAAR is able to meet the Commissioners objectives of introducing and an effective GAAR which seeks to tax only those taxpayers who have proven to have evaded tax, and the effect this has on the taxpayers position.

⁹². SARS.(2006). Revised Proposals on Tax Avoidance and section 103 of the Income Tax Act 1962 (Act No 58 of 1962). Available: www.sars.gov.za

⁹³. SARS (2010). Draft comprehensive guide to the GAAR. Available: www.sars.gov.za

The new GAAR has been met with much criticism due to the complexities of the new provisions found in s80A-L of the Income Tax Act. It has been said that the provisions of the new GAAR perplex even the most impressive minds.⁹⁴

The effectiveness of the new GAAR may be severally impacted by the fact that many of the terms remain undefined in the Act. This is problematic for the following reasons.

- Taxpayers have not been given clear guidance and parameters for many key points which will affect the manner in which schemes are concluded. This applies specifically to *sole or main purpose* and *business purpose test* just to name a few.
- Increased pressure on the judiciary
Due to the fact that many key terms have not been defined in the income tax act, this job becomes the responsibility of the courts. This shall be applied on a case by case basis at the discretion of the courts. This may give rise to several inconsistencies. The application of certain terms may ultimately prove not to be in line with the original intentions of the Commissioner
- Provide more administrative issues for the Commissioner.
The new GAAR were put in place because the old GAAR presented a large amount of administrative issues and ultimately made implementation very difficult. The amount of uncertainty that rests around the new GAAR may potentially present similar problems because of the recourses to be utilised in investing taxpayers unnecessarily.

The provisions set out by GAAR have effectively widened the scope of the arrangements that fall into the definition of an impermissible avoidance arrangement. The biggest issue to be considered is that the new GAAR provisions are yet to be tested in the courts, and given the ambiguity that exists around some of the provisions this may prove to be a strenuous task for the courts and once again fail to meet the objectives by the commissioner with the implementation of the GAAR.

A poor design of a GAAR is likely to have adverse consequences. [the] benefit is entirely reversed if the GAAR is ambiguous in design or administration creating uncertainty for the taxpayers .⁹⁵

⁹⁴. Drummod,B(2006).A purposive approach to drafting tax legislation.British tax Review

⁹⁵. Tax controversy and Dispute Resolution alert PWC(2012).General anti avoidance rules. Available: www.pwc.com

The Commissioner however at all times does have the responsibility to all taxpayers to respect their right to arrange their arrangements in such a manner so as to minimise their tax liability⁹⁶. No obligation rests on the taxpayer to pay a greater tax than that actually due by him as determined by the income tax act⁹⁷.

The King case⁹⁸ was able to clarify this line somewhat as was discussed in the introduction that the distinction that lies in the means and manner employed to conduct the avoidance arrangement and whether or not the sole or main purpose was to obtain a tax benefit.

It remains clear that the purpose test plays an essential role in the determination of the existence of an impermissible avoidance arrangement. The key change to be noted here is that this test has ceased to be a subjective one and is now purely objective based on the specified definition in the act. The fact that case by case circumstances will no longer be considered may result in many taxpayers being treated unfairly.

It was clear that simply relying on the taxpayers stated intention was an ineffective system as many taxpayers that should have persecuted were not. However a complete change to a purely objective testing may not result in a more successful implementation of the GAAR provisions. The change to an objective test coupled with the inclusion of section 80G may unfairly prejudice the taxpayer. I would seek to argue the new GAAR must place a higher reliance on the taxpayer's *ipse dixit* as a means of balancing the rebuttable presumption of entering into the avoidance was to obtain the tax benefit, as proving that the sole or main purpose of entering into the avoidance arrangement was not to obtain the tax benefit will prove difficult if not impossible in some cases

⁹⁶. Explanatory Memorandum on the Revenue Laws Amendment Bill.(2006). WP2 2006 at 62.

⁹⁷. Du plessis, L.(2008). *Tax Hell or Tax haven*.ASA SEPTEMBER 2008. Pg 12-21.

⁹⁸. 1947 (2) SA 196 (A), 14 SATC 184.

The fourth and final requirement relates to the existence of one or more tainted elements in the arrangement. The burden of proof in this regard rests with the Commissioner. The tainted elements test seeks to assess the avoidance arrangements in a business context and non business context.

The inclusion of the safe harbour seek to provide some form of relief to the taxpayer but this may not prove to be enough, as the relief is only applicable in certain circumstances. The safe harbour provisions are not applicable if it is established that the presumptive test for lack of commercial substance is applicable.

The new GAAR was introduced because the previous GAAR no longer presented an effective deterrent to tax avoidance due to the following reasons:

- Abnormality requirement.
Taxpayers and promoters of illegal schemes were usually able to provide valid business purposes for having entered into certain agreements
- The purpose requirement
The onus rested on the Commissioner to disprove the fact that the sole or main purpose of the taxpayer entering into the arrangement was to obtain a tax benefit.
- Procedural and administration issues
This related to the uncertainty around to what extent the GAAR could be applied to the individual steps of a transaction within a larger transaction. The other issue related to whether the provisions of the GAAR could be applied where another provision was in dispute.

In order to combat this SARS sought to widen the scope of the GAAR through implementation of twelve new provisions found in S80A-L of the Income tax act. However one could argue that the scope has been widened too much, to the detriment of the taxpayer. From the introduction of S80G which represents a rebuttable presumption that the purpose of entering into the avoidance was to obtain a tax benefit, to the now objective test with regards to the purpose of the arrangement. In both instances it will be near impossible to prove the contradictory position. The effect will of not only unduly prejudicing the taxpayer but will create a hostile relationship between the taxpayer and the Commissioner.

The effectiveness of the new GAAR is yet to be tested in South African courts. This will represent the real test for the new legislation as the courts try to govern the implementation of the new harsher provisions while still trying to protect the rights of the taxpayer.