



# **An analysis of the South African GAAR: Exploring Australian judicial experience**

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## **ABSTRACT**

In general, taxpayers do not like to pay taxes and will try to find and utilise loopholes in tax legislation in order to avoid or reduce the liability of paying taxes. Tax authorities' response to this is to design anti-avoidance measures. One of these anti-avoidance measures includes the general anti-avoidance rules. The South African legislature introduced the general anti-avoidance rules in the form of section 90 in 1941 for the first time, which was subsequently amended to section 103 and later amended with effect from 2 November 2006 to the current section 80A to 80L. The current general anti-avoidance rules have been in existence for more than a decade, but have not been tested before the courts as yet. The current general anti-avoidance regime was reproached for containing weaknesses and uncertainties as it is a complex piece of legislation.

In many ways, the South African and Australian general anti-avoidance rules found in section 80A to 80L in Part IIA of the Income Tax Act and found in Part IVA of the Income Tax Assessment Act respectively are similar. The decisions of recent Australian case law relating to the general anti-avoidance regime was cause for concern among the Australian tax community, as the Assistant Treasurer proclaimed that the Australian Government will protect the integrity of the Australian tax system by making amendments to the general anti-avoidance regime as a direct response to the loss of recent Part IVA court cases.

Since the South African general anti-avoidance rules have uncertainties regarding the interpretation and application and have not yet been applied on a practical basis in the courts, this research analyses the South African general anti-avoidance rules with reference to the facts of selected Australian case law which spurred on the legislative changes. This analysis demonstrates that the current South African general anti-avoidance rules have weaknesses and uncertainties and are not an effective deterrent to curb tax avoidance.

## **KEY WORDS**

- Amended assessment
- General anti-avoidance rules (GAAR)
- Impermissible avoidance arrangement
- Part IVA
- Purpose
- Scheme
- Tax avoidance
- Tax benefit

## TABLE OF CONTENTS

ACKNOWLEDGMENTS .....	i
ABSTRACT .....	ii
KEY WORDS.....	iii
LIST OF TABLES AND DIAGRAMS .....	vii
CHAPTER 1 INTRODUCTION, BACKGROUND, RESEARCH QUESTION AND RESEARCH METHODOLOGY .....	1
1.1 INTRODUCTION.....	1
1.1.1 Background to the research area.....	1
1.1.2 The South African general anti-avoidance rules.....	1
1.1.3 The Australian general anti-avoidance rules.....	2
1.2 MOTIVATION OF TOPIC ACTUALITY .....	4
1.3 RESEARCH QUESTION .....	4
1.4 RESEARCH OBJECTIVES .....	4
1.5 METHODOLOGY .....	5
1.6 CHAPTER OUTLINE.....	6
CHAPTER 2 – SELECTION OF AUSTRALIAN CASE LAW.....	8
2.1 INTRODUCTION.....	8
2.2 HISTORICAL BACKGROUND OF THE AUSTRALIAN GENERAL ANTI-AVOIDANCE RULES .....	8
2.3 ELEMENTS OF THE OLD AND REFORMED AUSTRALIAN GENERAL ANTI-AVOIDANCE RULES.....	9
2.3.1 Scheme .....	9
2.3.2 Tax benefit .....	10
2.3.3 Sole or dominant purpose .....	14
2.4 SELECTION OF THE CASE LAW .....	16
2.4.1 The population and selection criteria.....	17
2.4.2 Selection criteria of the case law from the population.....	21
2.4.3 Selection of case law .....	23
2.5 SUMMARY .....	26
CHAPTER 3 THE FACTS AND FINDINGS OF THE SELECTED CASE LAW .....	27
3.1 INTRODUCTION.....	27
3.2 INTRODUCTION OF THE FACTS OF THE CASE LAW AND THE GROUP STRUCTURE.....	27
3.2.1 Entities involved in the scheme.....	28
3.3 BACKGROUND ON THE FACTS AND CIRCUMSTANCES SURROUNDING THE SELECTED CASE LAW .....	28
3.3.1 Background of business operations in the group structure .....	28

3.3.2 Background facts .....	29
<b>3.4 DETERMINATION OF THE APPLICATION OF PART IVA OF THE INCOME TAX ASSESSMENT ACT ON THE TRANSACTION.....</b>	<b>31</b>
3.4.1 Scheme .....	32
3.4.2 Tax benefit .....	33
3.4.3 Dominant purpose.....	34
3.5 SUMMARY .....	35
<b>CHAPTER 4 GENERAL ANTI-AVOIDANCE RULES OF THE SOUTH AFRICAN INCOME TAX ACT.....</b>	<b>37</b>
4.1 INTRODUCTION.....	37
4.2 THE PREVIOUS GENERAL ANTI-AVOIDANCE REGIME – SECTION 103 .....	38
4.3 CURRENT GENERAL ANTI-AVOIDANCE REGIME.....	40
4.3.1 Arrangement .....	41
4.3.2 Tax benefit .....	41
4.3.3 Sole or main purpose of the arrangement.....	43
4.3.4 Tainted elements .....	44
4.3.4.1 Abnormality element .....	45
4.3.4.2 Lack of commercial substance element.....	46
4.3.4.2.1 Substance over form indicator .....	47
4.3.4.2.2 Round trip financing indicator .....	47
4.3.4.2.3 Accommodating or tax-indifferent parties indicator .....	49
4.3.4.2.4 Offsetting or cancelling indicator .....	50
4.3.4.3 The creation of rights or obligations not at arm’s length element.....	51
4.3.4.4 Misuse or abuse of the Act element .....	51
4.4 COMMISSIONER’S DISCRETION .....	52
4.5 COMPARISON OF THE SOUTH AFRICAN AND AUSTRALIAN GENERAL ANTI-AVOIDANCE PROVISIONS.....	53
4.6 SUMMARY .....	54
<b>CHAPTER 5 DISCUSSION OF THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULES ON THE FACTS OF THE SELECTED CASE LAW .....</b>	<b>55</b>
5.1 INTRODUCTION.....	55
5.2 SUMMARY OF FACTS OF SELECTED CASE LAW.....	55
5.3 APPLICATION OF SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULES WITH REFERENCE TO THE SELECTED CASE LAW .....	56
5.3.1 Arrangement .....	56
5.3.2 Tax benefit .....	57
5.3.3 Sole or main purpose of the arrangement.....	59
5.3.4 Tainted element requirement.....	62
5.3.4.1 Abnormality element .....	62

5.3.4.2 The transaction lacks commercial substance .....	63
5.3.4.3. The arrangement created rights and obligations that are not at arm's length .....	63
5.3.4.4 Misuse or abuse of provisions of the Income Tax Act .....	64
5.4 SUMMARY .....	64
CHAPTER 6 SUMMARY, CONCLUSION AND RECOMMENDATIONS .....	66
6.1 INTRODUCTION.....	66
6.2 ACHIEVEMENT OF RESEARCH OBJECTIVES .....	66
6.2.1 Selecting case law .....	66
6.2.2 South African general anti-avoidance rules .....	67
6.2.3 Weaknesses identified in the South African general anti-avoidance rules .....	68
6.2.3.1 Terms undefined .....	69
6.2.3.2 Tax benefit and determining the sole or dominant purpose .....	69
6.2.3.3 Wide scope of the general anti-avoidance rules .....	70
6.2.3.4 Abnormality element .....	70
6.2.3.5 Other weaknesses, including new concepts.....	70
6.3 LIMITATIONS OF THIS RESEARCH STUDY .....	71
6.4 RECOMMENDATIONS.....	71
6.5 CONCLUSION .....	72
6.6 SUGGESTIONS FOR FUTURE RESEARCH .....	72
REFERENCES.....	74

## **LIST OF TABLES AND DIAGRAMS**

Table 2.1: Brief background to the case law in the population, judgment dates and outcome of case law

Table 2.2: Criteria applied to case law

Diagram 3.1. Group structure



# **CHAPTER 1 INTRODUCTION, BACKGROUND, RESEARCH QUESTION AND RESEARCH METHODOLOGY**

## **1.1 INTRODUCTION**

The objective of this chapter is to establish the problem statement and research objectives this study has to achieve. Further, the research methodology for the remainder of the study will be established.

The concept of tax evasion and tax avoidance is as old as tax itself (Evans, 2008:2). The difference between tax evasions and tax avoidance is that tax evasion involves the use of an illegal and dishonest manner to step aside the liability of paying taxes (Van Zyl, 2016:811). On the other hand, tax avoidance involves the use of a perfectly legal manner to sidestep or lessen the liability of paying taxes (Van Zyl, 2016:811). A tax system's feasibility relies in part on reducing tax avoidance as far as possible (Cassidy, 2009:740). This research will be conducted on tax avoidance with a specific focus on the general anti-avoidance rules which are concerned with impermissible tax avoidance. An effective tax system relies on an appropriate general anti-avoidance regime (Satumba, 2011:2).

### **1.1.1 Background to the research area**

It was noted in SARS (2005:7) that over the past ten years, tax avoidance has been an increasing problem internationally. The Organisation for Economic Cooperation and Development (cited by Steenkamp, 2011:2) "...warns that tax avoidance and tax evasion threaten government revenues throughout the world." The 'choice principle' as set by British common law in *IRC v Duke of Westminster* [1936] 19 TC 490, states that taxpayers are allowed to arrange their affairs to pay the least amount of tax. This principle also applies to South African taxpayers (SARS, 2010:2). The general anti-avoidance regime targets 'impermissible tax avoidance' as the unacceptable category between tax evasion and legitimate tax planning (SARS, 2010:2).

### **1.1.2 The South African general anti-avoidance rules**

The South African tax legislation has general anti-avoidance rules contained in Part IIA in section 80A to 80L of the Income Tax Act No 58 of 1962 (Income Tax Act) and in addition, includes various forms of specific anti-avoidance legislation. Therefore, the South African Revenue Service (SARS) is not excluded from the struggle that government revenues face worldwide due to taxpayers who generally do not like paying taxes and due to the legislation being scattered with specific anti-avoidance rules as well as the existence of a general anti-avoidance regime to counter impermissible tax avoidance (Calvert, 2011:1).

The South African legislature introduced the general anti-avoidance rules in the form of section 90 in 1941 for the first time, which was subsequently amended to section 103 and later amended with effect from 2 November 2006 to the current section 80A to 80L. The current general anti-avoidance regime has been in existence for more than a decade but has not been tested before the courts as yet. The current general anti-avoidance regime was criticised for containing uncertainty as it is a lengthy and a complicated piece of legislation (Liptak, 2017:1). According to Liptak (2017:1), the current general anti-avoidance regime failed to overcome the primary weakness of the previous general anti-avoidance regime, which is to be a more effective deterrent to impermissible tax avoidance. An impression was created that SARS and the National Treasury lacked faith in the new general anti-avoidance regime or that they did not fully understand their own legislation as the first notice under section 80J was only issued in 2012 (Liptak, 2017:1).

The South African general anti-avoidance rules require the following main elements:

- i) an arrangement must be present;
- ii) a tax benefit must originate from the arrangement;
- iii) the sole or main purpose of the arrangement must have been to obtain a tax benefit;
- iv) and finally, one of the tainted elements must be present in addition to obtaining the tax benefit, which can be that the transaction is not entered into a manner normal for *bona fide* business purposes (abnormality element), the transaction lacks commercial substance, the rights or obligations created are not at arm's length, or it would result in the misuse or abuse of the provisions of the Income Tax Act.

In many ways the South African and Australian general anti-avoidance rules found in section 80A to 80L in Part IIA of the Income Tax Act and found in Part IVA of the Income Tax Assessment Act, 1936 (Income Tax Assessment Act) respectively are similar, although they are different in their design, each of the rules are aimed at the same end (Calvert & Dabner, 2012:53). In many countries tax avoidance is referred to differently for example, in South Africa it is described as 'impermissible or abusive tax avoidance' and in Australia, it is described as 'aggressive tax planning' (Ho, 2013:1).

### **1.1.3 The Australian general anti-avoidance rules**

As mentioned above, the South African and Australian general anti-avoidance rules do have similarities although they differ in their design, each is aimed at the same end (Calvert & Dabner, 2012:53). The Australian general anti-avoidance rules require three main elements:

- i) a scheme must be present;
- ii) a tax benefit must originate from the scheme; and

- iii) having regard to the eight matters set out in section 177D of the Income Tax Assessment Act, the scheme, or any part of such scheme, must have been entered into for the sole or dominant purpose of obtaining a tax benefit (Louw, 2007:14).

The Australian general anti-avoidance rules have not been tested before the courts for about eight years before an avalanche of cases began with regards to Part IVA of the Income Tax Assessment Act (Calvert & Dabner, 2012:54). The Australian Taxation Office (ATO) has lost a few Part IVA of the Income Tax Assessment Act cases since 2010 that were argued before the Federal Court (Cliffe Dekker Hofmeyr, 2012:15). The effectiveness of the Australian general anti-avoidance rules have been under consideration recently to determine whether there is a need to radically increase the scope and breadth of the operation of the rules (Seymour, 2013). During March 2012, the Assistant Treasurer, (Arbid, 2012) announced as a direct response to the loss of recent Part IVA court cases, that the Australian Government will protect the integrity of the Australian tax system by making amendments to the general anti-avoidance regime. Therefore, the loss of court cases relating to the general anti-avoidance regime has spurred on legislative changes to Part IVA in the Income Tax Assessment Act (Cliffe Dekker Hofmeyr, 2012:15).

In some of these recent court cases relating to the general anti-avoidance regime, the taxpayers made a 'no tax benefit' argument and won (Cliffe Dekker Hofmeyr, 2012:15). The 'no tax benefit' argument seeks to prove that the arrangement could not have been done in any other way (Cliffe Dekker Hofmeyr, 2012:15). In essence this means that the taxpayer can argue that the taxpayer would have either done nothing, in which case no tax benefit would have arisen and consequently also no tax would have been payable at all, or alternatively the taxpayer can argue that it could have done the transaction in a manner resulting in a comparable tax result, in other words, the tax outcome would have been similar to that achieved under the scheme (Cliffe Dekker Hofmeyr, 2012:15-16).

The amendments to the Australian general anti-avoidance rules as announced during March 2012, intended to ensure that a taxpayer can no longer argue that it could have entered into a different transaction that also would have resulted in tax avoidance or in other words would have resulted in a similar tax outcome, or the taxpayer could have postponed their arrangements for an indefinite period or done nothing at all (Arbid, 2012). On 13 February 2013, the Tax Laws Amendment Bill 2013, was introduced into the House of Representatives. The Bill contained amendments to the general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act as well as new transfer pricing provisions (Trethewey, 2013).

The Australian courts held in effect by accepting the 'no tax benefit' argument that a taxpayer should not be taxed on the basis of a transaction that the taxpayer would never have entered into (Cliffe Dekker

Hofmeyr, 2012:16). According to Cliffe Dekker Hofmeyr (2012:17), under the appropriate circumstances, it is probable that a South African taxpayer could also use the ‘no tax benefit’ argument when defending a scheme in relation to the general anti-avoidance rules by arguing that the taxpayer would not have entered into the scheme at all, or alternatively it can be argued that it could have entered into a different transaction from one or more alternatives, but it would have resulted in a similar tax outcome as the transaction entered into.

## **1.2 MOTIVATION OF TOPIC ACTUALITY**

The research will analyse the South African general anti-avoidance rules by exploring Australian judicial experience. The decisions of recent Australian case law relating to the general anti-avoidance regime was cause for concern among the ranks of the Australian tax community, as it had an impact on the amendments to the Australian general anti-avoidance rules. Since the South African general anti-avoidance rules have not yet been applied on a practical basis in the courts and further because uncertainty exists regarding the interpretation and application of the legislation, this research will analyse the South African general anti-avoidance rules with reference to facts of selected Australian case law, which spurred on the legislative changes in Australia. This research will aim to fill a gap based on the facts of the selected Australian case law, analyse the South African general anti-avoidance rules, in order to determine whether it might provide an indication as to how the South African general anti-avoidance rules may be applied and potential weaknesses and uncertainties may be identified.

## **1.3 RESEARCH QUESTION**

The following research question will be applicable to this dissertation:

- i) With reference to the application of selected Australian case law, are the current South African general anti-avoidance rules an effective deterrent to tax avoidance?

## **1.4 RESEARCH OBJECTIVES**

To address the research question, the research objectives pursued in answering the research question were formulated as follows:

- i) case law will be selected based on specific criteria including the amendments of the Australian general anti-avoidance rules in chapter 2 and the selected case law will be summarised in chapter 3, in order to meet objective iii);
- ii) an investigation will be done on the general anti-avoidance rules of South Africa which will be addressed in chapter 4; and

- iii) the selected Australian case law will be applied to the South African general anti-avoidance rules as it might provide an indication as to how the South African general anti-avoidance rules may be applied and potential weaknesses and uncertainties may be identified, this application will be addressed in chapter 5.

## **1.5 METHODOLOGY**

The research will be conducted using a qualitative research approach following legal doctrinal methodology. A doctrinal methodology is a research methodology that provides a methodical discussion of the rules governing a specific legal category, analyses the correlation between rules, explains areas of difficulty and predicts future developments (Hutchinson & Duncan, 2012). A comparative approach falls within this research methodology (Coetzee, van der Zwan, & Schutte, 2014). The reason for the chosen research methodology is that this research will analyse the South African general anti-avoidance legislation and apply the facts of selected Australian case law to the South African general anti-avoidance rules in order to answer the research question.

The data collection method for this research study will be secondary data, in other words, journal articles, theses, court cases and published reports that will be used, analysed and compared. The main sources of information will include publications (journal articles, articles, or published studies including dissertations) on matters that fall within the scope of the research question. South African and Australian tax legislation will also be used as sources for the analysis of the South African and Australian general anti-avoidance rules in this study. Internet-based searches will be performed on key words like 'general anti-avoidance rules' and will be used as a source of information for this study, if relevant. The SARS and ATO websites will also be used as sources of information.

The research objectives will be achieved by performing a literature review in order to select relevant Australian case law and to analyse the current general anti-avoidance rules of South Africa to be able to draw a conclusion on whether the general anti-avoidance rules in South Africa are an effective deterrent to tax avoidance, based on the application of facts of selected Australian case law to the South African general anti-avoidance rules. The aim of this research study is to explore landmark Australian case law and apply it to South African legislation, as it could provide important information on the South African untested general anti-avoidance regime. For purposes of this study landmark cases are defined as those that concern themselves with a new significant point of law (Elliott, 1973:1). The selection criteria as set out in chapter 2 are representative of the development of the amendments of the Australian general anti-avoidance rules which was spurred on by the loss of recent court cases. The selection of the case law is not merely to describe the facts but to analyse the South African general anti-avoidance rules against the facts.

It is necessary to determine whether any limitation and bias exist for this research study. This study explores the Australian and South African general anti-avoidance rules respectively and the facts of selected Australian case law will be applied to the South African general anti-avoidance rules. Any findings must therefore be interpreted in the context of the specific facts of the Australian case law that was selected. The aim of this research study is not to address all possible cases that may come before the courts since it will only focus on landmark case law that recently came before the Australian courts as this research may provide some insight on how the untested South African current general anti-avoidance rules may be applied. Further, this study is only a comparison of the South African legislation and Australian legislation with the application of the selected Australian case law to the South African general anti-avoidance rules. Therefore, there are limitations regarding principles and lessons from other jurisdictions which will not be considered. As noted in Calvert (2011:8) “Many decisions in court are derived from the views of judges. Subjectivity is inherent in the field interpreting GAAR legislation...”. This research study only focuses on landmark case law, therefore the intention of this research study is not to be statistically valid. Lastly, this research study only focuses on the general anti-avoidance rules and therefore any South African and Australian specific anti-avoidance provisions will not be considered as part of the scope of this research study.

## **1.6 CHAPTER OUTLINE**

Listed below are the chapters that will be included in the study as well as a brief overview of its contents.

### **CHAPTER 1**

#### **Introduction, background, research question and research methodology**

The objective of this chapter is to establish the problem statement and research objectives this study aims to achieve. Furthermore, the research methodology for the remainder of the study will be established.

### **CHAPTER 2**

#### **Selection of Australian case law**

The objective of this chapter is to perform a literature review on general anti-avoidance legislation in Australia including the amendments in order to select case law to be used in this research study. The case law selected for use in this study has been determined with reference to all the recent general tax avoidance cases reported on the legal database of the ATO’s website and by applying specific criteria. The criteria used in selecting the case law included the amendments of the Australian general anti-avoidance rules in order to be able to select landmark case law.

## **CHAPTER 3**

### **The facts and findings of the selected case law**

The objective of this chapter is to summarise and analyse the background and facts of the Australian case law that were selected in chapter 2. The facts of the case law will be outlined in light of the application of the facts to the South African general anti-avoidance rules.

## **CHAPTER 4**

### **General anti-avoidance rules of the South African Income Tax Act**

The objective of this chapter is to review the literature on tax avoidance legislation in South Africa. This chapter begins with a focus on the general anti-avoidance rules in South Africa over time and then continues with an analysis of essential definitions applicable to tax avoidance. Furthermore, the requirements of the general anti-avoidance rules will be untangled in order to obtain an understanding with reference to the application of the facts of selected Australian case law to the South African general anti-avoidance rules and identify weaknesses and uncertainties.

## **CHAPTER 5**

### **Discussion of the South African general anti-avoidance rules on the facts of the selected case law**

The objective of this chapter is to apply the facts of the selected Australian case law to the South African tax legislation due to the many uncertainties that exist in the current South African general anti-avoidance rules and to determine whether light can be shed on how the South African general anti-avoidance rules will be applied in practice and to identify further potential weaknesses and uncertainties.

## **CHAPTER 6**

### **Summary, conclusion and recommendations**

This chapter will summarise the research findings in chapters 2, 3, 4 and 5 with regards to the application of the facts of selected Australian case law to the South African general anti-avoidance rules. A summary will be provided on weaknesses and uncertainties of the South African general anti-avoidance rules and recommendations will be made on how the general anti-avoidance rules could potentially be amended. Finally, a conclusion will be provided as to whether the current South African general anti-avoidance rules are an effective deterrent to tax avoidance or not.

## **CHAPTER 2 – SELECTION OF AUSTRALIAN CASE LAW**

### **2.1 INTRODUCTION**

As discussed in chapter 1, the Australian Government acted on the loss of court cases argued before the Courts relating to the general anti-avoidance rules, by introducing amendments to provisions which deal with the general anti-avoidance rules found in Part IVA of the Income Tax Assessment Act (Cliffe Dekker Hofmeyr, 2012:15). Due to the similarities between the South African and Australian general anti-avoidance rules, the research question will be answered by applying the facts of selected Australian case law, on which the government acted on by making the amendments to Part IVA of the Income Tax Assessment Act, to the South African general anti-avoidance rules. The objective of this chapter is to provide a literature review of the Australian general anti-avoidance rules in order to determine the selection criteria of the landmark case law to be selected in order to be able to discuss it further and answer the research question. This chapter begins with a focus of the Australian general anti-avoidance rules over time and then continues with an analysis of the components of general tax avoidance legislation in Australia including the amendments to the general anti-avoidance provisions in order to apply selection criteria to the court cases. Finally, the chapter concludes with the landmark case law to be applied to the South African general anti-avoidance rules in order to answer the research question.

### **2.2 HISTORICAL BACKGROUND OF THE AUSTRALIAN GENERAL ANTI-AVOIDANCE RULES**

Australia has had a statutory general anti-avoidance regime for a very long time and possibly had the longest experience with a statutory general anti-avoidance regime (Kujinga, 2016:632). The Australian general anti-avoidance regime was enacted in section 260, in 1936 in the Income Tax Assessment Act, but the current Australian general anti-avoidance rules can be found in Part IVA of the Income Tax Assessment Act. The general anti-avoidance rules in Part IVA were introduced for the first time in 1981 to fight against schemes that were 'blatant, artificial and contrived' and entered into with the sole or dominant purpose of obtaining a tax benefit (Cliffe Dekker Hofmeyr, 2012:15). Part IVA of the Income Tax Assessment Act works within the framework of the 'choice principle' as set out by *IRC v Duke of Westminster* [1936] 19 TC 490 (Morse & Deutsch, 2015:117). The application of Part IVA requires the following elements:

- i) there must be a scheme;
- ii) a tax benefit must result from the scheme; and
- iii) taking into account certain matters, the dominant purpose of the scheme must be to obtain a tax benefit.



Under Part IVA, an alternative postulate should be considered when determining whether there is a tax benefit (Parliament of the Commonwealth of Australia, 2013:1.24-1.26). As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.4), a key perceived weakness of Part IVA of the Income Tax Assessment Act related to the process of identifying a tax benefit. This weakness included the so-called ‘do nothing’ alternative in which taxpayers argued that the tax savings were essential to the completion of the business transaction (Trethewey, 2013:2). The recent amendments to the general anti-avoidance provisions addressed this ‘do-nothing’ counterfactual argument (Morse & Deutsch, 2015:132).

New section 177CB which deals with the basis for determining the alternative postulate was introduced as part of the amendments to the general anti-avoidance provisions, as well as section 177D which was slightly reconstructed, which deals with the dominant purpose test (Trethewey, 2013:2-3). The reconstruction of section 177D is to ensure that the determination of a tax benefit forms part of a single analysis in relation to the dominant purpose (Trethewey, 2013:3).

## **2.3 ELEMENTS OF THE OLD AND REFORMED AUSTRALIAN GENERAL ANTI-AVOIDANCE RULES**

A discussion of each of the elements before and after the amendments that need to be present before section 177D of the Income Tax Assessment Act will apply will now follow. It is necessary to gain an understanding of the old and the reformed general anti-avoidance rules in order to determine the selection criteria later in this chapter and further to be able to identify the similarities with the South African general anti-avoidance rules.

### **2.3.1 Scheme**

As per section 177D of the Income Tax Assessment Act, the first requirement to be met is that there must be a scheme. The term ‘scheme’ is widely defined in section 177A of the Income Tax Assessment Act and reads as follows: “...means (a) any agreement, arrangement, understanding, promise or undertaking, whether expressed or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and (b) any scheme, plan, proposal, action, course of action or course of conduct.”

The term ‘scheme’ is widely defined and was not altered as part of the recent amendments and therefore the precedent set by previous case law will apply. As per case law it is acceptable for the Commissioner to identify alternative schemes, including steps in a broader scheme as long as such scheme is capable of standing on its own without being rendered meaningless when taken from the primary scheme (Kujinga, 2016:635).

With the recent amendments to Part IVA, the concept of 'scheme' is now integrated with the concept of 'tax benefit' in the new section 177CB of the Income Tax Assessment Act (Travers, 2014:12). Therefore, although the term 'scheme' was not altered it could require the Commissioner to be more specific regarding the scope of the scheme it depends on for Part IVA to apply (Travers, 2014:170).

### **2.3.2 Tax benefit**

The second requirement for Part IVA of the Income Tax Assessment Act to apply, is that there must be a 'tax benefit' to be derived from the scheme. Section 177C of the Income Tax Assessment Act defines the term 'tax benefit'. This definition in the general anti-avoidance rules is fairly detailed. Section 177C of the Income Tax Assessment Act was not amended as part of the general anti-avoidance rules that were reformed (Travers, 2014:180). Section 177C(1) of the Income Tax Assessment Act sets out the types of tax benefits to which the general anti-avoidance rules can be applied. As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.28), section 177C(1) is concerned with the following tax outcomes:

- An amount that is not included in assessable income;
- A deduction that was allowed;
- A capital loss that was incurred;
- An offset of a foreign income tax being allowed; and
- Elimination of a liability for an amount of withholding tax.

Section 177C also specifies that a tax benefit will have been obtained if the tax benefit would not or would reasonably not have existed if the scheme did not occur.

Section 177(2) and (3) contain an exclusion from the concept of 'tax benefit'. This exclusion from the ambit of tax benefit applies in broad terms in circumstances where the taxpayer has been able to decrease his assessable income or increase his allowable deductions by means of a choice provided for under the Income Tax Assessment Act (Warneke, 2005:94).

As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.24-1.26), to determine a 'tax benefit', a hypothesis is required as to what might reasonably be expected to have occurred had the scheme not been entered into or carried out. There will be a 'tax benefit' if the most reasonable alternative postulate would have resulted, where there has been a reduction in a taxpayer's tax liability, that reduction would not reasonably have been expected to have occurred (Calvert & Dabner, 2012:71). The alternative postulate can lead to uncertainty and complexity as there may be a range of potential actions the taxpayer could have taken. The alternative postulate to identify a tax benefit led to some court decisions on the basis that the

taxpayers had not obtained a tax benefit for Part IVA purposes and so the question of purpose did not need to be addressed (Kujinga, 2016:636). This was due to taxpayers arguing that they would either have entered into schemes with comparable tax outcomes (Kujinga, 2016:636), or that they would have reasonably refrained from entering into the arrangement that attracted the tax liability, such that it would have ‘done nothing’ in the alternative (Morse & Deutsch, 2015:132-133).

The Australian courts held in effect by accepting the ‘done nothing’ argument, that taxpayers can’t be taxed on the grounds of an arrangement it would never have entered into (Cliffe Dekker Hofmeyr, 2012:16). As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.4, 1.32) revised legislative provisions were introduced due to the Government’s concern regarding increases in court decisions in favour of taxpayers due to the relative ease taxpayers were able to counter the ‘tax benefit’ argument. The eight matters necessary to determine the taxpayer’s purpose were unconnected to the inquiry of the alternative postulate, the alternative determined was rather viewed as an investigation into what the person reasonably would have anticipated to have done, if the person had not entered into the particular scheme (Travers, 2014:192). As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.51), the Government considered that the inquiry of the alternative postulate should rather focus on whether there were alternative ways in achieving the substance of the scheme, with the tax implications aside.

As part of the amendments to Part IVA of the Income Tax Assessment Act, section 177CB was introduced and reads as follows:

“(1) This section applies to deciding, under section 177C, whether any of the following (*tax effects*) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

- (a) an amount being included in the assessable income of the taxpayer;
- (b) the whole or a part of a deduction not being allowable to the taxpayer;
- (c) the whole or a part of a capital loss not being incurred by the taxpayer;
- (d) the whole or a part of a foreign income tax offset not being allowable to the taxpayer;
- (daa) the whole or a part of an innovation tax offset not being allowable to the taxpayer;
- (da) the whole or a part of an exploration credit not being issued to the taxpayer;

- (e) the taxpayer being liable to pay withholding tax on an amount
- (2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).
- (3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.
- (4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:
  - (a) have particular regard to:
    - (i) the substance of the scheme; and
    - (ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but
  - (b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).
- (5) Subsection (4) applies in relation to the scheme as if references in that subsection to the operation of this Act included references to the operation of any foreign law relating to taxation:
  - (a) if this Part applies to the scheme because of section 177DA or 177J; or
  - (b) for the purposes of determining whether this Part applies to the scheme because of section 177DA or 177J.”

Section 177CB of the Income Tax Assessment Act provides two situations in which the ‘tax benefit’ can be quantified, which is the annihilation approach and the reconstruction approach (Travers, 2014:20). Satisfying the annihilation or reconstruction approach together with the other provisions of Part IVA can give rise to the application of the general anti-avoidance rules. As per the annihilation approach which is provided in section 177CB(2), it is required to compare the tax effect between the scheme and what would have been the tax effect if the scheme had not been entered into. To apply the annihilation approach, the tax position of a taxpayer is calculated on all transactions and events, excluding the steps of the particular scheme as the steps should be annihilated or ignored (Travers,

2014:191, 193). Section 177C will then be satisfied if the ‘tax benefit’ which was obtained under the particular scheme would not have been obtained if the scheme had simply not existed. Up to date the approach used by the courts could indicate that the annihilation approach could have fairly limited application as this approach works appropriately where the non-tax effects of the scheme are limited (Travers, 2014:191, 193). The reason for the fairly limited application in terms of the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.81-1.82) is that the application of the annihilation approach will only be achieved in a situation in which the particular scheme does not produce any substantial non-tax results or consequences for the taxpayer.

The reconstructive approach, which is provided in section 177CB(3), with limitations set under section 177CB(4), will be satisfied if the tax effect might reasonably be expected to have occurred if the scheme had not been carried out and it must be based on a postulate that is a reasonable alternative or could reasonably take the place of the scheme. As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.39), the reconstructive approach envisages a postulate that will reasonably reconstruct the scheme and related actions in connection with the scheme, while disregarding any tax implication. This will provide that it will no longer be possible to dispute that the alternative postulate is to ‘do nothing’ (Parliament of the Commonwealth of Australia, 2013:1.39). This alternative scheme will now be determined under section 177CB(3), and should substantially achieve similar non-tax outcomes as those achieved through the scheme (Parliament of the Commonwealth of Australia, 2013:1.85). This postulate will require prediction of the state of affairs that would reasonably have occurred if the scheme had been reconstructed, as these non-tax results should be comparable (Parliament of the Commonwealth of Australia, 2013:1.87, 1.110). As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.88), the taxpayer will obtain a ‘tax benefit’ under the reconstructive approach if the tax outcome that would have flowed from the application of the taxation law to the alternative postulate as determined in terms of section 177CB(3) is less advantaged as what the taxpayer was able to secure in connection with the particular scheme entered into.

These amendments have not yet been tested by Australian courts and there might be uncertainties on the interpretation of the new legislative provisions. The application of the general anti-avoidance rules will depend on each scenario’s specific facts and the objective inquiry regarding the alternative postulate.

### 2.3.3 Sole or dominant purpose

The third requirement for Part IVA of the Income Tax Assessment Act to be applicable, is that the taxpayer's sole or dominant purpose must be to obtain the identified tax benefit. Section 177D of the Income Tax Assessment Act provides an in-exhaustive list of eight factors that can be applied to determine whether the sole or main purpose was to obtain a particular tax benefit. The test to determine the taxpayer's sole or dominant purpose is objective in nature taking into account the eight factors, the subjective views of the taxpayer will only be considered if it supports the objective evidence (Kujinga, 2016:639). The eight matters are still contained in the amended section 177D of the Income Tax Assessment Act, but the amendment to Part IVA in addition to dealing with the identification of a tax benefit also intended to address the inter-relation concerning a tax benefit and the dominant purpose (Parliament of the Commonwealth of Australia, 2013:1.125). As per Corrs (2013) the inquiry of whether Part IVA applies, should be a single, comprehensive inquiry into whether the scheme was entered into with a sole or dominant purpose of obtaining a tax benefit, rather than to start with the consideration whether the taxpayer received a tax benefit as it was done before the amendments. Further, the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.22) states that the test of whether a taxpayer, entered into a scheme for the dominant purpose of enabling the taxpayer to obtain a tax benefit is "...indeed the fulcrum upon which Part IVA turns...", therefore the purpose test distinguishes between permissible and impermissible tax avoidance.

In determining the purpose and considering the eight factors it is important to note that section 177D does not rely on a factual finding regarding the taxpayer's actual dominant purpose, but it is rather a judgmental finding taking into account the eight matters when determining a taxpayer's dominant purpose (Pagone, 2003:780). Therefore the scope of the eight matters is still open to debate (Pagone, 2003:780). The eight matters as per section 177D of the Income Tax Assessment Act that should be considered are:

- a) 'The manner in which the scheme was entered into or carried out.'

In *Commissioner of Taxation (Cth) v Spotless Services Limited* [1996] HCA 34, 25 'manner' was described as "...consideration of the way in which and method or procedure by which the particular scheme in question was established." If the way in which a taxpayer enters into the scheme, are commercially accepted and an expected manner into which similar schemes are entered into in normal business or family dealings, the manner will not indicate a dominant purpose of obtaining the tax benefit (ATO, 2005:132).

- b) 'The form and substance of the scheme.'

If the form of the transaction, taking into account what the scheme purports to achieve commercially and the practical effect, differs significantly from the substance it could be an indication that the scheme was entered into with the dominant purpose of obtaining the tax benefit (ATO, 2005:134).

- c) 'The time at which the scheme was entered into and the length of the period during which the scheme was carried out.'

This matter considers the time of the scheme when it was carried out and length of the scheme, for example, a transaction entered into just before the financial year end or other tax sensitive dates, could potentially indicate the purpose of the transaction (ATO, 2005:140).

- d) 'The result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme.'

The actual tax outcome should be considered and the significance of the tax result, compared to the alternative postulate and the commercial outcome of the scheme (Travers, 2014:234). If this comparison is not significant it could indicate that the purpose was not to obtain the tax benefit with regards to the scheme (Travers, 2014:234).

- e) 'Any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme.'
- f) 'Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result from the scheme.'
- g) 'Any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out.'

Matter e) to g) focus on the non-tax outcomes of the scheme for the taxpayer and connected parties (ATO, 2005:145). Under these three matters, the practical effect, financial effect, legal effect, economic effect and any other relevant effect or outcome obtained by the scheme are considered for both the taxpayer and connected persons (ATO, 2005:145). For example, if the financial position of the taxpayer and other parties reflect changes as what is expected from similar commercial transactions, then it could indicate a dominant purpose other than obtaining the related tax benefit.

- h) 'The nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).'

The word 'any' gives this matter a very wide interpretation and it does not only involve related parties. Considering how unrelated persons under an arm's length commercial transaction would have acted could indicate the nature of the connection of the parties that is part of the scheme (ATO, 2005:149).

The Australian general anti-avoidance rules were discussed in this part of this chapter, which included a discussion on the recent amendments to the general anti-avoidance rules in order to set selection criteria in the next part of this chapter. As can be seen from this part of this chapter, the Australian general anti-avoidance rules require three main elements, which consist of:

- i) a scheme must be present;
- ii) a tax benefit must originate from such scheme; and
- iii) with regards to the eight matters set out in section 177D of the Income Tax Assessment Act, the scheme, or any part of such scheme, must have been entered into for the sole or dominant purpose of obtaining a tax benefit.

As part of the Australian amendments to the general anti-avoidance rules, section 177CB was introduced which deals with the basis for determining the alternative postulate when determining the tax benefit. Further, as was noted by Trethewey (2013), the dominant purpose test in section 177D was slightly reconstructed to ensure that the determination of a tax benefit forms part of a single inquiry in relation with the dominant purpose. The selection criteria will follow in the remainder of this chapter taking into account the amendments to the general anti-avoidance rules.

## **2.4 SELECTION OF THE CASE LAW**

In order to achieve the objectives of this research study and answer the research question, the selected Australian case law will be applied to the South African general anti-avoidance rules. This might provide an indication as to how the South African general anti-avoidance rules may be applied and potential weaknesses and uncertainties may be identified to determine if it is an effective deterrent to tax avoidance. Therefore, it is first of importance to select the case law on which the South African general anti-avoidance rules will be applied. This chapter will meet research objective i) by selecting case law based on specific selection criteria including the amendments of the Australian general anti-avoidance rules.

This study will examine landmark Australian case law and apply it to South African general anti-avoidance rules. For purposes of this study, landmark cases are defined as those that concern themselves



with a new significant point of law (Elliott, 1973:1). Therefore, this study will use selection criteria in order to select case law to be analysed against the South African general anti-avoidance rules. To ensure quality in selecting cases, criteria can be applied in the selection process (Creswell, 2013:157-158). In this part of the chapter, the case law that will be used for purposes of this study will be selected based on specified criteria as set out below.

#### **2.4.1 The population and selection criteria**

To find a set of relevant case law to be used in this study, the population of case law has been established with reference to recent general tax avoidance cases which were reported on the legal database of the ATO's website ([www.ato.gov.au](http://www.ato.gov.au)). These cases represent actual court cases that have come before the courts relating to the Australian general anti-avoidance provisions.

The population was determined with reference to the decision impact statement on the cases regarding the general anti-avoidance regime, reported on the ATO's website ([www.ato.gov.au](http://www.ato.gov.au)). The timeframe this research is mainly concerned with is court cases between March 2009 and March 2012 since the series of recent judgments on Part IVA of the Income Tax Assessment Act began in March 2009 and it was announced by the Assistant Treasurer during March 2012 that the Australian Government will act on the loss of recent court cases by introducing amendments which was subsequently proposed on 13 February 2013 in the Tax Laws Amendment Bill 2013 (Arbid, 2012; Cooper, 2011; Greenwoods & Freehills, 2011:1). As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.60-1.61), the government had the intention to act on these court cases as amendments to Part IVA of the Income Tax Act were introduced. Each decision impact statement from 2009 – 2015 on the ATO's website ([www.ato.gov.au](http://www.ato.gov.au)) was scrutinised to ensure that only the court cases that in fact dealt with Part IVA of the Income Tax Assessment Act would be considered. This was achieved by scrutinising the subject reference in the decision impact statement that provides the key subject of the court cases. In each court case the following key words were searched in the subject reference list:

- Amended assessment
- Part IVA
- Scheme
- Tax avoidance
- Tax benefit

Each of the court cases with one of the above keywords were further scrutinised to identify whether it relates to Part IVA of the Income Tax Assessment Act. The reason for also scrutinising the 2013 to 2015 decision impact statements is due to the fact that an appeal on a case will only be included at the

second (appeal) date as a decision impact statement. This could therefore result that there was an actual court case during 2009 to 2012 but will only appear as a decision impact statement at a later date (the judgment date of the appeal) on the ATO's legal database.

Based on this measure, the Part IVA of the Income Tax Assessment Act court cases that came before the courts during March 2009 and March 2012 were obtained from the ATO's website ([www.ato.gov.au](http://www.ato.gov.au)) and are listed in Table 2.1 below. The Part IVA of the Income Tax Assessment Act court cases involved complex commercial structures and transactions on which a brief background will be provided as understanding the nature of the court cases is important in selecting the relevant case law which will be used for purposes of this study (Cooper, 2011).

**Table 2.1: Brief background of the case law in the population, judgment dates and outcome of case law**

<b>Court Case</b>	<b>Brief background of the case</b>	<b>Federal Court judgment date</b>	<b>High Court judgment date</b>	<b>Ultimate win or loss for ATO</b>
<i>Federal Commissioner of Taxation v BHP Billiton Finance Ltd</i> [2010] FCAFC 25	Bad debt deductions on loans made to group companies by an in-house finance company (Cooper, 2011).	17 March 2010	1 June 2011	Loss
<i>Federal Commissioner of Taxation v News Australia Holdings Pty Ltd</i> [2010] FCAFC 78	A corporate restructure was implemented to move the holding company of News Corporation from Australia to the United States of America (USA) which resulted in a capital loss. If the relocation would have been done directly, it would have given rise to a large capital gain tax liability ( <i>Federal Commissioner of Taxation v News Australia Holdings Pty Ltd</i> [2010] FCAFC 78, 2 and 9).	30 June 2010	-	Loss

<b>Court Case</b>	<b>Brief background of the case</b>	<b>Federal Court judgment date</b>	<b>High Court judgment date</b>	<b>Ultimate win or loss for ATO</b>
<i>Federal Commissioner of Taxation v Trail Bros Steel &amp; Plastics Pty Ltd</i> [2010] FCAFC 94	Contributions were made to a fund for employees which the taxpayer deducted, but the Commissioner disallowed the deduction.	29 July 2010 (corrigendum 2 August 2010)	-	Win
<i>British American Tobacco Australia Services Ltd v Federal Commissioner of Taxation</i> [2010] FCAFC 130	In anticipation of a corporate merger, assets were transferred within the group prior to the merger. Subsequently the disposal of the above mentioned assets to persons outside the merged group, resulted in capital gains being offset against existing capital losses (Cooper, 2011).	10 November 2010	-	Win
<i>Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd</i> [2010] FCAFC 134	A complex structured arrangement in which the taxpayer disposed of a subsidiary in exchange for shares, and the scrip-for-scrip rollover relief was selected to defer tax on the resulting gain (Cooper, 2011).	18 November 2010	-	Loss
<i>Noza Holdings Pty Ltd &amp; Ors v. Federal Commissioner of Taxation</i> [2011] FCA 46	The deductibility of dividends paid by the taxpayer "...on shares that were re-classified as debt...and the liability to Australian withholding tax..." of foreign shareholders (Cooper, 2011). In <i>Noza Holdings Pty Ltd and Ors v. Federal Commissioner of Taxation</i> [2012] FCAFC 43, 3	4 February 2011	-	Loss

<b>Court Case</b>	<b>Brief background of the case</b>	<b>Federal Court judgment date</b>	<b>High Court judgment date</b>	<b>Ultimate win or loss for ATO</b>
	the Commissioner did not appeal on Part IVA.			
<i>Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd &amp; Ors</i> , [2011] FCAFC 49	As per the decision impact statement of <i>Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd &amp; Ors</i> , [2011] FCAFC 49, précis, the case involved “Multiple layers of deductions...” relating to “...bad debts, interest on borrowings and transferred tax losses, in relation to...” loans between group companies	8 April 2011	-	Loss
<i>Federal Commissioner of Taxation v Citigroup Pty Ltd</i> [2011] ATC 20-262	Tax paid offshore on a bond transaction resulted in a foreign tax credit.	10 May 2011	-	Win
<i>RCI Pty Limited v Federal Commissioner of Taxation</i> [2011] FCAFC 104	A payment of an exempt dividend from an offshore subsidiary which occurred prior to the disposal of shares held in that subsidiary (Cooper, 2011).	22 August 2011	10 February 2012	Loss
<i>Macquarie Bank Ltd &amp; Anor v Federal Commissioner of Taxation</i> [2011] FCA 1076	Sale of shares held in a subsidiary compared to the tax consequences if they were sold before it became a subsidiary.	26 September 2011	-	Win
<i>Federal Commissioner of Taxation v Futuris Corporation Ltd</i> [2012] FCAFC 32	The reorganisation of a group including a complex series of steps prior to the listing of a subsidiary which resulted in an	19 March 2012	-	Loss

Court Case	Brief background of the case	Federal Court judgment date	High Court judgment date	Ultimate win or loss for ATO
	increase in the cost base of the shares in the float vehicle ( <i>Federal Commissioner of Taxation v Futuris Corporation Ltd</i> [2012] FCAFC 32, 1).			

#### 2.4.2 Selection criteria of the case law from the population

Purposive sampling will be used to apply selection criteria in order to select case law for purposes of this study. Purposive sampling is described by Yin (2011:311) as “The selection of participants or sources of data to be used in a study, based on their anticipated richness and relevance of information in relation to the study’s research questions.” According to Maxwell (as cited by Guetterman, 2015) the researcher's intent is to describe and explain from the sample in order to interpret the development of a phenomenon and not to generalize from the sample to a population. In choosing sampling strategies to select cases, Creswell (2013:157-158) states critical cases which provide specific information on a problem could be used. Pre-defined selection criteria will be determined in order to select landmark case law. The first selection criterion to be applied in selecting landmark case law critical for this study is to exclude case law from Table 2.1 in which the anti-avoidance rules were successfully applied. The reason being that this study focuses on the case law that resulted in a loss for the ATO which spurred on the amendments to Part IVA of the Income Tax Assessment Act. Subsequent to the application of this criterion only seven cases remain available for selecting case law for this study. The seven court cases that resulted in a loss for the Australian Commissioner are:

- *Federal Commissioner of Taxation v BHP Billiton Finance Ltd* [2010] FCAFC 25
- *Federal Commissioner of Taxation v News Australia Holdings Pty Ltd* [2010] FCAFC 78
- *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd* [2010] FCAFC 134
- *Noza Holdings Pty Ltd & Ors v. Federal Commissioner of Taxation* [2011] FCA 46
- *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd & Ors*, [2011] FCAFC 49
- *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104
- *Federal Commissioner of Taxation v Futuris Corporation Ltd* [2012] FCAFC 32

Further selection criteria to be considered to select case law from the remaining population will be as follows:

## 1) Criteria 1: Nature of the case

In order to choose case law that in its nature is critical to the research study, the reason behind the amendments to the general anti-avoidance provisions should be investigated.

Criteria 1.1 – no ‘tax benefit’: As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.4), a key perceived weakness of Part IVA related to the manner in which a tax benefit is identified. In a press release during March 2012, obtained from the ATO’s website, Arbib, the Assistant Treasurer announced that the government would act to protect the integrity of the Australian tax system by amending Part IVA of the Income Tax Assessment Act, these amendments will include addressing the taxpayers’ counterfactual arguments (Arbid, 2012). The loss of recent court cases spurred on the amendments of the Australian general anti-avoidance rules. The changes to the general anti-avoidance rules revolved mainly around section 177CB which provides additional guidance on the identification of a tax benefit. Therefore, the first criteria to be applied on the remaining seven court cases is that the decision of the court should be that there was no ‘tax benefit’, as ‘tax benefit’ was amended by adding section 177CB.

Criteria 1.2.- ‘done nothing’ argument: In addition to the criterion set above, the Assistant Treasurer, Arbid (2012) said "In recent cases, some taxpayers have argued successfully that they did not get a 'tax benefit' because, without the scheme, they would not have entered into an arrangement that attracted tax." Further, Arbid (2012) said: “Such an outcome can potentially undermine the overall effectiveness of Part IVA and so the Government will act to ensure such arguments will no longer be successful.” Therefore, the second criterion to be considered with regards to the nature of the case, will be case law in which the taxpayer made the ‘done nothing’ argument as the government acted on these cases to ensure these arguments will not be successful.

## 2) Criteria 2: Highest level of judicial precedence (appeal to the High Court)

The highest court in Australia is the High Court. Any appeal that goes to the High Court will require special permission and decisions of the High Court are binding on all other courts throughout Australia. The second criterion to be applied to determine the case law to be considered for this study will be cases that were appealed to the High Court that relates to the general anti-avoidance rules.

Cases that meet all the criteria as set out above will be regarded as critical case law and will be used in this study. The seven court cases that resulted in a loss for the ATO will be considered against the criteria set out above, will be discussed below.

### 2.4.3 Selection of case law

The landmark case law to be selected for purposes of this study will be refined by applying the selection criteria as was determined under paragraph 2.4.2. The table below indicates which court cases meet and do not meet the relevant criteria for refining the case law to be used in this study.

**Table 2.2 legend:**

√ - criteria met

X – criteria not met

**Table 2.2: Criteria applied to case law**

<b>Court Case</b>	<b>Further background of the court case regarding the application of the general anti-avoidance provisions</b>	<b>Criteria 1.1: no 'tax benefit'</b>	<b>Criteria 1.2: 'done nothing' argument</b>	<b>Criteria 2: Appeal to the High Court</b>
<i>Federal Commissioner of Taxation v BHP Billiton Finance Ltd</i> [2010] FCAFC 25	In <i>Federal Commissioner of Taxation v BHP Billiton Finance Ltd</i> [2010] FCAFC 25, 65 it was determined that there was no 'tax benefit' as the debt was irrecoverable, irrespective of the withdrawal of the comfort letter and not due to the counterfactual. In <i>Federal Commissioner of Taxation v BHP Billiton Lrd &amp; Ors</i> [2011] HCA 17, 83-84, the appeal by the Commissioner did not agitate the decision regarding Part IVA of the Income Tax Assessment Act, but "It is the construction of s 243-20 which is challenged by the Commissioner in this Court."	√	X	X
<i>Federal Commissioner of Taxation v News Australia Holdings Pty Ltd</i> [2010] FCAFC 78	In <i>Federal Commissioner of Taxation v News Australia Holdings Pty Ltd</i> [2010] FCAFC 78, 14, 56 the parties disagreed on the alternative postulate as "...the applicant's alternative postulate is to do nothing after the First Spin.", but the parties agreed that News Australia Holdings Pty Ltd did receive a 'tax benefit' in connection with the scheme.	X	√	X

<b>Court Case</b>	<b>Further background of the court case regarding the application of the general anti-avoidance provisions</b>	<b>Criteria 1.1: no 'tax benefit'</b>	<b>Criteria 1.2: 'done nothing' argument</b>	<b>Criteria 2: Appeal to the High Court</b>
<i>Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd</i> [2010] FCAFC 134	In <i>Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd</i> [2010] FCAFC 134, 146 it was noted "...AXA submitted that it was "content" for a direct sale to MBF to be the alternative postulate."	√	X	X
<i>Noza Holdings Pty Ltd &amp; Ors v. Federal Commissioner of Taxation</i> [2011] FCA 46	In <i>Noza Holdings Pty Ltd &amp; Ors v. Federal Commissioner of Taxation</i> [2011] FCA 46, 274-275, the taxpayer claimed that there was no tax benefit as section 177C(2)(b)(i) was engaged, which the judge rejected and determined that the taxpayer did receive a tax benefit in terms of section 177C. Further, the judge rejected the Commissioner's counterfactuals as neither were an alternative means of achieving the commercial objectives of Project Gemini. The reason this case resulted in a loss for the Commissioner is due to the judge concluding that the general anti-avoidance rules will not be applicable as the dominant purpose of the transaction was not to obtain the tax benefit.	X	X	X
<i>Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd &amp; Ors</i> , [2011] FCAFC 49	In <i>Ashwick (QLD) No 127 Pty Ltd &amp; Ors v Federal Commissioner of Taxation</i> [2009], FCA 1388, 237 the primary judge determined that there was no tax benefit as it falls within the exception under s 177C(2)(b).  In <i>Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd &amp; Ors</i> , [2011] FCAFC 49, 160 the judge noted "While I do not think the	√	X	X



Court Case	Further background of the court case regarding the application of the general anti-avoidance provisions	Criteria 1.1: no 'tax benefit'	Criteria 1.2: 'done nothing' argument	Criteria 2: Appeal to the High Court
	<p>"counterfactuals" relied on by the Commissioner... are sufficiently reliable to constitute a reasonable expectation as to what might have taken place if the Commissioner's scheme or schemes had not been entered into, I would not be prepared to find, on the material before the primary judge, that no tax benefit was obtained by one or more of the respondent taxpayers in connection with that scheme or those schemes."</p> <p>Based on this in <i>Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd &amp; Ors</i>, [2011] FCAFC 49, 204 the judge considered the dominant purpose of the scheme and determined that the dominant purpose was not to obtain a tax benefit.</p>			
<i>RCI Pty Limited v Federal Commissioner of Taxation</i> [2011] FCAFC 104	The Full Federal Court found in <i>RCI Pty Limited v Federal Commissioner of Taxation</i> [2011] FCAFC 104, that the taxpayer did not receive a 'tax benefit' because RCI Pty Ltd would not have implemented the restructuring of the group and the subsequent disposal of the shares, which resulted in the alleged tax benefit if the costs, including the high tax cost were excessively high (Cliffe Dekker Hofmeyr, 2012:16). The Commissioner filed a special leave application with the High Court to appeal against the decision of the judgment in the Federal Court during 2011.	√	√	√
<i>Federal Commissioner of Taxation v Futuris</i>	The Full Federal Court found in <i>FCT v Futuris Corporation Limited</i> [2012] FCAFC 32 that the taxpayer showed that it would not have entered into	√	√	X

<b>Court Case</b>	<b>Further background of the court case regarding the application of the general anti-avoidance provisions</b>	<b>Criteria 1.1: no 'tax benefit'</b>	<b>Criteria 1.2: 'done nothing' argument</b>	<b>Criteria 2: Appeal to the High Court</b>
<i>Corporation Ltd</i> [2012] FCAFC 32	the scheme at all if it had not been done in the specific manner by restructuring to divest a certain services division through a public listing (Cliffe Dekker Hofmeyr, 2012:16).			

In the above table, selection criteria were applied in order to select critical case law to be analysed against the provisions of the South African general anti-avoidance rules. As can be seen from the above table, *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 meets all the selection criteria which were set for the selecting of case law and will therefore be the only case law used in this study.

## 2.5 SUMMARY

The South African general anti-avoidance rules will be untangled in chapter 4 in order to understand shortcomings and uncertainty and to be able to apply facts of case law which were selected in this chapter to the South African general anti-avoidance rules. The landmark case law to be used for this comparison of the facts of the case law on the South African general anti-avoidance rules were selected based on a predefined selection criteria under purposive sampling. The nature of the changes to the Australian general anti-avoidance rules was the first selection criteria and the ranking of the courts was the second selection criteria. The outcome of this chapter is that *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 was selected as the case law on which the facts will be untangled in chapter 3 and compared to South African legislation in chapter 5.

## **CHAPTER 3 THE FACTS AND FINDINGS OF THE SELECTED CASE LAW**

### **3.1 INTRODUCTION**

In order to be able to apply the facts of the selected Australian case law to the South African general anti-avoidance rules and answer the research question, it is firstly important to analyse the facts of the case law which was selected in chapter 2. This chapter will summarise and untangle the facts and findings of Australian Income Tax case, *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 which was the selected case law to be used for purposes of this study. The facts of *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 will be outlined in the light of the application of the facts on the South African general anti-avoidance rules in chapter 5.

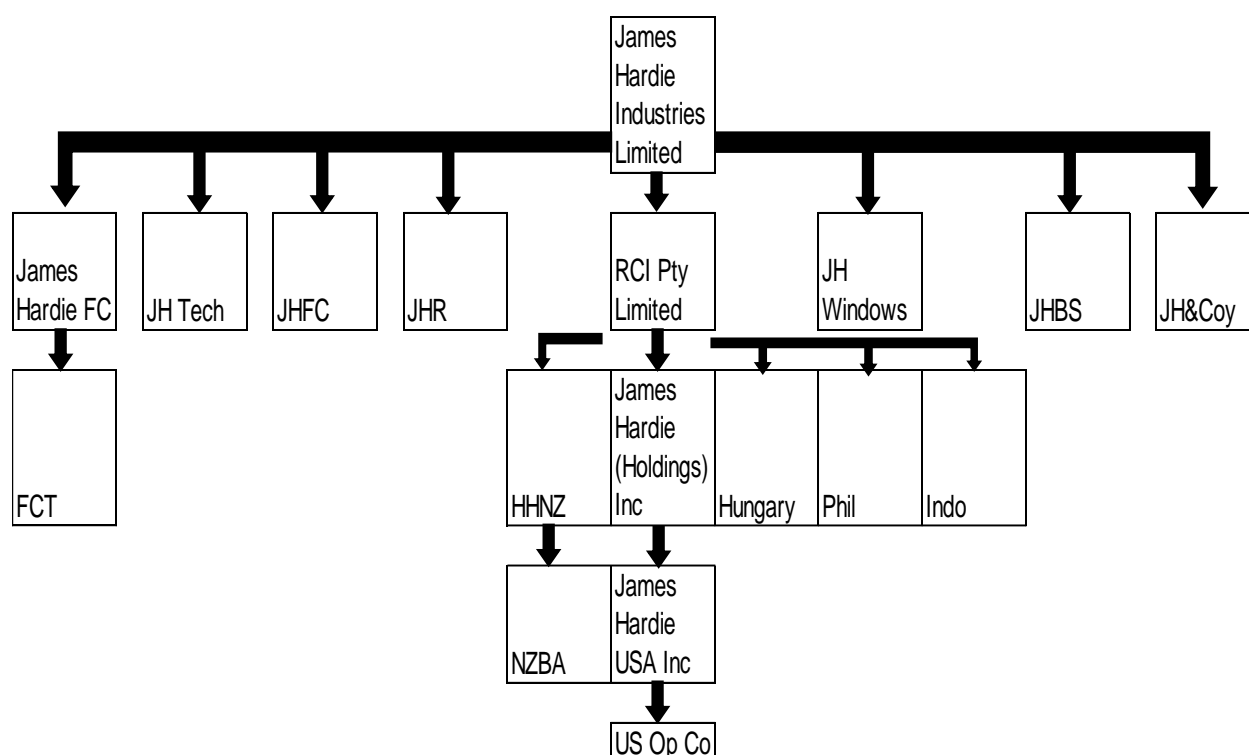
### **3.2 INTRODUCTION OF THE FACTS OF THE CASE LAW AND THE GROUP STRUCTURE**

For the 1998/1999 tax year the Australian Commissioner issued an amended assessment to RCI Pty Ltd including the sum of A\$478,237,746 pursuant to Part IVA of the Income Tax Assessment Act. In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, RCI Pty Ltd appealed against the Australian Commissioner, who disallowed an objection against the amended assessment of the 1998/1999 tax year. This appeal was dismissed. However, in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, RCI Pty Ltd appealed the outcome of *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939 which was allowed. Before the facts of the court case will be discussed it is firstly important to analyse the group structure in which the taxpayer operated at the time. Below is a diagram of the group structure followed by a discussion of the entities that were involved in the scheme.

#### **Diagram 3.1. Group structure**

### Structure as at 31 March 1998

#### James Hardie Group of Companies



*(RCI Pty Limited v Federal Commissioner of Taxation [2011] FCAFC 104: Attachment A)*

### **3.2.1 Entities involved in the scheme**

Some of the entities involved in the scheme identified by the Australian Commissioner of Taxation was RCI Pty Ltd, an Australian resident company and a wholly owned subsidiary of James Hardie Industries Limited (JHIL), a company which was also a resident of Australia which was the ultimate parent of the James Hardie group during the duration of the scheme. RCI Pty Ltd owned all of the shares in James Hardie Holdings Inc. (JHH(0)), a USA company which was the holding company of the James Hardie group's USA subsidiaries. JHH(0) owned all of the shares in James Hardie USA Inc. (JHH(1)), which was a USA subsidiary of the group (Trethewey, 2010).

## **3.3 BACKGROUND ON THE FACTS AND CIRCUMSTANCES SURROUNDING THE SELECTED CASE LAW**

### **3.3.1 Background of business operations in the group structure**

Prior to the early 1990s, the James Hardie group of companies ('the group') mainly derived revenue from selling building materials in Australia. The Group started manufacturing and selling fibre cement

building materials in the USA in the late 1980s (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:26). The operations in the USA performed at a loss which resulted in group accumulated tax losses up to 1995. The USA operations invested in interest-bearing deposits in subsidiaries and utilised some of the USA tax losses by setting of the interest income derived from the deposits against the USA tax losses (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:27).

The USA operations were able to recoup the remaining USA tax losses at around 1995 due to the improvement in the group's performance. During more or less the same time the group's Australian operations experienced some difficulty in generating profits. The group's Australian operations had a future income tax benefit ("FITB") balance of A\$81 million of which A\$70 million was attributable to Australian tax by 31 March 1996. The group's Australian operations incurred debt to help fund the group's previous struggling USA operations which also contributed to the increased losses in the group's Australian operations. In order to recognise the accumulated tax losses as an asset in the form of a FITB, the realisation of the benefit by recoupment of the losses had to be virtually certain within a three year framework (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:28).

### **3.3.2 Background facts**

Section 177F(1)(a) of the Income Tax Assessment Act provides that the Commissioner may make a decision to include an amount in the assessable income of a taxpayer, which has been excluded or omitted when a tax benefit was obtained in connection with a scheme to which Part IVA applies (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:2). The Australian Commissioner issued an amended assessment for the 1999 tax year pursuant to a Part IVA determination due to an outcome of an audit conducted. The amended assessment stemmed from the basis that RCI Pty Ltd had obtained a tax benefit amounting to A\$478,237,746 as a result of an amount which was not included as part of a capital gain. The Australian Commissioner amended, by the application of Part IVA of the Income Tax Assessment Act, the assessment of RCI Pty Ltd to increase a capital gain that was obtained in October 1998 by RCI Pty Ltd on the disposal of shares that RCI Pty Ltd held in JHH(0) to RCI Malta Holdings Limited (RCI Malta). This disposal of the shares in JHH(0) was part of an international corporate re-organisation of the James Hardie group called, Project Chelsea (initially called Project Scully), in which the James Hardie Group shifted its operational companies into a new, more commercially and tax effective structure headed by James Hardie NV (Trethewey, 2010).

From Project Chelsea's inception, one of the steps which had been planned since early 1997 was for JHH(0) to revalue assets and a subsequent payment of a dividend. RCI Pty Ltd, a wholly owned subsidiary of JHIL, transferred its wholly owned USA subsidiary, JHH(0) to a new group company,

RCI Malta in October 1998. The transfer of the shares held in JHH(0) to RCI Malta triggered a capital gain tax event for RCI Pty Ltd in the 1999 tax year.

Trethewey (2010) notes that the steps given rise to the dispute during March 1998, about seven months prior to the disposal of the shares held in JHH(0), consisted of the following events:

- (a) JHH(0) revalued its shares in its immediate wholly owned USA subsidiary, JHH(1). The revaluation resulted in the recognition of a US\$318 million surplus;
- (b) JHH(0) declared and paid a dividend of US\$318 million to RCI Pty Ltd out of the revaluation amount which was exempt in terms of section 23AJ of the Income Tax Assessment Act; and
- (c) JHH(0) paid US\$20 million in cash to RCI Pty Ltd as partial payment of the dividend. To settle the remaining of the liability to RCI Pty Ltd, JHH(0) issued a promissory note (PN1) to JHIL for US\$307,415,972 in exchange for JHIL crediting US\$298 million to RCI Pty Ltd's intercompany account with JHIL (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:6).

Trethewey (2010) also notes the following steps that occurred later in 1998:

- (a) RCI Pty Ltd injected approximately US\$50 million additional equity into JHH(0) by way of purchasing shares during August 1998. This was needed to satisfy the USA thin capitalisation rules, resulting in the reduction of JHH(0)'s capital due to the payment of the dividend. RCI Pty Ltd assigned a promissory note (PN2) to JHH(0) on 23 September 1998 to satisfy the issue price of the additional shares. PN2 was issued originally to RCI Pty Ltd by JHIL as partial payment of the amount owing as per (c) above. For partial payment of the amount JHH(0) owed to JHIL, PN2 was assigned back to JHIL on 28 September 1998, and paid the remaining amount with a loan from James Hardie Finance Limited.
- (b) RCI Pty Ltd disposed of all the shares that RCI Pty Ltd held in JHH(0) to RCI Malta in exchange for shares in RCI Malta during October 1998. A capital gain of A\$45,971,746 from the disposal of JHH(0) was included in RCI Pty Ltd's 1999 income tax return (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:118).

Witnesses provided extensive evidence concerning the background and context to the transactions in question, including the restructuring of the James Hardie group that became known as 'Project Chelsea' (Trethewey, 2010).

Trethewey (2010) notes that this evidence established, among other things:

- The USA operations of the James Hardie group had been profitable from around 1995 and the Australian operations were experiencing declining profits, but in former years, the situation had been the opposite. The Australian operations' losses were approximately A\$194 million by 1996 and included interest expense resulting from borrowings to fund the earlier unprofitable USA operations (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:28).
- The USA profits and the loss suffered by Australia had the effect of creating commercial and tax inefficiencies as the USA profits were subjected to taxation at more than one level once they reached JHIL's Australian shareholders (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:11).
- The Australian tax losses cannot be recognised as a FITB, as it could only be recognised in JHIL's consolidation if the recoupment of those losses was 'virtually certain' (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:11).
- During the second half of 1996 numerous strategies were considered by the group to address the identified problems including paying a dividend of US\$50 million from the USA to RCI Pty Ltd during March 1997 (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:14).
- While it was considered to pay a further dividend, there was also consideration regarding the complex structure of the group and addressing this to deal with profit imbalance in the group and the resulting tax problems. This resulted in the development of 'Project Chelsea', involving the restructuring of the group.
- One of RCI Pty Ltd's advisors, a United States tax professional confirmed that he hasn't encountered a transaction where more than 90 percent of the dividend was paid by an intercompany loan account supported by a promissory note and resulted in a negative equity of such magnitude (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:48).

Based on the above background facts of the operations and transactions in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, the application and judgment regarding the Australian general anti-avoidance rules will follow in the next part of this chapter.

### **3.4 DETERMINATION OF THE APPLICATION OF PART IVA OF THE INCOME TAX ASSESSMENT ACT ON THE TRANSACTION**

In part 3.3 of this chapter, an understanding of the facts and circumstances surrounding *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 was obtained in order to determine and understand the application of the general anti-avoidance rules on the facts.

### 3.4.1 Scheme

In Section 177A of the Income Tax Assessment Act, a scheme is defined as “...(a) any agreement, arrangement, promise or undertaking whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and (b) any scheme, plan, proposal, action, course of action or course of conduct.”

The Australian Commissioner established a ‘narrow scheme’ consisting of steps (a), (b) and (c) of the transaction of March 1998 above and an alternative ‘wider scheme’ consisting of the narrower scheme as well as the further steps, steps (a) and (b) taken during 1998. At the core of both schemes is the payment of the dividend (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:9; Trethewey, 2010).

For the purpose of Part IVA of the Income Tax Assessment Act, RCI Pty Ltd submitted the steps that related to the payment of the dividend in March 1998 was not sufficiently related to the disposal of the shares in August 1998, that RCI Pty Ltd held in JHH(0), for it to be established that they were part of one scheme. According to RCI Pty Ltd the payment of the dividend did not relate to the restructuring of the group of which the disposal of the shares in JHH(0) formed part of, but rather that the payment of the dividend was part of a strategy to increase interest-bearing debt in the USA and increase the assessable income in Australia. RCI Pty Ltd further argued that there was no evidence that they would have proceeded with the restructuring, including the disposal of the shares it held in JHH(0) at the time the dividend was declared (Trethewey, 2010).

In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 41, the judge found that the evidence supported the assessment the Commissioner made regarding the scheme, namely that the dividend and the share transfer were connected as it exhibited no doubt that the project will continue. Further, in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 72 the evidence exhibited that the payment of the dividend formed part of a group restructure known as Project Chelsea and was indeed a fundamental part of the planning of the restructuring since early in its initiation. In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, the judge rejected RCI Pty Ltd’s argument that the narrow scheme did not include the disposal of the shares and therefore could not result in a tax benefit (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:74-79).

It was noted in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 10 that the Australian Commissioner adhered to the identification of the narrow scheme and the wider scheme as discussed above, both before the primary judge in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939 and on the hearing of the appeal. It was noted in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 14, that RCI Pty Ltd submitted both before the primary judge and on the



appeal that the narrower scheme as identified by the Commissioner is not a scheme. Further, in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 15 RCI Pty Ltd submitted both before the primary judge and on appeal that the payment of the dividend by JHH(0) to RCI Pty Ltd did not bear a sufficient relationship to the sale of the shares RCI Pty Ltd held in JHH(0) to be part of the same scheme.

### **3.4.2 Tax benefit**

The definition of a tax benefit in section 177C(1)(a) of the Income Tax Assessment Act includes an amount that was omitted in the assessable income in a tax year of a taxpayer, where such an amount would reasonably be expected to be included in the assessable income of the taxpayer in that tax year if the scheme had not been entered into or carried out.

The dividend declared during March 1998 was exempt from Australian income tax in accordance with section 23AJ of the Income Tax Assessment Act. The Australian Commissioners argued that the declaration of the dividend of US\$318 million reduced the market value of the shares and consequently reduced RCI Pty Ltd's capital gain on the subsequent transfer of the shares in JHH(0) to RCI Malta (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:2)

In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 82 it was determined that there must be a comparison between the scheme identified and an alternative postulate. The Australian Commissioner's alternative postulate was that JHH(0) would have only declared a cash dividend of US\$20 million from profits in the absence of the scheme and RCI Pty Ltd would not have bought the additional shares in JHH(0) in step (a) during August 1998. Further, RCI Pty Ltd still would have transferred its shares in JHH(0) with the result that the market value of RCI Pty Ltd's shares in JHH(0) when they were transferred to RCI Malta would have been greater (Trethewey, 2010). In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 86-87, RCI Pty Ltd's alternative postulate was that, the transfer of the shares in JHH(0) would probably not have taken place without the benefit of the dividend, however RCI Pty Ltd's submissions of the alternative postulate was rejected as RCI Pty Ltd did not supply sufficient evidence to support it, but expected the Court to draw this inference as a matter of business logic. RCI Pty Ltd also argued that it could not reasonably be assumed that JHIL would have suggested to their shareholders a disposal of shares that would have carried such a large tax liability as was determined by the Australian Commissioner (*RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939:86). In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 87 the judge rejected this submission since there was no evidence to support it.

The primary judge in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 88 found that RCI Pty Ltd was unsuccessful in discharging its onus of proving a more reasonable alternative to the transaction

which excluded the disposal of the shares (Trethewey, 2010). However, in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 130, it was noted that the court should determine objectively based on all of the evidence what could reasonably be expected to have happened if the particular scheme was not entered into and it is therefore not an issue of whether the Australian Commissioner puts forward a reasonable counterfactual or not. Further, in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 135, it was noted that the absence of evidence regarding the alternative postulate does not result in the taxpayer failing to discharge the onus of proof.

In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 150, the judges reached a conclusion that the reasonable expectation if the scheme had not been entered into or carried out, is that the parties involved in the scheme would have either: i) abandoned the proposal completely, or ii) indefinitely deferred it, or iii) would have changed the proposal not to involve the transfer of the shares that RCI Pty Ltd held in JHH(0) to RCI Malta, or iv) ultimately pursued other alternatives that the board considered before this proposal was pursued. It can reasonably be expected that they would not have continued to have RCI Pty Ltd transfer its shares in JHH(0) to RCI Malta at such a large tax expense. On this view, the Federal Court in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 determined that RCI Pty Ltd did not obtain the tax benefit as was alleged by the Australian Commissioner in connection with the scheme. In effect the avoidance the Australian Commissioner complained of is what led to the Court to conclude that RCI Pty Ltd would not have continued with Project Chelsea at such a large tax expense.

### **3.4.3 Dominant purpose**

In *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 117 the judge concluded with regard to the factors in section 177D(b)(i)-(viii) of the Income Tax Assessment Act that the parties involved in the scheme, carried out the scheme, or part of the scheme with the dominant purpose for RCI Pty Ltd to obtain a tax benefit. Among other things, the judge in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 101 - 105 noted the following:

- The significance of the dividend declared by JHH(0) gave rise to JHH(0) being undercapitalised and had to be recapitalised by RCI Pty Ltd in the form of subscribing for additional shares as it was in danger of breaching the USA thin capitalisation rules after the declaration and payment of the dividend;
- The manner in which the scheme was carried out suggests a purpose beyond the dividend paid to RCI Pty Ltd;
- There seemed to be a lack of advice obtained regarding the revaluation and the recommendation of paying a dividend to the board of JHH(0) which is in contrast to the detailed planning of Project Chelsea;

- The complexity of the arrangement for the payment of the dividend, with only a portion to be paid by cash and the majority of the dividend to be paid by inter-company loans;
- That the evidence suggested that during the period leading up to the payment of the dividend, there was constant concern regarding the capital gains tax implications with regards to the low cost base of RCI Pty Ltd's shares in JHH(0); and
- That there were significant differences between the dividend paid in 1998 and the dividend that was paid only one year earlier. The difference being that the 1997 dividend was paid from money that was borrowed from external lenders and therefore paid in cash to RCI Pty Ltd, which generated interest income to absorb the Australian losses as it was placed on deposit. Further, it was noted that a US\$100 million dividend was rejected in 1997 as being too excessive, but a year later a dividend of US\$318 million was declared. It was found that the dividends were motivated by different concerns.

In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 151 it was noted that it was strictly not necessary to make any finding about the dominant purpose of the scheme due to there being no tax benefit, but in the event that the judge in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939 was correct, the dominant purpose was still discussed.

In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 164 the judges disagreed with the conclusion of the 2010 court case that the 1997 dividend and the 1998 dividend were motivated by different concerns. In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 169 the judges found that the size of the dividend of US\$318 million could be the only indications that the parties to the scheme, entered into the agreement with the dominant purpose to obtain a tax benefit as it is a significant amount of money and considerably larger than the dividend declared one year earlier during 1997 and that JHH(0) did not have enough funds to pay the dividend but had to lend money. However, the size of the dividend was justifiable for other reasons as argued by RCI Pty Ltd, and therefore it could not be concluded that the parties had entered into the transaction for the dominant purpose of obtaining a tax benefit to avoid tax (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 169). In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 170 it was noted that in the event where the judge was wrong with regards to the scheme of RCI Pty Ltd not resulting in a tax benefit it would also have come to a different conclusion than the primary judge regarding the dominant purpose of the scheme.

### 3.5 SUMMARY

In this chapter a summary of the facts and findings of the selected case law, *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 were outlined and summarised. In order to answer the research question, taking into account the understanding which was obtained from the selected case

law, chapter 5 will apply the requirements of the South African general anti-avoidance rules based on the facts and findings of the RCI Pty Ltd court case in order to shed some light on how the general anti-avoidance rules could be applied. Before the facts of the selected case law can be applied to the South African general anti-avoidance rules, it is first necessary to analyse and untangle the South African general anti-avoidance rules which will follow in the next chapter.

## **CHAPTER 4 GENERAL ANTI-AVOIDANCE RULES OF THE SOUTH AFRICAN INCOME TAX ACT**

### **4.1 INTRODUCTION**

A tax system's feasibility relies in part on reducing tax avoidance as far as possible (Cassidy, 2009:740). The first general anti-avoidance rules were introduced in section 90 of the Income Tax Act 31 of 1941 in South Africa. Through the years the general anti-avoidance rules necessitated amendments until section 103 of the Income Tax Act had been introduced, and currently the general anti-avoidance rules are enacted in section 80A to 80L of the Income Tax Act and apply to arrangements entered into after 2 November 2006. Section 103 consisted of one section whereas the current general anti-avoidance rules consist of 12 sections, thus rendering it very broad in scope. Even though the new general anti-avoidance rules have a broad scope, many concepts were borrowed from the now repealed section 103 which contained weaknesses and uncertainties that necessitated the change in the general anti-avoidance regime. Many of the concepts of section 103 have been interpreted by the courts and where the new general anti-avoidance rules have borrowed concepts from section 103, the interpretation and precedent set by the courts will still apply.

Since the amendment in the general anti-avoidance regime, there has not been relevant case law which creates a level of uncertainty regarding the current general anti-avoidance regime. The intended effect of the new general anti-avoidance regime might not be achieved as the new general anti-avoidance rules have added additional complexity and uncertainty to the South African tax system, which could result in the possibility that it may be repressively interpreted by the courts (Satumba, 2011:3, 18).

The general anti-avoidance rules of South Africa and Australia have many concepts and features that are the same even though the design of the two general anti-avoidance regimes differ in some ways (Calvert & Dabner, 2012:53). The Australian government acted to protect the tax system by amending the tax avoidance provisions after the loss of court cases relating to the general anti-avoidance rules. By applying the South African general tax avoidance provisions on facts of case law which were selected in chapter 2, it might shed some light on how the current South African general anti-avoidance rules will be applied and interpreted. Before the anti-avoidance provisions can be applied to facts of case law, it is firstly of importance to analyse the general anti-avoidance rules.

The objective of this chapter is to review the literature on tax avoidance legislation in South Africa with reference to the application of the tax avoidance provisions on selected Australian case law that spurred on the amendments in the Australian general anti-avoidance rules as discussed in chapter 2. This chapter begins with a focus on the general anti-avoidance rules in South Africa over time and then continues

with an analysis of important definitions surrounding tax avoidance legislation and the components of the current general anti-avoidance rules will be untangled.

## **4.2 THE PREVIOUS GENERAL ANTI-AVOIDANCE REGIME – SECTION 103**

Before the detail of section 80A to 80L of the Income Tax Act are untangled under part 4.3 of this chapter, it is important to understand the previous general anti-avoidance regime including the weaknesses which enacted the current general anti-avoidance rules.

Section 103(1) of the Income Tax Act 58 of 1962 read as follows:

“(1) Where any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property) has been entered into or carried out which has the effect of avoiding or postponing liability for any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act), or of reducing the amount thereof, and which in the opinion of the Secretary, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out—

- (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 the Secretary is of the opinion that the avoidance or the postponement of such liability, or the reduction of the amount of such liability was the sole or one of the main purposes of the transaction, operation or scheme, the Secretary shall determine the liability for any tax, duty or levy on income and the amount thereof as if the transaction, operation or scheme had 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.”

Based on the above, for section 103 of the Income Tax Act to apply, it was necessary for the Commissioner to ascertain that the following elements were present:

- i) there had to be a ‘transaction, operation or scheme’;
- ii) the transaction must result in the avoidance or postponement of a tax liability;

- iii) based on the circumstances under which the transaction was entered into, the third requirement would be, either abnormality or the transaction created abnormal rights and obligations; and
- iv) the last requirement was that the transaction must have been entered into or carried out solely or mainly for the purpose of obtaining a tax benefit.

Section 103 of the Income Tax Act, applied if both the subjective test, consisting of the determination of the sole or main purpose, and the objective test, consisting of the abnormality requirement, were present (Bodlo, 2015:15). This meant that section 103 of the Income Tax Act would not apply if the taxpayer entered into a transaction which meets the abnormality requirements but the sole or main purpose was not to avoid tax (Bodlo, 2015:15). Alternatively, the taxpayer could enter into a transaction that meets the subjective test, namely that the taxpayer's sole purpose is to obtain a tax benefit, but the transaction does not meet the abnormality requirement (Bodlo, 2015:15).

SARS described section 103 of the Income Tax Act as an inconsistent and ineffective deterrent to impermissible tax avoidance and abusive avoidance schemes due to the increasingly sophisticated schemes taxpayers were entering into in order to exploit the provisions of the general anti-avoidance rules (SARS, 2005:1, 41). The major weaknesses in the previous general anti-avoidance regime which were intended to be addressed by the 2006 amendments of the general anti-avoidance rules will briefly be discussed below.

The significant commitment of time and resources over lengthy battles to combat the increasingly sophisticated schemes that taxpayers entered into has proved to be costly and had a negative impact on the relationships between SARS and taxpayers (SARS, 2005:42). The second weakness identified relates to the abnormality requirement. Taxpayers were usually able to provide plausible business purposes for having entered into certain agreements and were able to step aside the abnormality requirement with relative ease (SARS, 2005:43). The third weakness identified relates to the purpose requirement. The word 'mainly' was not addressed by section 103 of the Income Tax Act and has been construed to mean predominant. The Commissioner found it difficult to prove the predominant purposes as the tax benefit, as the subjective test required the Commissioner to look at the taxpayer's intention rather than the transaction itself, and most transactions had at least a colourable commercial rationale (SARS, 2005:43). The conjunction of the purpose test and abnormality test placed taxpayers in a powerful position, as the taxpayers were able to justify either the abnormality or purpose requirements with relative ease (Calvert, 2011:44). Further weaknesses related to procedural and administration issues which mainly included: i) uncertainty regarding the degree to which the general anti-avoidance rules could be applied to a single step within a larger scheme, and ii) uncertainty as to the application of the general anti-avoidance rules where another provision was also in dispute (SARS, 2005:44).

These weaknesses in the previous general anti-avoidance regime necessitated amendments which resulted in the current general anti-avoidance regime which can be found in section 80A to 80L of the Income Tax Act and will be discussed below.

#### **4.3 CURRENT GENERAL ANTI-AVOIDANCE REGIME**

The weaknesses as was discussed above, of the previous general anti-avoidance regime necessitated amendments to the general anti-avoidance rules. Each of the elements of the current general anti-avoidance rules will be discussed in detail below. However, the following major changes were implemented and the changes to the general anti-avoidance regime are applicable to arrangements which were entered into after 2 November 2006:

- Section 80A defines impermissible avoidance arrangement.
- A commercial substance test was included as one of the tainted elements.
- A ‘misuse or abuse test’ was inserted as one of the tainted elements.
- The Commissioner now has the power to consider connected persons and tax-indifferent parties as one and the same person.

The current general anti-avoidance provisions combat an impermissible avoidance arrangement, which is defined in section 80A of the Income Tax Act. The heading of the section implies that only some types of arrangements will be considered impermissible tax avoidance arrangements (Haupt, 2014:640). Section 80A of the Income Tax Act reads as follows:

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

- (a) in the context of business—
  - (i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
  - (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;
- (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit; or
- (c) in any context—



- (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
- (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part)."

A discussion of each of the elements required to be present for a transaction to be considered an impermissible avoidance arrangement will now follow.

#### **4.3.1 Arrangement**

Section 80L of the Income Tax Act provides a definition for the term 'arrangement'. In terms of section 80L an arrangement is defined as "...any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property". The current general anti-avoidance rules do not provide a definition for the words 'transaction', 'operation', 'scheme', 'agreement' and 'understanding' which could lead to uncertainty.

The words 'transaction', 'operation' and 'scheme' were found in the previous general anti-avoidance rules and had been interpreted widely by the courts. There are currently no new case law relating to these terms and the principles established by the courts previously will therefore continue to apply. In *Meyerowitz v Commissioner for Inland Revenue* [1963] 25 SATC 287, it was noted that "...“scheme” is a wide term and...it is sufficiently wide to cover a series of transactions...". Loof (2013:9) noted that since the courts established that the term 'scheme' has a wide meaning it was unnecessary to include the terms 'agreement' and 'understanding' as the definition of 'arrangement' is not broadened by the insertion of these terms.

Museka (2011:20) noted that uncertainty exists in the determination of an oral agreement as one or more parties can dispute the agreement to say there were no meeting of minds. Museka (2011:76) notes that the inclusion of oral agreement could be considered unnecessary as it will almost be impossible to prove the existence of an oral agreement if one or both taxpayers argue that there were no meeting of the minds. The wording of section 80L which includes oral agreements creates confusion and uncertainty as there are no guidelines of how the existence of an oral agreement will be determined.

#### **4.3.2 Tax benefit**

In terms of section 80A of the Income Tax Act, the arrangement should give rise to a tax benefit. A 'tax benefit' is defined in section 1 of the Income Tax Act to include "...any avoidance, postponement or reduction of any liability for tax". The word 'any' placed in front of the word liability in the definition

of a tax benefit directs that ‘liability’ will be interpreted as widely as possible (De Vos, 2016:47). In terms of section 80L of the Income Tax Act, tax is defined to include “...any tax, levy or duty imposed by this Act or any other Act administered by the Commissioner”. The definition of tax includes all taxes for example income tax, but it also includes levies or duties for example, customs duty administered by SARS (Calvert, 2011:23). The term ‘tax benefit’ is not new to the general anti-avoidance rules and has been judicially explained.

In *Commissioner for Inland Revenue v King* [1947] 14 SATC 184 it was stated that ridding oneself from taxation derived from future income or the effect of reducing an amount of income to less than it was previously results in a ‘tax benefit’. In *Smith v Commissioner for Inland Revenue* [1964] 25 SATC it was stated that ‘avoiding liability’ within the meaning of the general anti-avoidance rules is to get out of the way of, escape or prevent an anticipated liability. In *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) it was said that the anticipated liability for tax can “...vary from an imminent certain prospect to some vague, remote possibility”. On the other hand, in *Commissioner for Inland Revenue v Louw* [1983] 45 SATC 113 the directors of a company entered into a loan with the company to borrow money and the court found that the directors would have probably received the equivalent in salary or dividends had the transaction which was loans to directors not been entered into, and therefore they received a tax benefit within the general anti-avoidance regime (Warneke, 2005:97). *Income Tax Case No 1625* [1996] 59 SATC 383 gives an additional example of this second approach that determines that the taxpayer would have suffered tax but for the transaction. In terms of *Income Tax Case No 1625* [1996] 59 SATC 383, 387 it was noted “That if the transaction in issue in this case had not been entered into the appellant would not have acquired the property, it would not have earned the income and it would not have incurred the interest expenditure...”. The Income Tax Act does not have guidelines to determine a tax benefit, however, as per *Commissioner for Inland Revenue v Louw* [1983] 45 SATC 113 and *Income Tax Case No 1625* [1996] 59 SATC 383, the courts have come up with the ‘but for’ test. The ‘but for’ test determines whether the taxpayer suffered tax but for the existence of a transaction (Calvert, 2011:24). The ‘but for’ test obliges the Commissioner to make a determination of what the taxpayer would have done if the taxpayer did not enter into the particular arrangement (Loof, 2013:14). This prediction by the Commissioner would be difficult for the Commissioner to determine as it is subjective.

Based on the above, to determine whether a particular arrangement resulted in a tax benefit, the following two questions should be considered (Calvert, 2011:41):

- “Has the tax benefit arisen because the taxpayer had effectively stepped out of the way of, escapes or prevented an anticipated liability?” (*Smith v Commissioner for Inland Revenue* [1964] 25 SATC)

- “Would a tax liability have existed but for this transaction (but for test)?” (*Income Tax Case No 1625* [1996] 59 SATC 383; *Commissioner for Inland Revenue v Louw* [1983] 45 SATC 113)

In terms of section 80F of the Income Tax Act, the Commissioner may regard connected persons and accommodating or tax-indifferent parties, as one and the same person. This section will play a role when determining a tax benefit as for example a tax liability can result from an existing income stream that was transferred to a connected person. The term ‘tax benefit’, has a lot of uncertainty associated to it. Although the term is defined, there are no guidelines in the Income Tax Act of how a tax benefit should be determined and it is left to the courts to interpret.

Based on the above, the term ‘tax benefit’ is defined, but the definition has a very wide scope and there are no clear guidelines of how a tax benefit should be determined. Based on previous judicial explanation, a tax benefit will be determined by asking two questions as discussed above. First, it should be considered whether the tax benefit arose because the taxpayer had effectively stepped out of the way of, escaped or prevented an anticipated liability and secondly, it should be considered if the tax liability has existed but for this transaction (but for test).

#### **4.3.3 Sole or main purpose of the arrangement**

As per the definition of an impermissible avoidance arrangement, the sole or main purpose of the arrangement must be to obtain the tax benefit before section 80A of the Income Tax Act could potentially apply. The words ‘sole’ or ‘main’ are not defined and are also not new to the general anti-avoidance regime as the words were used in section 103 of the Income Tax Act and therefore, the meaning as determined by previous case law will still be applicable as there are currently no relevant case law on the new general anti-avoidance rules.

In terms of section 80G(1) of the Income Tax Act, the onus of proof that the sole or main purpose was not the avoidance of tax is on the taxpayer. It is unclear whether a subjective or objective test should be considered when determining the sole or dominant purpose of an arrangement when one reads section 80A and 80G(1) (Loof, 2013:35). In section 80G a presumption for purpose is created and reads as follows:

- “(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.”

If the intent of the legislature was for it to be a more objective test, then it is still unclear how the courts will apply a purely objective test while taking into account the relevant facts and circumstance which could be subjective (Loof, 2013:35). The investigation of the purpose of the transaction is critical and due to the uncertainty both the subjective test and the objective test will be considered for purposes of this study. The subjective test determines whether the stated intention of the taxpayer was to enter into an arrangement with the sole or main purpose of obtaining a tax benefit (*Secretary for Inland Revenue v Gallagher* [1978] (2) SA 463 (A)). In *Commissioner for Inland Revenue v King* [1947] 14 SATC 184 it was stated that “...“the purpose”... meant the “dominant purpose” and not merely a subsidiary purpose.” If the arrangement has more than one purpose, it needs to be considered whether the dominant intention for entering into the arrangement was for the purpose of obtaining the tax benefit (*Commissioner for Inland Revenue v Conhage (Pty) Ltd* [1999] 61 SATC 391). The objective test on the other hand, determines whether the real effect of the arrangement supports the stated intention of the taxpayer (Calvert, 2011:26-27, 41; *Ovenstone v Secretary for Inland Revenue* [1980] 42 SATC 55 (A)).

An uncertainty exists regarding the manner in which the current general anti-avoidance regime should be applied. It is untested legislation and two taxpayers for example, may enter into a similar transaction with one taxpayer’s motivation being tax considerations while the other taxpayer’s transaction is motivated by business reasons.

One of the tainted elements must be present before an arrangement, that resulted in a tax benefit and was entered into with the dominant purpose of obtaining a tax benefit, will be an impermissible arrangement in terms of section 80A of the Income Tax Act and will therefore be discussed below. Unlike section 103 of the Income Tax Act, the new general anti-avoidance regime allows the Commissioner to apply general anti-avoidance rules to individual steps and parts of the agreement and not just to the arrangement as a whole. The Commissioner can question the intention of a single step or part of an arrangement that has been inserted for its tax effectiveness, even if the arrangement as a whole has a main purpose not related to a tax benefit (Clegg & Stretch, 2017:26.3.2, 26.3.4).

#### **4.3.4 Tainted elements**

As per the definition of an impermissible avoidance arrangement under paragraph 4.3 of this chapter, an avoidance arrangement must be characterised by at least one tainted element that was entered into either in the context of business, in any context other than business or in any other context. The four tainted elements are: 1. the transaction is not entered into a manner normal for *bona fide* business

purposes (abnormality element), 2. the transaction lacks commercial substance, 3. the rights or obligations created are not at arm's length, and 4. it would result in the misuse or abuse of the provisions of the Income Tax Act. The old general anti-avoidance regime required an 'abnormal' transaction, with non-arm's length rights and obligations. Therefore, any precedent set by court cases relating to 'abnormality' and 'arm's length rights and obligations' will still apply as these elements were retained in the new general anti-avoidance provisions with additional elements added (Langenhoven, 2016:38). A discussion of the four tainted elements will follow below.

#### **4.3.4.1 Abnormality element**

This requirement was retained from the previous general anti-avoidance regime despite the uncertainty around the word 'normal'. Uncertainty existed regarding the term 'normal' in the previous general anti-avoidance regime and still exists in the new regime because what may be normal to one person could be abnormal for another since there is no 'normal' way of doing business (Museka, 2011:42).

Williams (1997:680) notes that the issue is not whether the transaction was entered into for commercial reasons, but rather the way in which the transaction was entered into. The change that can be noted from section 103 of the Income Tax Act is that the abnormality test is now intended to be a more objective test (SARS, 2010:24). In *Income Tax Case No 1712* [2000] 63 SATC 499 it was held "That the hypothetical model of the 'normal' transaction is determined by asking how would businessmen generally, not motivated by any tax considerations but rather by '*bona fide* business purposes' have structured that transaction?"

The 'business purpose test' therefore necessitates a comparison between the actual arrangement and the manner in which a comparable arrangement would ordinarily be carried out, as the test is not whether the arrangement itself has a business related or commercial purpose, but whether the manner in which the transaction is carried out, is a manner which would ordinarily be used for *bona fide* business purposes other than to gain a tax benefit (Loof, 2013:20).

In the *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) case, it was noted that if the transaction is carried out at arm's length, the rights or obligations created, and the means and manner employed in entering into the transaction, will be regarded as normal. On the other hand, if the transaction is not carried out at arm's length, it would amount to an abnormal transaction. The 'rights or obligations created are not at arm's length' tainted element will be dealt with later in this chapter.

#### 4.3.4.2 Lack of commercial substance element

The commercial substance test, which only applies in the context of business, can be found in section 80C(1) of the Income Tax Act which contains a general rule, and in section 80C(2) which contains a non-exclusive list, indicative of a lack of commercial substance (Loof, 2013:22). Section 80C of the Income Tax Act describes the lack of commercial substance as follows:

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

The general rule of the lack of commercial substance element as contained in section 80C(1) of the Income Tax Act determines that an arrangement will lack commercial substance when it resulted in a significant tax benefit without having a significant effect on the business risks or net cash flows. The phrases ‘significant tax benefit’ and ‘significant effect’ has been left undefined by the Income Tax Act which creates uncertainty regarding the application of the general anti-avoidance rules on the basis of the commercial substance rule (Bodlo, 2015:23).

Section 80C(2) of the Income Tax Act stipulates that the indicative characters of a lack of commercial substance is not an exhaustive list. Therefore, the term ‘lack of commercial substance’ could have a wide interpretation as the list does not limit the interpretation, but provides guidance on what could be included as a lack of commercial substance. The indicative characters of a lack of commercial substance in section 80C(2) of the Income Tax Act will be discussed below.

#### **4.3.4.2.1 Substance over form indicator**

Mvuyana (2014:31) notes that a different meaning to substance over form, as established in common law, is applicable for the general anti-avoidance rules as the common law meaning of ‘substance over form’ has failed to act as a successful deterrent to simulated or sham transactions. Therefore, the traditional ‘legal substance over form’ test established through common law must not be confused with substance over form (Langenhoven, 2016:41). The ‘legal substance over form’ test under the common law principle challenges sham transactions where parties have intentionally concealed the true nature of the transaction, where on the other hand, section 80C(2)(a) of the Income Tax Act refers to a test where the parties to the arrangement have acted in good faith but the rights and obligation created are not aligned with the parties’ actions (Langenhoven, 2016:41-42).

In the draft comprehensive guide to the general anti-avoidance rule (SARS, 2010:29), SARS directs that discrepancies between the legal effect of the arrangement compared to the legal form, is indicative of a lack of commercial substance and further, if the commercial substance compared to the legal form indicates inconsistencies, it is considered to be indicative of a lack of commercial substance.

It was held in *Commissioner for South African Revenue Service v NWK Limited* [2010] ZASCA 168 (SCA) that the court must determine what the transaction really is and not what form it purports to be. A transaction will be simulated if the intention of an arrangement is only to achieve tax evasion and the mere fact that parties act in terms of the agreement does not show that it is not simulated (Calvert, 2011:33).

As discussed above, the current general anti-avoidance rules can be applied to a single step in an arrangement. However uncertainty exists as it is unclear how a single step in the arrangement can be evaluated against the legal substance or a commercial effect regardless of the purpose of the arrangement in its entirety (Loof, 2013:25). When an isolated step is considered, it could lead to the isolated step losing commercial substance which creates uncertainty as it is unclear whether in such instance the isolated step can be considered in the light of the composite transaction in its entirety (Kujinga, 2013:108). This provision puts all multi-step arrangements potentially at risk, as a single step cannot achieve numerous commercial end results (Loof, 2013:25).

#### **4.3.4.2.2 Round trip financing indicator**

If an arrangement can be characterised as ‘round trip financing’, it can be an indication that the arrangement lacks commercial substance. The term ‘round trip financing’ was not contained in section 103 of the Income Tax Act, but is now described in section 80D of the Income Tax Act as follows:

- “(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.”

As per the draft comprehensive guide to the general anti-avoidance rule (SARS, 2010:30), ‘round trip financing’ includes “...any situation involving circular cash or paper flows (such as cheques, promissory notes or wire transfers) that leave little real capital at risk and little or no net cash for investment or use in a party’s underlying business or investment activities”. Round trip financing basically entails the use of funds in a circular fashion in a deceptive manner between parties to an avoidance arrangement. Parties to round trip financing typically do not use actual money or funds and there is no real risk of loss (Kujinga, 2013:114). In the draft comprehensive guide to general anti-avoidance rule (SARS, 2010:30) it was noted that the way in which the round tripped amounts are transferred are not of a concern as section 80D(2)(c) applies to any round tripped amounts and may include for example, “...a loan arrangement whereby the original loan amount finds its way back to the lender by way of a security deposit.” In effect round trip financing does not comprise of a true business transaction, but simply tries to obtain a tax benefit as money appears to pass between the parties to the scheme, but the funds end up back in the hands of the parties of the arrangement and all participants are in the same position as they were at the beginning of the arrangement, except for the tax benefit which was obtained and the payment of fees to the intermediaries (De Koker, 2017:19.39).



#### **4.3.4.2.3 Accommodating or tax-indifferent parties indicator**

Section 80E(1) of the Income Tax Act defines the main characteristics of a tax-indifferent party. It reads as follows:

- “(1) A party to an avoidance arrangement is an accommodating or tax-indifferent party if—
- (a) any amount derived by the party in connection with the avoidance arrangement is either—
    - (i) not subject to normal tax; or
    - (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.”

In the draft comprehensive guide to the general anti-avoidance rule (SARS, 2010:30), tax-indifferent party has a very wide definition and the mere existence of an accommodating or tax-indifferent party where the sole or main purpose of such arrangement is to derive a tax benefit will be sufficient to render such arrangement impermissible. Any party who essentially disposes of their tax advantages are included as a tax-indifferent party, regardless of the relationships with any of the other contracting

parties (Calvert, 2011:37). As per section 80E(2) of the Income Tax Act this indicator of the lack of commercial substance does not require the parties to be connected in relation to any party of the arrangement (Calvert, 2011:37). The Commissioner may treat connected persons and accommodating or tax-indifferent parties as one and the same in terms of section 80F of the Income Tax Act.

Section 80E(3) provides exclusions from the tax accommodating or tax-indifferent parties indicator which read as follows:

“(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) of the Income Tax Act if it were located outside the Republic and the party in question were a controlled foreign company.”

#### **4.3.4.2.4 Offsetting or cancelling indicator**

Another indicator of lack of commercial substance is when elements have the effect of offsetting or cancelling each other as per section 80C(2)(b)(iii) of the Income Tax Act. This provision focuses on the presence of elements within an arrangement that result in the elements offsetting or cancelling each other out, as it indicates that such elements of the arrangement have no real outcome and were planned for the purpose of obtaining a tax benefit (Calvert, 2011:38). The Income Tax Act creates uncertainty since an exhaustive list of these elements is not provided. De Koker (2017:19.39) notes that this indicator of a lack of commercial substance aims to eliminate intentionally misleading elements added into complicated arrangements, for example complicated financial derivatives, with the purposes of one leg creating rights and obligations while being extinguished in another leg of the scheme.

If one looks at the round trip financing indicator of a lack of commercial substance, it will also result in the offsetting of steps and therefore it seems that it was unnecessary to insert the round trip financing provision which could result into confusion and uncertainty (Loof, 2013:36).

#### **4.3.4.3 The creation of rights or obligations not at arm's length element**

The third tainted element is the non-arm's length rights and obligations element. The term 'arm's length' is not defined in the legislation which could cause uncertainty. This element has been retained from the previous general anti-avoidance provisions and thus the interpretation by the courts regarding the previous general anti-avoidance regime will still be authoritative. The courts' definition in *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) determine that "It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself". Based on this, non-arm's length rights and obligations can be interpreted to mean the determination of what unconnected parties would have done in the same situation. If it is determined that the transaction was entered into at arm's length, the rights and obligations created by the transaction will be regarded as normal and therefore not lacking in commercial substance (*Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A)).

In *Secretary for Inland Revenue v Geustyn Forsyth and Joubert* [1971] (3) SA 567(A), SARS's argument was that the transfer of a partnership in this case constituted a scheme in which the taxpayers entered into to avoid tax. The court however determined that transferring a partnership into a company is normal and common in the commercial world. This tainted element might be quite difficult to apply as the onus of proof that a degree of abnormality exists, rests on the Commissioner and the Commissioner might have a very slim chance of succeeding (Museka, 2011:65). The Commissioner will have a very slim chance of succeeding in proving that abnormality exists due to taxpayers that will be able to argue with relative ease that the transaction is 'normal' or common in the commercial world.

#### **4.3.4.4 Misuse or abuse of the Act element**

The fourth tainted element applies when there is a 'misuse or abuse of the Act'. The 'misuse or abuse' element is new to the general anti-avoidance regime. This concept has not been defined and there has not been any case law as yet, which creates potential uncertainty on the application of the misuse or abuse indicator. Section 80A(c)(ii) is written in positive language and provides a basis for differentiating between abusive tax avoidance and legitimate tax planning (Van Schalkwyk & Geldenhuys, 2009:168). Section 80A(c)(ii) is based on taxpayers who abuse the provisions of the Act to obtain a tax benefit and avoid tax (Kujinga, 2013:116). In the Australian report of the *Review of Business Taxation* the term 'misuse' or 'abuse' was described as being "often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of the law and a focus on form and legal effect rather than substance" (Australia, 1999:6.2c).

Museka (2011:70) notes that the interpretation of this tainted element might seem easy to understand, but it will not necessarily be the case as “...one has to look at how practical it is to apply the purposive or contextual methods of interpretation to an arrangement.” The courts might interpret the purpose of provisions differently as it would be difficult to determine the underlying purpose of the legislature which could lead to inconsistencies within the courts (Museka, 2011:70). This new tainted element creates confusion and uncertainty due to the wide scope of this element and further due to the conflicting and inconsistent methods and conclusions that could be reached in determining the underlying purpose of the legislature on a provision.

#### **4.4 COMMISSIONER’S DISCRETION**

Section 80B of the Income Tax Act provides what the Commissioner may establish with regards to impermissible avoidance arrangements and reads as follows:

- “(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.”

Section 80H of the Income Tax Act addressed one of the weaknesses of the previous general anti-avoidance regime by making a provision that the Commissioner may apply sections 80A to 80L to a single step or parts of an arrangement. The application of section 80H has been explained in the draft

comprehensive guide to the general anti-avoidance rule (SARS, 2010:46) as follows: “Sections 80H and 80G(2) address the Commissioner’s authority to apply the general anti-avoidance rules to steps in or parts of an arrangement. These provisions must be read with the definition of an “arrangement” in section 80L, which explicitly provides that the term includes, and applies to, all the steps in or parts of an arrangement, as well as to the entire arrangement itself, and with section 80B(1)(a) which authorises the Commissioner to disregard, combine or re-characterise steps in or parts of an impermissible avoidance arrangement in determining the tax consequences of that arrangement for any party.” As was discussed above under 4.3.4.2.1, uncertainty exists on how a single step in the arrangement can be evaluated against the legal substance or a commercial effect of the entire arrangement (Loof, 2013:25).

As was discussed in chapter 2, recent losses of court cases by the ATO relating to the general anti-avoidance rules spurred on the amendments to the Australian general anti-avoidance rules. Due to the weaknesses and uncertainties of the South African general anti-avoidance rules and the fact that the current general anti-avoidance rules are still untested before the courts, it is relevant to apply actual facts of case law to the South African general anti-avoidance provisions. Since the South African and Australian general anti-avoidance rules have similarities, the Australian facts of case law can be used for the application of the South African general anti-avoidance rules. The similarities between the South African and Australian general anti-avoidance rules are summarised in the next part of this chapter.

#### **4.5 COMPARISON OF THE SOUTH AFRICAN AND AUSTRALIAN GENERAL ANTI-AVOIDANCE PROVISIONS**

The general anti-avoidance provisions of South Africa and Australia have some commonality in the essential elements, although the two differ in their design (Calvert & Dabner, 2012:73). These commonalities can be found in the following:

- i) under the South African provisions there must be an arrangement, whereas under the Australian provisions there must be a scheme. Although worded differently, both these requirements have a very wide interpretation and both can be applied to a step within the bigger scheme;
- ii) under both the South African and Australian provisions a tax benefit must have been obtained by a taxpayer;
- iii) under the South African provisions the arrangement under which a tax benefit was received must have been entered into for the sole or main purpose of obtaining the tax benefit, whereas the Australian provisions determine that the dominant purpose of the scheme must have been to obtain the tax benefit; and
- iv) lastly, both South African and Australian provisions provide references on guidance on how the purpose can be determined based on specific circumstance or factors. This requirement of the two general anti-avoidance provisions are the greatest difference between these two as the South

African provisions provide reference to the tainted elements as discussed in this chapter, part 4.3.4, whereas the Australian provisions provide that the purpose should be determined with reference to the eight matters as discussed in chapter 2 under 2.3.3. As per Calvert and Dabner (2012:73), it was noted that, "...upon delving deeper into the Australian case law, the differences may be more apparent than real."

Due to the similarities between the South African and Australian general anti-avoidance rules and the amendments that were made in the Australian general anti-avoidance rules, the South African legislation will be analysed by applying the selected Australian case law to the South African general anti-avoidance provisions.

#### **4.6 SUMMARY**

In this chapter the historical background and the previous general anti-avoidance regime was briefly discussed in order to comprehend the weaknesses that resulted in the 2006 amendments to the general anti-avoidance regime. The current general anti-avoidance provisions are contained in section 80A to 80L in the Income Tax Act. In terms of the current general anti-avoidance regime, sections 80A to 80L of the Income Tax Act will apply if:

- i) the taxpayer entered into an arrangement,
- ii) the arrangement resulted in a tax benefit,
- iii) the sole or main purpose of the arrangement was to obtain a tax benefit; and
- iv) at least one of the tainted elements must be present.

Currently in South Africa there is no relevant case law on the new general anti-avoidance regime. Due to uncertainty of the South African general anti-avoidance regime and the similarities there are between the South African and Australian general anti-avoidance regimes, it is relevant to apply the facts of recent Australian case law to the current South African general anti-avoidance regime as it could shed some light on how it will be interpreted and what the potential weaknesses are compared to the Australian general anti-avoidance regime. The four requirements of an impermissible avoidance arrangement were discussed in this chapter and will be applied to the facts of the Australian case law as selected in chapter 2.

## **CHAPTER 5 DISCUSSION OF THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULES ON THE FACTS OF THE SELECTED CASE LAW**

### **5.1 INTRODUCTION**

As discussed in chapter 4, the Australian and South African general anti-avoidance rules are similar in many ways. The Australian Government acted to protect the integrity of the tax system by making amendments to the general anti-avoidance rules (Arbid, 2012). In this chapter the facts of the Australian case law selected in chapter 2 and summarised in chapter 3, will be analysed in the context of the South African tax legislation. This is relevant as the current South African general anti-avoidance rules were amended in 2006 and have not yet been tested in the courts. This application of the facts of the selected case law on the South African general anti-avoidance rules could shed some light on how the general anti-avoidance rules will be applied and could indicate weaknesses and uncertainties in the South African general anti-avoidance rules. This application will be applied on the assumption that the South African Commissioner would have reacted in the same manner as the Australian tax authorities in amending the assessment. The facts of the selected case law will be applied on the South African tax legislation as it is currently in the Income Tax Act with the general anti-avoidance rules and the Eighth Schedule being applicable to the transaction. Even though the current Income Tax Act could have specific anti-avoidance provisions that could be relevant on the fact pattern, this study focuses on the general anti-avoidance rules and therefore any specific anti-avoidance provisions will not be discussed as it does not form part of the scope of this research study. Below a brief summary of the fact pattern of the selected court case which was discussed in chapter 3 in order to apply it to the South African general anti-avoidance rules.

### **5.2 SUMMARY OF FACTS OF SELECTED CASE LAW**

In chapter 2 selection criteria were determined in order to select landmark case law to use for purposes of this study. The selection resulted in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 being selected as the case law to be used. The facts of the case law were discussed in chapter 3. A brief summary of the facts will now follow before the facts are applied to the South African general anti-avoidance rules.

The Australian Commissioner issued an amended assessment to RCI Pty Ltd including an additional sum as a capital gain pursuant to Part IVA of the Income Tax Assessment Act. This amended assessment was due to RCI Pty Ltd that disposed of shares it held in JHH(0) as part of an international corporate re-organisation after JHH(0) declared an exempt dividend resulting in a reduced share price. This disposal of the shares resulted in a capital gain tax event for RCI Pty Ltd. As noted by Trethewey (2010), the following events occurred prior to and as part of the restructuring:

- i) JHH(0) revalued the shares owned in its wholly owned USA subsidiary, JHH(1). The revaluation resulted in the recognition of a US\$318 million surplus;
- ii) Subsequently to the revaluation, JHH(0) paid a dividend of US\$318 million to RCI Pty Ltd which was exempt in terms of the Australian Income Tax Assessment Act;
- iii) The payment of the dividend was paid partially in cash and partially through issuing promissory notes to JHIL in exchange for JHIL crediting RCI Pty Ltd's intercompany account;
- iv) RCI Pty Ltd injected approximately US\$50 million additional equity into JHH(0) by way of a share subscription later in the same year as the revaluation and in which the dividend was paid.
- v) Lastly, RCI Pty Ltd disposed of all the shares it held in JHH(0) to RCI Malta in exchange for shares in RCI Malta.

### **5.3 APPLICATION OF SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULES WITH REFERENCE TO THE SELECTED CASE LAW**

In chapter 4, the literature of the South African general anti-avoidance rules was reviewed in order to apply the facts of selected Australian case law to the general tax avoidance provisions of South Africa. The general anti-avoidance rules in South Africa were discussed over time and the study continued with an analysis of important definitions with regards to the tax avoidance legislation. Each of the components of the current general anti-avoidance rules were then further untangled. In terms of the current general anti-avoidance regime, sections 80A to 80L of the Income Tax Act will apply if:

- i) the taxpayer entered into an arrangement;
- ii) the arrangement resulted in a tax benefit;
- iii) the sole or main purpose of the arrangement was to obtain a tax benefit; and
- iv) at least one of the tainted elements must be present.

The four tainted elements are: i) the transaction 'entered into a manner not normal for *bona fide* business purposes' or in other words, the 'abnormality' element, ii) 'lack in commercial substance' element, iii) 'rights or obligations created are not at arm's length' element, or, iv) 'misuse or abuse of the provisions of the Act' element. The facts of the selected Australian case law which were summarised in chapter 3 will now be applied to the South African general anti-avoidance rules.

#### **5.3.1 Arrangement**

The first step in determining whether the South African general anti-avoidance rules will apply, will be to determine whether there is an arrangement within the meaning of section 80L of the Income Tax Act. An arrangement is defined in terms of section 80L as "...any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes



any of the foregoing involving the alienation of property”. An avoidance arrangement is defined in section 80L as “...any arrangement that, but for Part IIA, results in a tax benefit”. Similarly, the Australian general anti-avoidance rules require a scheme to be present. The Australian Commissioner identified a narrow and a wider scheme. The 2006 South African general anti-avoidance rules can be applied to the arrangement as a whole or to a specific step of the arrangement.

The transactions entered into by RCI Pty Ltd (i.e. the declaration of a dividend and a share transfer) satisfy the definition of an arrangement as contemplated in section 80L, as the declaration of a dividend and the transfer of shares can be classified as a transaction, operation or scheme respectively. In order for the South African general anti-avoidance rules to apply, the arrangement should be an avoidance arrangement and therefore from the above arrangement it should be determined whether the declaration of the dividend and the transfer of shares resulted in a tax benefit.

### **5.3.2 Tax benefit**

The second step will be to determine whether a tax benefit resulted from the arrangement. Tax benefit is defined in South Africa in section 1 of the Income Tax Act to include “...any avoidance, postponement or reduction of any liability for tax”. Similarly, the Australian general anti-avoidance rules also require that a tax benefit must have been obtained.

In order to determine, based on South African general anti-avoidance rules, whether a tax benefit was gained from the transaction in terms of the fact pattern of *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, it is necessary to determine whether the taxpayer escaped or prevented an anticipated tax liability. According to the ATO, when the taxpayer transferred its wholly owned USA subsidiary to a new group company it triggered a capital gains tax for the taxpayer.

It is necessary to apply the steps that resulted in an alleged capital gains tax on the South African Income Tax Act including the Eighth Schedule in order to determine the income tax consequences. The first step in the scheme, was JHH(0) that revalued its shareholding in its USA subsidiary. This revaluation resulted in a US\$318 million surplus. In the second step of the scheme, JHH(0) declared a dividend of US\$318 million to RCI Pty Ltd. This dividend would have been exempt under section 10B(2)(a) of the Income Tax Act. Section 10B(2) determines that, “...there must be an exemption from normal tax any foreign dividend received by or accrued to a person – (a) if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in the company declaring the foreign dividend...”. JHH(0), a USA company was a wholly owned subsidiary of RCI Pty Ltd, therefore, RCI Pty Ltd held at the time of the payment of the foreign dividend more than 10% of the equity shares and the foreign dividend would have been exempt. In the third step of the scheme, JHH(0) paid the dividend of US\$318

million to RCI Pty Ltd by paying US\$20 million of the dividend in cash and the remainder was paid through a promissory note for US\$307,415,972 that was issued to JHIL in exchange for JHIL to credit RCI Pty Ltd's intercompany account with US\$298 million. Furthermore, RCI Pty Ltd injected an approximate of US\$50 million extra equity in JHH(0) by way of purchasing extra issued shares. Finally, RCI Pty Ltd transferred all the shares it held in JHH(0) to RCI Malta in exchange for shares in RCI Malta. This will trigger a capital gain in the Income Tax Act as per *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939, 3 the shares that RCI Pty Ltd held in JHH(0) were part of the group structure of the group of companies and were therefore not held as trading stock. The capital gain will be determined by taking the proceeds less the base cost of the asset as per the Eighth Schedule of the Income Tax Act.

As discussed in chapter 4, the word 'any' that is placed in front of the word liability in the definition of a tax benefit indicates that 'liability' will be interpreted as widely as possible (De Vos, 2016:47). The Income Tax Act does not specify guidance or a clear test to establish whether a tax benefit was derived from an arrangement (Benn, 2013:27).

Cliffe Dekker Hofmeyr (2012:17) noted that a South African taxpayer could potentially, depending on the circumstances, argue that it would not have entered into any transaction at all or that out of a series of alternatives, an alternative transaction with the same commercial end result could be selected, but would have resulted in a similar tax outcome. Both these approaches have been used in South African Income Tax cases under the previous general anti-avoidance regime (Warneke, 2005:97). In order to determine whether the facts of *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, resulted in a tax benefit, the following two questions should be considered (Calvert, 2011:41), refer to chapter 4, 4.3.2:

- “Has the tax benefit arisen because the taxpayer had effectively stepped out of the way of, escapes or prevented an anticipated liability?” (*Smith v Commissioner for Inland Revenue* [1964] 25 SATC)
- “Would a tax liability have existed but for this transaction (but for test)?” (*Income Tax Case No 1625* [1996] 59 SATC 383; *Commissioner for Inland Revenue v Louw* [1983] 45 SATC 113)

The payment of the dividend which is exempt in the hands of RCI Pty Ltd, does result in a lower capital gain since the proceeds are less than it would have been if the dividend was not paid due to the reduction in the share price. This arrangement will allow the taxpayer to avoid an anticipated liability for tax as the capital gain is reduced and this in effect reduces the taxable income. In applying the 'but for test', it is necessary to estimate what the tax consequence would have been had the arrangement not been entered into. When considering the arrangement it is evident that the taxpayers would not have had a larger tax liability if the arrangement had not been entered into, as the shares would not have been

disposed of. Therefore, the wider scheme as was identified seems not to constitute an avoidance arrangement as defined in section 80L of the Income Tax Act as it would probably not result in a tax benefit. On the contrary, the Australian Commissioner determined the tax benefit on the basis that had the scheme not been entered into it might reasonably be expected that a restructuring of the group involving the transfer by RCI Pty Ltd of its shares in JHH(0) to RCI Malta in exchange for shares in RCI Malta would nevertheless have proceeded (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 137). By applying the South African ‘but for test’ on a single step in the wider scheme it could be argued that the taxpayer would have had a larger tax liability if the payment of the dividend did not take place as JHH(0) did not have enough funds to pay the dividend and the disposal of the shares still took place.

The term ‘tax benefit’ is defined in the South African Income Tax Act, but there are no guidelines in the Income Tax Act on how to determine a tax benefit which results in uncertainty. Based on the above, it cannot be determined with certainty whether the arrangement would result in a tax benefit. This uncertainty is due to a taxpayer that can argue that it would have done nothing in the alternative, in which case no tax benefit would have arisen and consequently no tax would have been payable similarly to the ‘done nothing’ argument that was made by taxpayers in Australia. However, the ‘but for’ test that was established by the South African courts under the previous general anti-avoidance regime was formed without taking into account individual steps of the arrangement. There has not been any judicial consideration on the current general anti-avoidance regime and therefore a South African court could potentially reach a conclusion, taking into account the single step of the payment of the dividend, that the transactions constitute an avoidance arrangement as defined in section 80L of the Income Tax Act.

### **5.3.3 Sole or main purpose of the arrangement**

In *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 151 the judge concluded that there is no tax benefit. However, the judge still addressed section 177D(1) of the Income Tax Assessment Act due to the primary judge’s reasons in *RCI Pty Ltd v Commissioner of Taxation* [2010] FCA 939. The reason being that the judge in the RCI Pty Ltd 2010 court case found that RCI Pty Ltd did obtain a tax benefit. Due to this and as discussed above, there is a possibility that South African courts could potentially conclude that a tax benefit was obtained by only considering a step in the scheme, therefore the sole or main purpose will also be discussed further in this study.

Both the South African and the Australian general anti-avoidance rules include the requirement that the sole or main purpose of the arrangement must have been to obtain a tax benefit, although worded slightly differently, the Australian requirement is that the dominant purpose must have been to obtain a tax benefit. In applying the third requirement of the South African general anti-avoidance rules, the sole or main purpose requirement will be considered by taking into account both the subjective test and the

objective test. The subjective test determines whether the stated intention of the taxpayer was to enter into an arrangement for the sole or main purpose of obtaining a tax benefit (Calvert, 2011:25-26, *Secretary for Inland Revenue v Gallagher* [1978] (2) SA 463 (A)). The objective test on the other hand, determines whether the real outcome of the arrangement, supports the non-tax benefit stated intention of the arrangement (Calvert, 2011:26; *Ovenstone v Secretary for Inland Revenue* [1980] 42 SATC 55 (A)).

Calvert (2011:46) notes that when the subjective and objective tests are applied, the following principles may be considered:

- The dominant purpose should be established if an arrangement has more than one purpose (*Commissioner for Inland Revenue v Conhage (Pty) Ltd*, [1999] 61 SATC 391);
- If a taxpayer could achieve the same commercial outcome in a different way but chose the option which did not attract tax or attracts less tax, the dominant purpose of the arrangement will not be to obtain a particular tax benefit (*Commissioner for Inland Revenue v Conhage (Pty) Ltd*, [1999] 61 SATC 391); or
- If the intention of the taxpayer is considered and it is determined that the dominant subjective purpose of the avoidance arrangement was to achieve a particular non-tax business purpose, it would show that the dominant purpose of the arrangement was not to obtain a particular tax benefit.

According to RCI Pty Ltd, the transaction had more than one purpose but the main purpose of the transaction was the repatriation of funds from the then profitable USA Group to Australia, where losses had been incurred in the past and were continuing to be incurred, so as to take advantage of those losses and preserve a balance sheet asset which recognised the FITB of those losses. “The dominant purpose of JHIL, RCI Pty Ltd and JHH(0) in entering into or carrying out any scheme which included, the payment of the March 1998 dividend, was to achieve the following benefits:

- (1) the detachment of JHH(0) profits of US\$318 million, which became an asset of RCI Pty Ltd;
- (2) the dividend of US\$318 million which was wholly exempt from Australian tax;
- (3) minimum USA withholding tax (US\$2.39 million);
- (4) an increase in interest-bearing debt in the USA, generating deductions in the USA;
- (5) an increase in assessable income in Australia, which was sheltered by available tax losses; and

- (6) the ability to continue to recognise the substantial FITB asset in the accounts of JHIL, and in addition, avoiding a write down that would reduce JHIL profits.” (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 159).

On the contrary, the Australian Commissioner determined that the main purpose of the transaction was to be a precursor to the implementation of a reorganisation of the group. The reorganisation’s overall purpose was the movement of companies in the group, or the assets of companies in the group, underneath the umbrella of a vehicle. The Australian Commissioner said the purpose of the scheme was to reduce the market value of the shares in JHH(0) in anticipation of the share transfer by RCI Pty Ltd in order to reduce the capital gain for RCI Pty Ltd. The payment of the dividend was the first step in the implementation of the reorganisation project in which RCI Pty Ltd reduced its capital gain (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104, 6).

Alternatives were considered to raise capital and repatriate funds to Australia from the USA. These alternatives included a new royalty agreement between JHH(0) and RCI Pty Ltd, payment of a large dividend by JHH(0) to RCI Pty Ltd and lastly, JHH(0) would buy assets owned by Australia and lease them back (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:16-19). The same commercial result of the arrangement could have been obtained via a royalty or a sale and lease back as it would have raised funds in Australia. Though three options were present, a taxpayer is allowed to arrange his affairs in order for the tax attaching under the appropriate Act to be less than it would be.

In view of the representations made by RCI Pty Ltd, if it was not for the need to raise capital, the arrangement would not have been entered into. According to RCI Pty Ltd there is a dominant non-tax business purpose for entering into the scheme which included the declaration of the dividend and later the disposal of the shares in JHH(0), which was for unrealised capital profits to be repatriated to Australia from the USA (*RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104:6).

In section 80G of the South African Income Tax Act, a presumption for purpose is created and this presumption places an immense burden on the taxpayer as it could be an extremely challenging task to prove that the dominant purpose was not to obtain a tax benefit. It is therefore difficult to determine with certainty what the conclusion would be regarding the sole or dominant purpose if the facts of RCI Pty Ltd came before the courts, especially since the new general anti-avoidance rules may be applied to a step in an arrangement. Furthermore, another problematic issue that the courts will have to consider if the facts of RCI Pty Ltd came before the courts, is to determine the dominant purpose of the transaction from a list of multiple purposes or benefits that RCI Pty Ltd were aiming to achieve from the arrangement and to determine whether the dominant purpose was indeed the repatriation of funds.

Based on the above, it cannot be said with certainty whether the ‘dominant purpose’ test will be satisfied in order to determine whether the general anti-avoidance rules will apply. The tainted elements will be briefly discussed below, as one of the tainted elements must be present before an arrangement that resulted in a tax benefit and was entered into with the sole or main purpose of obtaining a tax benefit, will be an impermissible arrangement in terms of section 80A of the Income Tax Act.

#### **5.3.4 Tainted element requirement**

The greatest design difference between the Australian and the South African general anti-avoidance provisions is in relation to the tainted elements in the South African tax legislation and the considerations of the eight factors in the Australian tax legislation. As noted by Calvert and Dabner (2012:73), upon a deeper look at these two respective requirements the differences are more apparent than real.

An avoidance arrangement which can be: 1. in the context of business or 2. in any context other than business or 3. in any other context, must be characterised by at least one tainted element. The four tainted elements are: i) the transaction is not entered into a manner normal for *bona fide* business purposes or in other words the abnormality element (refer to paragraph 5.3.4.1), ii) the transaction lacks commercial substance (refer to paragraph 5.3.4.2), iii) the rights or obligations created are not at arm’s length (refer to paragraph 5.3.4.3), and iv) it would result in the misuse or abuse of the provisions of the Income Tax Act (refer to paragraph 5.3.4.4). Each of the tainted elements will briefly be discussed below with reference to the facts of *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104.

##### **5.3.4.1 Abnormality element**

In considering the first tainted element in the South African general anti-avoidance rules, it should be considered whether there is a difference between the arrangement that the taxpayer entered into and a transaction entered into for *bona fide* business purposes in the absence of the tax consideration (Louw, 2007:27). The terms ‘*bona fide*’ and ‘normality’ are not defined in the legislation and there is no specific test in the legislation to determine what constitutes ‘normal’. This creates uncertainty of how it should be applied and it is difficult to apply in practice.

Based on the facts of the court case of RCI Pty Ltd, it can be assumed that the courts could come to a conclusion that the arrangement was carried out by means or in a way which would normally be employed, as it might be difficult to prove that a group restructuring and the repatriation of funds are abnormal in business. However, the significance of the amount of the dividend when there were no

funds to pay the dividend and funding had to be obtained, could indicate that the transaction was not dealt with at arm's length which will be discussed later in this chapter.

#### **5.3.4.2 The transaction lacks commercial substance**

The commercial substance element, which only applies in the context of business, can be found in section 80C(1) of the Income Tax Act which contains a general rule, and in section 80C(2) which contains a non-exclusive list, indicative of a lack of commercial substance (Loof, 2013:22). There are various indicators to be considered to determine whether an arrangement lacks commercial substance. These indicators consist of the general 'lack of commercial substance' indicator, the 'substance over form' indicator, the 'round trip financing' indicator, the 'tax indifferent party' indicator and the 'offsetting and cancelling' indicator. In terms of section 80C of the Income Tax Act, a transaction will lack commercial substance if a transaction indicates a lack of a significant effect upon the net cash flows or business risks but resulted in a significant tax benefit. In the substance over form test, the true intention of the parties should be considered, for example it should be considered whether the risks and rewards resulting from a particular arrangement are what is to be expected from such a transaction or is the objective of the transaction only to gain a tax benefit that allows the evasion of tax. In terms of section 80D of the Income Tax Act, round trip financing should be considered if funding has been transferred between parties through some sort of reciprocal action, resulting directly or indirectly in a tax benefit. In terms of section 80E of the Income Tax Act, the tax-indifferent party test should be considered if there is a party who effectively disposed its tax advantage to others, regardless of its connection with any of the contracting parties. Finally, in the offsetting or cancelling test it should be considered if there are elements within the transaction that have the effect of offsetting or cancelling each other out as this indicates that the parts of the transaction that offset were arranged with the objective of obtaining a tax benefit and a lack of commercial substance.

In chapter 4, these elements mentioned above, were discussed in more detail as well as pointing out certain areas which will cause uncertainty and confusion. From the facts of the case, it seems that it will be difficult to prove that the restructuring is abnormal and that the transaction as a whole did lack commercial substance as the attempt to repatriate funds as part of a restructuring has commercial substance.

#### **5.3.4.3. The arrangement created rights and obligations that are not at arm's length**

In *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) it was held that dealing at arm's-length connotes that each party will attempt to get the highest possible advantage out of the transaction for themselves. Therefore, the use of the term 'at arm's length' can be understood to mean in the context of rights and obligations what unconnected persons would have done in a similar situation. If the

arrangement in which RCI Pty Ltd entered into resulted in a tax benefit with the sole or dominant purpose of obtaining the particular tax benefit, then the size of the dividend of US\$318 million could indicate that the transaction was not at arm's length. For example, it was a sizeable sum of money which JHH(0) did not have available to pay to the shareholder but had to borrow money from connected persons as the payment of the dividend could not be funded from external sources. Furthermore, the dividend was extensively larger than the dividend paid in the previous year. This could potentially lead to a tainted element being present in the scheme, but on the other hand the Commissioner has the onus of proof that a degree of abnormality exists and it will seem like a very difficult task to prove before courts as companies do finance the payment of dividends for commercial reasons. On its own, it is not sufficient to prove that this is an impermissible avoidance arrangement as it cannot be said with certainty whether the sole or main purposes as determined above was to obtain a tax benefit.

#### **5.3.4.4 Misuse or abuse of provisions of the Income Tax Act**

Section 80A(c)(ii) is based on taxpayers who abuse the provisions of the Act to obtain a tax benefit and avoid tax (Kujinga, 2013:116). It cannot be determined with certainty whether the arrangement resulted in a misuse or abuse of the provisions of the Income Tax Act as the decisions made in the fact pattern of RCI Pty Ltd was in terms of the Australian tax legislation. However, it does not seem based on the facts of RCI Pty Ltd that the arrangement exploits the purpose of any of the provisions of the Income Tax Act as the intention of the taxpayer was to repatriate funds from the USA to Australia and the taxpayer is allowed to arrange his affairs in order for the tax attaching under the appropriate Act to be less than it otherwise would be. The application of the fact pattern within the scope of this study to the South African legislation would result in the dividend that was paid by JHH(0) being exempt under section 10B(2)(a) and furthermore, the capital gain would be determined based on the Eighth Schedule of the Income Tax Act and therefore does not seem that it would exploit any provision of the Income Tax Act.

### **5.4 SUMMARY**

The Australian Government acted to protect the integrity of the tax system by making amendments to the general anti-avoidance rules after the loss of recent court cases. The court cases that were lost by the ATO played a role in the amendments to the Australian general anti-avoidance rules and therefore it can be assumed that the Australian Commissioner attacked the scheme of RCI Pty Ltd as it is of the belief that this type of transaction should have been caught by the Australian general anti-avoidance rules. The amended Australian general anti-avoidance rules will aim to ensure that a taxpayer can no longer argue that it could have entered into a different transaction that also would have resulted in tax avoidance or in other words would have resulted in a similar tax outcome, or the taxpayer could have deferred their arrangements indefinitely or done nothing at all.



After the application of the fact pattern of RCI Pty Ltd on the South African general anti-avoidance rules it cannot be said with certainty how the South African courts will interpret the current general anti-avoidance rules. Based on the application of the selected Australian case law on the South African general anti-avoidance rules in this chapter it will be concluded that the arrangement as per the fact pattern would most likely have not been caught by the South African general anti-avoidance rules. This chapter corroborates that there are many uncertainties and weaknesses in the current general anti-avoidance regime due to the following:

- i) If looking at the wider scheme, taxpayers should with relative ease be able to justify that the purpose of an arrangement was not to obtain a tax benefit;
- ii) By only considering an isolated step in the scheme, it could lead to the isolated step losing commercial substance which creates uncertainty as it is unclear whether in such instance the isolated step can be viewed in the light of the composite transaction as a whole;
- iii) RCI Pty Ltd had multiple reasons for entering into the restructuring and it could be difficult for the courts to determine out of all the reasons entered into the scheme, which purpose or reason was in fact the dominant purpose;
- iv) The tainted elements pose many uncertainties and it could be very difficult to apply in practice. Uncertainties existed on some of these tainted elements that were borrowed from the predecessor and the new general anti-avoidance rules did not address the weaknesses and uncertainties in many instances. Further, there are uncertainties on the new concepts in the general anti-avoidance rules as many concepts and terms have been left undefined or unexplained.

The following chapter deals with the conclusion and will provide a summary of the research findings in chapters 2, 3, 4, and 5 with regards to the application of the facts of selected case law on the South African general anti-avoidance rules. A conclusion will be given on the research question including the weaknesses and uncertainties of the South African general anti-avoidance rules.

## **CHAPTER 6 SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **6.1 INTRODUCTION**

In this research study the facts of selected Australian case law were applied to the current South African general anti-avoidance legislation and by analysing the current South African general anti-avoidance rules with reference to the application of the Australian case law aimed to fill a gap in tax avoidance research. This research is relevant due to the South African general anti-avoidance rules that have not yet been applied in the courts and further because uncertainty exists regarding the interpretation and application of the legislation. The problem statement determined in chapter 1 is: With reference to the application of selected Australian case law, are the current South African general anti-avoidance rules an effective deterrent to tax avoidance? To answer the research question, this research focused on the application of facts of selected Australian case law to the South African general anti-avoidance rules. This study focused on the Australian and South African general anti-avoidance rules due to the similarities between the respective general anti-avoidance regimes. Furthermore, due to the Australian general anti-avoidance rules proving to be ineffective after the announcement made by the Assistant Treasurer that the Government will protect the integrity of the Australian tax system by amending the Australian general anti-avoidance rules as a direct response on the recent avalanche of court cases in which the majority was lost by the Australian Commissioner (Arbid, 2012).

This chapter will discuss the findings by providing a summary of the research findings in chapters 2, 3, 4, and 5, including a summary of the weaknesses and uncertainties identified and will provide some recommendations to address the weaknesses. A conclusion will be given on whether the current South African general anti-avoidance rules are an effective deterrent to tax avoidance.

### **6.2 ACHIEVEMENT OF RESEARCH OBJECTIVES**

#### **6.2.1 Selecting case law**

In chapter 2, case law was selected to be used in this research in order to apply the facts of case law to the South African general anti-avoidance rules. In selecting the case law, the Australian general anti-avoidance rules including the amendments was explored in order to determine selection criteria to select landmark case law.

The Australian general anti-avoidance rules require the following main elements:

- i) a scheme must be present;
- ii) a tax benefit must be derived from such scheme; and
- iii) the scheme, or any part of such scheme, must have been entered into for the sole or dominant purpose of obtaining a tax benefit with regards to the eight matters set out in section 177D of the Australian Income Tax Assessment Act.

The Australian Government introduced amendments to the general anti-avoidance rules as a response to recent court decisions that resulted in a loss for the ATO. By introducing the amendments to the general anti-avoidance rules, the Australian government is aiming to protect the integrity of the Australian tax system as was announced by the Assistant Treasurer (Arbid, 2012).

These amendments stemmed from taxpayers arguing that they did not receive a tax benefit as the taxpayer would have either done nothing, in which case no tax benefit would have arisen and consequently also no tax would have been payable at all, or alternatively the taxpayer argued that it could have done the transaction in a manner resulting in a comparable tax result, in other words, the tax outcome would have been similar to that achieved under the scheme (Cliffe Dekker Hofmeyr, 2012:15-16).

As per the explanatory memorandum of the Tax Laws Amendment Bill 2013 (Parliament of the Commonwealth of Australia, 2013:1.4), a key perceived weakness of Part IVA of the Income Tax Assessment Act related to the process of identifying a tax benefit. The changes to the general anti-avoidance rules revolved mainly around section 177CB which provides additional guidance on the identification of a tax benefit.

The amendments to the Australian general anti-avoidance rules were taken into consideration in the selection criteria as set out in chapter 2. These selection criteria resulted in *RCI Pty Limited v Federal Commissioner of Taxation* [2011] FCAFC 104 being the landmark case law selected for this research study. The facts and findings of the selected case law were summarised in chapter 3 in order to be applied to the South African general anti-avoidance rules.

### **6.2.2 South African general anti-avoidance rules**

In chapter 4, the South African general anti-avoidance rules were discussed. Chapter 4 first looked at the history of the general anti-avoidance regime over time and then continued with an analysis of important definitions surrounding tax avoidance and finally, the requirements of the general anti-avoidance rules were untangled in order to understand weaknesses and uncertainties.

As per Part IIA of the Income Tax Act, the current general anti-avoidance rules of South Africa will find application, if the following requirements have been met:

- i) an arrangement must have been entered into or carried out;
  - ii) a tax benefit must result from the arrangement;
  - iii) the sole or main purpose of entering into the arrangement must have been to obtain a tax benefit;
- and

iv) one of the four tainted elements must be present.

The four tainted elements are:

- The transaction is not entered into a manner normal for *bona fide* business purposes (abnormality element);
- The transaction lacks commercial substance;
- The rights or obligations created are not at arm's length; and
- It would result in the misuse or abuse of the provisions of the Income Tax Act.

As can be seen above, the Australian general anti-avoidance rules found in Part IVA of the Income Tax Assessment Act and the South African general anti-avoidance rules found in section 80A-80L in Part IIA of the Income Tax Act are in many ways similar although they differ in their design (Calvert & Dabner, 2012:53).

The above South African elements of the general anti-avoidance rules have been untangled in chapter 4 and the case law as was selected in chapter 2 were applied to the South African general anti-avoidance rules in chapter 5. When one considers the weaknesses and uncertainties identified in chapters 4 and 5, it will be concluded that the current general anti-avoidance rules are not an effective deterrent to tax avoidance. Below follows a summary on the weaknesses and uncertainties of the South African general anti-avoidance rules that were identified in this research study.

### **6.2.3 Weaknesses identified in the South African general anti-avoidance rules**

The current general anti-avoidance rules are not an effective deterrent to tax avoidance as weaknesses and uncertainties were identified in this research study. One of the weaknesses in the previous general anti-avoidance regime related to procedural and administration issues. The new general anti-avoidance rules may potentially face similar weaknesses due to the level of uncertainty that has been identified in the current general anti-avoidance rules which could result in arrangements unnecessarily being attacked by SARS (Mvuyana, 2014:39).

Some weaknesses and uncertainties of the current general anti-avoidance rules identified in this research study relate to:

- Terms undefined;
- Tax benefit and determining the sole or dominant purpose;
- Wide scope of the general anti-avoidance rules;
- Abnormality element; and

- Other weaknesses, including new concepts.

A brief overview of the weaknesses and uncertainties identified in the current general anti-avoidance rules will be discussed below.

#### **6.2.3.1 Terms undefined**

The first weakness identified is that the general anti-avoidance rules do not define many of the terms in Part IIA of the Income Tax Act. Some of the concepts and terms that are not defined in the general anti-avoidance rules include: ‘scheme’; ‘sole’ or ‘main’ purpose; ‘*bona fide*’; and furthermore, under the lack of commercial substance tainted element ‘significant tax benefit’ and ‘significant effect’ were also left undefined.

The risk of leaving terms undefined in the general anti-avoidance rules is that it will lead to uncertainty as it leaves room for diverse interpretations resulting in a lack of effectiveness of the general anti-avoidance rules (Mvuyana, 2014:39). Furthermore, the diverse interpretations by the courts could potentially not be in line with the Commissioner’s intention (Mvuyana, 2014:39).

#### **6.2.3.2 Tax benefit and determining the sole or dominant purpose**

The general anti-avoidance rules do not provide a test or specific guidelines to determine whether a tax benefit exists (Loof, 2013:14). The courts however did establish the ‘but for’ test under the previous general anti-avoidance regime and since this element was retained any precedent set by the courts will still apply. In Australia, in recent court cases the taxpayers made a ‘no tax benefit’ argument and won by stating that the taxpayers would have either done nothing, in which case no tax benefit would have arisen and consequently also no tax would have been payable at all, or alternatively the transaction could have been entered into in a manner resulting in a comparable tax result. The Australian government acted upon these arguments by amending the general anti-avoidance rules by inserting guidelines on how the tax benefit and alternative postulate should be determined. As can be seen from the research study uncertainty exists around the determination of a tax benefit in South Africa and taxpayers could potentially be successful if they make the ‘no tax benefit’ argument.

The purpose test still plays a fundamental role in determining whether the general anti-avoidance rules can be applied. As mentioned above, the legislation does not define the terms ‘sole’ or ‘main’ and does not provide guidelines on how this should be interpreted. Furthermore, the legislation is not clear whether the test to determine the sole or main purpose should be objective or subjective.

### **6.2.3.3 Wide scope of the general anti-avoidance rules**

The current general anti-avoidance regime has a very wide scope. Some examples of the wide scope include:

- As mentioned above, there is no clear test to determine whether a taxpayer received a tax benefit in terms of an arrangement entered into.
- The tainted element relating to ‘commercial substance’ only lists indicative characters of what could constitute a lack of commercial substance and does not supply an exhaustive list, which widens the scope of the general anti-avoidance rules (Mvuyana, 2014:37).
- There is no list of the elements which have the effect of offsetting or cancelling each other, creating uncertainty and further, the round trip financing provision will result in the offsetting of steps and therefore it seems that it was unnecessary to insert the round trip financing provision (Loof, 2013:36).

### **6.2.3.4 Abnormality element**

A weakness of the predecessor of the general anti-avoidance regime was found in the abnormality requirement and this requirement was retained in the new general anti-avoidance rules. By retaining the abnormality element in the general anti-avoidance rules without a clear definition or guidelines, uncertainty from the predecessor still remain which could leave the general anti-avoidance rules potentially ineffective (Loof, 2013:35). There is a very slim chance for the Commissioner to succeed in proving that a transaction created rights or obligations that are not at arm’s length due to the uncertainty surrounding abnormality (Museka, 2011:65).

### **6.2.3.5 Other weaknesses, including new concepts**

The new general anti-avoidance rules contain many provisions, concepts and terms that were borrowed from the predecessor, but also include many new provisions. Since the new general anti-avoidance rules have not yet been tested before the courts it is uncertain how the courts will interpret these new provisions, concepts and terms.

One of the weaknesses of the predecessor was addressed, as the definition of an ‘arrangement’ in the current general anti-avoidance rules includes the application of the general anti-avoidance rules on a single step of an arrangement, regardless of the purpose of the arrangement in its entirety (Loof, 2013:35). Numerous commercial results cannot be achieved through a single step, which could result in uncertainty of how a legal substance or commercial effect of an arrangement in its entirety can be compared to a single step, which could potentially put all multi-step arrangements at risk (Loof, 2013:36).

A new tainted element which was inserted was the ‘misuse or abuse of the provisions of the Act’ element. This new tainted element widens the scope of the general anti-avoidance rules as it could be interpreted very narrowly by the courts or could be interpreted differently as it would be difficult for the courts to determine the underlying purpose of the legislature on a provision which could lead to inconsistencies within the courts and create confusion (Museka, 2011:70).

The current general anti-avoidance regime applies to written and oral arrangement, but it could be difficult to apply an oral arrangement to the general anti-avoidance rules as a taxpayer could easily dispute the existence of an oral agreement (Museka, 2011:76).

### **6.3 LIMITATIONS OF THIS RESEARCH STUDY**

It was determined in chapter 1, 1.5 that this study does have limitations. The first limitation is that it only explores the Australian and South African general anti-avoidance rules respectively. Therefore, there are limitations regarding principles and lessons from other jurisdictions which will not be considered. Furthermore, this study applies the facts of selected Australian case law to the South African general anti-avoidance rules and therefore, any findings must be interpreted in the context of the specific facts of the selected case law. The aim of this research study is not to address all possible cases that may come before the courts since it focused on landmark case law that recently came before the Australian courts and furthermore, by applying selection criteria the intention of this research study is not to be statistically valid. Lastly, this research study only focuses on the general anti-avoidance rules and therefore any South African and Australian specific anti-avoidance provisions will not be considered as part of the scope of this research study.

### **6.4 RECOMMENDATIONS**

The weaknesses and uncertainties as was described above need to be addressed in order for the general anti-avoidance rules to be effective. It is submitted that the above weaknesses can be addressed by reducing the uncertainty within the general anti-avoidance rules. To reduce some of the weaknesses and uncertainty in the general anti-avoidance rules, the following recommendations are put forward:

- To define the undefined terms or to provide guidelines on widely defined terms and concepts in the general anti-avoidance rules to provide clarity, including a definition of the term ‘normal’ to address the weaknesses surrounding the abnormality elements.
- Guidelines should be provided to quantify ‘significant tax benefit’ and ‘significant effect’ under the lack of commercial substance tainted element.
- From this study it was seen that Australia amended the general anti-avoidance rules by including a specific provision on how to determine the tax benefit. South Africa could also consider providing specific guidelines on how the tax benefit should be determined.

- Guidelines on how to determine the sole or main purpose, specifically if it is an objective or subjective test should be considered.
- Where the scope of the general anti-avoidance rules are too wide it should be more specific. For example, an exhaustive list should be provided on what constitutes a lack of commercial substance. Furthermore, an extensive list should be provided for elements that offset or cancel each other.
- Loof (2013:35) noted that it is recommended that the application of the general anti-avoidance rules are specific to steps “...which are not commercially essential to achieve an intended end result.” and not any single step.

## **6.5 CONCLUSION**

Due to the similarities between the South African and Australian general anti-avoidance rules and the impact recent Australian court decisions had on the amendments to the Australian general anti-avoidance rules, this research analysed the South African general anti-avoidance rules by exploring Australian judicial experience. Australian case law was selected and summarised in order to apply the facts of case law to the South African general anti-avoidance rules. The South African general anti-avoidance regime was analysed and finally the facts of the selected Australian case law were applied to the South African general anti-avoidance rules. The analysis of the South African general anti-avoidance rules revealed weaknesses and uncertainties in the general anti-avoidance rules. Furthermore, it is evident that the provisions relating to the general anti-avoidance rules are complex and difficult to apply.

When the weaknesses and uncertainties that exist and the insights that were obtained from this research study on how difficult it could be to apply the general anti-avoidance rules in practice are considered, it could be concluded that the current general anti-avoidance rules are not an effective deterrent to tax avoidance. Therefore, the South African general anti-avoidance regime which was amended in 2006 in order to address previous weaknesses is still of a concern and may need future amendments.

## **6.6 SUGGESTIONS FOR FUTURE RESEARCH**

From this study, the following suggestions for future research had been identified:

- A detailed study could be performed to compare the South African general anti-avoidance rules to the amended Australian general anti-avoidance rules. This may be useful to determine whether the amended Australian general anti-avoidance rules were improved by removing previous weaknesses and uncertainties and furthermore, it could be determined whether South Africa can learn lessons from the Australian amendments.



- Selection criteria were applied to determine landmark case law to be used for purposes of this study. A detailed study could be performed on the application of the South African legislation on the fact patterns of all the cases that recently came before the courts in Australia that resulted in a loss.
- Selection criteria were applied to determine landmark case law to be used for purposes of this study. The first applied criteria eliminated the court cases that resulted in a win for the ATO. Therefore, a study could be performed to analyse the fact patterns of the cases in which the Australian general anti-avoidance rules were effective, to determine whether the South African general anti-avoidance regime would also have been successful on the fact patterns of these case law.

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