TACKLING INTERNATIONAL TAX AVOIDANCE: IF SOUTH AFRICA HAS GENERAL ANTI-AVOIDANCE RULES, WHY DOES IT NEED THE PRINCIPAL PURPOSE TEST?

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ABSTRACT

The OECD's MLI was tabled for signature on 7 June 2017 and South Africa was amongst the first 68 countries to sign the MLI on that date. With its signature, South Africa made the provisional selection to adopt the PPT minimum standard, which was introduced by the OECD's Final Report on BEPS Action 6. This minimum standard effectively incorporates a treaty GAAR into South Africa's treaties that are covered under the MLI.

However, South Africa already has a very comprehensive and complicated domestic GAAR. In their review of the OECD's Final Report on BEPS Action 6, the Davis Tax Committee observed that the GAAR and the PPT serve a similar purpose and that the GAAR can be applied to prevent the abuse of treaties. They stated further, that one could therefore argue that there is no need for South Africa to amend its treaties to include the PPT. Nevertheless, as much as the OECD Final Report on BEPS Action 6 clearly explains that domestic law provisions can be applied to prevent treaty abuse, there could be concerns of treaty override if South Africa applies its GAAR in a treaty context.

This dissertation's objective was to investigate the Davis Tax Committee's propositions noted above. An in depth analysis and comparison of the GAAR and the PPT resulted in the conclusion that the Davis Tax Committee's propositions were correct. The core purpose and functions of the GAAR and PPT are similar to the extent that the GAAR could be applied to prevent treaty abuse, instead of the PPT. The South African legal framework is further set up in such a way that the GAAR can not only be legally applied in a treaty context, but that it would trump a treaty provision in the event of an irreconcilable clash, which results in the Davis Tax Committee's concern for treaty override.

Despite the conclusion that the GAAR may replace the PPT, it may not be practical for South Africa to apply its GAAR in a treaty context and it was concluded that it is highly unlikely that South Africa would substitute the PPT for the GAAR.

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LIST OF ABBREVIATIONS AND DEFINITIONS

Abbreviation	Meaning
1941 Act	Income Tax Act, no 31 of 1941
1959 Amendment Act	Income Tax Act, no 78 of 1959
1978 Amendment Act	Income Tax Act, no 101 of 1978
1996 Amendment Act	Income Tax Act, no 36 of 1996
BEPS	Base erosion and profit shifting
BEPS Action Plan	Action Plan to prevent Base Erosion and Profit Shifting
BEPS Report	Refers, unless otherwise stated, to the OECD/G20 Action 6 2015 Final Report on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
CIR	Commissioner for Inland Revenue
Commentary	Refers to the Commentaries to the OECD's Commentaries on the Articles of the Model Tax Convention on Income and on Capital 2017, unless otherwise noted. Years noted before the term refers to that specific year's Commentary
CTA	Covered tax agreement – a DTA that is subject to the MLI because both countries included it in its MLI selection
CSARS	Commissioner of SARS
DTA	Double tax agreement
DTCom	Davis Tax Committee
Explanatory Statement	Explanatory Statement to the Multilateral Convention to Memorandum Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
GAAR	General anti-avoidance rule
G20	Group of Twenty
IRS	Internal Revenue Service of the United States of America

ITA	Income Tax Act, no 58 of 1962, as amended
LOB	Limitation of benefits
MAP	Mutual Agreement Procedure
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNE	Multinational enterprise
OECD	Organisation of Economic Cooperation and Development
MTC	OECD Model Tax Convention on Income and Capital (2017)
2003 MTC	OECD Model Tax Convention on Income and Capital (2003)
PE	Permanent Establishment
PPT	MLI Principal Purpose Test
SA	South Africa
SAAR	Specific anti-avoidance rules
SARS	South African Revenue Service
SATC	South African Tax Cases Reports
SIR	Secretary for Inland Revenue
The Commissioner	The Commissioner of the South African Revenue Service
UK	United Kingdom
US	United States of America
VCLT	Vienna Convention on the Law of Treaties

CHAPTER 1: INTRODUCTION

1.1 Background

It is established law that taxpayers are entitled to order their affairs so that the tax charged under the appropriate acts is less than it otherwise would be.[1]

Thus, tax avoidance can be seen as many things including the amoral dodging of one's societal duties or the right of every citizen to lessen their tax burdens. Nevertheless, it is legal. By contrast, tax evasion is the general term for efforts by taxpayers to evade the payment of taxes by illegal means. This usually entails deliberate misrepresentation or concealing the true state of affairs to tax authorities to reduce tax liabilities, and includes in particular, dishonest tax reporting.[2]

1.1.1 The cost of tax avoidance

The OECD estimated (conservatively in its opinion) that revenue loss as a result of tax avoidance worldwide amounts to between USD 100 to 240 billion annually.[3]

The Commissioner notes that accurate estimates of the problem are difficult to make, however, there is no question that that the amounts at stake are substantial and the most immediate harm caused by impermissible tax avoidance is short-term revenue loss.[4]

South Africa relies on taxes to fund nearly a third[5] of its GDP and in the 2019 year of assessment, corporate income tax comprised 16.6%, personal income tax 38.3% and value added tax 25.2% of the total revenue collected by SARS, amounting to R1.28 trillion.[6] Extremely outdated estimates from 1994, estimated that South Africa lost between 10% to 33% of its annual tax revenue due to tax avoidance schemes.[7]

1.1.2 The OECD's BEPS Action Plan

Increased focus on the prevention of tax avoidance in the last decade is therefore not surprising and it seems logical that the easiest way to curb tax avoidance would be through international and domestic legislative amendments. Thus, from 2012 the OECD together with

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[1] UK: *Inland Revenue Commissioners v Duke of Westminster* 1936 19 TC 490 see also De Koker & Williams 'Tax avoidance' *Silke on South African Income Tax* (2020), LexisNexis at 19.1.
[2] De Koker & Williams ibid.
[3] OECD *Background Brief: Inclusive Framework on BEPS* (2017), OECD.
[4] SARS *Discussion paper on tax avoidance and section 103 of the Income Tax Act (Act No. 58 of 1962)* (2005), SARS, p.9.
[5] OECD *Revenue Statistics in Africa 2019 - South Africa* (2020), OECD.
[6] SARS and National Treasury *2019 Tax Statistics* (2019), SARS.
[7] SARS op cit n.4.

the G20 started working on the BEPS Action Plan and published the final reports on the BEPS Action Plan on 5 October 2015.[8]

BEPS Action 6, the prevention of the granting of treaty[9] benefits in inappropriate circumstances, is of particular importance to this dissertation. A number of the BEPS Actions, including Action 6 would only be successfully implemented through changes to existing tax treaties. Therefore, BEPS Action 15 dealt with the development of a multilateral instrument to enable countries to implement these Actions through a once off amendment of their bilateral tax treaties.

1.1.3 The MLI

With a multilateral instrument in mind an ad hoc Group, mandated by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors, began its work in May 2015 and in November 2016, over 100 jurisdictions concluded negotiations on the MLI.[10]

The MLI[11] has three minimum standards, meaning that countries have agreed that these standards are compulsory for countries adopting the MLI.[12] They comprise:

- The PPT in Article 7, discussed below,
- Article 6 which requires the wording of the preamble of the relevant treaty to be updated to expand the treaty's scope and address the elimination of opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and
- Article 16 which requires the inclusion of MAP or the implementation of a bilateral notification or consultation process for dispute resolution.

The MLI was tabled for signature on 7 June 2017 and South Africa was among the first 68 countries to sign it on that date.[13] The MLI entered into force on 1 July 2018 and its first provisions entered into effect on 1 January 2019. However, South Africa has yet (at the date of this dissertation) to deposit its instrument of ratification with the OECD. As a result, the MLI has not come into force in respect of any of South Africa's tax treaties.

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[8] OECD *Explanatory Statement: G20 Base Erosion and Profit Shifting Project* (2015), OECD.
[9] Any reference throughout this dissertation to the term "treaty" refers to a tax treaty or DTA, unless the VCLT is referenced, or the term is otherwise qualified.
[10] OECD *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (2016), OECD, p.1.
[11] OECD *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (2016), OECD.
[12] OECD op cit n.10.
[13] OECD *Signatories and Parties to the MLI* (2017), OECD.

1.1.4 The PPT

The PPT is a treaty-based anti-avoidance rule that requires tax authorities to make a determination as to whether the principal purpose, or one of the principal purposes of an arrangement/transaction, was to obtain treaty benefits following which, if it was found to be the case, treaty benefits are denied.[14]

Article 7 also includes an "LOB provision" in addition to the PPT. The LOB provision allows for limited treaty benefits to be granted in specific circumstances where such treaty benefits would otherwise have been denied under the treaty.[15]

Further, a detailed LOB and either rules to address conduit financing structures or provisions that are similar to a PPT can replace the PPT. To ensure compliance with the minimum standard PPT, countries that apply this second option must reach a mutual anti-avoidance solution with other MLI signatories that aligns with the minimum standard PPT.[16]

Because the PPT is a minimum standard, countries can only opt out of it in two situations. Firstly, under the circumstances addressed in the preceding paragraph.[17] Secondly, if its treaties already include provisions that deny all treaty benefits where the principal purpose or one of the principal purposes of any arrangement was to obtain those benefits.[18]

South Africa opted to apply the minimum standard PPT on a standalone basis.[19]

1.1.5 The South African GAAR

South Africa has an extensive and complex GAAR enacted in the ITA.[20] The GAAR[21] is applicable to residents as well as non-residents earning South African sourced income,[22] and aims to capture tax avoidance not addressed by the various SAAR in the ITA.[23]

[14] OECD op cit n.11 Article 7(1).
[15] OECD ibid Articles 8-13.
[16] OECD ibid Article 7(15)(a).
[17] Ibid.
[18] MLI Article 7(15)(b).
[19] National Treasury *Status of List of Reservations and Notifications at the Time of Signature* (2017) OECD, p.27.
[20] ITA, sections 80A - 80L.
[21] Unless otherwise indicated "the GAAR" refers to the South African GAAR as it read at the time of this dissertation. Appendix 2 includes the full GAAR.
[22] De Koker & Williams op cit n.1 at 19.34.
[23] Ibid at 19.5.

The DTCom opined in their final BEPS report[24] that, technically, the GAAR could be applied to prevent tax treaty abuse and further that the GAAR and the PPT serve the same purpose.[25] However, the DTCom noted that the application the GAAR in a treaty context amounts to treaty override.[26] This and contradictory views[27] will be analysed in chapter 4.

1.2 Research question

The research question is based on the DTCom's presumptions. If the GAAR and PPT serve the same purpose and the GAAR could be applied to prevent tax treaty abuse, why does South Africa need the PPT?

The objective of this dissertation is a critical analysis of the GAAR and the PPT. This will serve as the basis for determining whether the GAAR can operate in the place of the PPT.

The critical analysis will interpret and consider the:

- Main features of the PPT and GAAR.
- Procedural requirements for the application of the GAAR and PPT.
- Legal implications to apply the GAAR in a treaty context.

The key findings from the analysis of GAAR and the PPT will be compared against each other in order to determine if these two instruments have the same object and purpose.

In achieving the objective, this dissertation will consider primary sources including the ITA and relevant case law. Secondary sources will also be consulted and include the Explanatory Statement, the BEPS Report, books and journal articles.

1.3 Research method

The research will be conducted using a qualitative research approach following legal doctrinal methodology. Qualitative research is typically about seeking answers to questions and not about proving or disproving hypotheses.[28] A doctrinal methodology is a research methodology that provides a systematic exposure of the rules governing a particular legal category,

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[24] DTCom *Second and Interim Report on Base Erosion and Profit Shifting in South Africa. Summary of DTC Report on Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstance* (2016). The report was published in November 2017 but it was drafted in September 2016, prior to South Africa signing the MLI.
[25] Ibid p.102.
[26] Ibid p.93
[27] Held by Cilliers 'Anti-Avoidance' in De Koker & Brincker (eds.) *Silke on International Tax* (2020), LexisNexis at 46.37.
[28] McKerchar 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation' *eJournal of tax Research* (2008), vol.6 no.1 p15.

analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments.[29]

A comparative approach falls within the doctrinal methodology[30] and the reason for the chosen research methodology is that this research will analyse both the GAAR and PPT and compare the findings of the analyses.

The research method will be applied in a four tiered approach. Firstly, the relevant and available research materials will be surveyed. Next, the surveyed information will be summarised followed by the third step, in which the author will compare the current GAAR and PPT structures. Finally, the findings will be presented in this study in a rational and structured manner.

1.4 Limitation of scope

A critical discussion of each aspect of the GAAR does not fall within the scope of this study. Instead, key aspects identified in the research objective will be used to identify focus areas for the GAAR discussion.

This study does not attempt to critically analyse the operation of the MLI or its anticipated success or failure to curb BEPS. Further, the analysis of the MLI's Article 7 is limited to the PPT. An analysis of the guiding principle is not in the scope of this dissertation.

This dissertation is limited to a discussion of GAARs and no discussion about SAARs is undertaken.

1.5 Benefit

Much uncertainty still exists around the implementation of the PPT. This research may provide some clarity as to how the PPT may applied in practice and interpreted by courts.

Further, this dissertation will provide an analytical framework and recommendations around the application of the PPT, based on the application of, and lessons learned from the GAAR.

1.6 Chapter outline

This chapter 1 provided the background to the topic, set out the research objectives, limitations and benefits and provided the chapter outline.

Chapter 2 analyses the GAAR. The analysis includes an overview of prior GAAR versions, how the GAAR functions, its interpretation and application at the hand of case law.

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[29] Hutchinson 'Developing legal research skills: expanding the paradigm' *Melbourne University Law Review* (2008), 32. p.1068.
[30] West & Roeleveld *Research Methods in Tax* (2018), p.31.

Chapter 3 analyses the PPT. The various features of the PPT, its application and interpretation are considered in light of the views and opinions of various international scholars in emerging literature, the BEPS Report, Explanatory Statement, and the Commentary.

Chapter 4 compares the GAAR and the PPT, based on the findings of preceding chapters. This chapter aims to investigate whether their object and purpose are similar. The chapter will also consider whether the South African legislative framework allows for the application of the GAAR in a treaty context.

Chapter 5 concludes on whether the GAAR could replace the PPT and summarises key findings from the analyses of the GAAR and the PPT.

CHAPTER 2: THE SOUTH AFRICAN GAAR

2.1 The birth of general anti-avoidance rules

"Every man is entitled to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."[31]

The quote from the 1936 *Duke of Westminster* case has become so famous that citing it has become a cliché. Nevertheless, despite being subject to some change over the years, this *dictum* remains relevant because most jurisdictions around the world, including South Africa,[32] allow taxpayers to arrange their affairs within the framework of income tax laws in order to avoid or reduce their tax liabilities.

However, recent decades have seen a shift towards an expectation that the taxpayer should contribute his just share of tax to the fiscus. Aubrey Silke, thought to be the modern parent of tax practitioners of income tax in South Africa,[33] may have been the first in South Africa to state that the *Westminster dictum* resulted in an unfair advantage whereby (usually) rich tax avoiders shift their tax burdens onto (usually) poorer taxpayers.[34] Silke's view was that widespread tax avoidance may result in losses to the fiscus, which would be recovered by an increase in tax rates, depriving the taxpaying public from a reduction in tax rates.[35] In later years, South African courts would share Silke's view.[36]

GAARs were introduced worldwide as a mechanism to counter the avoidance behaviour so accurately described by Silke. Naturally, South Africa was no exception and SARS cited reasons that resonated with Silke's view when the GAAR was reviewed in 2005.[37] It is prudent to point out, however, that Silke did not consider GAARs as the panacea to stop tax avoidance.

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[31] Supra n.1.
[32] See for instance: *Commissioner of Customs and Excise v. Randles Brothers & Hudson Limited* (1941) 33 SATC 48; *CIR v Estate Kohler* 1953 (2) SA 584 (A); *CIR v King* 1947 (2) SA 196 (A); *SIR v Hartzenberg* 1966 (1) SA 405 (A); *SIR v Geustyn, Forsyth & Joubert* (1971) 33 SATC 113, *Westerns Bank Ltd v Registrar of Financial Institutions* 1975 (4) SA 37 (T); *Hicklin v SIR* 1980 41 SATC 17. *Partington v. Attorney General* (21) LT 370 confirmed by *CIR v George Forest Timber Co Ltd* 1924 (1) SATC 20; *CIR v Wolf* 1928 AD 177 and *CIR v Delfos* 1933 (6) SATC 92.
[33] Hattingh 'Aubrey Silke's 1958 PhD on Tax Avoidance' *The Taxpayer* (2016), Volume 65 no.3 p.41.
[34] Silke *Tax avoidance and tax reduction within the framework of South African income tax legislation, with special reference to the effect on the fiscus and to current anomalies and inequities*, (PhD, University of Cape Town, 1958), p.561. SARS op cit n.4. at 4.5 also takes this view.
[35] Silke ibid.
[36] See for instance *Glen Anil Development Corporation Limited v SIR 1975 (4) SA 715 (A); COT v Ferera 1976 (2) SA 653 (SR); ITC 1496* (1990) 53 SATC 229. It should however be noted that the *Ferera dictum* was widely criticised in South Africa.
[37] SARS op cit n.4 p.6.

Rather, Silke stated that tax authorities should instead concentrate on specific provisions to counter obvious avoidance devices and loopholes.[38]

2.1.1 Introduction to the South African GAAR

South Africa has a long history with GAARs, the first being the 1941 GAAR which was housed in section 90 of the 1941 Act. The 1959 amended GAAR was also housed in section 90 of the 1941 Act, but was re-enacted in 1962 by the ITA in section 103(1). The 2006 re-enacted GAAR (ITA sections 80A to 80L) replaced the 1962 re-enacted GAAR. Appendix 1 contains the wording of the various GAARs over the years.

This chapter will discuss and analyse the various versions of the South African GAAR. The historic GAARs are included in this discussion for two reasons:

1. The provisions and judicial interpretation of the historic GAARs formed the basis of the 2006 re-enacted GAAR. In fact, the 2006 GAAR retained many elements from historic GAARs and reliance will inevitably be placed on case law from prior GAAR versions, as and if applicable, when the 2006 GAAR is tested in court[39] as has already been seen.[40]
2. Secondly, as illustrated in chapter 4, the historic GAARs and the PPT are alike in important areas, such that they could be indicative of the PPT's future interpretation.

2.2 The GAAR before its 2006 re-enactment

2.2.1 1941 GAAR

It is believed that the *Hiddingh* case[41] led to the enactment of the original 1941 GAAR.[42] The taxpayer disposed of an income-bearing asset by divesting himself of his right to claim income under a trust. The Commissioner attempted to charge tax to the taxpayer on this income, despite his divestment. The court held that the income flowing from that trust did not accrue to and was not taxable in the taxpayer's hands. It is suggested that the GAAR was introduced to prevent a taxpayer from avoiding liability by means of assignments of income such as were made in *Hiddingh*.[43]

This GAAR provided that the Commissioner could determine the income of the taxpayer as though a transaction, operation or scheme had not been entered into, provided that the

[38] Silke op cit n.34 p.15.
[39] De Koker & Williams op cit n.1 at 19.4.
[40] *X v CSARS; Y v CSARS* (2020) ZATC 16.
[41] *Hiddingh v CIR* (1940) 11 SATC 205 AD.
[42] 1941 Act, section 90.
[43] Supra n.41.

Commissioner was satisfied that any transaction, operation or scheme was entered into by a taxpayer for the purpose of avoiding or reducing liability for the payment of tax.[44]

While the taxpayer could object and appeal to the application of the GAAR, the GAAR applied a rebuttable presumption that the taxpayer/arrangement's purpose was to avoid or reduce tax once the Commissioner proved a tax avoidance or reduction effect. The burden of rebutting this presumption lay with the taxpayer.[45]

Some scholars noted that the scope of the 1941 GAAR, when read literally, was too broad and that it could effectively disallow all tax avoidance transactions, including transactions where tax benefits were made available through other sections of the 1941 Act.[46]

The *King* case[47] set the precedent for the interpretation and eventual amendment of the 1941 GAAR and is briefly discussed.

a. CIR v King

The facts of the *King*[48] case are: During June 1942, the taxpayer entered into an agreement whereby he sold certain shares, owned by him in private companies, to his son subject to certain terms and conditions. One of the conditions entailed that all dividends on the shares declared in respect of trading from July 1941 and all profits and losses from that date, should vest in the purchaser.[49] The Commissioner refused to recognise the agreements when assessing the taxpayers for income and super tax and taxed them as if the agreements had not been entered into.[50]

In interpreting the 1941 GAAR, the court stated that the expression "avoiding liability for the payment of any tax", when interpreted in its ordinary meaning, was ambiguous and that it would lead to absurd results.[51] In order to address this ambiguity, the court applied a restrictive interpretation to the phrase and noted that there is a difference between men who order their affairs to have no income that expose them to tax as opposed to escaping tax liabilities, which they ought to pay.[52]

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[44] 1941 Act, section 90(1).
[45] 1941 Act, section 90(2).
[46] Kujinga *A comparative analysis of the efficacy of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa* (PhD, University of Pretoria, 2013) p.79.
[47] Supra n.32.
[48] Ibid.
[49] Ibid at p.157.
[50] Ibid.
[51] Ibid at p.163.
[52] Ibid.

Further, in what was probably the most significant part of the judgment, the court held that the Commissioner could only justifiably invoke the GAAR where a transaction created "abnormal or unnatural situations" that resulted in tax avoidance "to the detriment of the fiscus."[53] It was also held that the GAAR's application is limited to instances in which tax avoidance or reduction was the dominant motive.[54]

The court held that the GAAR only applied if the fruits of a taxpayer's capital or labour accrued to another, i.e. if as a result of the transaction, operation or scheme, the taxpayer has parted with income which is in reality his income.[55] Since this was not the case in *King*, the court decided in favour of the taxpayer.

For this same reason Silke was of the view that the GAAR would also not have applied to the *Hiddingh* case, if it existed at the time, even where the main or dominant purpose was to avoid or reduce a tax liability, since Hiddingh disposed of an income-bearing asset and not the income itself.[56]

2.2.2 1959 and 1962 GAARs

Twelve years after *King* the 1959 Amendment Act comprehensively amended the 1941 GAAR, in an attempt to address certain aspects of the *King* case.

Appendix 1 illustrates that the amended section 90 resulted in a different GAAR with a narrower scope that only applied to "abnormal" transactions, operations, or schemes, with the sole or one of the main purposes to avoid tax.[57] This author notes that it is the first time that the application of the GAAR extended from a single purpose test to a plural "one of the main purposes" test.

Once a tax avoidance or reduction effect was proved, the same rebuttable presumption that existed under the 1941 GAAR was established.[58]

In 1962, relatively shortly after the 1959 GAAR was enacted, the ITA replaced the 1941 Act in its entirety and the GAAR moved to section 103(1). However, the wording of the GAAR remained unchanged.[59] It is for this reason that they are discussed together in this section.

[53] Ibid at p.169.
[54] Ibid at p.168.
[55] Silke op cit n.34 p.32. See *King* supra n.32 at p.169.
[56] Silke ibid p.2.
[57] 1959 Amendment Act, section 90(1).
[58] ITA, section 103(4).
[59] Refer Appendix 1.

Following its 1959 and 1962 amendments, much reliance were placed on South African courts to interpret the GAAR. One of the first cases under the 1962 GAAR, the *Geustyn* case,[60] confirmed that the GAAR contained four key elements that must all be present and so proved, before the Commissioner could invoke the GAAR. The four elements were:

— a transaction, operation or scheme[61]
— a resultant tax saving or tax avoidance[62]
— purpose[63]
— abnormality[64]

Each requirement is discussed below.

a. Transaction, operation or scheme

The ITA did not define a "transaction, operation or scheme" for the purposes of the GAAR. In the absence of a definition, the normal meaning of these words were used. This resulted in a wide interpretation with the effect that the Commissioner could subject almost any arrangement to the GAAR.

The court confirmed the wide interpretation of "transaction, operation or scheme" in *Meyerowitz.*[65] The wide interpretation of this phrase has not been subject to much dispute since.

Further, in *Meyerowitz* the court interpreted "scheme" as an open-ended term that can include a series or combination of transactions where they are united towards a tax avoidance purpose. Therefore, a taxpayer cannot count on the fact that the first part of a series of transactions were not entered into with the purpose to avoid tax, when other parts of the transaction had such a purpose.[66] This was confirmed in the *Louw*[67] case.

However, in *Conhage,*[68] the court found that if an overall scheme had an overriding business purpose, steps in the transaction could not be isolated and deemed to lack a business purpose. As such, it controversially disregarded *Meyerowitz's* decision that the GAAR can isolate steps or a series of transactions within a scheme.[69]

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[60] Supra n.32.
[61] ITA, section 103(1).
[62] ITA, section 103(1)(a).
[63] ITA, section 103(1)(c) and the definition of "tax benefit" in ITA, section 103(7).
[64] ITA, section 103(1)(b).
[65] *Meyerowitz v CIR* (1963) 4 All SA 148 (A).
[66] Ibid.
[67] *SIR v Louw* (1983) 45 SATC 113.
[68] *CIR v Conhage (Pty) Ltd* (1999) 61 SATC 391 p.398.
[69] Ibid.

Further case law confirmed that mere plans or ideas for transactions, operations or schemes were not sufficient for the Commissioner to invoke GAAR. A transaction, operation or scheme had to be implemented and not only formulated.[70]

b. Resultant tax saving or tax avoidance

"Resultant tax saving or tax avoidance" was not defined by the GAAR and its meaning was developed by the South African courts' interpretation thereof.

In this regard the *Smith*[71] case is the widely accepted authority.[72] The facts of the Smith case are set out in the discussion of this case under the normality requirement below.[73]

In *Smith,* following the amendments introduced by the 1959 GAAR (i.e. the normality and the purpose requirements), the court rejected the restrictive interpretation of the phrase "*effect of avoiding or postponing liability*" applied in the *King*[74] case. Instead, the court agreed with the Commissioner's argument that the ordinary meaning should be applied to the phrase, resulting in a wider interpretation.[75]

In *Smith,* based on the ordinary meaning of the phrase, the court decided that the taxpayer's effective control of the companies he formed enabled him to obtain payment of an equivalent amount to himself at any time, in a form or manner that would render it free from tax or subject to a lesser tax. The court reached this decision even though the dividends (not having been produced by the taxpayer's own efforts) may in reality not have been the taxpayer's income (but the company declaring the dividend's income).[76]

c. Purpose test

As noted, the purpose requirement was broadened to a plural purpose test. Accordingly, the GAAR could now apply to instances where a transaction was entered into for the sole or *one of the main purposes* to avoid tax. In contrast, the 1941 GAAR applied to transactions where there was *a purpose* to avoid tax, interpreted in *King* to refer to the *dominant* purpose, indicating a single purpose test.

In determining "purpose," the courts have held that the test is a subjective one and that just because a transaction has the (objective) effect of avoiding tax, it does not necessarily mean

[70] *Overstone v SIR* 1980 (2) SA 721 (A).
[71] *Smith v CIR,* 1964 (1) SA 324 (A).
[72] *Smith* has been confirmed by a number of cases including *Hicklin* supra n.32 and *ITC 1625* (1996) 59 SATC 383.
[73] At 2.2.2(d)(ii) below.
[74] Supra n.32.
[75] Supra n.71 p.2.
[76] Ibid p.14.

that this was its purpose.[77] The subjective test requires an investigation of the thinking of the person who instigated the scheme and evidence as to why the scheme was entered into.

In the absence of a definition of this requirement, there were many cases interpreting the purpose test.[78] Four of the key cases that interpreted and applied the purpose test are considered below. A brief conclusion then summarises key points from the court cases.

i. SIR v Geustyn, Forsyth, and Joubert

The *Geustyn* case[79] was a "test case" meant to determine the correctness of the practice of the Commissioner in relation to the incorporation of professional practices.

The facts of this case were, briefly, that an engineering partnership was transferred into a company. The company undertook to pay the partnership R240,000 for goodwill and to employ the three partners at an annual salary of R10,000 each. The goodwill of R240 000 was credited to the directors' loan accounts in equal amounts of R80,000 each. The directors of the company were also the partners in the partnership.

The Commissioner's argument in this case was that the transfer of the partnership was a scheme that the taxpayers entered into to avoid tax and as such, the avoidance of tax was at least one of the main purposes of converting the partnership into a company.[80] The court considered "purpose" as the vital inquiry of the case.[81] The taxpayers contended that obtaining a tax benefit was not a consideration when they decided to convert the partnership.[82]

The court did not explicitly state that the purpose test requires a subjective test, however, it held that the intention or purpose with which any particular transaction is entered into is a question of fact.[83] Further, while a scheme may have the resulting effect of a tax benefit, this effect is not necessarily the purpose for which the scheme was entered into.[84]

In reaching its decision, the court accepted that tax avoidance was not a consideration when the partners decided to convert the partnership.[85] The court noted that the circumstances[86]

[77] *SIR v Gallagher* 1978 (1978) 40 SATC 39.
[78] See more cases in De Koker & Williams op cit. n.1.
[79] Supra n.32.
[80] Ibid p.543.
[81] Ibid p.547.
[82] Ibid.
[83] Ibid p.549.
[84] Webber Wentzel Bowens Attorneys 'Extended anti-tax avoidance provisions' *Integritax* (1997), SAICA, 409.
[85] *Geustyn* supra n.32 p.549.
[86] Ibid p.545.

confirmed the taxpayers' reasons for the conversion of the partnership and decided in the taxpayers' favour.

ii. SIR v Gallagher

The facts of the *Gallagher*[87] case follows. In 1968 the taxpayer formed a company. He was the sole shareholder and subsequently sold certain assets to the company by way of an interest-free loan owed to him. The taxpayer then formed three trusts, one for the benefit of each of his three children, and donated his shares in the company to these trusts.[88] See Figure 1 in this regard.

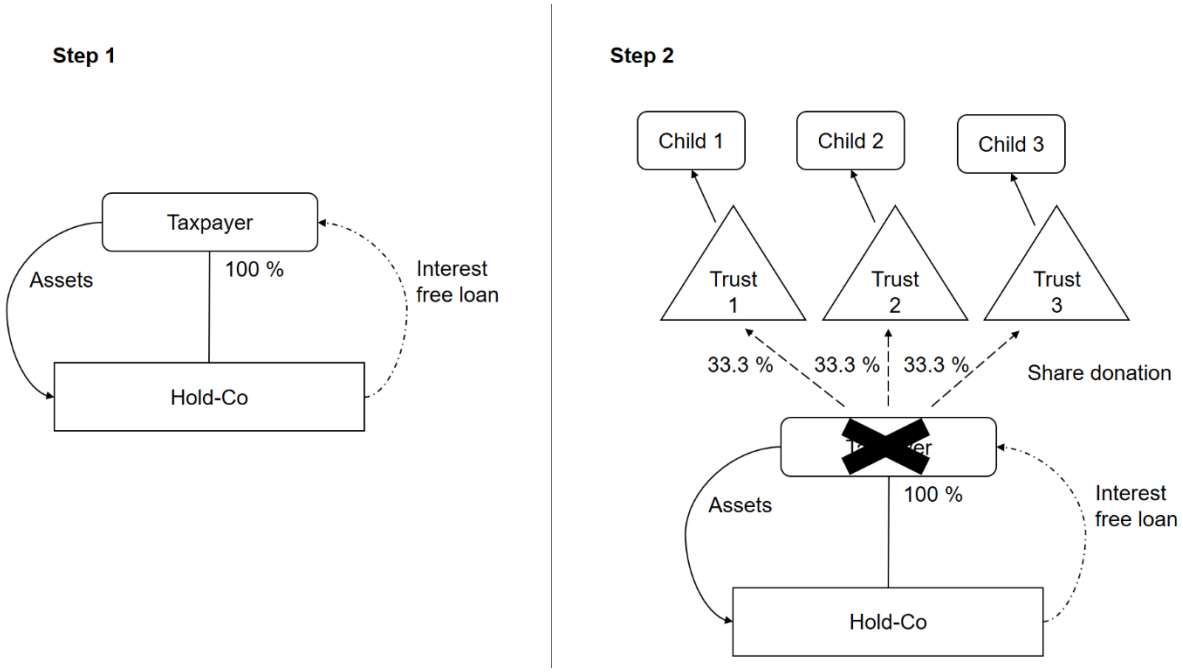

Figure 1. Gallagher case structure

The Commissioner disregarded the scheme, invoked the GAAR and included dividend income for the 1969 to 1971 years of assessment in the taxpayer's income, instead of acknowledging that it accrued to the three trusts.

The taxpayer in this case conceded that three requirements for the application of the GAAR (being a transaction or scheme, a tax avoidance or saving effect and abnormal rights or obligations) had been met in relation to the transaction in question.[89] However, he contended that the transaction could not be reconciled with the GAAR's purpose requirement, because the sole purpose or one of the main purposes were not to avoid income tax levied by the

[87] Supra n.77.
[88] Ibid p.39.
[89] Ibid p.48.

provisions of the ITA.[90] Rather, he stated, he had an intention to reduce the estate duty liability upon his death.[91]

In deciding the case, the court rejected the Commissioner's argument that an objective test should be applied. Instead, the court confirmed that the test was undoubtedly a subjective one, because an objective test considered the effect of the scheme as opposed to the purpose for which the scheme was entered into.[92] In support of the aforementioned, it stated that the GAAR drew a clear distinction between the effect of a scheme (with the normality and resultant tax saving requirements) and its purpose.[93] Additionally, the court confirmed the court *a quo*'s statement that a witness's testimony regarding the purpose of a scheme could only be discarded if there was credible evidence to the contrary or if there were weighty probabilities that contradicted the testimony.[94]

The court accepted the taxpayer's evidence and decided that the taxpayer did not have the sole purpose or one of the main purposes to avoid tax.[95]

The importance of this case, in this author's view, is that the court's decision reiterated that the purpose requirement requires a subjective test.

iii. SIR v Louw

The *Louw* case[96] was similar to the *Geustyn* case[97] as it also concerned the incorporation of a professional partnership.

Before the company was incorporated, the net profit of the practice was the partners' income. After incorporation, the profit belonged to the company, which paid the directors a basic salary for their services. To supplement the basic salary, the directors borrowed substantial amounts from the company, interest free. This arrangement meant that the salary received by Louw was significantly less than the amount he had received as a partner prior to the incorporation.[98] The Commissioner invoked the GAAR and issued an assessment to the taxpayer, taxing his pro rata share of the company's income.

[90] Ibid p.48.
[91] Ibid p.51.
[92] Ibid p.48.
[93] Ibid.
[94] Ibid p.50.
[95] Ibid p.53.
[96] Supra n.67.
[97] Supra n.32.
[98] *Louw* supra n.67 p.292–294.

In this case, the court split the arrangement and analysed two transactions: firstly, the incorporation of the practice and secondly, the granting of the loans to the directors. In this section, the purpose requirement is considered for both transactions.

Regarding the incorporation of the practice, the court found, like in *Geustyn*, that the incorporation of the practice did not justify an invocation of the GAAR.[99]

However, regarding the granting of the loans to the directors, the court found that a strong probability existed that, had the taxpayer and his co-directors not received amounts by way of loan, they would have received these amounts, or a substantial portion thereof, by way of additional salary and/or dividend. The court held that it seemed unlikely that the taxpayer and his co-directors would have been content to receive, as reward for their labours, amounts that were only sufficient to meet living expenses, with no residue, and to leave large surplus cash reserves, which in fact represented the fruits of their labours, lying in the coffers of the company.[100]

Thus, the court concluded that the payment of loans to the directors amounted to a means to avoid tax since the directors would have received similar amounts in taxable form, were it not for the loans.[101]

This case was important, because it confirmed the *Gallagher* decision regarding the use of a subjective purpose test.[102] The court further confirmed the *Meyerowitz* case i.e. that the Commissioner was entitled to apply the GAAR to individual steps within a bigger scheme.[103]

iv. CIR v Conhage

Another important case, which is said to have led to the retirement of the 1962 GAAR even before its 1996 amendment (discussed at 2.2.3 below),[104] is *Conhage.*[105]

The facts are that the taxpayer wanted to expand his business and needed capital to do so. The financier and taxpayer realised that the taxpayer could deduct the full rental payment if a sale-and-leaseback arrangement was entered into, as opposed to a loan agreement, which would only allow the deduction of the interest portion of the repayment. Thus, the taxpayer

[99] Ibid p.305.
[100] Ibid p.308.
[101] Ibid.
[102] Ibid p.303.
[103] Ibid p.300.
[104] Liptak 'Battling with Boundaries: The South African GAAR Experience' in Freedman (ed.) *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management* (2008), Oxford, p.23.
[105] Supra n.68.

"sold" and "leased back" his equipment from the financier, for the sole purpose of raising capital.[106]

The Commissioner attacked the transaction on the common law substance over form doctrine and argued that no sale and leaseback actually took place. The Commissioner argued further that the parties had no intention to enter into a sale and leaseback agreement, that in reality the taxpayer merely borrowed the purchase price of the equipment and that the arrangement was entered into for the sole purpose of reducing or avoiding a tax liability. The Commissioner also disallowed the deduction of rental payments under the GAAR.[107]

Only the court's consideration of the GAAR's application is discussed, however, it must be noted that this case confirmed that the Commissioner could apply the GAAR in the alternative.[108]

The court accepted the taxpayer's testimony that obtaining capital was the sole purpose of the transaction, and that the reduction in tax through the arrangement, was not the main purpose. The court held that the Commissioner's arguments were based on sheer speculation, which were not supported in the evidence and that it was against the probabilities of the circumstances.[109] In deciding in favour of the taxpayer, the court found that the taxpayer did not approach the financier in order to lessen his tax liability, but rather to obtain capital.[110]

The court found that the series of transactions in question had two purposes, namely the acquisition of finance and to obtain that finance in a tax effective manner.[111] Crucially even though obtaining a tax benefit was one of the main purposes for the financing vehicle chosen, the court found that the sole or main purpose of the financing transaction as a whole, was to obtain capital.[112]

This case is further important because it is authority for the proposition that, if an overall scheme had an overriding business purpose, steps in the transaction could not be isolated and deemed to lack a business purpose. This contradicts the earlier *Louw*[113] and

[106] Ibid p.398.
[107] Ibid p.392.
[108] De Koker & Williams op cit n.1 at 19.25 and confirmed by *CSARS v NWK Ltd 2011* (2) SA 67 (SCA) at 368.
[109] *Conhage* supra n.68 p.395.
[110] Ibid p.398.
[111] Ibid.
[112] Ibid.
[113] Supra n.67.

Meyerowitz[114] cases. The court also reaffirmed the principle that a taxpayer has a right to choose the most tax effective manner of conducting business.[115]

v. Conclusion

From the above it is clear that the courts were adamant that the purpose element required a subjective test. The *Gallagher* case set the precedent in this regard and as such, the taxpayer's *ipse dixit* was not conclusive, but it was not irrelevant either.[116] In the cases discussed above the courts did not depart from the taxpayers' testimonies, with the exception of the loan arrangement in *Louw.*

Uncertainty existed about whether the GAAR may be applied to steps within a larger scheme, as decided in *Louw* and *Meyerowitz,* or not as decided in *Conhage.*

In this author's view, the cases above also illustrated that changing the purpose test from a single "dominant purpose" test in the 1941 GAAR to a plural "one of the main purposes" test, from the 1959 GAAR onwards, made no practical difference to the application of the test. In practice, as illustrated specifically by *Louw, Meyerowitz* and *Conhage*, it is natural for courts to identify a dominant purpose for a transaction. As seen in *Conhage,* even if tax reasons were one of the main purposes, if the dominant purpose was not the avoidance of tax, the natural conclusion is that the GAAR cannot apply, despite the wording of the test.

d. Normality

The normality requirement was newly introduced by the 1959 GAAR. Other than including the arm's length principle as a benchmark, the term "abnormal" was not defined by the 1941 Act or the ITA. As such, this requirement was subjected to much scrutiny, and significant reliance was placed on courts to interpret this requirement.

Below a few prominent cases that dealt with the normality requirement are considered, followed by a brief conclusion on the key points from the court cases.

i. Meyerowitz v CIR

The *Meyerowitz*[117] case was the first case heard under the 1959 GAAR. The facts of the case are briefly summarised: The taxpayer had the right to a share of profits from a publication; however, he ceded this interest to a company, jointly owned by him and his wife, for no consideration. This company in turn ceded its right to the profits, for negligible consideration,

[114] Supra n.65.
[115] *Conhage* supra n.68 p.398.
[116] *Malan v Kommissaris van Binnelandse Inkomste* 1983 (3) SA 1 (A) at 18E.
[117] Supra n.65.

to a trust that was formed for the benefit of the taxpayer's children.[118] Figure 2 illustrates the scheme.

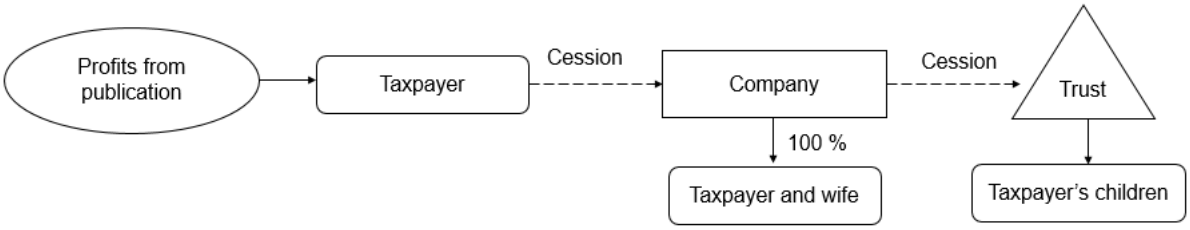

Figure 2. Meyerowitz case structure

This scheme resulted in the trust receiving income that was earned by the taxpayer. The appeal court agreed with the court *a quo's* finding that the scheme created rights and obligations which would not normally have been created between persons dealing at arm's length, because of the manner in which both the taxpayer and the company parted with valuable rights.[119]

In support of its conclusion, the court referred to *King*[120] and confirmed that it was appropriate, in the circumstances of the case, for the Commissioner to have taxed the income in the hands of the person to whom it belonged "in reality".[121] The court concluded that the application of the scheme by the taxpayer would result in an "extremely artificial and unrealistic" manner to determine Meyerowitz's tax liability.[122]

ii. Smith v CIR

The *Smith*[123] case, briefly, had the following facts: The taxpayer held shares in a company (A-Co) with large undistributed reserves that intended to declare a dividend. In anticipation of this dividend, the taxpayer implemented an elaborate series of steps, illustrated in Figure 3 below.

The series of steps can be explained as follows:[124]

— Steps 1 to 3: The taxpayer incorporated Rhodesian Company, which bought A-Co's shares.
— Step 4: The taxpayer incorporated South Africa Company.

[118] Ibid p.150.
[119] Ibid p.152.
[120] Ibid p.154.
[121] Ibid p.157.
[122] Ibid.
[123] Supra n.71.
[124] Ibid p.7.

— Steps 5 to 7: SA Hold-Co acquired A-Co's shares in exchange for its shares in Rhodesian Company, and Rhodesian Company sold the SA Hold-Co shares to South Africa Company.
— Steps 8 to 10: The taxpayer incorporated South West African Company which bought the shares of Rhodesian Company, resulting in the taxpayer being the sole shareholder of South West African Company which in turn was the sole shareholder of Rhodesian Company and so on.

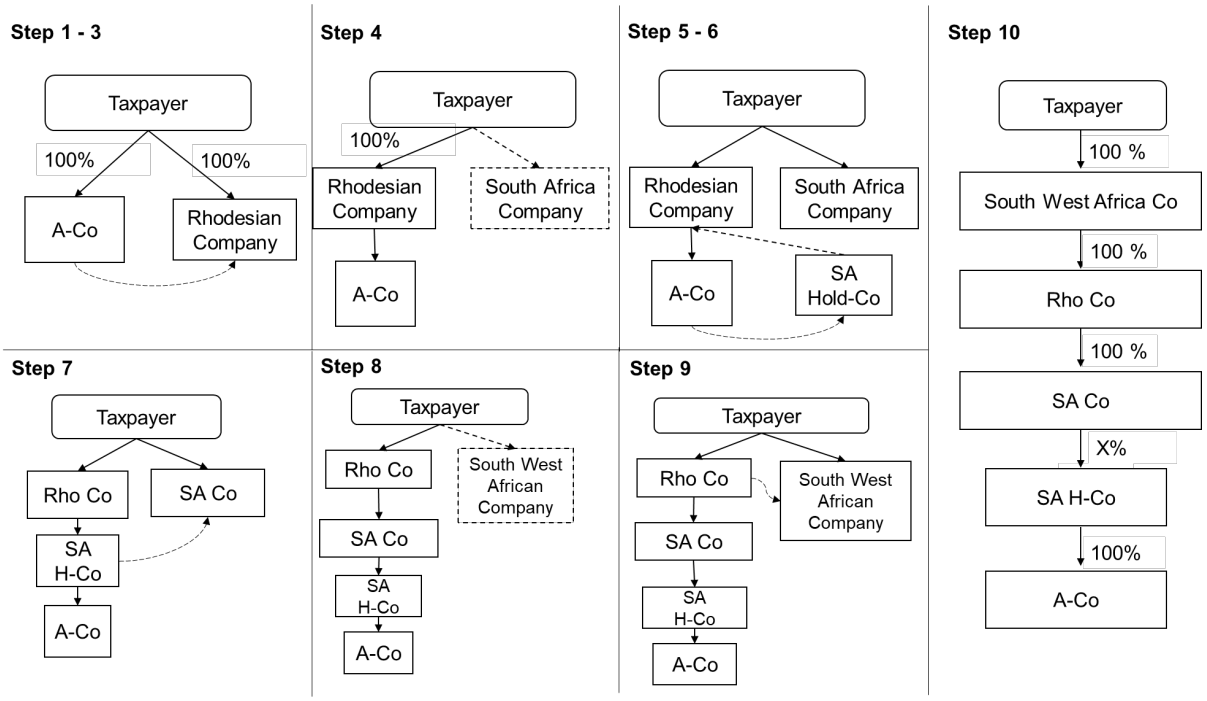

Figure 3. Smith case structure

As anticipated by the taxpayer, A-Co declared a dividend to SA Hold-Co, SA Hold-Co declared a dividend to the South Africa Company, which in turn declared a dividend to its parent, the Rhodesian Company.[125]

The Commissioner argued that, if the series of transactions/operations had not been entered into, the dividend would have come into the taxpayer's hands directly and that he should be subjected to South African income tax. Therefore, the Commissioner invoked the GAAR, disregarded the structure implemented by the taxpayer and included the dividend income in the taxpayer's income.[126]

The Commissioner contended that the scheme in question was not carried out by means or in a manner normally employed, nor were the rights or obligations created thereby such as

[125] Ibid p.8
[126] Ibid p.14.

would normally be created by persons dealing at arm's length.[127] The Commissioner further distinguished this case from *King*[128] (which was relied on by the taxpayer), because in *King* the taxpayer effectively disposed of his shares to his son with the result that he had no further interest in them, whereas in the present case the taxpayer never effectively disposed of his shares.[129]

The court agreed with the Commissioner's application of the GAAR stating that the transactions carried out by the taxpayer were admittedly abnormal in terms of the GAAR and that it was carried out for the purpose of avoiding a tax liability.[130]

iii. SIR v Geustyn, Forsyth, and Joubert

The facts of this case[131] were set out in the section dealing with the purpose test above. The court neither analysed nor decided on the court *a quo's* finding that the transaction was normal, as contemplated by the ITA, because the court thought it was not essential for the decision of the case to proceed down that avenue.

However, the court noted in passing that the court *a quo* erred in reaching its decision by not concluding whether the rights and responsibilities were at arm's length.[132]

iv. *Hicklin v SIR*

In this case,[133] Hicklin and two others were shareholders of a company that became dormant. However, the company had an accumulated undistributed profit. Because the profit was subject to a statutory exemption from tax, the distribution of the profit would have resulted in taxation for Hicklin and his co-shareholders, which is why the profit remained undistributed.[134]

To circumvent this issue, the shareholders sold their dormant company to a dividend stripping company for an amount equal to the net asset value of the company (made up of the loan levy and loans to the shareholders), less 10% of the distributable reserves. After gaining control of the company, the purchaser declared a dividend equal to the remaining distributable reserves and deregistered the company.[135]

The Commissioner argued that the transaction was abnormal and it had the sole purpose of avoiding tax and invoked the GAAR. Hicklin appealed against the decision, and the court of

[127] Ibid p.6.
[128] Supra n.32.
[129] *Smith* supra n.71 p.6.
[130] Ibid p.9.
[131] Supra n.32.
[132] Ibid p.547.
[133] Supra n.32.
[134] Ibid p.179.
[135] Ibid p.180.

appeal ultimately had to determine whether the Commissioner successfully established abnormality in relation to the transaction with the purchaser of the company.[136]

It was argued for the Commissioner that regard must be had to the circumstances under which the scheme was entered into or carried out. Further, the manner in which the scheme was carried out, and the rights and obligations conferred upon the parties, would not normally be created between persons dealing at arm's length.[137]

The Commissioner argued inter alia that it is not normal:[138]

— For a dormant company to lend its total assets to its shareholders in accordance with their shareholding or for directors to keep a dormant company in existence for the sole purpose of perpetuating directors' loans.
— To undeclare dividends or to convert all the assets of a company into debit loan accounts for the purpose of the sale of shares.
— To purchase a dormant company stripped of all assets. In this regard the question of normality must not only be seen from the side of the seller but also from the side of the purchaser.

The court stated that the arm's length principle is a useful, and often easily determinable, starting point of an inquiry into the normality requirement. It also expressed an assumption that, persons involved in a scheme, acting at arm's length, will create normal rights and obligations, because each party, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself.[139] The court also confirmed that the normality requirement must be considered in light of the surrounding circumstances of each case.[140]

The court applied the arm's length principle to the rights and obligations created by the transaction and held that the rights and obligations created by the agreement were on par to those normally associated with contracts of this nature.[141]

In light of the above, the court concluded that the manner in which the transaction was entered into was at arm's length, because the parties were not associated, they had no interest in each other, and the purchaser had no influence over the selling shareholders.[142]

[136] Ibid p.179.
[137] Ibid p.184.
[138] Ibid.
[139] Ibid p.195.
[140] Ibid p.196.
[141] Ibid p.197.
[142] Ibid p.190, 197.

As such, Hicklin's appeal was upheld and the GAAR was not applicable, because the Commissioner could not establish abnormality.

v. SIR v Louw[143]

The facts of this case were set out in its discussion under the purpose test above. As was stated above, the court analysed two transactions: the incorporation of the practice and the granting of the loans to the directors. The court found the granting of the loans to have the sole or one of the main purposes of avoiding tax. However, the GAAR would only apply if the granting of the loans were also abnormal.

Like in *Geustyn,* the partners of the partnership would also be the directors of the company, however unlike in *Geustyn,* where the court did not decide on the normality requirement, in *Louw* the court did.

The court concurred with the court *a quo* that the incorporation of the practice and the rights and obligations created under the scheme of incorporation was normal. In reaching this conclusion, it stressed that the special relationship between the directors could not and should not be ignored.[144] The incorporation transaction was found to be at arm's length, because a director in this case contracts with both the company and his fellow directors and seeks to extract from the transaction the best possible advantage for himself.[145]

However, insofar as the granting of the loans were concerned, the court concluded that in the circumstances, the loan transactions created rights or obligations which would not normally be created between persons dealing at arm's length.[146]

The court continued that if the loan was to be considered as a true loan, its abnormality (i.e. a situation where a taxpayer works and receives as reward money that he has to pay back with interest) becomes clear.[147]

Thus, the court confirmed that the Commissioner successfully established abnormality, however, only in respect of the granting of loans to the directors, and the GAAR was therefore only applicable to this step of the scheme under review.[148]

[143] Supra n.67.
[144] Ibid p.302.
[145] Ibid p.302.
[146] Ibid p.310.
[147] Ibid n.311.
[148] Ibid.

vi. Conclusion

From the cases discussed above, and as specifically noted in *Geustyn,* it is clear that the arm's length principle must be the starting point when courts consider the normality requirement.

However, courts in earlier cases did not provide clear guidelines in its application of the arm's length principle. *Hicklin* was the first case where the court provided some guidance when it stated that parties dealing at arm's length would strive to get the utmost possible advantage out of the transaction for themselves.

Louw added another important consideration, which was that the special relationship between parties should not be ignored when the arm's length principle is applied. The *Louw* decision further illustrated that the normality requirement was not inherently deficient and that it could be used to isolate and strike down a series of tax avoidance transactions within a bigger arrangement where it exhibited abnormal characteristics (although the more recent *Conhage* case discussed above, contradicted this).[149]

The cases above demonstrated that the Commissioner successfully argued the presence of abnormality in a number of cases. However, it would appear that the Commissioner's successes were usually only in cases where tax avoidance transactions were clearly artificial or abnormal in the circumstances, as illustrated by cases like *Meyerowitz, Smith* and *Louw*. This also illustrates that it can be difficult to establish abnormality, because there is uncertainty on what the "normal" way of structuring any transaction entails.[150]

Nevertheless, in this author's view, the normality requirement is the cornerstone of the Commissioner's successful application of the GAAR. This is because the GAAR could not be applied (even if the sole purpose of an arrangement is to avoid or postpone a tax liability) if the manner of the arrangement, and the rights and obligations created, are those which would normally be created between persons dealing at arm's length.[151]

2.2.3 1996 GAAR

In 1996, the GAAR was amended for a second time after its 1962 amendment.[152]

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[149] Kujinga op cit n.46 p.99.
[150] Ibid p.35.
[151] *Smith* supra n.71 p.11; see also Williams 'The 1996 Amendments to the General Anti-Avoidance Section of the Income Tax Act' *South African Law Journal* (1997), vol.114, part IV, p.675.
[152] It was amendment by the 1978 GAAR, section 14 of the 1978 Amendment Act, however, this amendment was not separately discussed or analysed in this dissertation, because, the provisions of the GAAR did not change. Rather, it was the way that the GAAR was laid out that changed. Appendix 1 includes the wording of the 1978 amendment.

The 1996 GAAR[153] amendment was material, although it mainly amended the normality requirement. The amendment was brought on because in the Commissioner's view, taxpayers could argue themselves out of abnormality by justifying that elements their schemes were common and normal in the commercial world.[154]

The 1996 amendment to the normality requirement introduced a business purpose test. The amendment focused on the manner in which the transactions were carried out and not on the transaction itself and was required to be consistent with what would be expected in a transaction entered into for *bona fide* business purposes.[155] The changes brought on by the 1996 GAAR are discussed under the 2006 GAAR.

While there were case law from the 1996 GAAR,[156] these cases are not separately discussed because they did not particularly focus on the newly introduced business purpose test, but instead confirmed positions under existing case law.

2.3 The 2006 re-enacted GAAR

The 2006 GAAR[157] repealed and replaced the 1996 GAAR.[158] It is reproduced in Appendix 2. The 2006 GAAR has been enacted in a most complicated manner, resulting in a GAAR which has been described as "difficult enough to perplex even the most impressive minds."[159] To aid with its discussion the diagram in Figure 4 depicts the 2006 GAAR.

Under the 2006 GAAR, the four key elements identified in *Geustyn*[160] remains applicable. These elements were:

- an arrangement/operation/scheme
- resultant tax benefit
- purpose to have obtained such tax benefit, and
- abnormality.

This chapter will discuss each of the four requirements and their application under the 2006 GAAR in sections 2.3.2 to 2.3.5 below.

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[153] Section 23 of the 1996 Amendment Act.
[154] Williams & Louw *Income Tax and Capital Gains Tax in South Africa: Law and Practice* (2001), Butterworths, p.799 and Broomberg 'The new general anti-avoidance rule' *presentation at IFASA seminar* (2007), Cape Town.
[155] Kujinga op cit n.46 p.94.
[156] See *ITC 1864* (2012) 75 SATC 233 and *ITC 1862* (2012) 75 SATC 34.
[157] ITA sections 80A-80L.
[158] Incorporated into the ITA by section 34(1)(a) of the Revenue Laws Amendment Act 20 of 2006.
[159] Drummond 'A purposive approach to the drafting of tax legislation' *British Tax Review* (2006), p.10-11.
[160] Supra n.32.

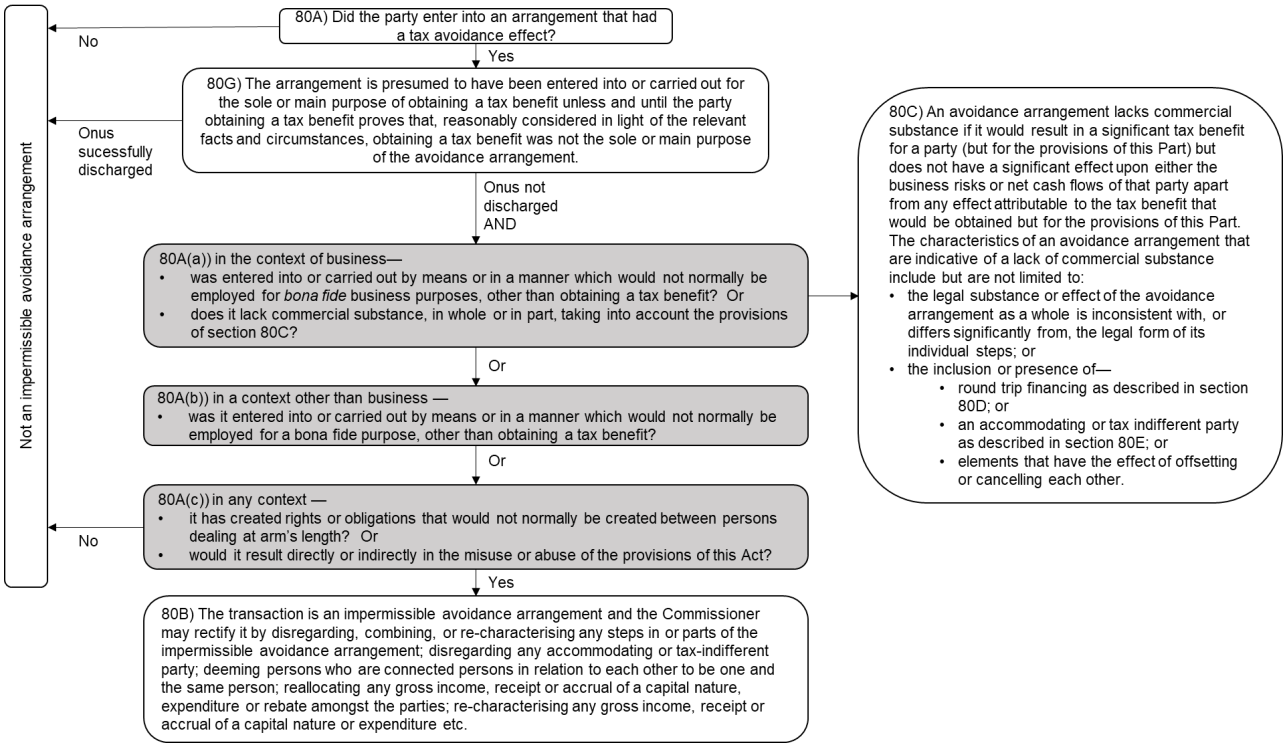

Figure 4. The 2006 GAAR structure

2.3.1 Notable changes to the 2006 GAAR

Due to the intricate composition of the 2006 GAAR, per Figure 4 above, an overview of the most notable changes to the 2006 GAAR is warranted before the discussion on the four elements proceeds.

a. Application of the GAAR in the alternative

The 2006 GAAR authorised the Commissioner to apply the GAAR in the alternative.[161] This cleared up existing contradictions[162] and confirmed the *Conhage*[163] decision.

In this regard, so called "simulated" transactions deserves special consideration. An arrangement that lacks commercial substance will also frequently be a disguised or simulated transaction[164] in which case the court can, in terms of common law principles, disregard the superficial arrangement and give effect to the real transaction.

In this author's view, the common law remedy is more powerful than the GAAR since the substance over form principle applies even in the absence of a sole or main purpose to obtain a tax benefit. As such, an argument exists that the Commissioner should first attempt to fight

[161] Per section 80I of the ITA.
[162] Caused by *ITC 1625* supra n.72.
[163] Supra n.68.
[164] *NWK* case supra n.108.

any arrangement where the substance differed from the form of a transaction with common law principals, reverting to the GAAR only if the common law principals are unable to reconcile a matter.[165] It appears that the Commissioner has taken a similar view and there has been a plethora of cases on the substance doctrine in recent years.[166]

b. Applied to steps within a larger scheme

Another contradiction that was cleared up in the 2006 GAAR was that it could be applied to steps within a larger scheme.[167]

The effect is that the older decisions of *Louw*[168] and *Meyerowitz,*[169] where the court found that a general business purpose for a larger scheme is not sufficient to shield each and every step in that scheme from review, remains applicable and the later *Conhage*[170] decision, which stood in direct contradiction to the aforementioned, becomes redundant.

Nevertheless, there are concerns around the isolation of steps or parts of an arrangement including that such isolation could change the nature of the isolated step or part[171] and unfairness resulting from isolating the single step that is decisive towards securing the tax benefits sought.[172] The Commissioner stated, however, that the isolated step or part would still need to satisfy the requirements for GAAR, including at least one of the tainted elements (discussed at 2.3.1(d) below) and, as such, this provision does not violate any rights.[173]

c. Presumption of a tax avoidance purpose

Similar to the previous versions of the GAAR, once an avoidance arrangement has been established, the arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit.[174]

The 2006 GAAR updated the rebuttable presumption by the inclusion of a reasonableness test.[175] Thus, the taxpayer had to prove that obtaining a tax benefit was not the sole or main

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[165] Williams 'Smoke and mirrors or genuine commercial venture?' *Synopsis Tax Today* (2009), PWC p.2-4.
[166] Eg. *NWK* supra n.108, *Sasol Oil v CSARS* (2018) ZASCA 153, *CSARS v Bosch* (2014) ZASCA 171, *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* (2014) ZASCA 40, *Moola v Salie* (2011) ZAWCHC 324.
[167] ITA section 80H.
[168] Supra n.67.
[169] Supra n.65.
[170] Supra n.68.
[171] Broomberg 'Then and now – II' *Income Tax - Tax Planning Corporate and Personal* (2007), LexisNexis, vol.21 p.131.
[172] Kujinga op.cit n.46 p.107.
[173] SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* (2010), SARS. The Guide was never published in final format and copies thereof are no longer available in the public domain.
[174] ITA Section 80G.
[175] Ibid.

purpose of the avoidance arrangement, in light of the relevant facts and circumstances *reasonably* considered.

The reasonableness test clearly introduces an objective element to the GAAR's purpose test,[176] because the courts must take an objective view of the facts and circumstances, although it still includes the *ipse dixit* of the taxpayer.[177]

d. Non-exhaustive list of abnormality indicators

The Commissioner expanded the normality requirement from previous GAARs and introduced a list of non-exhaustive factors for consideration when abnormality is being determined.[178] Three new elements were introduced in addition to the existing normality requirement, being the commercial substance, business purpose and misuse or abuse elements. These are referred to collectively as the "tainted elements" and if any one of them are present, they render taxpayers' schemes as impermissible avoidance arrangements.

The tainted elements are discussed in detail in section 2.3.5 below.

e. Objective purpose test

Through amendments to the legislation the Commissioner changed (or attempted to change) the purpose test from a subjective test to an objective test. This change is discussed in detail in section 2.3.4 below.

The discussion now proceeds to the four elements of the GAAR.

2.3.2 Arrangement

The 2006 GAAR defines the term "arrangement" in a wide manner to include any transaction, operation, scheme, agreement, or understanding (whether enforceable or not).[179] This wide definition includes all steps or parts of an arrangement, including the alienation of property. In this regard, the wide interpretation provided by *Meyerowitz*[180] remains applicable.

The 2006 GAAR also defines an avoidance arrangement as any arrangement that, but for the GAAR, results in a tax benefit.[181]

[176] Cilliers op cit n.27 at 46.19.
[177] Clegg & Stretch 'Tax avoidance and reportable arrangements' *Income Tax in South Africa* (2020), LexisNexis at 26.3.4.
[178] ITA section 80A and 80C.
[179] ITA section 80L.
[180] Supra n.65.
[181] ITA section 80L.

2.3.3 Tax benefit

The ITA widely defines "tax benefit"[182] as the avoidance, postponement or reduction of any liability for tax.

The 2006 GAAR's concept of a "resultant tax saving or avoidance" means that the *Smith*[183] and *Hicklin*[184] cases, which confirmed a wide interpretation in terms of the ordinary meaning of the words, remain applicable.

2.3.4 Sole or main purpose

There were three notable changes to the purpose test in the 2006 GAAR. The first, this author noted, is that the Commissioner had intended to keep a plural purpose test, i.e. "the sole or *one of the main purposes*".[185] However, it was changed to a single "sole or main purpose" test due to serious misgivings about the plural purpose test, including concerns that the proposed test could adversely affect genuine business transactions by making it easier for the Commissioner to attack even the most insignificant legitimate tax planning.[186] In the author's view, this change confirms the fact that a dominant purpose will always be seeked out in the application of the GAAR, as discussed at the conclusion of section 2.2.2(c)(v).

Secondly, the Commissioner moved the phrase "having regard to the circumstances" from the normality test under previous versions of the GAAR, to the purpose test under the 2006 GAAR,[187] despite concerns that this re-introduces an element of "subjectivity" into the purpose test.[188] However, while the 2006 GAAR does not prevent the taxpayer from presenting his *ipse dixit*,[189] it is the Commissioner's intention that it should only be considered insofar it is supported by the objective facts and circumstances.[190]

The Commissioner's intention is supported by the inclusion of the reasonableness test discussed at 2.3.1(c) above, in terms of which the taxpayer must prove in light of the relevant facts and circumstances being reasonably considered, that obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

The third change, noted at 2.3.1(e) above, is that the Commissioner attempted to apply an objective test to "purpose". The goal was to ensure that an arrangement could not be excluded

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[182] ITA section 1.
[183] Supra n.71.
[184] Supra n.32.
[185] SARS op cit n.4 p.74.
[186] SARS *Tax avoidance and section 103 of the Income Tax Act, 1962 An Interim Response* (2006), SARS, p.19.
[187] SARS op cit n.4 p.48, 56.
[188] Ibid p.55.
[189] ITA section 80G(1), which refers to the relevant facts and circumstances.
[190] SARS op cit n.4 p.56.

from the GAAR because it could be explained out of the GAAR by stating that an arrangement is normal within the relevant business industry or family dealings.[191]

Scholars are outspoken regarding the test under the 2006 GAAR and many suggest that the requirement refers to the purpose of the arrangement and not that of the taxpayer because section 80A refers to "its", and hence, it is the effect (objective enquiry) of the arrangement and not the intention (subjective enquiry) that should be determined.[192]

Other scholars still support a subjective test[193] and argue that the sole or main purpose test remains a subjective one because an "arrangement can never of itself have a purpose". If this is the case, the prime importance in determining the purpose of the scheme would be the taxpayer's *ipse dixit* as confirmed by the court in *Gallagher*.[194]

Yet another view held by scholars, which is shared by this author, is that it is unlikely that the test could be completely objective.[195] One scholar uses the example of a hammer to illustrate his point: The main purpose of a hammer, while incidentally causing a noise, is to drive nails. However, in proving that the main purpose was to drive nails, the context in which the hammer was used becomes relevant when someone hammers in the middle of the night under a disliked neighbour's window.[196] In other words, both the subjective intention of the hammer driver and the objective circumstances are relevant.

It remains to be seen, however, whether the courts will depart from the *Gallagher* decision, which is authority for the subjective purpose test, or whether a combined, or purely objective test will be pursued.

2.3.5 Tainted elements

The tainted elements[197] introduced by the 2006 GAAR are illustrated by the grey blocks in Figure 4. Unlike the purpose test, there is no presumption that must be disproved by the taxpayer; instead, the onus is on the Commissioner to prove the presence of at least one of the tainted elements, in order to invoke the GAAR.[198]

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[191] Ibid p.34.
[192] De Koker & Williams op cit n.1 at 19.38, Clegg & Stretch op cit n.177 at 26, Broomberg op cit n.154.
[193] Including Meyerowitz 'What is tax avoidance?' *The Taxpayer* (2005), p.205.Olivier & Davis et al '80A Impermissible tax avoidance arrangements' in Olivier & Davis et al *Juta's Income Tax* (2009), Juta, at 80A-7.
[194] Supra n.77 p.40.
[195] De Koker & Williams op cit n.1 at 19.38, Cilliers op cit n. 27 at 46.19, Liptak 'The New GAAR 10 Years On – Part II: Mistakes and Missed Opportunities' *Taxtalk* (2016), SAIT.
[196] Ibid.
[197] ITA section 80A.
[198] De Koker & Williams op cit n.1 at 19.39.

Like previous versions of the normality requirement, the tainted elements are the deciding factor for the application of the GAAR, because, even if the GAAR's first three requirements were met, it can only apply to impermissible avoidance arrangements and the tainted elements requirement isolates and identifies such arrangements.[199]

In the Commissioner's view, retaining the normality requirement had the benefit of retaining GAAR precedent,[200] while the new indicators of impermissible avoidance arrangements widened the GAAR's scope.[201]

Figure 4 illustrates the aforementioned in that the normality requirement features in each of the three subsections of the tainted elements: in a context of business;[202] a context other than business;[203] and any other context.[204] In each of the three subsections, the normality requirement is paired with another tainted element. Consequently, the normality requirement remains a cornerstone of the GAAR's application, although the Commissioner needs only to establish either abnormality or the accompanying relevant subcategory's requirement.

Each of the tainted elements are discussed below.

a. Normality requirement

Under the 2006 GAAR the normality requirement lacks the phrase "having regard to the circumstances," which is now included under the purpose test. The Commissioner's view was that this omission results in a more objective test.[205]

However, criticism includes that this omission gives the Commissioner the authority to compare "oranges with apples."[206] By the Commissioner's own submission, [207] this omission results in the non-application of an important consideration in *Louw* (i.e. that the existence of a special relationship between parties must be taken into account when abnormality is considered).[208] Some authors are, however, confident that the courts will not depart from the logic in the *Louw* judgment. [209]

[199] Kujinga op.cit n.46 p.106.
[200] SARS *Tax Avoidance and Section 103 of the Income Tax Act, 1962 Revised proposals* (2006), SARS, p.5.
[201] Ibid.
[202] ITA section 80A(a).
[203] Ibid 80A(b).
[204] Ibid 80A(c).
[205] SARS op cit n.173 par.6.2 confirmed by Clegg & Stretch op cit n.177 at 26.3.5.
[206] De Koker & Williams op cit n.1 at 19.39.
[207] SARS op cit n.173 par.6.2.
[208] De Koker & Williams op cit n.1 at 19.39.
[209] Kujinga op.cit n.46 p.116.

The normality requirement under the first and second subcategories (see Figure 4) introduced a *bona fide purpose* requirement, instead of the arm's length principle. The GAAR provides no guidance as to what this requirement entails, which causes much confusion, primarily because the purpose-requirement has already been dealt with at this stage.[210] In this regard, some authors are of the view that the *Hicklin* decision, which stated that the arm's length principle should be the starting point when normality is considered, should remain authoritative.[211]

The abnormality requirement in the third subcategory being "any other context," remains almost identical to this requirement in the 2006 GAAR's predecessors, because it evaluates whether an arrangement was carried out in a manner that would not normally be created by persons acting at *arm's length.*[212] The result is that discussion of the normality requirement under the 1959 and 1962 GAARs, remains largely applicable to the normality requirement "in any other context." Thus, in this author's view, existing precedent will result in a preference to the normality test that uses the arm's length principle as a starting point.

b. Business purpose element

The business purpose element is combined with the abnormality requirement in arrangements in the context of business.[213]

If an arrangement is carried out in a manner that would *normally be employed for bona fide business*, the fact that a tax benefit is obtained is negligent and the GAAR is not triggered, unless the arrangement includes one of the other tainted elements.[214] Some scholars are of the view that this test is not concerned with the purpose of the transaction, but the manner in which the transaction was carried out.[215]

The ITA provides no guidance as to what constitutes "*bona fide* business purposes" save that, in this context, they do not include obtaining a tax benefit, which causes further confusion and ambiguity around this tainted element. [216]

[210] De Koker & Williams op cit n.1 at 19.39.
[211] Kujinga op.cit n.46 p.116.
[212] ITA section 80A(c).
[213] ITA section 80A(a)(i).
[214] De Koker & Williams op cit n.1 at 19.39.
[215] Ibid.
[216] Ibid.

c. Commercial substance element

This element is relevant to arrangements entered into in the context of business and applies where an avoidance arrangement "lacks commercial substance."[217] It is therefore a commercial criterion, which turns on the existence of legal rights and obligations.[218]

This requires a comparison of the tax benefit that would be obtained from an arrangement and the commercial effect on the business from a non-tax perspective, including risk or cash flow considerations.

This element must be considered in conjunction with the ITA's provisions of section 80C which, for the purposes of the GAAR, states that an avoidance arrangement lacks commercial substance "if it would result in a significant tax benefit for a party…"[219] The GAAR identifies five characteristics that are generally indicative of arrangements that lack commercial substance. This includes instances where 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.[220] The other indicators include round trip financing, accommodating or tax-indifferent parties and offsetting or self-cancelling elements.[221]

These indicators are not discussed in this dissertation, save for this author remarking that section 80C most probably introduced further uncertainty and confusion by including a number of terms which are not defined in the GAAR (but borrowed from foreign GAARs),[222] potentially opening the door for judicial intervention regarding the interpretation of these terms.

As discussed at 2.3.1(a), this author expects that the Commissioner would favour the substance over form doctrine, hence the commercial substance element will probably only be pursued in the alternative.

d. Misuse or abuse element

This element is new to the South African GAAR and has its origins in the Canadian GAAR.[223] Essentially, the Canadian GAAR adopted a two-part enquiry in determining whether or not a transaction constitutes a misuse or abuse of the tax legislation. The first enquiry is to consider the purpose for which the legislation was created. The second enquiry is then to determine

[217] ITA section 80A(a)(ii).
[218] De Koker & Williams op cit n.1 at 19.39.
[219] ITA section 80C(1).
[220] ITA section 80C(2)(a).
[221] ITA sections 80C(2)(b), 80D and 80E.
[222] Including Australia, Canada, the US and UK, see Kujinga op cit n.46 p.292.
[223] SARS op cit n.173.

whether or not the application of the tax legislation in the context of the specific transaction abuses or misuses the intended purpose thereof.[224]

The concept of misuse or abuse works to deny tax benefits that are obtained in a manner that is within the letter of the law, but not in line with the purpose of the ITA.[225] In other words, the misuse or abuse doctrine presupposes that the relevant provisions of the ITA have been complied with, but that the arrangement fails an overarching test in that it has resulted in an "abuse" of those provisions.[226]

i. Literal versus purposive interpretation

The reason behind the introduction of the misuse or abuse provision to the GAAR was to reinforce the purposive approach to its interpretation.[227]

Historically, South Africa followed a literal interpretation approach.[228] Thus, if the literal interpretation was clear and unambiguous, a court should not depart from the ordinary meaning of the words. However, as early as the 1950's South African courts started taking steps towards purposive interpretation when, in the *Donges* case,[229] the court noted the importance of the context of legislative provisions, even where the grammatical meaning was unambiguous.

It would appear that the South African Constitution[230] also supports a purposive approach to the interpretation of all legislation, specifically the Constitution's section 39(2) which effectively requires that any legislation must promote the spirit, purport and object of the Bill of Rights, although it does not prescribe a purposive interpretational approach.[231]

Over the years there have been many tax cases that supported purposive interpretation of the ITA, including *Glen Anil Development Corporation*,[232] *CIR v Ocean Manufacturing Ltd,*[233] *DeBeers Marine (Pty) Ltd v CSARS,*[234] *Standard General Insurance Company Ltd v CCE,*[235]

[224] De Koker & Williams op cit n.1 at 19.39.
[225] Ibid.
[226] Ibid.
[227] SARS op cit n.200 p.16.
[228] Explained in *Partington* supra n.32.
[229] *Jaga v Donges NO and Another* 1950 (4) SA 653 (A).
[230] *Constitution of the Republic of South Africa*, 1996.
[231] Van Schalkwyk & Geldenhuys 'Section 80A(c)(ii) of the Income Tax Act and the interpretation of tax statutes in South Africa' *Meditari Accountancy Research* (2009), vol.17 no.2, p.178 and Botha *Statutory Interpretation: An Introduction for Students*, Juta (2012), p.99-105. See also *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism* 2004 (4) SA 490 (CC) para. 72, 80 and 90.
[232] Supra n.36.
[233] (1990) 52 SATC 151.
[234] 2002 (3) All SA 181 (A).
[235] 2005 (2) SA 166.

CSARS v Airworld and Another[236] *and Metropolitan Life Ltd v CSARS.*[237] Further, in *Bosch*[238] the Supreme Court of Appeal has made it clear that a purposive approach to the interpretation of tax statutes must be applied in all cases.

While the purposive interpretation is widely supported, as noted above, this approach is not free from criticism.[239] One author notes that the purposive interpretation of, especially, tax legislation is nothing more than a mechanism to prevent interpreters and courts from applying an overly literal interpretation of the law[240] and that South Africa has long since departed from excessively literal and non-purposive interpretation of tax laws.[241]

ii. Criticism of the misuse or abuse element

The misuse or abuse element acts as a limiting provision in the Canadian GAAR.[242] The Katz Commission[243] recommended the same application for it in the 2006 GAAR, but instead the misuse or abuse element operates as one of the indicators of impermissible avoidance.[244] The result is that the GAAR's application has no limits.[245]

One author calls this element the most problematic provision in the GAAR,[246] particularly since this international concept does not fit into the South African legal framework and (assuming that the purpose test is also satisfied) it constitutes a self-sufficient basis for invoking the GAAR. Further, the provision introduces uncertainty, which is underscored by the fact that the GAAR itself is subject to the misuse or abuse element.[247]

2.3.6 Application and case law

Based on information available in the public domain, it appears that the Commissioner only issued the first notifications to taxpayers of his intention to invoke the 2006 GAAR in 2012 (six years after the 2006 GAAR was enacted).[248] During this time, as discussed at 2.3.1(a) above, the Commissioner seems to have developed a preference to pursue tax avoidance matters

[236] 2008 (3) SA 335.
[237] 70 SATC 162.
[238] Supra n.162.
[239] Botha op cit n.231 p.2; Cilliers op cit n.27 at 46.3 and 46.20.
[240] Ibid 46.3.
[241] Ibid and Van Schalkwyk & Geldenhuys op cit n.231.
[242] Broomberg op cit n.171.
[243] Katz Commission *Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of The Katz Commission of Inquiry Into Taxation* (1995), p.25.
[244] In direct contradiction to the Katz Commission's recommendation, ibid.
[245] Broomberg op cit n.171.
[246] Cilliers op cit n.27 at 46.20.
[247] Ibid.
[248] Liptak op cit n.195.

under the common law, because the onus of proof is far less burdensome on the Commissioner.[249]

Despite the Commissioner's initial hesitation to invoke the 2006 GAAR, it has had at least one success story in the public domain: In 2014, the Commissioner reached a private settlement of R312 million, including interest, with the Hudaco Group after he imposed the GAAR on the company's 2007 to 2011 tax years.[250]

During the course of 2015, a taxpayer applied to the Commissioner for a binding private ruling.[251] The facts of the taxpayer's application, which involved the conversion of loans into share capital, were common and the tax treatment of the proposed transaction was clear. It was therefore speculated[252] whether the taxpayer attempted to obtain confirmation from the Commissioner that the proposed transaction did not result in an impermissible avoidance arrangement. However, the Commissioner specifically excluded a consideration on the application of the GAAR on the proposed transaction in its ruling.

Anecdotal evidence, including a recent court case,[253] confirmed that the Commissioner is in fact applying the 2006 GAAR, despite his preference of the substance over form doctrine. However, the recent case did not consider the Commissioner's application of the GAAR, rather the administrative process followed, and nearly 15 years after its inception, the Commissioner's interpretation of the 2006 GAAR is yet to be tested in a South African court.

2.4 Onus of proof

The ITA included a general rule regarding the incidence of the onus of proof.[254] However, in *Conhage*[255] the court found that the general onus of proof was not applicable to the GAAR and the onus to prove the facts on which the GAAR was invoked, was on the Commissioner.[256] Only then did the rebuttable presumption apply and the onus shift to the taxpayer.[257] It was

[249] Resulting in many cases based on this principle, such as: *Roshcon, NWK, Bosch, Sasol* supra n.162 and *Cape Empower Trust Ltd v Fisher Hoffman Sithole* (2013) ZASCA 16. While the last case did not involve a tax matter, the court recognised the issue of tax avoidance schemes in this case with reference to the GAAR.
[250] SENS *Initiation of Legal Proceedings by Hudaco for the Recovery of Secret profits and R312 Million Tax Settlement* (2015), SENS Announcements.
[251] BPR 213 available at: https://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BPR-2015-28%20-%20BPR213%20repayment%20of%20intercompany%20loans%20from%20proceeds%20of%20a%20new%20share.pdf.
[252] Strauss B 'Converting loans into equity: another SARS ruling' *Lexology,* (2016).
[253] *X; Y v CSARS* supra n.40.
[254] ITA secion 82, which was repealed in 2011.
[255] Supra n.68.
[256] *Conhage* confirmed this finding of the court *a quo* see *ITC 1636* (1998) 60 SATC 267.
[257] This was recently confirmed by *X; Y v CSARS* supra n.40.

discharged if the court had no reason to disbelieve the taxpayer and if his testimony was not contradicted by objective facts.[258] The Commissioner accepted[259] the *Conhage* decision and that the onus to prove the remaining three of four elements of the 2006 GAAR rested on him.[260]

There is some uncertainty regarding the aforementioned following contradictory statements in the draft Comprehensive Guide, which stated that the Commissioner will have formed an opinion that the arrangement lacked commercial substance and that the onus to prove commercial substance would be on the taxpayer.[261]

However, a compelling view is that, given the extraordinary nature of the GAAR, and despite the wide wording of the statutory onus provisions, they cannot be used to justify the stance that it is the taxpayer who should prove the absence of an avoidance arrangement.[262] Thus, the general principle of "he who alleges must prove" should apply.[263] Further, a very recent Tax Court[264] judgment confirmed that the Commissioner bears the primary onus and the duty to begin proceedings under the 2006 GAAR.[265]

Under the 2006 GAAR the rebuttable presumption is on the person who obtained the tax benefit,[266] which will ordinarily, but not necessarily, be the taxpayer.[267]

2.5 Process and consequences of invoking the GAAR

The 2006 GAAR includes clear instructions on the administrative process that must be followed when the Commissioner intends to invoke the GAAR.[268]

First, the Commissioner must give notice to the taxpayer, with reasons, of an intention to invoke the GAAR. The taxpayer then generally has 60 days to reply to the notice. After receipt of the reply, or expiry of the period for a reply, the Commissioner has 180 days to raise further queries, withdraw the notice, or invoke the GAAR.

When the Commissioner invokes the GAAR he has a wide discretion in respect of the "correction" of the impermissible avoidance arrangement.[269] Refer to Appendix 2 for a reproduction of his discretionary powers. For the purposes of this discussion it is sufficient to

[258] De Koker & Williams op cit n.1 at 19.38.
[259] SARS op cit n.173 at 9.8 and 6.1.
[260] De Koker & Williams op cit n.1 at 19.40.
[261] SARS op cit n.173 at 6.4.2.1.
[262] Cilliers op cit n.27 at 46.19.
[263] Ibid.
[264] *X; Y v CSARS* supra n.40.
[265] Ibid p.54.
[266] ITA section 103(4).
[267] De Koker & Williams op cit n.1 at 19.38.
[268] ITA section 80J.
[269] ITA section 80B(1).

note that the Commissioner's power in this regard could effectively result in the Commissioner imposing tax on fictional transactions where steps or transactions are disregarded.[270]

Under the GAAR,[271] the Commissioner cannot waive interest that is charged under the relevant penalty section in the ITA.[272] The implication of this is that the Commissioner must charge interest on the fictional amounts of tax that would have been payable, had the taxpayer not entered into a tax avoidance arrangement.[273]

Importantly, the Commissioner is obliged to make compensating adjustments to assessments in relation to other parties to the arrangement, to ensure consistent tax treatment.[274]

2.6 Conclusion

This chapter discussed the GAARs that preceded the 2006 re-enacted GAAR in order to illustrate the influence that it had on the 2006 re-enacted GAAR. Thereafter the 2006 GAAR, which retained the four basic requirements of preceding GAARs, was discussed.

One of the most notable changes to the 2006 GAAR was the inclusion the tainted elements, which indicate impermissibility. The onus to prove the presence of at least one of the four tainted elements is on the Commissioner. The tainted elements are grouped into three subcategories and the normality requirement, retained from pre-2006 GAARs, is included in each of the subcategories. However, under two of the three subcategories the requirement's standard is "*bona fide* purposes", instead of the arm's length principle used in pre-2006 GAARs.

The ambiguity around the *bona fide* purpose standard will, in this author's view, result in the third subcategory's normality requirement being favoured over the others, because this subcategory still uses the arm's length standard which comes with established legal precedent.

The remaining three tainted elements and their comprehensive and ambiguous provisions cause confusion, among others, because of their international origin that appears to have not been adjusted to suit the South African legal framework.

The rebuttable presumption of purpose remained in the 2006 GAAR and, once the Commissioner proved a tax benefit effect, the taxpayer still bears the onus to prove that the sole or main purpose of the arrangement was not to obtain a tax benefit. The legislature

[270] Cilliers op cit n.27 at 46.21.
[271] ITA section 80K.
[272] ITA section 89quat(3) /89quat(3A).
[273] As illustrated by the Hudaco settlement mentioned at 2.3.6 above.
[274] ITA section 80B(2).

changed this test from subjective to objective. However, a view this author agrees with, is that the test can never be completely objective and the taxpayer's *ipse dixit* will remain relevant to the extent that it is confirmed by objective facts and circumstances.

Regarding its application, the GAAR sets out a clear administrative process, however, the Commissioner has free reign to adjust the impermissible arrangement so that it is taxed as if the impermissible avoidance never took place. The result is that tax and interest can be imposed on fictional transactions.

While the 2006 GAAR includes some material changes and is generally complicated, it appears that much of the legal precedent from pre-2006 GAARs may remain applicable. It is this author's expectation that the 2006 GAAR, much like its predecessors, will rely heavily on judicial interpretation.

Ultimately, the 2006 GAAR is more specific than its predecessors, potentially making it much more challenging for the Commissioner to invoke. Further, it was noted that the common law substance over form doctrine is easier to successfully pursue and the Commissioner has illustrated a clear preference to this approach, since the GAAR can be applied in the alternative.

CHAPTER 3: THE MLI's PPT

The executive summary of the BEPS Report notes concerns similar to Silke's from many years ago. It states that taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving countries of tax revenue.[275]

The OECD's Conduit Companies Report[276] is perhaps the first OECD document that hinted at the inclusion of general denial-of-treaty-benefit provisions.[277] Later on, the OECD Report on Harmful Tax Competition[278] noted, broadly, that:

— the OECD's Committee on Fiscal Affairs intended to continue examining and proposing changes to the MTC to deny treaty benefits under certain circumstances;[279]
— treaties generally included no GAAR and few SAAR; and
— the Commentary should be clarified to remove uncertainty or ambiguity regarding the compatibility of domestic GAARs in treaties.[280]

Regarding the third point above, the application of domestic anti-avoidance rules in a treaty context could, without controls or limitations, result in potential problems such as the possible failure of a state to fulfil obligations imposed by the treaty,[281] imposing on the principle of good faith[282] and unilateral changes to the tax treatment of a transaction under a treaty, among others.[283] The aforementioned instances would amount to treaty override, in terms of which the other contracting state could invoke a breach of International Law.[284] From the aforementioned, it is clear that the unilateral application of domestic GAARs in a treaty context could, at the very least, result in the application the principle of *pacta sunt servanda,*[285] which

[275] OECD/G20 *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances Action 6 - 2015 Final Report Base Erosion and Profit Shifting Project* (2015), OECD, p.13.
[276] OECD *Report on Double Taxation Conventions and the Use of Conduit Companies* (1987), OECD.
[277] Van Weeghel 'A Deconstruction of the Principal Purposes Test' *World Tax Journal* (2019), IBFD, p.13.
[278] OECD *Harmful Tax Competition: An Emerging Global Issue* (1998), OECD.
[279] Ibid p.47-48.
[280] Ibid.
[281] Van Der Bruggen 'Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3(2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties' *European Taxation* (2003), IBFD, p.148-149
[282] VCLT article 27.
[283] Santos 'The United Kingdom's Diverted Profits Tax and Tax Treaties: An Evaluation' *Bulletin for International Taxation* (2016), IBFD, p.404.
[284] Ibid.
[285] VCLT articles 26 and 27.

is why the OECD would have to provide further guidance following the Committee on Fiscal Affairs' recommendations.

3.1 Introduction to the PPT

Before 2003, the OECD had the view that domestic anti-avoidance rules, or the denial of treaty benefits, should be bilaterally negotiated and agreed upon between contracting states.[286] The OECD noted that, since the abuse of treaty provisions related to treaties, it is unlikely that such situations could be addressed only by domestic GAARs.[287]

However, the introduction of the so called "guiding principal"[288] in the 2003 Commentary finally made it clear that treaties do not prevent the application of domestic GAARs. This update was viewed as a fundamental change in the approach to tax avoidance by some and merely as a clarifying mechanism by others.[289]

Still, the inclusion of an article dedicated to the denial of treaty benefits in the OECD only came to fruition during the BEPS Project in the form of the PPT, proposed by the BEPS Report.[290] The PPT, which is intended to be applied in the broadest manner,[291] has also been included in the MTC's new Article 29.

The OECD is not the first to include a PPT in the MLI or its MTC. Versions of a treaty PPT existed before, apparently mainly in UK treaties[292] although it also features in US treaty practice.[293]

Simply put, the PPT comprises three elements. Refer to the flow chart at Figure 5 (however, it excludes the first element) and Appendix 3 which includes the full wording of the PPT.

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[286] 1977 Commentary on Article 1 para.10, Santos op cit n. 283 p.404.
[287] De Broe & Luts 'BEPS Action 6: Tax Treaty Abuse' *Intertax* (2015), Kluwer Law International, p.127.
[288] Commentary on Article 1 para. 9.5.
[289] Van Weeghel op cit n.277 p.9 referring Arnold 'Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model' *Bulletin for International Fiscal Documentation* (2004), IBFD, p.245-246; Martín Jiménez 'The 2003 Revision of the OECD Commentaries on the Improper Use of Tax Treaties: A Case for the Declining Effect of the OECD Commentaries?' *Bulletin for International Fiscal Documentation* (2004) IBFD, p.18.
[290] Van Weeghel op cit n.277 p.10.
[291] OECD/G20 op cit n.275 p.13; Commentary on Article 29 paras.175-181 and Kuźniacki 'The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI: Exploring Challenges Arising from Its Legal Implementation and Practical Application' *World Tax Journal* (2018), IBFD, p.242.
[292] Baker 'The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' *British Tax Review* (2017), HeinOnline, p.283; Baker 'The BEPS Action Plan in the Light of EU Law: Treaty Abuse' *British Tax Review* (2015), HeinOnline, p.412. Duff 'The Principle Purpose Test' (2019), Amsterdam Centre for Tax Law's Full Day Conference.
[293] Hattingh 'The Impact of the BEPS Multilateral Instrument on International Tax Policies' *Bulletin for International Taxation* (2018), IBFD.

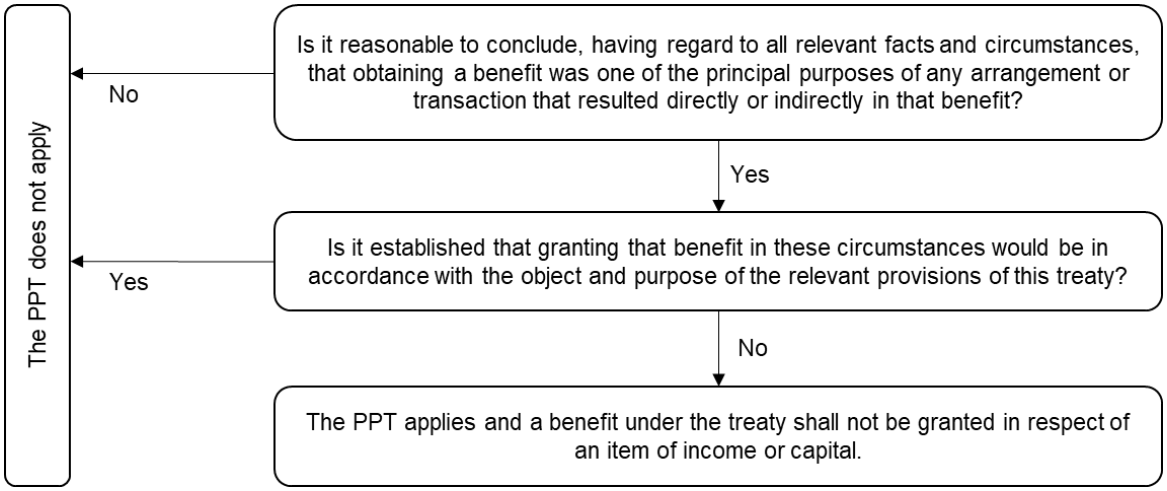

Figure 5. The PPT's structure

The first of the three elements, not included in the flow chart above, is an override function and states: "notwithstanding any provisions of a CTA…".

The second is the substantive element, which is also widely referred to as the PPT's subjective test. As indicated by Figure 5, it applies if "it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction".

The proviso is the third element and limits the application of the PPT to instances where the substantive element has been met *and* it was established that granting a benefit would *not* be in accordance with the object and purpose of the relevant provisions of the CTA.[294]

In this chapter, the PPT's second and third elements are analysed, followed by the onus of proof and procedural provisions.

3.2 Approach to interpreting the PPT

Just like any other international treaty, the PPT is subject to the principles of the VCLT, because it was clearly intended that the MLI should be governed by the rules and principles of international law, including the VCLT's interpretational guidelines.[295]

The VCLT's general rule of interpretation states that a treaty shall be interpreted in good faith in accordance with the:

— ordinary meaning to be given to the terms of the treaty in their context and

[294] Elliffe 'The Meaning of the Principal Purpose Test: One ring to Bind Them All?' *World Tax Journal* (2019), IBFD 2019; Danon 'The PPT in Post-BEPS Tax Treaty Law: It Is a GAAR but Just a GAAR!' *Bulletin for International Taxation* (2020), IBFD; Lang 'The Signalling Function of Article 29(9) of the OECD Model – The "Principal Purpose Test"' *Bulletin for International Taxation* (2020), IBFD.
[295] OECD/G20 op cit n.275 p.92.

— in the light of its object and purpose."[296]

It supports a textual interpretation of the object and purpose of the *treaty,*[297] restricting interpretation of treaties to the treaty text and other documents made in connection with the conclusion of the treaty.[298] However, the VCLT also provides that subsequent agreements, practice and relevant rules of international law applicable between the contracting states could be considered, which expands the narrow interpretation just noted.[299] In other words, the VCLT Article 31(1) supports a purposive interpretation that is limited to treaty text.[300]

In determining the ordinary contextual meaning of treaty text, the text should be interpreted in a broad manner, indicating its international origin.[301] Regarding the object and purpose, common law jurisdiction courts have generally taken the view that a broad purposive interpretation of the goals and objects of the relevant treaty is required, instead of a narrow domestic view of the words.[302]

The VCLT considers a treaty's preamble as part of the treaty itself.[303] The BEPS Report and Commentary confirm, in line with the aforementioned, that the provisions of the PPT must be read in the context of the relevant treaty, including its preamble.[304] Further, the BEPS Report states that the title and preamble of a treaty should play an integral role in the interpretation of its provisions, since it constitutes a general statement of the object and purpose of a treaty.[305]

Considering the preamble that was included by the MLI, the prevailing object and purpose of CTAs remains the elimination of double taxation while two ancillary purposes were added. These are the prevention of tax evasion and tax avoidance.[306]

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[296] VCLT article 31(1).
[297] Emphasis added; see Van Weeghel op cit n.277 p.23.
[298] Avery Jones 'The Interpretation of Tax Treaties with Particular Reference to Art. 3(2) of the OECD Model' *British Tax Review* (1984), HeinOnline, p.14.
[299] VCLT article 31(3).
[300] Lang 'BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties' *Tax Notes International* (2014), Universität Wien, p.661 and Danon op cit n.294 p.252; Van Der Bruggen op cit n.281 p.148.
[301] UK: *Anson v Commissioner for her Majesty's Revenue and Customs* (2015) UKSC 44.
[302] Elliffe op cit n.294 p.63 noted that a survey of common law jurisdictions indicated a broadly consistent approach and referred to Canadian, New Zealand and Australian case law. See also 2.3.5(d) above where this approach can be argued to be supported by South African courts as well.
[303] VCLT article 31(2) also emphasised in OECD/G20 op cit n.275 p.92.
[304] OECD/G20 op cit n.275 p.56 confirmed by Article 31(2) of the VCLT and para.173 of the Commentary on Article 29(9).
[305] OECD/G20 ibid p.93.
[306] OECD/G20 ibid para.16; Commentary, p.15; Commentary on Article 1 para.54; Van Weeghel op cit n.277 p.18; Kuźniacki op cit n.291 p.240.

For the purpose of this analysis, this author notes that granting treaty benefits pursuant to the PPT turns on the object and purpose of the relevant *provisions* of a treaty. Regardless, the object and purpose of the relevant treaty provisions have to be read in light of the object and purpose of the entire treaty, following the inclusion of the preamble that was introduced by the MLI.[307]

There are three important documents that can assist with the interpretation of the PPT. They are: the MLI itself (including its full title and preamble), the BEPS Report and the Explanatory Statement.[308] The Commentary on the PPT, which largely mirrors the commentary provided in the Action 6 Report, can be used as a supplementary means of interpretation for the PPT.[309]

3.2.1. PPT interpretive guides as "international tax language"

The concept of treaty text as an international tax language has been confirmed by various courts around the world, including the United Kingdom,[310] India,[311] the Netherlands,[312] New Zealand,[313] South Africa[314] and Australia,[315] without such a concept necessarily being formally adopted in these legal systems.

It is noted that Vogel was of the view that commentary on treaties would only become part of "international tax language" after enough time had lapsed for such commentary and terms to take on the "special meaning" referred to in Article 31(4) of the VCLT.[316]

While Vogel suggested a period of ten years,[317] this author is of the view that (considering the fast paced development of international tax concepts, the effort that went into the MLI and the fact that the BEPS Report represents the views of the OECD and G20) "enough time" in respect of the MLI may lapse much quicker, if it has not already since it has been more than five years after the BEPS final reports were published.

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[307] Chand 'The Principal Purpose Test in the Multilateral Convention: An in-depth Analysis', *Intertax* (2018), Kluwer Law Online, p.26.
[308] Elliffe op cit n.294 p.56.
[309] Avery Jones op cit n.298 p.94. This is also the view of the Australian Taxation Office's (**ATO**) PSLA 2020/2 on 1 October 2020. A PSLA is primarily an instruction to ATO staff, and provides guidance to ATO staff on the administrative process of applying a principal or main purposes test included in any of Australia's tax treaties, including the MLI PPT.
[310] UK: *Ostime (H.M. Inspector of Taxes) v Australian Mutual Provident Society* (1) (1960) 38 TC 492.
[311] IND: *Graphite India Ltd. v. DCIT* 78 TTJ 418 (Cal), *CIT v. Visakhapatnam Port Trust* 144 ITR 146 (AP), *DCIT v. ITC* 85 ITD 162 (Cal).
[312] NL: *Hoge raad, Beslissingen in Belastingzaken/Nederlandse Belastingrechtspraak* (BNB) 1991/248.
[313] NZ: *Commissioner of Inland Revenue v JFP Energy Incorporated* (1990) 3 NZLR p. 536.
[314] *SIR v Downing* 1975 (37) SATC 249.
[315] AUS: *Thiel v Federal Commissioner of Taxation* (1990) 21 ATR 531 p.537.
[316] Vogel 'The Influence of the OECD Commentaries on Treaty Interpretation' *Bulletin for International Fiscal Documentation* (2000), IBFD, p.612, 616.
[317] Ibid.

Further, the MLI fits in with treaty law, which has established its own international rules and principles with a meaning independent of domestic legal systems.[318]

3.2.2. Defining terms of the PPT

The MLI's Article 2 defines a number of MLI terms. Any term not defined in the MLI shall, unless the context requires otherwise, have the meaning that it has at that time under that relevant treaty.[319]

In this regard, Articles 3 to 5 of the MTC define key concepts. Insofar terms are not defined by the MTC, Article 3(2) of the MTC specifies that the domestic law meaning of an undefined term applies, but only if the context does not require an alternative interpretation and the competent authorities do not agree to a different meaning pursuant to the MAP provisions.[320] Does this mean that the meaning of certain terms of the PPT should, by default, be derived from the source state's domestic legislation?

No: The Explanatory Statement explicitly gives the BEPS Report a particular interpretative value, and as such it may be seen as "context," among others,[321] for the PPT to apply under Article 3(2) of the MTC.[322] At the very least this is the case in respect of the text of the BEPS Report that was included in the Commentary.

Domestic GAARs and case law can, at most, constitute supplementary means of interpretation to the PPT as part of international tax law.[323] This is because a country's experience with a GAAR is unique as a product of the interaction between legislative tradition and history, the effectiveness of the tax administration and the approach of the courts.[324] Thus, the use of domestic GAARs would differ from country to country and could potentially interfere with a universal understanding of the PPT.[325]

However, in the absence of clear guidance, especially the lack of procedural guidance, countries with similar GAAR terms and concepts to the PPT may very well opt to apply the

[318] Ibid.
[319] MLI Article 2(2).
[320] Commentary on Article 3 para.12.
[321] OECD op cit n.10 para.12.
[322] The BEPS Report, could also be considered for interpretative purposes as the object and purpose rather than the context of the MLI under Article 31(1) of the VCLT.
[323] Kuźniacki op cit n.291 p.243.
[324] Gomes 'The DNA of the Principal Purpose Test in the Multilateral Instrument' *Intertax* (2019), Kluwer Law International, p.72.
[325] Kuźniacki op cit n.291 p.243.

domestic meaning of PPT terms where BEPS Report guidance results in a conflicting meaning.[326]

This could potentially lead to a departure from an international autonomous meaning of the PPT,[327] resulting in a PPT that means two different things in two different contracting states, reducing the effectiveness of the PPT.[328]

It is crucial that the PPT be interpreted consistently, because the very same wording and test will be included in treaties around the world.[329] Various authors[330] noted the potential of inconsistent and contradictory interpretations globally, should states decide to apply the domestic meaning of PPT terms found in domestic GAARs.

Following on the above, an inconsistent interpretation of the PPT may lead to costly litigation, legal and commercial uncertainty, increased administrative burdens and potentially even loss of direct foreign investment,[331] among others.

3.2.3. The MTC's guiding principle

The introduction to this chapter touched on the inclusion of the guiding principle in the 2003 Commentary as a predecessor to the PPT. Thus, a question that arises is whether the PPT is subject to the guiding principle.

The guiding principle noted that the benefits of a treaty should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in the circumstances would be contrary to the object and purpose of the relevant provisions.[332]

Changes were made to the wording of the guiding principle in the Commentary following the introduction of the PPT. However, the Commentary reiterates the guiding principle and states that it "applies independently from the provisions of paragraph 9 of Article 29 (the MTC's PPT provision), which merely confirm it".[333]

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[326] Kuźniacki ibid, Elliffe op cit n.294 p.52; Hattingh 'The Multilateral Instrument from a Legal Perspective: What May Be the Challenges?' *Bulletin for International Taxation* (2017), IBFD. Baker (2017) op cit n.292, p.281-284.
[327] Elliffe op cit n.294 p.51.
[328] Baker *Double Taxation Conventions* (2001), Sweet & Maxwell, Loose-leaf, p.32; Vogel 'Double Taxation Conventions' (2017), Kluwer Law International, p. 208.
[329] Elliffe op cit n.294 p.52.
[330] Elliffe ibid; Hattingh (2017) op cit n.326. Baker (2017) op cit n.292 p.281-284.
[331] Kuźniacki 'Introduction of the Principal Purpose Test and Discretionary Benefits Provisions into Singapore's Tax Treaties: Not as Black as It Is Painted: Part 2 – Consequences' *Asia-Pacific Tax Bulletin* (2018), IBFD.
[332] 2003 Commentary on Article 1.
[333] Commentary on Article 1 para 61.

An analysis of the guiding principle is not in the scope of this dissertation; however, it is unlikely that the PPT was included in the MTC merely to confirm the guiding principle and the general rule of interpretation in Article 31 of the VCLT.[334] Instead the PPT adds expands the guiding principle.[335] Despite not discussing this in detail, the author confirms that, in her view, the PPT is not subject to the provisions of the guiding principle and that the PPT will override the guiding principle, among other reasons, because the PPT is found in the treaty itself, instead of the Commentary as is the case with the guiding principle.

3.3 General terms used in the PPT

The BEPS Report defines some terms of the PPT deliberately broadly including "benefit,"[336] "arrangement or transaction"[337] and "resulted directly or indirectly,"[338] indicating that a wide interpretation is required.[339]

Despite the broad definition of a "benefit", it is necessary to distinguish by virtue of which instrument/legislation the benefit is provided. If the benefit is provided by virtue of another treaty or domestic legislation, such benefit would be excluded from the scope of the treaty under consideration.[340]

There is also an argument that double non-taxation could be regarded as a treaty benefit,[341] which would therefore also be within the grasp of the PPT. The preamble introduced by the MLI makes it clear, though, that double non-taxation is not included in the object of treaties.[342]

Arrangements or transactions include any agreement, understanding, scheme, transaction or series of transactions, irrespective of whether or not they are legally enforceable. One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit. In both cases the PPT may apply.[343] However, some authors note that the failure from the OECD to provide a clear definition of the list of factors and circumstances in this regard will only increase uncertainty on whether an

[334] Van Weeghel op cit n.277 p.15; Kuźniacki op cit n.291 p.240.
[335] Van Weeghel ibid p.18.
[336] OECD/G20 op cit n.275 p.56.
[337] Ibid p.57.
[338] Ibid.
[339] Ibid.
[340] Lang (2014) op cit n.300 p.656.
[341] Kuźniacki op cit n.291 p.252.
[342] Báez Moreno 'GAARs and Treaties: From the Guiding Principle to the Principal Purpose Test. What Have We Gained from BEPS Action 6?' *Intertax* (2017), Kluwer Law International, p.439.
[343] OECD/G20 op cit n.275 p.57.

arrangement will relate to the overall transaction, a series of combined steps or all steps within the transaction or parts thereof.[344]

3.4 The substantive element

The substantive element includes two tests, separately referred to as the purpose and reasonableness tests.[345] These are two distinct elements of the PPT, however, some are of the view that the two are so inherently linked that they should be applied together.[346]

As such, they are the cause of an ongoing debate regarding the type of overall test that the PPT's substantive element requires. This debate is summarised as follows:

— Some authors are of the view that a subjective test is required,[347] however, objections to the use of a subjective test include that intention should not be an element of the tax law.[348] This is because subjective law could treat two taxpayers that are in the same factual position differently only because their demonstrated intentions are different.
— Other writers merely state that the rule is vague, as it does not provide objective criteria (ascertainable by a third party) in order to determine what is principal and secondary, and what is abusive and what is not.[349]
— Another view is that the test is objective, because it requires an objective analysis of the relevant facts and circumstances.[350]
— Finally, there is a view that the substantive element is a combination of both and that the subjective and objective tests are so intertwined that a clear distinction is difficult.[351]

Following an analysis of the principal purpose and the reasonableness test, this author will conclude this section by confirming why the last view noted above is correct, in her view.

3.4.1 Principal purpose test

Prior to its broad implementation through the MLI, treaty based PPTs were typically expressed as a main-purpose test, or a single purpose test. The principal purpose test contained in the MLI, on the other hand, does not require that the main or sole purpose of a transaction was to

[344] Gomes op cit n.324 p.74.
[345] Weber 'The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law' *Erasmus Law Review* (2017), Eleven International Publishing, p.49.
[346] Ibid.
[347] De Broe & Luts (2015) op cit n.287 p.134 (2015). See Lang (2014) op cit n.300 p.658; Van Weeghel op cit n.277.
[348] Báez Moreno op cit n.342 p.436.
[349] Cunha 'BEPS Action 6: Uncertainty in the Principal Purpose Test Rule', *Global Taxation* (2016), p.61.
[350] Weber op cit n.345 p.49; Elliffe op cit n.294 p.62.
[351] Van Weeghel op cit n.277 p.11.

secure a tax benefit. It is sufficient that it is one of the principal purposes and therefore, it uses a multiple purpose test.

In the absence of a definition of "principal purpose", the ordinary meaning of the words are considered. "Principal" may sometimes mean the most important and it is likely that the term in this context means "of a number of things or persons, or one of their number; belonging to the first rank; among the most important; prominent, chief, leading, main".[352]

"Purpose(s)" means "that which a person sets out to do or attain; an object in view; a determined intention or aim, and/or the reason for which something is done or made, or for which it exists; the result or effect intended or sought; the end to which an object or action is directed; aim."[353]

Assuming based on the above and for the purpose of this discussion that the test is subjective, a difficulty arises because "intentions or motives" cannot be proved.[354] However, in support of a subjective test, subjective criteria can always be deduced on the basis of external facts.[355]

One author notes that evidence on intentions or motives, by way of the taxpayer's *ipse dixit*, may not be relevant in practice, because courts will likely examine the overall objective behind the transaction when looking to ascertain the purpose of a transaction and not necessarily, what the taxpayer intends.[356] However, one view is that the principal purpose test has a wide criteria, and tax authorities may continue to apply a subjective test, since they only need to establish a motive or intention in order to shift the onus of proof onto the taxpayer.[357]

The consequences of the purpose test's wide criteria, is that treaty benefits could be denied by tax authorities even where there are material economic business reasons that drive the arrangement in conjunction with tax reasons, if one of the principal purposes of the arrangement is tax driven.[358]

Some authors are of the view that this standard is quite low, but note it is deliberate on the part of the OECD.[359] Concerns regarding the low standard include that it does not comply with

[352] 'Principal' Oxford English Dictionary (3rd ed., 2003).
[353] 'Purpose' ibid.
[354] Lang (2014) op cit n.300 p.658.
[355] Ibid.
[356] Elliffe op cit n.294 p.65.
[357] Lang (2014) op cit n.300 p.658.
[358] Danon 'Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups' *Bulletin for International Taxation* (2018), IBFD, p.44; Kok 'The Principal Purpose Test in Tax Treaties under BEPS 6' *Intertax* (2016), Kluwer Law International, p.408; Gomes op cit n.324 p.80.
[359] Kok ibid.

EU law.[360] Another concern is that the PPT should be applied in line with the preamble to the MLI and therefore, the denial of benefits is not always justified with respect to any arrangement or transaction for which one of the principal purposes was to obtain a treaty benefit.[361]

The BEPS Report, perhaps in trying to lift the standard, states that "it should not be lightly assumed that obtaining a benefit under a treaty was one of the principal purposes…" and that the PPT may be invoked "where an arrangement can only be reasonably explained by a benefit that arises under a treaty...".[362] However, some authors have noted that neither the BEPS Report nor the Commentary can amend the MLI or MTC's text.[363]

In order to address this issue, some authors have suggested that the text of the PPT be amended[364] so that it distinguishes between situations where an arrangement results in double non-taxation, but not where a treaty benefit eliminates double taxation, resulting in single taxation.[365] Another suggestion is that the purpose test cannot be satisfied if the proper factual inquiry leads to a conclusion that non-tax purposes outweigh tax purposes. This suggestion is supported by the BEPS Report, which states that the substantive element is not applicable when a principal consideration is not to obtain a treaty benefit.[366]

3.4.2 Reasonableness test

The reasonableness test requires that it is "reasonable to conclude" that the PPT should be applied.

Again, a popular view among scholars is that this test sets a low standard of proof on, and confers a great deal of discretion, to tax authorities.[367] However, a contrary view is that the term "reasonable to conclude" does not refer to the burden of proof on the tax authorities; rather it means that the tax authority's assessment must be obtained through an objective analysis based on facts and circumstances.[368]

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[360] Kuźniacki op cit n.291 p.256.
[361] Ibid p.257.
[362] OECD/G20 op cit n.275 p.58.
[363] Kuźniacki op cit n.291 p.257; Lang (2014) op cit n.300 p.660.
[364] De Broe & Luts op cit n.287 p.132.
[365] Kuźniacki op cit n.291 p.257.
[366] OECD/G20 op cit n.275 p.53.
[367] Cunha op cit n.349 p.49; Lang (2014) op cit n.300 p.658; Bhargava, 'The Principal Purpose Test: Functioning, Elements and Legal Relevance' in Blum and Seiler (eds.) *Preventing Treaty Abuse* (2016), p.318; Pinetz 'Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse' *Bulletin for International Taxation* (2016), IBFD, p.116; Pinetz, 'Use of the Principal Purpose Test to Prevent Treaty Abuse', in Lang et al. (eds.), *Base Erosion and Profit Shifting (BEPS)* (2016), Linde Verlag, p.271.
[368] Weber op cit n.345 p.51.

The BEPS Report and the Commentary provide some guidance to the test, in support of the latter view:[369]

— It must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances and weighing up all the evidence.
— Merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes.
— Merely asserting that the relevant structure/transaction was not undertaken to obtain treaty benefits is not sufficient.
— The possibility of different interpretations of the events must be objectively considered.

The above indicates that the reasonableness test is undoubtedly objective[370] (which may contribute to the ongoing debate regarding the substantive element's overall test).

Contrary to the concerns raised above, regarding authorities not being required to conclusively prove purpose, it is anticipated by some that tax authorities will take into account the reasonableness test of the substantive element at the concluding stages of the purpose test, even though the wording of the PPT does not require them to do so.[371] The need to consider the purpose of tax treaties according to the rule of interpretation under Article 31(1) of the VCLT also supports this observation.[372]

3.4.3 Relevant facts and circumstances

The PPT appears to almost combine the consideration of the relevant facts and circumstances with the reasonableness test. While they may be closely linked, they are not necessarily the same. Reasonableness refers to the administrative law standard for decision making, i.e. basing the outcome on plausible considerations. The issue of which facts are relevant and which are not, is a different one, although conclusions on reasonability will, no doubt, rely heavily on the relevant facts and circumstances.

The examples[373] in the Commentary provide some guidance on what may be "relevant facts and circumstances". They do not distinguish relevant facts from relevant circumstances but seem to consider them together as the source of evidence and factors used to determine the application of the PPT[374] including:

[369] OECD/G20 op cit n.275 p.48; Commentary on Article 29 para. 178.
[370] Weber op cit n.345 p.51.
[371] Kuźniacki op cit n.291 p.249 and Weber ibid.
[372] Ibid.
[373] Commentary on Article 29: Examples A-M (on general treaty abuse cases) para.182 and examples A-F (on conduit treaty abuse cases) para.187.
[374] Kuźniacki op cit n.291 p.253.

— Tax reasons and non-tax reasons for entering into an arrangement.
— The reason for creating entities: active or investment trade versus tax reasons such as the avoidance of a PE.
— The activities of entities: active trade and investment versus purely passive "holding" activities.
— Differences between the substance and form of an arrangement.
— The chosen tax residency jurisdiction.
— The residency status of the majority of board members of an entity, and whether this is in the state of the company's tax residence.
— The presence of circular cash flows.
— The impact of group transactions on net cash flows.

The examples indicate that economic substance and a business purpose (other than obtaining treaty benefits) are relevant when considering the application of the PPT. The above guidance confirms that all evidence must be weighed, including the possibility of different interpretations of the events and facts. In other words, merely making a decision based on the effect of an arrangement is not sufficient.[375]

It is also clear that this requirement adds objectivity to the substantive element.

3.4.4 Conclusion

In practice, where there are material economic business reasons that drive the arrangement in conjunction with tax reasons, this author expects that the PPT will not be applicable. In fact, this author expects that the PPT will only apply when the main purpose was tax avoidance *combined* with the absence of economic substance or business reasons. If this is the case, it ultimately results in a restrictive application of the substantive element.[376]

Following the analysis above, this author's view is that the substantive element is at the very least a combination of the objective and subjective tests, since it can be neither purely objective nor subjective.[377]

In practice, the taxpayer will most probably get the opportunity to present all the relevant facts and circumstances regarding the purpose of a transaction before the PPT is invoked,[378] since the test makes it clear that it can only be invoked if both the purpose and reasonableness tests

[375] Commentary on Article 29 para.179; Weber op cit n.345 p.51.
[376] Chand op cit n.307 p.41.
[377] Van Weeghel op cit n.277 p.11.
[378] Weber op cit n.345 p.51.

are present.[379] Thus, the correct application of the substantive element should prevent many of the concerns, raised by the authors referenced in this section, from realising.

3.5 The PPT's proviso

The PPT's application is limited by its proviso, generally known as the PPT's objective test. In this case the taxpayer must prove[380] that the granting of the benefit is in accordance with the object and purpose of the relevant treaty *provisions*, as opposed to the object and purpose of the treaty as a whole.[381] This part of the PPT is similar to Canada's misuse or abuse test, but for the onus of proof being on the taxpayer instead of the revenue authority.[382]

The proviso concerns each relevant state's idea of the purpose of a treaty and its provisions, something that is not always in the public domain.[383] Additionally, the OECD does not provide specific guidance in determining the object or purpose of treaty provisions under this test.

3.5.1 Treaty provisions: Object and purpose

The most important tool in the interpretation of the PPT is the MLI itself including its preamble, followed by the BEPS Report since it reflects the OECD and G20's views on the PPT. The VCLT's guidelines also remain applicable in the determination of treaty provisions' object and purpose under the PPT.[384]

The introduction of the MLI's preamble is intended to expressly state that the joint intention of the parties to a tax treaty is to eliminate double taxation without creating opportunities for tax evasion and avoidance, in particular through treaty shopping arrangements.[385] Thus, as stated at section 3.2 above, the main object and purpose of CTAs remain the avoidance of double taxation, with the avoidance or evasion of tax being ancillary.[386]

It is, however, the various provisions of a treaty that put this objective into effect and it does so under varying conditions.[387] In line with the VCLT's principles, the "relevant provisions" that are referred to under the objective test are the provisions upon which treaty benefits are based, i.e. Articles 6 – 22 of the MTC.[388]

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[379] See the PPT itself, further supported by the guidance in the BEPS Report and Commentary.
[380] Elliffe op cit n.294 p.69.
[381] Chand op cit n.307 p.24; Báez Moreno op cit n.342 p.437.
[382] Kandev & Lennard 'The OECD Multilateral Instrument: A Canadian Perspective on the Principal Purpose Test' *Bulletin for International Taxation* (2020), IBFD, p.58.
[383] Kuźniacki op cit n.291 p.262.
[384] OECD/G20 op cit n.275 p.93.
[385] Ibid p.10.
[386] Danon op cit n.294 p.258; Chand op cit n.307 p.25.
[387] Danon ibid.
[388] Ibid.

However, a strict or literal reading of treaty provisions in isolation will always result in the PPT not applying where the taxpayer respects the formal conditions of tax treaties, such as the conditions imposed by the time limit, ownership threshold and so on.[389] Thus, the object and purpose of the relevant provisions have to be read in light of the object and purpose of the entire tax treaty.[390]

One author applies a different reading to the PPT, stating that the PPT really only emphasises the need for purposive interpretation in general, without limiting it to situations where the PPT's application is being considered.[391] In other words, object and purpose must be considered not only when the PPT is applied, but in all instances; the PPT merely emphasises the necessity for an interpretation based on object and purpose in those cases in which one of the principal purposes of a transaction was to obtain a benefit.[392] The learned author notes that applying the PPT in the aforementioned manner should also solve some of the concerns outlined earlier, under the substantive element.

Regarding the proviso, a two-phased approach may be undertaken to confirm the object and purpose of the relevant provisions. Firstly, it must always be determined if the relevant treaty provisions have their own specific purpose.[393] Secondly, it must be proved that the transaction/arrangement respects the object and purpose of the relevant provisions.[394]

3.5.2 Criticism on the proviso

Many scholars have taken a view that the proviso's burden of proof is uneven between the tax authority and the taxpayer.[395] However, one author challenges this view and notes that, if the tax authority could not prove that the substantive element was present in an arrangement, that the taxpayer need not defend themselves under the proviso.[396]

Further criticism on the PPT's proviso include:

— Once a taxpayer has shown to be compliant with the wording of a provision, the taxpayer should not have the onus to disprove that he violated the object or purpose of the treaty.[397]

[389] Chand op cit n.307 p.24; Báez Moreno op cit n.342 p.437-439.
[390] Chand ibid p.26.
[391] Lang (2020) op cit n.294 p.266.
[392] Ibid.
[393] Danon op cit n.358 p.52-53.
[394] Chand op cit n.307 p.26
[395] De Broe & Luts op cit n.287 p.133; Lang (2014) op cit n.300 p.658; Danon op cit n.294 p.254; Chand op cit n.307 p.20.
[396] Kuźniacki 'Untangling the PPT's burden of proof' *Kluwer International Tax Blog* (2018), Kluwer Law International.
[397] Danon op cit n.294 p.254.

— The tax authority merely has to demonstrate that it is “reasonable” that the principal purpose of the arrangements is to obtain the benefits, while the taxpayer, has to demonstrate in a convincing manner that granting the benefit is in accordance with the object and purpose of the relevant provision.[398]
— Many treaty provisions are unsuitable for a purposive interpretation, because other than adjudicating the taxation of income, they generally do not indicate another purpose or object.[399]

One author states, though, the fact that a taxpayer sets up an arrangement with the aim to avoid tax is, in itself, not sufficient to deny him treaty benefits. Rather, the taxpayer should also act contrary to the objectives of the provision of which he seeks advantage.[400] In other words, even if the substantive element is met, an additional avoidance element, unrelated to the requirements of the relevant treaty provision would have to be present (for example round tripping, conduit arrangement or lack of commercial substance) and demonstrated to defeat the factual object and purpose of the relevant treaty provision.[401]

In this author’s view, the aforementioned, coupled with the PPT’s reference to “relevant” facts and circumstances, suggests an implicit business purpose or normality test.

3.6 Onus of proof

Initially the tax administration has to demonstrate that it is reasonable that the principal purpose of the arrangements is to obtain treaty benefits. There is no formal onus on either the tax authority or the taxpayer (although there may be suggestions of an implied onus[402]) to prove that the arrangement was impermissible/permissible or abnormal/normal, although if one existed it would arguably be on the tax authority together with the principal purpose requirement.

As discussed,[403] the taxpayer may challenge the tax authority’s conclusion under the substantive element, in which case it is logical that the general principal *qui allegat qui probat* would apply. Thus, the onus will be on the taxpayer to disprove the facts demonstrated by the

[398] Chand op cit n.307 p.21; De Broe & Luts op cit n.287 p.133; Lang (2014) op cit n.300 p.661, Kok op cit n. 358 p.409.
[399] Báez Moreno op cit n.342 p.439.
[400] Danon op cit n.294 p.261.
[401] Ibid p.260.
[402] See 3.5.2 above.
[403] See 3.4.4 above.

tax authority. The onus is further on the taxpayer to establish that granting the benefit is in accordance with the object and purpose of the relevant provision.[404]

This chapter noted the various complaints regarding the uneven burden of proof between the tax administration and the taxpayer. However, the split of the PPT's burden of proof, as stated above, generally conforms to the burden of proof under GAAR in many countries.[405]

3.7 Process and consequences of invoking the PPT

The OECD did not provide guidance with respect to the process of denial of benefits or the tax authority's powers when the PPT is applied, other than the denial of treaty benefits.

As a result, a great deal uncertainty exists around the PPT's application and the legal implications thereof[406] including: When can taxpayers expect to be notified by the tax authority that an arrangement is being investigated under the PPT and does an investigation under the PPT stay prescription? How or to where does the taxpayer appeal findings made under a PPT investigation? Will any part of the investigation be subject to MAP? Does the taxpayer have any rights if the investigating authority decides not to involve the other state's competent authority? What is the expected duration for the whole process? What about corresponding adjustments?

In this section, the potential process and consequences of invoking the PPT are considered.

3.7.1 Process of invoking the PPT

Regarding the substantive element, as mentioned earlier,[407] tax authorities may very well consider the reasonableness test at the concluding stages of the principal purpose test's application, even though the wording of the PPT does not require this. This author expects this to be a reasonable approach because of the inclusion of the "relevant facts and circumstances" requirement.

In order to obtain all the relevant facts and circumstances tax authorities would have to request the taxpayer to provide same.[408] Should the tax authorities not follow this approach and conclude, on the basis of the facts and circumstances at their disposal, that the principal

[404] Chand op cit n.307 p.21; De Broe & Luts op cit n.287 p.133; Lang (2014) op cit n.300 p.661, Kok op cit n.358 p.409.
[405] Kuźniacki op cit n.291 p.248.
[406] Palao Taboada 'OECD Base Erosion and Profit Shifting Action 6: The General Anti-Abuse Rule', *Bulleting for International Taxation* (2015), IBFD, p.606; Cunha op cit n.349 p.185; Chand op cit n.307 p.41.
[407] At 3.4.4 above.
[408] Weber op cit n.345 p.51.

purpose of an arrangement is to obtain a tax benefit, then the taxpayer can always dispute this in an objection against his tax assessment or before a court.[409]

If the tax authority obtained all the facts and circumstances from the taxpayer, this author expects that the PPT investigation will either be abandoned, because the substantive element is not present, or the PPT will be invoked. However, before invoking the PPT the tax authorities would presumably also have to consider whether the case at hand requires consultation through MAP with the other contracting state's revenue authorities. Only then can the PPT be invoked and potentially, through the MAP.

This author further expects that where a tax authority engages with a taxpayer to obtain the relevant facts and circumstances and still concludes that the principal purpose of an arrangement is to obtain a tax benefit, an aggrieved taxpayer can challenge this conclusion through an objection to assessment before a court,[410] through MAP or a combination of both.

Lastly, this author expects that the proviso will only be relied on by taxpayers in the alternative, in their challenge against the tax authority's conclusion under the substantive element, due to the legal uncertainty and confusion brought on by this test.

3.7.2 Denial of benefits

There is no guidance on the consequences in the residence state where the PPT is applied by the source state or even for more complicated cases, like instances where three or more countries are concerned.[411]

In other words, if a source state denies a benefit under the PPT, should the resident state give a credit for the tax charged? Can the resident state deny the credit by citing, among others, the PPT's application? [412] Another question is, where a taxpayer "re-characterised" income treated as dividends into income treated as CGT, for example, and the PPT is applied. Would treaty benefits be granted where the "avoidance transaction" is disregarded i.e. treaty relief under Article 10, or does the PPT refuse any benefits once applied?[413] In both cases the PPT's application may have a penalizing effect,[414] which could cause further constitutional issues regarding national formal and material requirements for both tax penalties and tax crimes.[415]

[409] Ibid.
[410] Ibid.
[411] Lang (2014) op cit n.300 p.662.
[412] Lang ibid; De Broe & Luts op cit n.287 p.134; Báez Moreno op cit n.342 p.443.
[413] Chand op cit n.307 p.39.
[414] Lang (2014) op cit n.300 p.662; Chand ibid; Báez Moreno op cit n.342 p.443.
[415] Moreno op cit n.342 p.444.

This author notes that the OECD initially intended, pursuant to the PPT being enacted into the MLI, for the item of income to be taxed under the domestic law of the source state.[416] Still, it is unclear if such treatment could result in the re-characterisation of income and, if so, whether treaty benefits would then be available to the income in its re-characterised form.

The OECD, perhaps in an attempt to provide guidance in this regard, suggested that treaties include an alternate treaty provision that would enable the competent authorities to provide discretionary relief.[417] However, most countries did not.[418]

3.7.3 Conclusion

The legal and procedural consequences of the PPT's application remain unclear,[419] especially where countries did not opt into the MLI's discretionary relief provision.[420]

There are authors, including this author as set out above, that expect MAP to play an integral role in the application of the PPT,[421] not only because of the lack of guidance on the PPT's application, but also because MAP is a minimum standard of the MLI and thus available to all MLI signatories.

3.8 Explanatory examples and case law

3.8.1 Commentary examples

The OECD provided a number of examples in the Commentary that are meant to provide guidance with the interpretation of the PPT.

The reader may note that this chapter did not analyse these examples, although this chapter noted some key considerations from the examples in sections 3.4.2-3.4.3 above. This is because the examples have been analysed in detail by many authors.[422] Further, for the overall purpose of this dissertation, the discussion of these fictional examples[423] in detail may not provide conclusive guidance in the interpretation of the PPT.

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[416] OECD 'Follow up work on BEPS Action 6: Preventing Treaty Abuse' (2014), p.10–11.
[417] MLI Article 7(4).
[418] 31 countries opted into this provision at the time of this dissertation; see MLI Matching Database, OECD, accessed 14 February 2021 at https://www.oecd.org/tax/treaties/mli-matching-database.htm.
[419] Báez Moreno op cit n.342 p.441.
[420] Which appears to be the majority of MLI signatories, including South Africa.
[421] Palao Taboada op cit n.406 p.606.
[422] Chand op cit n.307 from p.27; Van Weeghel op cit n.277 from p.31; Blessing 'Article 29 – Entitlement to Benefits (Global Perspective)' *Global Tax Treaty Commentaries* (2020), IBFD at 2.2.2.2.4; See Kuźniacki op cit n.291, at p.267; Elliffe op cit n.294; Weber op cit n.345; Danon op cit n.294.
[423] Despite the fact that six of the thirteen examples are based on well-known tax cases and that the remaining seven are based on examples contained in the exchange of letters between the US and the UKs to interpret the anti-conduit provision contained in Article 3(1)(n) of the 2001 US-UK tax treaty.

3.8.2 Case law

At the date of this dissertation, there has not been case law that centred on the MLI's PPT. However, within the context of a treaty PPT, the relatively recent *Starr*[424] case was noted by some authors as being potentially significant to the discussion of the MLI's PPT.[425]

In this case the court *a quo* held that it could not interpret the PPT due to the separation of powers doctrine and that the so-called "political question doctrine"[426] applied. The Federal Court of Appeals, however, held that the matter was one of treaty interpretation and, as such, the District Court did have jurisdiction to interpret the PPT.[427] However, the taxpayer never proceeded with its appeal and therefore the PPT was never interpreted by the District Court.[428]

This author notes that the authors referenced above published their views before the taxpayer decided not to proceed with their appeal. Following the taxpayer's decision not to proceed with the appeal, this case lost any relevance it may have had regarding the PPT's interpretation.

However, had the taxpayer proceeded with the appeal, it would have been interesting to see how the court would have dealt with the IRS's case when interpreting the PPT, because the IRS relied heavily on its own subjective determination of the taxpayer's intent, building its case on the taxpayer's history of "suspicious" tax-based relocations.[429] This approach is contrary to the US's own Technical Explanation, which is objective,[430] and the MLI's PPT, which applies a test that leans towards being more results-centred.[431]

3.9 Conclusion

In this chapter, the background of the PPT was briefly addressed, followed by an analysis of the PPT. The discussion in this chapter also noted the confusion and contradictory views among commentators regarding the interpretation of the PPT. The legal uncertainty around the denial of benefits and the process when the PPT is invoked was also analysed.

The VCLT was confirmed as the basis for interpreting the PPT, because the MLI falls within the context of international treaty law. Further, the MLI, and therefore the PPT, was developed by and for use in an international tax arena and it is intended to form part of international tax

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[424] US: *Starr International Co. v. United States* No. 17-5238 (D.C. Cir. 2018).
[425] Hattingh (2018) op cit n.293; Elliffe op cit n.294 p.53.
[426] Brauner 'Discretionary Treaty Benefits in Tax Treaty Case Law around the Globe' in Lang et al (eds.) *General titles* (2020), IBFD at 4.
[427] Supra n.424 at III. Conclusion.
[428] Boris 'Starr Drops $38M Tax Refund Suit Despite Winning Appeal' *Law360 Tax Authority* (2019).
[429] *Starr* supra n.424; Brauner op cit n.426.
[430] Technical Explanation: Department of the Treasury Technical Explanation of the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income.
[431] See 3.4.4 above.

language. Therefore, the use of domestic GAARs with similar provisions should be avoided in the interpretation of the PPT, because a material risk exists that the use of domestic GAARs could result in inconsistent interpretations of the PPT globally. Despite the aforementioned, this author is of the view that the absence of clear guidance on the PPT will result in courts relying (perhaps heavily) on domestic GAARs and case law for guidance, especially where the domestic GAAR bears resemblance to the PPT.

The debate regarding the test applied by the PPT was investigated and this author concluded that the PPT's substantive element combines the subjective and objective tests, as the PPT cannot be invoked in the presence of only one. Additionally, the presence of legitimate business reasons and/or economic substance are indications that the reasonableness test has not been met. The aforementioned may indicate an implicit normality or permissibility requirement that would need to be satisfied in order for the PPT to apply. There have also been suggestions for such amendment to the PPT among commentators.[432]

This author expects aggrieved taxpayers to challenge tax authorities on their findings under the substantive element, irrespective of whether they were provided with an opportunity to provide all the relevant facts and circumstances before the PPT was invoked.

The proviso provides the taxpayer with an opportunity to establish that the intentions of the contracting states to the relevant treaty are not frustrated if the benefit of a provision is granted. Due to the uncertainty around this element, this author expects that taxpayers will only take up this onus in the alternative to challenges raised under the substantive element.

Further, in the absence of rules around the denial of benefits, this author expects MAP to play an integral role, which could cause further legal uncertainty as well as time consuming and costly administration for tax authorities and taxpayers alike.

[432] Báez Moreno op cit n.342 p.436.

CHAPTER 4: DOES SOUTH AFRICA NEED THE PPT?

This chapter investigates two propositions by the DTCom following their statement that technically, the PPT and the GAAR serve the same purpose and that the GAAR could be applied to prevent treaty abuse.[433]

The first is that the GAAR and the PPT have the same objective and mechanisms to fulfil their respective objectives. In order to investigate this proposition, the GAAR and PPT are compared against each other. If the outcome is that they are inherently the same rule dressed up in different provisions, the proposition will be proven correct.

Secondly, the proposition that the GAAR can be applied in a treaty context would also have to be confirmed. Therefore, the investigation of this proposition will consider South Africa's legal framework.

4.1 Comparing the GAAR to the PPT

This section will consider the two rules' similarities and differences in detail. However, this author notes that the comparison does not quite compare apples with apples, as explained below.

While neither the GAAR nor PPT are charging provisions, but rather provisions "guarding" against treaty or ITA provision abuse, the PPT is narrower in that it is limited to a bilateral treaty context. The GAAR is also wider in that it aims to "protect" the charge to tax, in addition to "guarding" against abuse.[434]

The comparison is nonetheless useful, because the PPT duplicates a part of the GAAR's wider function. Further, if the GAAR were to be applied in a treaty context, the same limitations of the PPT would apply to it in that treaty context, i.e. in a treaty context, the GAAR would be limited to a bilateral treaty context and a "guarding" function.

4.1.1. Wide interpretation assigned to general terms

From the analyses of the PPT[435] and GAAR[436] it is clear that the ordinary meaning of general terms such as "benefit", "arrangement or transaction", "resulted directly or indirectly" and so on, are meant to be interpreted broadly. This includes meanings assigned to these terms by case law and guidance that constitutes context (for the PPT).[437]

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[433] DTCcom op cit n.24 p.102.
[434] *Glen Anil* supra n.36.
[435] Refer chapter 3.
[436] See chapter 2.
[437] Sections 2.2; 2.3 and 3.3 above.

Notably the GAAR allows the Commissioner to consider a whole series of transactions or steps and parts thereof, while the OECD's intentions are the same for the application of the PPT.[438]

4.1.2. Normality and permissibility

As stated before, the PPT, on a literal reading, can technically apply to any scheme, arrangement or transaction (in a treaty context), while the GAAR by virtue of the tainted elements requirement only applies to "impermissible avoidance arrangements." This is perhaps the biggest difference between the two instruments.

The 1941 GAAR, like the PPT, did not distinguish between different types of tax avoidance. Thus, as is the case with the PPT in a treaty context, any type of tax avoidance arrangement could be subjected to the 1941 GAAR. This was the first criticism raised against the 1941 GAAR, including by the Commissioner himself,[439] and the *King* case promptly applied a normality requirement to the GAAR.[440]

At first glance, it appears that the PPT's proviso and 2006 GAAR's misuse or abuse element are similar. It must be noted, though, that while their effect is the same in a treaty context, their framing is different: the PPT's proviso[441] limits the application of the PPT, while the GAAR's misuse or abuse requirement indicates impermissible avoidance arrangements.

Thus, it is clear that the PPT and GAAR, on a literal reading, are not similar in respect of a normality or permissibility requirement and because of this, the PPT has a wider scope than the GAAR.

However, while guidance on the PPT does not explicitly refer to normality or permissibility requirements, the BEPS Report and Commentary include considerations around the normality of an arrangement when the PPT's application is considered.[442] Such considerations include economic substance, business purpose and tax and other reasons for arrangements among others and examples in both the BEPS Report[443] and the Commentary[444] acknowledge normal arrangements.

The question therefore arises whether the PPT has an implicit business purpose or normality test in its reference to "relevant facts and circumstances"? The examples noted in the

[438] See the last paragraph at 3.3 above.
[439] SARS op cit n.4 p.42-44.
[440] 2.2.1 above.
[441] Section 4.1.5 below discusses the proviso.
[442] 3.4.3 above.
[443] Examples B and F at para.19 Section A, p.66, 68.
[444] Article 29 commentary, examples B and F, para 187.

preceding paragraph suggests that the presence of business purpose can be the decisive "relevant" fact.

Further, the potential application of the PPT to any arrangement that meets the purpose test is clearly not the PPT's intention;[445] and such application may lead to absurd results in the absence of an additional avoidance element that is unrelated to the requirements of the relevant treaty provision.[446]

Therefore, this author believes that PPT's guidance and its interpretation to date suggests the presence of an implicit normality or permissibility test, as opposed to the GAAR's formal inclusion thereof. Consequently, this author's view is that the GAAR may still be applied instead of the PPT in this regard.

4.1.3. The purpose test

a. Single purpose versus multiple purpose test

The PPT applies a multiple purpose test while the GAAR applies a single purpose test. At a first glance, this difference seems significant.

Nevertheless, this author holds the view that this aspect of the PPT and the GAAR are similar. This is because (as illustrated by the 1959-1996 GAARs, which also applied a multiple purpose test), it is inevitable that the taxpayer and tax authority will establish a hierarchy of purposes, or at least allude to it when establishing "one of the principal purposes. Examples from South African case law that illustrate this point include *Geustyn,*[447] *Louw,*[448] *Conhage*,[449] *Gallagher*[450] and *Hicklin*.[451]

From the above, while the PPT and 1959-1996 GAARs may be similar in this regard, the question around the relevance of this comparison for the purposes of this dissertation may arise, since these GAARs are no longer in force. In this author's view, the practical application of the PPT's purpose test will be no different from the 1959-1996 GAARs, which is also no different from the 2006 GAAR since the application of the old 1959-1996 GAARs inadvertently resulted in the determination of the main purpose.[452]

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[445] OECD/G20 op cit n.275 p.9.
[446] 3.5.2 above.
[447] 2.2.2(c)(i) above.
[448] 2.2.2(c)(iii) above.
[449] 2.2.2(c)(iv) above.
[450] 2.2.2(c)(ii) above.
[451] 2.2.2(d)(iv) above.
[452] 2.3.4 above.

Consider the following example:[453] A US company was founded in 1943, incorporated in Panama. Its headquarters moved to Bermuda in 1970 and to Ireland in 2004, followed by a move to Switzerland in 2005. The treaty benefits between Ireland and Switzerland are the same, except that the latter's treaty benefits are not automatic. It is this last move that is scrutinised by the tax authority. It denies treaty benefits because it argues that one of the taxpayer's main purposes for the move was to obtain tax benefits.

The taxpayer stated that the move was primarily necessitated by two pressing matters: flexibility for its charity from a regulatory perspective and legal protection for its assets. Further, the consideration of favourable treaty countries was ancillary to the main purpose, which would not have existed were it not for the primary reasons. Argued by the taxpayer: "a principal purpose must be at least a first purpose among equals".[454]

Accepting the taxpayer's arguments for the purposes of this example, and considering the purpose test only, under the 1959-1996 GAARs the business reasons would outweigh the tax reasons if it was supported with sufficient evidence. Under the 2006 GAAR only the main purpose is relevant to determine if the GAAR can be applied. The main purpose being business reasons, the 2006 GAAR would not apply. A literal application of the PPT would result in its application, however, based on the arguments presented in this dissertation, the PPT too should not apply on the same basis that the 1959-1996 GAARs did not apply, which is that the business reasons will outweigh the tax reasons.

Thus, the practical application of the GAAR and PPT's purpose tests will probably result in the same outcome, as discussed above. Arguments around the purpose will then inevitably centre on which party's primary purpose is more believable, based on the relevant facts and circumstances.

b. Objective versus subjective purpose test

Both chapters on the GAAR and the PPT included a dedicated discussion regarding the type of test applied by the purpose requirement.

While the test was subjective under the pre-2006 GAARs, the Commissioner made it clear that the test is objective under the 2006 GAAR.[455] However, many scholars, including this one, hold the view that it is unlikely that a purely objective test could be applied in practice.[456]

[453] Example based on the *Starr* case facts.
[454] US: *Starr International Co. v. United States*, 275 F. Supp.3d 228, 248 n.14 (D.D.C. 2017).
[455] See 2.3.4 above.
[456] Ibid.

In this regard, the GAAR's test is similar to the PPT's test, because in the absence of clear guidance around the PPT's test, one of the more compelling views are that the objective facts and circumstances around an arrangement must be considered when the taxpayer's purpose is determined under the PPT.[457]

In other words, the subjective circumstances alone are not sufficient for the tax authority to determine purpose. In this author's view, this results in a combined purpose test for the PPT,[458] just like the GAAR.

4.1.4. Reasonableness test

Both the PPT and the GAAR include a reasonableness test that renders the principal purpose test more objective.

There are no notable differences between the PPT and GAAR's reasonableness tests as both require the tax authority to reasonably consider all the relevant facts and circumstances. This opens the window for the taxpayer to present his *ipse dixit,* although the courts will be limited in considering it only insofar it does not contradict objective evidence.[459]

Following from discussions in the preceding chapters and the comparison of the PPT and GAAR's purpose test in the section above, it is clear that the reasonableness test is inherently linked with the purpose test in both instruments. This is because *ipse dixit* is as much a fact as any other and, in the absence of an explicit indication to the contrary, even for the purposes of an objective test, it arguably remains one of the potentially relevant facts and circumstances, because it may be relevant to the objective characterisation of the situation.[460]

4.1.5. "Relevant" facts and circumstances

Both the GAAR and PPT require this consideration.

This requirement's discussion has been interwoven with other requirements in this chapter and from the overall discussions in this dissertation, it is clear that this requirement is crucial to both instruments.

4.1.6. Proviso

The PPT's proviso requires the taxpayer to prove that the granting of benefits are not contrary to the object and purpose of the relevant treaty provisions.[461]

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[457] 3.4.4 above.
[458] Ibid.
[459] 2.3.4; 3.4.2 above.
[460] Cilliers op cit n.27 at 46.19.
[461] 3.5 above.

The GAAR does not contain a proviso and it has no limitations. However, it will not apply if one of the tainted elements were not present in an arrangement, even if the taxpayer had an avoidance purpose, and *vice versa*, if one of the tainted elements were present, but the taxpayer proves there was not avoidance purpose, the GAAR cannot apply.

4.1.7. Purposive interpretation

Both the PPT's proviso,[462] as well as the GAAR's misuse or abuse element,[463] require purposive interpretations.

A two-phase approach was acknowledged under both instruments, which requires that the purpose for the provision is firstly established and secondly that a determination is made as to whether the granting of benefits would be agreeable with the object and purpose of the provisions.[464]

Discussions under both instruments also indicated that the requirement for a purposive interpretation could merely serve as an indication that an overly strict and literal interpretation should not be applied. Both indicate that interpretation is a holistic exercise in which context must be taken account of from the very beginning and not only if an ambiguity arises.[465]

4.1.8. Onus of proof

While not explicitly stated by the PPT, the tax authority has the initial responsibility to demonstrate that it is reasonable to invoke the PPT because, having regard to all relevant facts and circumstances, one of the principal purposes of an arrangement was to obtain a treaty benefit.[466] There is no formal onus on either the tax authority or the taxpayer to prove that the arrangement was permissible/normal.

Under the GAAR, the Commissioner bears the onus to prove the presence of three of the four requirements.[467] Once the Commissioner demonstrated a tax benefit effect, a rebuttable presumption exists that the sole or main purpose of the arrangement was to obtain a tax benefit, shifting the onus to the taxpayer. Similarly, the onus would be on the taxpayer under the PPT if he challenged the tax authority's conclusion regarding the facts and purpose.[468]

At first glance, it appears that the tax authority's onus is less burdensome under the PPT. However, the mere wording of the PPT does not necessarily refer to the weight of the tax

[462] 3.5.1 above.
[463] 2.3.5(d) above.
[464] 3.5.1 and 2.3.5(d) above.
[465] Ibid.
[466] 3.6 above.
[467] 2.4 above.
[468] 3.6 above..

authority's onus, but rather the manner in which it must reach its conclusions.[469] It is therefore reasonable to expect that the "he who alleges must prove" principal applies to the PPT and that the tax authority must establish the facts upon which the PPT is invoked, as well as the presence of some additional avoidance element,[470] just like the GAAR.[471]

The one difference that cannot be reconciled between the GAAR and the PPT is the onus under the PPT's proviso, which is on the taxpayer. Under the GAAR the onus is on the Commissioner since it is a tainted element. However, as discussed at 4.1.2, the function of these provisions is not comparable and thus the difference in the onus of proof is not a surprise. Based on the underlying functions of these requirements, this difference is not material.

Thus, the onus of proof under both instruments are essentially, similarly, split between the tax authority and the taxpayer. Further, if the tax authorities fail to discharge their initial burden under either instrument, there will be no reason to apply the PPT or GAAR and taxpayers will not need to defend themselves.

4.1.9. Consequences of invoking the rules

The PPT and the GAAR do not align by virtue of PPT's lack of procedural guidance as opposed to the clear process set out in the GAAR.[472]

However, the amount of taxpayer uncertainty caused by the consequences of invoking both of these instruments could very well be similar, because the PPT includes no clear guidance other than stating that treaty benefits must be denied and the Commissioner's "corrective" powers are vast under the GAAR.[473]

4.2 Applying the GAAR in a treaty context

The OECD attempted to resolve the ongoing argument around whether or not domestic GAARs can be applied in a treaty context, through the 2003 Commentary with the introduction of its guiding principle in terms of which, as a general rule, there will be no conflict between domestic GAARs and treaties.[474]

[469] 3.4.2 above.
[470] Discussed at 4.1.2.
[471] 2.4 above.
[472] 3.7 and 2.5 above.
[473] Ibid.
[474] 2014 Commentary on Article 1 para.9.2.

However, the international academic community,[475] tax authorities and courts of several (OECD and non-OECD) countries did not simply accept this change and it was subject to criticism from all fronts.[476]

The Commentary distinguishes between States that consider the abuse of a tax treaty as an abuse of domestic law and those that consider it as independent from abuses of domestic law.[477] The Commentary concludes that the former, read together with the guiding principle,[478] entitles jurisdictions to deny treaty benefits under both scenarios where arrangements constitute an abuse of the provisions of that treaty.[479]

One of the updates to the Commentary, regarding the guiding principle, states that if the main aspects of a GAAR conform to the main aspects of the guiding principle and the PPT, no conflict will be possible (between a GAAR and the PPT). This is because the relevant domestic GAAR will apply in the same circumstances as the PPT and in the absence of the PPT, the guiding principle.[480] Many authors criticised this update as nonsensical because the distinction is artificial and unjustified.[481]

However, flawed or not, the Commentary acknowledges that a GAAR can be applied in a treaty context.[482] The next question then centres on the legal position from a South African perspective: Does South African law allow for the application of the GAAR in a treaty context? In other words, does it regard the abuse of a tax treaty as an abuse of domestic law?[483] The answer to this question that will ultimately determine the outcome of this analysis.[484]

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[475] Arnold op cit n.289 p.244–247; Arnold & Van Weeghel 'The Relationship Between Tax Treaties and Domestic Anti-Abuse Measures' in Maisto (ed.) *Tax Treaties and Domestic Law* (2006), IBFD, at 5.4. Martín Jiménez op cit n.289; De Broe *International Tax Planning and Prevention of Abuse* (2008), IBFD, at 4.1.2; Pérez & Báez 'The 2003 Revisions to the Commentary to the OECD Model on Tax Treaties and GAARs: A Mistaken Starting Point' in Lang et al (eds.) *Tax Treaties: Building Bridges Between Law and Economics* (2010), IBFD, p.132–138; Báez Moreno op cit n.342 p.432-435.

[476] 2014 Commentary to Article 1 Observations: Chile, Ireland, Luxembourg, Netherlands, and Switzerland disagreed that there is generally no conflict between GAARs and the provisions of treaties. 2017 Commentary to Article 1 reservations: France, Germany, Hungary, Ireland, Luxembourg and Switzerland.

[477] Commentary on Article 1 paras.58, 59.

[478] Ibid para.60.

[479] Ibid para.61.

[480] Ibid para.77.

[481] De Broe, op cit n.287 at 4.1.2; Báez Moreno op cit n.342 p.433; Cilliers op cit n.27 at 46.32.

[482] Assuming that the treaty itself does not restrict the application of a domestic GAAR, see Furuseth *The Interpretation of Tax Treaties in Relation to Domestic GAARs* (2018), IBFD.

[483] Commentary op cit n.477.

[484] Chand & Elliffe 'The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties in the Post-BEPS and Digitalized World' *Bulletin for International Taxation* (2020), IBFD, p.320.

4.2.1. The legal status of treaties under South African domestic law

The legal status of treaties is determined by the Constitution,[485] which states that an international agreement binds the country only after Parliament has approved it.[486] An international agreement becomes law when it is enacted into law by national legislation.[487]

Tax treaties are typically tabled for Parliament's approval and thereafter, the treaty is published in the Government Gazette, after which it "shall have the effect as if it was enacted in the ITA."[488] This means that a treaty not only becomes part of South African domestic legislation, it is effectively incorporated into the ITA and therefore, technically, equal to other provisions of the ITA.

Further, customary international law is law, unless it is inconsistent with the Constitution or an Act of Parliament.[489] The ITA is an "Act of Parliament" and the VCLT is widely accepted to be a codification of international customary law and provides guidance to South Africa (even though it is not a signatory).[490]

The Constitutional Court has accepted on various occasions that some of the VCLT's "major provisions" from part of South African law, on the basis of it being customary international law.[491] Crucially, South Africa's highest courts also tend to apply the VCLT specifically in cases concerning tax treaty interpretation.[492]

The Constitution further states that when interpreting any legislation, every court *must* prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.[493] The effect of this provision is effectively that, once a court decides that there is an "irreconcilable conflict" between customary international law and an Act of Parliament, the Act of Parliament must prevail in terms of the Constitution's Section 232.[494]

Thus, in the event of an irreconcilable difference between the GAAR and a treaty, the above inevitably means that the GAAR should trump the relevant treaty provision, not only because

[485] Constitution section 231.
[486] Constitution section 231(2).
[487] Constitution section 231(4).
[488] ITA section 108(2).
[489] Constitution section 232.
[490] Cilliers op cit n.27 at 46.34; Dugard et al (eds.) *International Law A South African Perspective* (2013), 4th edition, Juta, p.28.
[491] See *Harksen v President of the Republic of South Africa* (2000) ZACC 29 and *Law Society of South Africa and Others v President of the Republic of South Africa and Others* (2018) ZACC 51.
[492] See, *SARS v Werner van Kets* (2012) 3 SA 399 (WCC) and *SARS v. Tradehold Ltd* (2012) ZASCA 61.
[493] Emphasis added, Constitution section 233.
[494] Cilliers op cit n.27 at 46.34.

of the law, but also because the GAAR's scope (under the *generalia specialibus* principle).[495] This would even be the case where the relevant treaty included its own treaty-GAAR, or similar provisions.[496] However, this outcome should not be assumed lightly as it could result in South Africa failing to adhere to obligations imposed on it by the relevant treaty[497] such as imposing on the principle of good faith and applying unilateral changes to the tax treatment of a transaction under a treaty - an outcome that is disallowed by customary international law[498] as discussed at 3.2 above.

As mentioned in chapter 1, the DTCcom pointed out the risk of treaty override and recommended that the GAAR should not be applied in a treaty context.[499] Whether the Commissioner shares this view or not, there are no recorded cases of the GAAR's application in a treaty context to date.

It may not always be possible to reconcile a clash between the GAAR and the treaty resulting in the GAAR trumping the treaty, at the very least from a South African domestic perspective. Should the Commissioner apply the override within the international sphere, i.e. deny treaty benefits based on a transaction that was re-characterised by the GAAR, the treaty partner may very well (rightfully so) regard this as a breach of South Africa's obligations in terms of international law.[500] This may result in a termination or suspension of the treaty or application of sanctions, as the case may be, to force compliance from South Africa.[501]

Thus, the discussion this in section confirms that the DTCom's warnings are not unfounded.

4.2.2. Solving conflicting application of the GAAR and treaty provisions

Despite the DTCom's concerns, realistically, a clash between the GAAR and treaties are unlikely to result in the extreme outcome noted above and potential issues in this regard should be avoidable on the basis of:[502]

- MAP: It is highly likely that a court would refer any disputes from clashes noted above back to the Commissioner for a MAP, staying the case until the MAP has been concluded.
- *Quid pro quo*: A bilateral agreement may be reached between the treaty parties whereby South Africa may apply its domestic GAAR, as long as South Africa obliges the treaty partner to do the same.

[495] Cilliers op cit n.27 at 46.37.
[496] Ibid.
[497] Commentary on Article 25 para.27.
[498] Cilliers op cit n.27 at 46.35.
[499] DTCom op cit n.24 p.93.
[500] Cilliers op cit n.27 at 46.21 and section 2.5 above.
[501] Ibid at footnotes 493-494.
[502] Ibid at 46.37.

— Tacit agreement: Per the VCLT,[503] the practice of states may result in the tacit amendment of a treaty, while the failure of a state to officially protest against perceived treaty override by another, may result in that state accepting the latter's behaviour as valid under the treaty. Under these circumstances the aggrieved state loses its right to invoke a ground for invalidating, terminating, withdrawing from or suspending the operation of a treaty.

4.3 Conclusion

The comparison between the GAAR and the PPT is summarised by Figure 6.

Mechanism compared		GAAR	PPT
General terms	Wide interpretation of ordinary meaning	X	X
Purpose test	Single purpose test	X	
	Multiple purpose test		X
	Combined objective and subjective test	X	X
	Reasonableness test	X	X
	"Relevant" facts and circumstances	X	X
Normality and permissibility requirement		X	?
Proviso limiting the instrument's application if proved by taxpayer		X	X
Purposive interpretation of instrument		X	X
Onus of proof initially on the tax authority and then shifts to taxpayer		X	X
Consequences of invoking	Regulated administrative process	X	
	Regulated corrective measures	X	

Figure 6. GAAR compared to the PPT

Following the comparison of the GAAR and the PPT, three differences between the two emerged. Ultimately, though, the PPT and the GAAR are inherently similar at their cores and the differences identified between the two do not result in material differences between their object and purpose. Therefore, these differences will not prevent the GAAR's application in

[503] VCLT article 45.

the PPT's stead in a treaty context, for the reasons set out in this chapter and summarised below.

Firstly, and the greatest difference in this author's view, is that the PPT does not include a formal normality or permissibility requirement, as opposed to the GAAR's intricate tainted elements requirement. However, indications of an unofficial normality and/or permissibility requirement were found following the PPT's analysis. While implied, the implications of the requirement are similar to the GAAR's very formal requirement, even if only with regards to the normality requirement. As such, this core purpose and function of the GAAR is also present in the PPT, although intertwined with the PPT's purpose test. As noted, this author expects that courts will formally adopt a normality requirement when the PPT is brought before it.

Secondly, under the purpose test, it appears that an arrangement caught under the GAAR will always be caught under the PPT while the opposite is not true, because of the PPT's multiple purpose test. However, as discussed in this chapter, this author believes that the results, following the practical application of these tests, will be similar. Additionally both instruments' purpose tests comprise a combination of an objective and subjective test. Therefore, these differences should not disqualify the GAAR from applying instead of the PPT.

Thirdly, the PPT's lack of procedural guidance and range of potential consequences. While the author discussed a potential framework for the aforementioned, it remains hypothetical and the PPT and GAAR cannot be compared conclusively in this regard. However, while the GAAR regulates both the procedural and the corrective powers, the Commissioner basically has *carte blanche* when it comes to the correction of impermissible avoidance arrangements. In this regard, the taxpayer uncertainty caused by the lack of clear guidance in the PPT and the GAAR may be equal.

The second section of this chapter considered whether the GAAR could legally apply in a treaty context, assuming that the relevant treaty itself does not explicitly prevent it. This analysis confirmed that South Africa's Constitution and the ITA not only allow for the application of the GAAR in a treaty context, but it can also compel it in cases of irreconcilable clashes between the ITA and relevant treaty. Further, in extreme cases the ITA may very well override treaty provisions.

Therefore, both propositions investigated in this chapter are correct. The GAAR and the PPT have the same core purpose and functions and the GAAR can legally apply in a treaty context, although the DTCom's concerns for treaty override (in extreme cases) are not unfounded.

CHAPTER 5: CONCLUSION

The primary objective of this dissertation was to determine whether South Africa's GAAR could apply to its treaties instead of the MLI's PPT. In addressing this question, this dissertation analysed and compared the GAAR and PPT. In addition, this dissertation considered the legal status of treaties in relation to South African legislation.

5.1 Applying the GAAR instead of the MLI's PPT

Chapter 4 concluded that, although some of their functions may differ, the PPT and the GAAR share the same core purpose and that the GAAR could be used to prevent treaty abuse, instead of the PPT.

The aforementioned could be achieved by applying the GAAR in a treaty context through the MTC's guiding principle, discussed at 3.2.3, in respect of treaties that are not covered by the MLI. In respect of treaties covered by the MLI, South Africa should be able to opt out of the PPT[504] because, treaties are automatically incorporated into the ITA upon their ratification,[505] and thus they technically include provisions that deny all treaty benefits where the principal purpose or one of the principal purposes of any arrangement was to obtain those benefits.

The DTCom's concern for treaty override because of the GAAR's application in a treaty context remains valid, although it is likely only in extreme cases and mitigating measures were noted in chapter 4 to prevent same.

Nevertheless, this author is of the view that the Commissioner will not opt out of the PPT and apply the GAAR in its treaties for the following reasons:

1. The Commissioner has never invoked the GAAR in a treaty context and there are no indications, from the Commissioner himself or among commentators, that he will do so within the near future.
2. The risk, although relatively small, remains that a treaty partner may regard the application of the GAAR in a treaty context as a breach of South Africa's obligations in terms of international law.
3. As a popular foreign investment destination and holding jurisdiction for investment into other African jurisdictions,[506] the potential reputational damage that even a perceived

[504] See 1.1.4 above.
[505] See 4.2 above.
[506] South Africa ranked third in Rand Merchant Bank's 2020 Where to Invest in Africa report available at https://www.rmb.co.za/page/where-to-invest-in-africa-2020

treaty override incident may cause is probably just not be worth the risk for National Treasury.

4. With 95 countries having signed the MLI to date and 85 of them opting into the PPT,[507] the MLI and PPT are leading the way to a new tax treaty era and to remain a competitive investment jurisdiction and South Africa would not want to be perceived as being "left behind."
5. The MLI is a cost effective and convenient way to amend a large number of treaties at the same time. Suffering from a lack of administrative and financial resources, the MLI potentially greatly benefited the Commissioner.

5.2 PPT: Key findings and predictions

In relation to the PPT a few key findings and predictions are noted.

5.2.1. Potential relevant lessons learned from the history of the GAAR

There are indications of an implicit normality and/or permissibility requirement in the PPT, the onus of which would be on the tax authority. It is expected that this implicit requirement will inevitably be developed by courts when interpreting and applying the PPT, similar to the development of the GAAR in the *King* case decided under the 1941 GAAR.

In reality the substantive element comprises a combined objective and subjective test. As such, the taxpayer's *ipse dixit* is relevant, insofar as it is confirmed by objective facts and circumstances.

In order to establish one of the principal purposes, it is inevitable that the taxpayer and tax authority will establish a hierarchy of purposes, or at least allude to it. As such, and as demonstrated by the 1959-1996 GAARs, the PPT's multiple propose test will function practically the same as a single purpose test.

5.2.2. Predictions of the PPT's application

In linking with the previous paragraph above, if the proper factual inquiry leads to the conclusion that 'non-tax purposes' outweigh 'tax purposes', then the PPT will not be applicable, because the principle purpose test has not been satisfied.

Tax authorities will, even though not so required, request the relevant facts and circumstances from taxpayers prior to invoking the PPT, in order to satisfy the PPT's substantive element.

[507] MLI Matching Database op cit n.418.

Taxpayers will primarily challenge tax authorities' findings under the substantive element, by relying on the relevant facts and circumstances and only, in the alternative, seek relief under the proviso. Additionally, MAP will play an integral role in the application of the PPT.

5.2.3. Closing comment

The PPT strikes this author as naïve in its drafting, very much like the 1941 GAAR. As the PPT's flaws, discussed throughout this dissertation, are exposed, one can hope that it will be refined. However, because of the slow and taxing task to change tax treaties as, opposed to amend domestic legislation, it is likely that the naïve version of the PPT will only be re-interpreted over time.

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APPENDIX 1: GAAR amendments from 1941 to 2006

1941 GAAR Section 90 of Act 31 of 1941	**1959 and 1962 GAARs** - Section 90 amended by section 17 of Act 78 of 1959 and replaced by - Section 103 of Act 52 of 1962	**1978 GAAR** Section 103 amended by section 14 of Act 101 of 1978[508]	**1996 GAAR** Section 103 amended by section 29 of Act 36 of 1996	**2006 GAAR** Section 103 replaced by Section 80[509] of Act 20 of 2006
90.(1) Whenever the Commissioner is satisfied - a) that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act) has been entered into or carried out for the purpose of avoiding liability for the payment of any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act) or reducing the amount thereof, and has the effect of avoiding liability for the payment of any tax, duty or levy on income or of reducing the amount thereof, the liability for any tax, duty or levy on income and the amount thereof may be determined as if the	90.(1) / 103.(1) a) Where any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act) 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 Commissioner, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out- i. was entered into or carried out by means or in a manner which would	103.(1) Whenever the Secretary 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-	103.(1) Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act; and including a transaction, operation or scheme involving the alienation of property) — a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof; and b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out— i. was entered into or carried out-	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

[508] Amendment not discussed because, the provisions of the GAAR did not change. Rather, it was the layout, which was incorporated in the amendment as well.

[509] The full wording of the 2006 GAAR, i.e. sections 80A to 80L can be found in Appendix 2.

1941 GAAR Section 90 of Act 31 of 1941	**1959 and 1962 GAARs** - Section 90 amended by section 17 of Act 78 of 1959 and replaced by - Section 103 of Act 52 of 1962	**1978 GAAR** Section 103 amended by section 14 of Act 101 of 1978[508]	**1996 GAAR** Section 103 amended by section 29 of Act 36 of 1996	**2006 GAAR** Section 103 replaced by Section 80[509] of Act 20 of 2006
transaction, operation or scheme had not been entered into or carried out;" b) whenever the Commissioner is satisfied that any agreement or any change in the shareholding in any company, as a direct or indirect result of which income has been received by or has accrued to any company during any year of assessment, has been entered into or effected by any person solely or mainly for the purpose of utilizing any balance of assessed loss incurred by the company, in order to avoid liability on the part of any person for the payment of any tax, duty or levy on income, or to reduce the amount thereof, the set-off of any such balance against any such income may be disallowed.	not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or ii. has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the transaction, operation or scheme in question, and the Commissioner 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 one of the main purposes of the transaction, operation or scheme, the Commissioner shall determine the liability for any tax, duty or levy on income and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out in such a manner as in the	i. was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or ii. has created rights· or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and c) was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax, duty or levy (whether imposed by this Act or any previous Income Tax Act or any other law administered by the Secretary) or the reduction of the amount of such liability,	(aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would not normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit; and (bb) in the case of any other transaction, operation or scheme, being a transaction, operation or scheme not failing within the provisions of item (aa), by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or ii. has created rights or obligations which would not normally be created between persons dealing at	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).

1941 GAAR Section 90 of Act 31 of 1941	1959 and 1962 GAARs - Section 90 amended by section 17 of Act 78 of 1959 and replaced by - Section 103 of Act 52 of 1962	1978 GAAR Section 103 amended by section 14 of Act 101 of 1978[508]	1996 GAAR Section 103 amended by section 29 of Act 36 of 1996	2006 GAAR Section 103 replaced by Section 80[509] of Act 20 of 2006
	circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.	the Secretary shall determine the liability, for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.	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 obtaining a tax benefit the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out or in such a manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.	

APPENDIX 2: The 2006 GAAR - Sections 80A to 80L of the ITA

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

(*a*)
in the context of business—

(i)
it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or

(ii)
it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

(*b*)
in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit; or

(*c*)
in any context—

(i)
it has created rights or obligations that would not normally be created between persons dealing at arm's length; or

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

80B. Tax consequences of impermissible tax avoidance.— (1) The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by—

(*a*)
disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;

(*b*)
disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;

(*c*)
deeming persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;

(*d*)
reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;

(*e*)

re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or

(*f*)

treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.

(2) Subject to the time limits imposed by sections 99, 100 and 104 (5) (*b*) of the Tax Administration Act, the Commissioner must make compensating adjustments that he or she is satisfied are necessary and appropriate to ensure the consistent treatment of all parties to the impermissible avoidance arrangement.

80C. Lack of commercial substance.— (1) For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.

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

(*a*)

the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or

(*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.

80D. Round trip financing.— (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 transfer of the funds would—

(i)

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

(ii)

significantly reduce, offset or eliminate any business 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 the purposes of this section, the term **"funds"** includes any cash, cash equivalents or any right or obligation to receive or pay the same.

80E. Accommodating or tax-indifferent parties.— (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

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

(*b*)
either—

(i)
as a direct or indirect result of the participation of that party 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 or accruals of a capital nature of that party; or

(*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; or

(*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 not be 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.

(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 cumulatively subject to income tax by one or more spheres of government of countries other than the Republic 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 place of business, place, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment as defined in section 9D (1) if it were located outside the Republic and the party in question were a controlled foreign company.

(4) For the purposes of subsection (3) (a), the amount of tax imposed by another country must be determined after taking into account any applicable agreements for the prevention of double taxation and any assessed loss, credit or rebate to which the party in question may be entitled or any other right of recovery to which that party or any connected person in relation to that party may be entitled.

80F. Treatment of connected persons and accommodating or tax-indifferent parties.— For the purposes of applying section 80C or determining whether or not a tax benefit exists for purposes of this Part, the Commissioner may—

(*a*) treat parties who are connected persons in relation to each other as one and the same person; or

(*b*) disregard any accommodating or tax-indifferent party or treat any accommodating or tax-indifferent party and any other party as one and the same person.

80G. Presumption of purpose.— (1) An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

(2) 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.

80H. Application to steps in or parts of an arrangement.— The Commissioner may apply the provisions of this Part to steps in or parts of an arrangement.

80I. Use in the alternative.— The Commissioner may apply the provisions of this Part in the alternative for or in addition to any other basis for raising an assessment.

80J. Notice.— (1) The Commissioner must, prior to determining any liability of a party for tax under section 80B, give the party notice that he or she believes that the provisions of this Part may apply in respect of an arrangement and must set out in the notice his or her reasons therefor.

(2) A party who receives notice in terms of subsection (1) may, within 60 days after the date of that notice or such longer period as the Commissioner may allow, submit reasons to the Commissioner why the provisions of this Part should not be applied.

(3) The Commissioner must within 180 days of receipt of the reasons or the expiry of the period contemplated in subsection (2)—

(*a*)
request additional information in order to determine whether or not this Part applies in respect of an arrangement;

(*b*)
give notice to the party that the notice in terms of subsection (1) has been withdrawn; or

(*c*)
determine the liability of that party for tax in terms of this Part.

(4) If at any stage after giving notice to the party in terms of subsection (1), additional information comes to the knowledge of the Commissioner, he or she may revise or modify his or her reasons for applying this Part or, if the notice has been withdrawn, give notice in terms of subsection (1).

80K. Interest.— Where the Commissioner has applied this Part in determining a party's liability for tax, the Commissioner may not exercise his or her discretion in terms of section 89*quat* (3) or (3A) to direct that interest is not payable in respect of that portion of any tax which is attributable to the application of this Part.

80L. Definitions.— For purposes of this Part—

"arrangement" means 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;

"avoidance arrangement" means any arrangement that, but for this Part, results in a tax benefit;

"impermissible avoidance arrangement" means any avoidance arrangement described in section 80A;

"party" means any—

(*a*)
person;

(*b*)

permanent establishment in the Republic of a person who is not a resident;

(*c*)
permanent establishment outside the Republic of a person who is a resident;

(*d*)
partnership; or

(*e*)
joint venture,

who participates or takes part in an arrangement;

"tax" includes any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner;

"tax benefit" . . . . . .

APPENDIX 3: Article 7(1) of the MLI

Notwithstanding the other provisions of this Convention, a benefit under the Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.