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The Effectiveness of Section 80A of the South Africa Income Tax Act

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DECLARATION

I, **Rawlings Obenembot Enowkenwa**, declare that the mini dissertation entitled "**THE EFFECTIVENESS OF SECTION 80A OF THE SOUTH AFRICAN INCOME TAX ACT**" hereby submitted for the degree of MASTER OF BUSINESS ADMINISTRATION (MBA) has not previously been submitted by me for a degree at this or any other university. I further declare that this is my work in design and execution and that all materials contained herein have been duly acknowledged.

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Student

Signed at _____ on this _____ of _____ 2018

Prof W Musvoto

Supervisor

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To the entire staff of the School of Business and Governance of the North West University, a memorable thank you for the opportunity given me to achieve this qualification.

DEDICATION

To my late parents Mr. & Mrs. OBENEMBOT and to my wife and children, especially Phoebe Tabot. My sincere thanks for your love and moral support during this period of study.

ABSTRACT

This study was undertaken to establish the effectiveness of the current Section 80A-80L of the General Anti-Avoidance Rule (GAAR) of the South African Income Tax Act No-58 of 1962, in combating tax avoidance schemes.

Tax avoidance is a key contention of the South African Revenue Service (SARS) and other tax authorities. This research report will examine the effective application of the impermissible tax avoidance provision regarding the meaning of a tax benefit, substance over form and stimulated transactions as well as the sole or main purpose of taxpayers entering into transactions.

The results indicated that the provision of the GAAR on the meaning of a significant tax benefit in the tax legislation has left room for the taxpayer to successfully argue on what constitutes a significant tax benefit and so there is a need for an interpretation not to further guide the tax authorities as well as taxpayers on the quantitative meaning of these terms.

Keywords:

Anti-avoidance provision, Taxpayers, Tax avoidance, Arrangement, Impermissible avoidance arrangement, Tax benefit, South African Revenue Service, General anti-avoidance rule, Tax planning.

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CHAPTER ONE

1.1 Introduction

In South Africa, as in many countries around the world, there has always been an ongoing struggle of balancing the needs of the government against the needs of taxpayers when it comes to the principles of tax avoidance. On the one hand, taxpayers seek new and innovative ways to structure agreements in such a way to reduce the tax burden imposed on them, and on the other hand, the government tries to keep legislation up to date in order to curtail this new and innovative ways of tax avoidance.

Tax avoidance involves the use of legitimate means of paying less tax. It has always been stated that a taxpayer may structure his affairs in a manner that would allow him to pay the least amount of tax (Lord Tomlin, 1936). Tax evasion on the other hand, involves the use of illegal means of paying the least amount of tax and could lead to severe penalties (Haupt, 2017:629). South Africa incorporated general anti-avoidance rule (GAAR) in the tax legislation in order to combat tax avoidance and to ensure taxpayer compliance.

The ineffectiveness of the previous Section 103(1) of the General Anti-Avoidance Rule (GAAR) of the South African Income Tax Act (Act No, 58 of 1962), to combat tax avoidance arrangements (SARS Discussion paper, 2005), has placed a huge burden on honest and dedicated taxpayers to support the 45.5 percent of South Africans who depend on Social Security Services to make ends meet (Statistics South Africa, 2015). Following the emergence of impermissible tax avoidance schemes entered into by taxpayers in South Africa, the tax authority has resorted to combating tax avoidance by implementing new provisions that were inserted in Sections 80A to 80L and apply to any arrangement entered into on or after 2006 to fight the complex schemes entered into by taxpayers with the sole or main purpose of avoiding the payment of tax.

The General Anti-Avoidance Rules in the now-repealed section 103(1) does not apply to a transaction, operation or scheme entered into on or after 2 November 2006, being the date that the new General Anti-Avoidance Rules came into force. The tax authority is of the opinion that the previous section 103(1) of the income Tax Act (Act No. 58 of

1962), was not stringent enough to combat the complex tax avoidance arrangements entered into by taxpayers, hence the promulgation of the General Anti-Avoidance Rule (GAAR) (Section 80A-80L), that came into existence in 2006.

Tax planning and avoidance can be carried out by the taxpayer which leads a tax decrease arrangement which may meet three requirements of the Income Tax Act (Stiglitz, 1985). Legitimate tax planning is said to have taken place when the results of these arrangements are in line with the requirements of the GAAR. When tax planning or avoidance minimises taxes in a way and manner that is unacceptable with the intent of the Act the arrangements would lead to an “impermissible tax avoidance scheme” (Discussion paper on GAAR, 2005).

Impermissible tax avoidance arises when a person intentionally undertakes or enters into transactions with the sole or main intention of obtaining a tax benefit (Act No, 58 of 1962), and the arrangement contravene specific or the GAAR of the tax Act that free himself or herself from a tax liability. Tax avoidance also includes instances where a taxpayer eliminates tax through an arrangement or arrangements that are in agreement with the Common Law but at the same time are contrary to the Tax Act (Stiglingh, Koekemoer, Schalkwyk, Wilcocks, & Swardt, 2014:811).

A taxpayer has the right to structure his/her commercial arrangements to reduce or minimise his/her tax obligation as much as he can (IRC v Duke of Westminster (1936) AC 1 (HL)19. At the same time, acts done by him with intention to either evade, or accommodate another taxpayer will be countered by the provision of the tax Act (Haupt, 2014:637).

Section 80A–80L has provided the requirements that leads an arrangement to be regarded as a tax avoidance arrangement (Act No, 58 of 1962). Section 80F of the Act allows the Commissioner to set aside or regard the arrangement as if it was entered into by one person (Act No, 58 of 1962), if in his opinion the sole or main intent of the taxpayer is the avoidance of tax.

For section 80A to be successfully applied, four requisites must all be present (Section, 103(1) (Act No, 58 of 1962). In the absence of one of them, no attempt may be made by the Commissioner to attack an arrangement, transaction or an understanding for tax avoidance (Enowkenwa, 2014).

In deciding whether a transaction constitutes a tax avoidance scheme, the court looks at the commercial nature and or substance of the transaction and not the form and the rights and obligations of arrangement (Dachs and Du Plessis, 2011). A further note will be drawn at considering if the transaction or operation lacks commercial substance (section 80C), or it accommodates or tax indifferent parties (section 80E) and or it contains round-trip financing (section 80D). Section 80E (2) makes it clear that any party can be an accommodating or tax indifferent party and the parties need not be connected to each other.

If a person is found to have entered into a transaction with another party to avoid tax, either he or the other party will be liable for the tax (Section 80F (b) (Act No, 58 of 1962). The Act empowers the Commissioner to take certain actions if the taxpayer is found to have deliberately entered into a transaction with the intent of avoiding tax liability.

The main purpose of establishing the new GAAR (Section 80A-80L) is to combat tax avoidance schemes, to prevent to an extent taxpayers' money being wasted on the numerous cases involving SARS on complex tax avoidance arrangements and finally to encourage honest and legitimate taxpayers. The enquiry that needs to be answered remains largely, is the new Section 80A up to the task?

1.2 Background of the concept of taxation

Taxation is defined as the means or manner whereby the state accumulates funds from its citizens and residents to finance for its administration and for the welfare and or endowments it provides to its persons (Haupt, 2017:1). Collecting tax is one of the sole means that governments are able to address insufficiency and disparity in the national economy (Oxfam policy paper, 2016).

At the helm of the development and growth of every society, taxation is central in the provision of much-needed government funding for infrastructure on which economic activities can be based (Pfister, M. 2009). Revenue collection further provides for the basic needs of the citizens and residents. A properly designed tax system can minimize tax losses from impermissible avoidance arrangements and even raise the growth rate of a Nation (Barro and Sala-i-Martin 1992). For this reason, it is imperative for any government, to implement consistent measures to fight impermissible tax avoidance arrangements. Some writers of tax developments hold the view that a fair tax system free from corruption, illegitimate tax avoidance schemes and which applies the rule of Law paves the way for good governance measures (Pfister, 2009).

Tax avoidance is defined as; an attempt by the taxpayer to minimise tax liability using legitimate means in regulating the business transactions in such a manner that leads to a minimum amount of tax payable (Haupt, 2017:1). Tax avoidance and tax evasion are often used interchangeably. In the process of a taxpayer trying to avoid taxation, it may to a certain extent lead to tax evasion. The Minister of Finance (2017), in his Budget Speech on combating tax avoidance stated that,

“Multinational corporations continue to use inconsistencies in global tax rules to their advantage and to avoid tax liabilities. South Africa intends to sign a multilateral instrument this year which will assist in the updating of treaties and will reduce the scope for aggressive tax avoidance activities” (budget speech, 2017).

However, it should be noted that efforts have been put in place by the National Treasury to step up the pace of income tax reforms (minister of finance, 2000), to curb impermissible tax avoidance schemes. This is further evident in the year 2006 when Section 80A replaced its predecessor Section 103(1) of the GAAR of the Act (Act No, 58 of 1962). No wonder some recognized organizations (for example KPMG) have expressed their views on the new section 80A-80L of the Act in an interim response on tax avoidance, as follows;

“An appropriate general anti-tax avoidance regime is a prerequisite for an effective tax system”

Section 103(1) was found to have created confusion to the taxpayers and to have restrictive interpretation by the relevant authorities. In the Court case concerning the Commissioner for Inland Revenue v King (1947(2) SA 155 (A) 14 SATC 184, the court stated that,

“the fundamental difficulty in dealing with section 90 is to avoid, on the one hand, giving it a meaning which because of its absurd and indeed revolutionary consequences, the legislature could not have intended and on the other hand, giving it no effect at all, in view of the already existing power of the court to strip disguises from transactions and declare what the real act was. A sphere of operation, reasonable and at the same time effective, must if possible, be discovered for the section”.

Taking into consideration the decision held by the court, the need arose for the review of Section 103(1) of the Income Tax Act (Act No, 31 of 1941). Section 103(1) was confirmed to be restrictive in its interpretation and hence its replacement by Section 80A-80L of the Act.

The South African Revenue Service (SARS) (2006), issued a statement that:

“In its current form, the GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly complex and sophisticated forms of impermissible tax avoidance schemes and has not kept up with international developments”

SARS was of the view that the weakness of Section 103(1) was in the abnormality context of the provision. The provision provided the taxpayer with a chance to successfully argue that it is not abnormal to arrange a commercial transaction so as to minimise liability for tax because it is acceptable business practice to do so (Williams, 2006:780).

Due to the complex nature of the Section, there were chances that the courts may misinterpret the provision, and or taxpayers to further use it as a breeding ground for further tax avoidance advantage. This was evident from the many complex transactions entered into by taxpayers with the assistance of tax advisers.

1.3 Problem statement

A report by Statistics South Africa, (2013/2014), indicated that 16 million South Africans are receiving social grants benefits. The country's tax system may not be able to keep pace with the ever increasing number of grants beneficiaries (SAIRR, 2013), this is further aggravated with the increasing incidents of tax avoidance schemes perpetrated by taxpayers. The current state of the South African economy looks bleak, with 45.5% of the population depend on taxpayers' money through the Social Grant system to survive (Statistics South Africa, 2015).

The research examined the administration of Section 80A-80L (General Anti-Avoidance Rule), to determine its effectiveness in preventing taxpayers from avoiding tax compared to its predecessor, Section 103(1). Section 103(1) was confirmed to be an unreliable and at times unsuccessful (SARS Discussion paper on tax avoidance, 2005), in combating the increasingly complex and sophisticated transactions, operations or schemes entered by taxpayers.

1.3.1 The short comings of Section 80A

Cilliers (2006) and Smith (2005) are of the view that it is hazardous to frame a GAAR too generally. It leaves room for uncertainty and or limits the taxpayer with regard to the amount of tax chargeable, and the extent to which they will be considered as engaged in impermissible avoidance arrangements.

1.4 Research questions

The research questions are the following:

- 1) Is the current Section 80A-80L (General Anti- Avoidance Rule) legislated well enough to effectively combat the complex business transactions or schemes entered into by tax payers for tax avoidance purpose?
- 2) Should the public expect another amendment of the General Anti-Avoidance Rule?

1.5 Research aims and Objectives

The objectives of the study are to evaluate the effectiveness of the current GAAR in combating complex tax arrangements in South Africa that lead to avoidance schemes. The new GAAR (Section 80A) will be compared to the previous Section 103(1) of the Income Tax Act, to determine its resilience and long-term achievement in combating impermissible tax avoidance arrangements by taxpayers.

1.6 Significance of the study

The nature and extent of tax avoidance practices in South Africa have, however caused the inclusion of the various anti-avoidance measures in the Income Tax Act (Stack & Cronje, 1999: 631). The study will be of benefit to the tax authorities as well as the wellbeing of the State in reducing the enormous number of taxpayers committing impermissible avoidance arrangements. It will alert Policy makers on new and complex developments on avoidance arrangements and contribute to further research to strengthen the provision of impermissible arrangements.

The successful combating of tax avoidance arrangements, operations and schemes will contribute to generate more revenue for the system and increase gross domestic product of the State.

1.7 Research methodology

The research method used is the archival method and an extended argument by the researcher. In the attempt to answer the above research questions, an extended argument of the South African Tax Legislation relating to impermissible tax avoidance arrangements or schemes was analyzed; case law, text books and journal articles relating to impermissible tax avoidance schemes were explored.

1.8 Chapter outline

Chapter one

This chapter is based on the introduction which provides an overview of the concept of taxation. It focuses on the General Anti-Avoidance Rule (GAAR), and the enactment of section 103(1), and the current Section 80A (Act No, 58 of 1962).

Chapter two

The chapter is based on the analysis of the meaning of an Arrangement or scheme as contained in Section 103(1) and 80A of the Income Tax Act, and a further examination of tax planning as defined by the provision, and lastly looks at the definitions and meaning of transaction, operation or scheme and Steps or parts constituting an arrangement as defined by the Income tax Act.

Chapter three

Chapter three deals with the meaning of, and the examination of what in the opinion of the tax authorities constitutes a significant tax benefit. It further looks at the Presumption of purpose and the misuse or abuse of any legal provisions by the taxpayer. Cases of tax avoidance will be analysed by comparing the application of sections 103(1) and 80A-80L to determine if the outcome or judgement would have been different under the current section 80A-80L.

Chapter four

The chapter deals with the conclusion and possible recommendations.

CHAPTER 2

An analysis of the meaning of arrangement, transaction or scheme

2.1. Introduction

One of the most noteworthy amendments to the Act was the GAAR “General Anti-Avoidance Rule” (GAAR) (Roodt inc, 2017), in November 2006 was replaced by sections 80A–80L which deal with “impermissible avoidance arrangements”. Despite extensive levels of research being undertaken, developing tax policy is a complex exercise and many alterations are proposed on narrow basis (James and Edwards, 2008). As a result, the provisions have been inadequate to combat impermissible tax avoidance arrangements entered into by taxpayers. Efforts made by tax authorities to implement tax avoidance measures have been met with complex trade arrangements by tax planners and taxpayers.

It is unsuitable to frame a GAAR to effectively combat tax avoidance schemes too widely, for it creates doubt regarding the sum of tax payable by tax payers if found to have contravene the provision (Cilliers, 2006), if found to have entered into a transaction that leads to an impermissible avoidance arrangement, and it creates further uncertainty to determine the part thereof of an arrangement that was entered into for the purpose of avoiding tax.

Since 1994, the Government has embarked on measures to move away from destructive tax practices that are not beneficial to the national economy (Minister of Finance, 24 October 2002), as taxpayers have been seeking ways to minimise their tax burden by entering into arrangements to avoid liability for tax. This is evident when Jesus Christ was asked by the Pharisees if it is proper and honourable thing to pay tax (Olivier, 1996). The avoidance of tax has both moral and emotional overtones (Clegg, 1991:536), and this attitude has to an extent been monitored by the interpretation of the anti-avoidance provision by the Courts.

The discussion on tax avoidance usually begins with the emphasis to distinguish between effective and legitimate tax planning, and an impermissible avoidance arrangement (Discussion Paper GAAR, 2005). Wiese (2006), is of the idea that in

South Africa, no legal distinction between legitimate tax planning and tax avoidance has been established.

An analysis is made of the term “avoidance arrangement” to ascertain what constitutes an avoidance arrangement entered into by a taxpayer. The question that largely remains unanswered is whether in itself, Section 80A has effectively addressed the shortcomings of Section 103(1).

2.2. Tax Evasion

Tax evasion is illegal, dishonest and deliberate acts (Acceptable tax planning, 2009), and refers to transactions purposely entered into by the taxpayers to free themselves from the tax liability which the legislation charges on them (Divaris and Stein. 2014:342). Tax evasion may lead to several penalties including imprisonment. Tax evasion involves deceit by the taxpayer to minimise tax liability by the not disclosing certain income or the over deduction of business expenses. An example of tax evasion is when a taxpayer deliberately omits or is assisted by any party to omit income from his/her or its annual tax return (Venter, Koekemoer, Oosthuizen, Cass, Bruwer, Stedall and Cucciolillo. 2016:520). Tax evasion is associated with the use of unlawful means to diminish a tax liability (Haupt 2015:690). For the taxpayer to successfully evade tax, he may suppress the business income, or falsify accounting records or not disclose business income to aid in reducing his tax liability (PricewaterhouseCoopers, 2008). The successful conviction of a taxpayer for tax evasion may lead to a fine or even imprisonment.

2.3. Tax Avoidance

Tax avoidance by a taxpayer is a situation in which the affairs of the business transactions are ordered within the bounds of the legislation to either reduce the taxable income or show no income to be taxed (Stiglingh, Koekemoer, Schalkwyk, Wilcocks, & Swardt, 2015:805). The Act provides for anti-avoidance measures in two ways: the “specific anti-avoidance measures” and the “general anti-avoidance rule” (GAAR) (Waerzeggers and Hillier, 2016). The focus of this research is on the general anti-avoidance rule which is currently under the provision of Section 80A-80L of the Act (Act No, 58 of 1962).

This provision states the following:

“Whenever the Commissioner is satisfied that any transaction, operation or scheme...

(a) Has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by the Act or reducing the amount thereof; and

(b) Having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out-

(i) was entered into or carried out-

(aa) in the case of a (business) transaction, operation or scheme, in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and

(bb) in the case of any other transaction, operation or scheme... 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 a transaction, operation or scheme in question, or

(ii) Has created rights or obligations which would not normally be created between persons dealing at arm’s length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and

(c) Was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit,

the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme has not been entered into or carried out, or in such manner as in the circumstances of the case he deems appropriate for the prevention of diminution of such avoidance, postponement of reduction” (Section 103(1) (Act No, 58 of 1962).

Based on Section 103(1), the burden was on the SARS (Commissioner) to prove that the arrangement entered into contained all four of the above requirements in order for the taxpayer or any party to be held liable for tax. Section 103(1) mandated the Commissioner to impose the tax liability to the taxpayer if he was found to have

entered into an understanding which resulted in a tax benefit to any party to the transaction. On the other hand, the Courts had to formulate a standard to determine if the business or any other arrangement entered into has created any abnormal privileges and responsibilities that would not normally be created in any normal commercial transaction.

A taxpayer cannot be held liable to pay tax if he enters into a bona fide transaction that either reduces his tax liability or avoids tax. This was reiterated by Lord Tomlin in the case of *Duke of Westminster v IRC (1936)*, made the following remarks:

“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax”

Based on the above, it could be said that legitimate tax planning that results to a lesser amount of taxable income or minimal tax liability is acceptable and if the intent does not lead in the abuse of any tax Legislation.

In *CIR v King (1947 A)*, the Court clearly stated the following:

“A taxpayer may close down his business or resign from his employment. It would be absurd to supposed that the legislature intended to impose a tax upon a taxpayer on such a deemed income which does not exist anymore”.

The legislation makes it clear to taxpayers that if a bona fide transaction is entered into that results in the reduction of income, no tax liability would be held against any party. For the Commissioner to apply the provisions under Section 103(1) to set aside an arrangement, and or to prevent the avoidance of any tax liability, all four requirements must be present:

- 1) “There must be a transaction, operation or scheme”,
- 2) “It must have the effect of either avoiding or postponing tax liability”,
- 3) “The manner in which a business transaction is entered into must have been abnormal and finally”,

- 4) "Its dominant purpose must have been to obtain a tax benefit" (Stack, Cronje and Hamel. 2002:638)

This does not advocate that the presence of any one or all of these characteristics in a transaction will automatically point to the presence of a tax avoidance motion in an arrangement.

In the absence of the Commissioner being unable to prove that all the four requirements have been met, the transaction, operation or scheme may not be set aside. Section 103(1) was found to have been affording the taxpayer the opportunity to enter into complex transactions with the sole intension of avoiding tax and to successfully defend himself.

2.3.1 An overview of tax avoidance

Taxpayers under normal circumstances, according to James and Edwards, are expected to act as responsible citizens, therefore they should abide to the expected obligations of the tax schemes without the need for heavy enforcement activities (James and Edwards, 2008). This may be partly so to a certain extent.

Adam Smith, (1776), as adopted by (Campbell and Skinner) in his famous book on "the wealth of nations", stated that:

"The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state".

It can be deduced from the above that every nation generates revenue to run the state's affairs through the contributions from its citizens in the form of tax or any form of duty, and this contribution should be in percentage to the respective income which they enjoy from the state (Haupt, 2017:2). Although a taxpayer has the right to plan his business transactions to minimise their tax liability, they may only act within the confines of the tax legislation, otherwise their acts may result in an impermissible tax avoidance arrangement (Urquhart, 1987). Taxpayers have the right to legally structure or plan their business affairs to minimise their tax burden (Lord Tumlin, 1936). This is in line with Stack & Cronje (1999:636), when they state the following:

“Personal tax planning can properly be described as ...the management and arrangement of the affairs of an individual, so as to legally minimise as far as possible and as cost effectively as possible, all taxes payable, within the constraints imposed by the commercial and other objectives of that and associated taxpayers”

Others have associated tax avoidance with evil because it deprives the government of revenue to assist in its obligations and responsibilities to its citizens. This is evident when it was expressed by the House of Lords in the matter involving Lord Vestey's Executions and *Vestey v IRC* (1949) 31 TC 1 HL90 as:

“Tax avoidance is an evil, but it would be the beginning of much greater evil if the Courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapprove”

The Courts at the same time are restricted to interpret each case within the restrictions of the provisions legislated in the Tax Act. Due to the alleged inconsistency of Section 103(1) and the complex and sophisticated nature of certain transactions, operations or schemes (Discussion Paper GAAR, 2005), entered into by taxpayers over the years, a review of section 103(1) by the Revenue Service was necessary. In SARS Discussion Paper, (2006b:2), relating to Tax Avoidance, the following was stated:

“The legislature enacted South Africa's first GAAR in 1941, to define and limit impermissible tax avoidance arrangements. Section 90 of the Income Tax Act 31 of 1941 was later replaced by section 103(1) of the Income Tax Act 58 of 1962. In 2005, the South African Revenue Service (SARS) proposed amendments to enhance the effectiveness in eliminating impermissible tax avoidance agreements”

SARS was of the opinion that in itself, Section 103(1) contained “inherent weaknesses”. The revised proposals on GAAR of October 2006 included some new provisions (Discussion Paper GAAR, 2005), to ensure a GAAR which is broad enough to prevent complex tax avoidance schemes by taxpayers (Discussion Paper,2006b:2). This general anti-avoidance provision was known as the “catch all” (PricewaterhouseCoopers, 2007:304), where transactions to avoid tax were entered into by taxpayers. The dominant intent was to achieve a balance between the need

for a resilient and effective General Anti-Avoidance Rule, and in contrast, to frustrate the efforts of impermissible avoidance measures (Discussion Paper GAAR, 2005).

Section 103(1) was accordingly repealed by the Revenue Laws Amendment Act and replaced by a new GAAR, found in sections 80A-80L of the Act (Schalkwyk & Geldenhuys, 2009).

2.3.2 A new wave of tax avoidance

Due to the stringent measures employed by the current GAAR under section 80A-80L, it seems taxpayers are moving towards the formation of various trusts to further aid in the avoidance of tax. Even though the treatment of transfers or low interest loans to trusts are covered under section 7C, it could be worth noting that this provision has opened a new wave for taxpayers to shield their wealth in trust accounts. This is evident in the 2016 Draft Taxation Law Amendment Bill:

- a) The 2016 Draft Taxation Law Amendment Bill proposes the introduction of a specific anti-avoidance measure in section 7C of the Act (Act No, 58 of 1962). This provision has the dominant purpose of preventing taxpayers from transferring their wealth to low interest or interest free loans to trust to which their connected are the main beneficiaries.

- b) The proposed section 7C assumes as a starting point that all interest free or low interest loans to a trust are used for the main purposes of avoiding any form of tax (National Treasury and SARS. 26 September 2016).

Section 7C deals with specific anti-avoidance provisions while section 80A-80L deals with general anti-avoidance rules; the scope of this research is limited to the GAAR.

2.4 Tax Planning

Tax planning and tax avoidance are very similar concepts in that a taxpayer can organize his affairs in such a way that he pays a minimal amount of tax. Tax planning is where the taxpayer takes advantage of a more attractive option offered to him by

the legislation and arranges his or her tax affairs in the most tax efficient manner, where he will be liable to a reduced tax burden.

2.4.1 An analysis of tax planning

Tax planning is the process by which a taxpayer structures his/her or its affairs in a manner or way that lessen, postpone or avoid taxes or has no income to be taxed (Stiglingh, Koekemoer, Van Zyl, Wilcocks & Swardt, 2017;797). The South African Revenue Service (SARS) is in agreement with that “Legitimate tax planning is concerned with the organisation of a taxpayer’s business arrangements or structuring of transactions so that they result to the minimum tax liability” (Discussion Paper on GAAR, 2005). It is challenging to determine and differentiate and set the line between “legitimate tax planning and impermissible tax avoidance arrangements” by taxpayers and the tax authority without resorting to the arm of the law (Sonnenbergs, 2009)

The aim of the tax authority concerning tax planning is to stamp out unacceptable tax avoidance arrangements (Waerzeggers and Hillier, 2016). Ineffective and or unacceptable tax planning process is the “postponing of taxes from the current period into future periods, arbitraging across different income streams facing different tax treatment and transferring income from higher tax brackets to lower tax brackets thereby leading to a tax reduction” (Stiglitz, 1985).

If a taxpayer plans his business transactions in such a manner that ends up in a reduction or postponement of tax liability without resort to “impermissible tax avoidance scheme”, he cannot be held liable for tax (the Duke of Westminster, 1936), and the provisions of section 80A to 80L cannot be applicable.

In the case of IRC v Duke of Westminster (1936) (19 TC 490 at 520), the Court held that:

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

The legislation is still not very clear to the taxpayer and even to the tax authorities about what constitutes a “permissible or impermissible avoidance arrangement”. This

may be true based on the recent case of Commissioner for the South African Revenue service v NWK Limited (2010) and other cases, where the impermissible avoidance provision was interpreted by the Tax Authorities to strongly remind taxpayers that any complex trade arrangements would attract the Commissioner's attention.

Using the conclusion arrived at in the case between the CIR v King 1947 (2) SA 196 (A), the focus of the decision was based on whether a taxpayer is legally allowed to structure his or her business transactions to result to an avoidance or postponement of tax. The Court resorted that:

"it is absurd to suppose that the legislation intended to impose a tax upon a taxpayer on such a deemed income which does not exist anymore, simply because he enters into a transaction which reduces the amount of his income from what it was in the previous year merely because his purpose was to reduce the amount of his income and consequently of his tax"

It is clear from the above that the Legislature, is not drafted with the intention to levy penalties or tax liability on any taxpayer who enters into a genuine business transaction that results in a reduction of his taxable income or tax liability. Due to the complex nature of understanding now undertaken by taxpayers, it was identified by the Commissioner of the SARS that, there was a need for a more objective standard to the GAAR (Williams, 1996). Hence the introduction of the current section 80A-80L (GAAR).

2.5 An analysis of the meaning of a tax benefit

Section 1 of the Act (Act No, 58 of 1962), defines a "tax benefit" as "including any avoidance, postponement or reduction of any liability for tax" by the taxpayer. On this note, it implies that if a taxpayer enters into any arrangement which has the outcome of the postponement or reduction of any liability for tax on the part of any party, it will be considered as an "impermissible tax avoidance arrangement".

For a transaction to result in an impermissible avoidance arrangement, the sole or dominant purpose of the taxpayers to the transaction, operation or scheme must be to result to a tax benefit (section 103(1)). Before an understanding is considered as an "impermissible avoidance arrangement" as defined in Section 80L of the Act, it must

have been established that a tax benefit has accrued to any one of the parties to the transaction. Upon the establishment that an “arrangement” is an “avoidance arrangement”, as determined by the provision, the next step is to determine whether that avoidance arrangement is an “impermissible avoidance arrangement” and whether it has resulted in an undue tax benefit within the meaning of the GAAR (Act No, 58 of 1962).

There is no formal test established by the tax legislation or provision of GAAR to determine the presence of a tax benefit from an arrangement. The legislation has empowered the Commissioner to recognise income that would otherwise have accrued to any of the parties, or an increase in the deductions of the expenses to the transaction or arrangement. A further test would be to establish the existence of or an abnormality in the drafting of the contract which creates abnormal rights and obligations for any of the parties (Act No, 58 of 1962). To determine this, an abnormality test will be conducted to determine if the transaction or operation was conducted at arm’s length. The test is further conducted to establish if the arrangement has created rights or obligations to any party that is not normal for business transactions.

In the background of commercial arrangements, if the understanding carried out lacks commercial substance, then an “impermissible avoidance arrangement” is considered to have been entered into by the parties to the transaction, operation or scheme (Draft Comprehensive Guide to GAAR, 2010).

In *Meyerowitz v Commissioner for Inland Revenue (1963 A)*, the taxpayer in this case received a share of profits from certain books he had authored and diverted the income to a trust, the beneficiaries of the trust being the minor children of the taxpayer.

In this case, upon investigation of the main purpose of the arrangement, the Court held that the dominant purpose of the transaction was the avoidance of tax, hence resulting in a tax benefit (*Meyerowitz v CIR, 1963*). But had the taxpayer accounted for tax on the income received before diverting the income to the trust, there would not

have been any tax benefit and the transaction should not have contained any element of abnormality.

In *Lambeth London Borough Council v Grewal* (1985) 84 LGR 538, the court held that:

“Significance cannot be arrived at by assuming that it is the obverse of insignificance. A significant tax benefit presumably implies that the tax benefit is significant in the context of the taxpayer’s annual net profit or his net assets or even his financial affairs in general”

2.6 The analysis of the meaning of “arrangement” in terms of section 103(1)

Section 103(1) of the Act (Act No, 58 of 1962), defines an arrangement as follows:

- 1) “A transaction, operation or scheme, including one involving the alienation of property, was entered into or carried out”
- 2) “Which has the effect of avoiding, postponing or reducing liability for any tax”
- 3) “Having regard to the circumstances in which the transaction, operation or scheme was entered into or carried out”, it
 - a) “Was entered into or carried out in a means or manner not normally employed in a transaction, operation or scheme of the kind in question”, or
 - b) “Has created rights or obligations not normally created between persons dealing at arm’s length under such a transaction, operation or scheme”: and
- 4) “Was entered into solely or mainly for the purpose of avoiding, postponing or reducing liability for any tax” (Act No, 58 of 1962).

If all the requirements for the above provision are present in an arrangement, of Section 103(1) is complied with, the Commissioner is obliged by the legislation to determine any tax imposed by the Act in one of the following two ways: (De Koker and Urquhart, (1989).

- a) “To set aside the understanding as if it had not been carried out by the parties”, and or

- b) “In such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of the avoidance, postponement or reduction of tax” (Act No, 58 of 1962).

2.7 The Weaknesses of Section 103(1)

Section 103(1) was found to have been ineffective based on the complex transactions that were now being entered into by taxpayers for the main or sole purpose of avoiding tax.

2.7.1 Not an Effective Deterrent to Tax Avoidance

Due to the complex, aggressive and increasingly sophisticated transactions or operations now undertaken by taxpayers (Discussion Paper on GAAR, 2005), the GAAR has greatly failed to defend the purpose of its inception in courts of law. The level of commitment of time and resources to detecting and combating these complex and sophisticated transactions, operations or schemes have been very costly to the tax authorities (Olivier, 1996:378), and had led to a negative impact on the relationship between SARS and authentic taxpayers (SARS, 2005:42). The abnormality and purpose requirements of Section 103(1) were identified as the most significant provisions leading to the ineffectiveness of the provision, hence there was a need to legislate a new provision that would combat these sophisticated or complex transactions carried out by taxpayers.

2.8 The meaning of “Arrangement” in terms of the new GAAR

Section 80L of the Act, defines “arrangement” *“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 new definition contained in Section 80L, includes the terms ‘enforceable or not’ and ‘steps there in or parts thereof constituting’ an ‘arrangement or an understanding’ (Act No, 58 of 1962), which was not the case in the predecessor section 103(1).

An arrangement entered into by parties according to section 80L (Act No, 58 of 1962), need not be enforceable for the general anti-avoidance provision to be invoked. The arrangement can be legally summary to writing or can be entered into verbally (Draft Comprehensive guide to the GAAR, 2010). Where the agreement is entered into orally or is unenforceable, the court will based their findings on the substance (intention) of the arrangement in order for the parties not to deliberately avoid tax (Olivier and Honiball, 2008: 399). Therefore an understanding entered into between parties, whether enforceable or not will constitute an arrangement. If an agreement is structured to fall outside the specific provision, the provisions of section 80A-80L are still applicable because the intention of the legislature is to levy tax (Olivier & Honiball, 2008: 386). If parties conceal their true intention or purpose of an arrangement, and if the court is called in, it will consider the substance of the transaction and not its form. The substance over form intention in a transaction is the starting point to detect any impermissible avoidance arrangement.

2.9 Substance over form and simulated transactions

The substance over form principle will be looked into from two different dimensions; the simulated and label agreement (Surtees and Millards, 2004). The simulated element of the transaction is a fraudulent or sham agreement, while the label transaction, operation or scheme contains a wrong label, but parties act in good faith (Legwaila, 2012).

The 'substance over form' doctrine, can only be invoked where the Commissioner determines that the understanding between the parties is not in line with their true intention (Hofmeyr 2014). The Commissioner has been bestowed with the power by the Court of Law to attack any transaction where in his opinion the substance is not in line with its form. In other words, the consideration of the true nature of a transaction should be based on its substance and not on its form.

The provision of the tax liability allows taxpayers the entitlement of arranging their transactions so as to remain outside the taxing ambit (Legwaila, 2012). Nevertheless, arrangements in the opinion of the Commissioner that contain simulated or dishonest elements are prone to challenge by the tax authorities, and the courts will based their judgment on the substance of the arrangement.

In CSARS v NWK Ltd (2011) 73 SATC 55, the details of the understanding were as follows:

The company NWK Ltd was a co-operative society trading in maize. The company needed finances to improve its operations, so two banking officials tabled the following proposals.

- 1) A subsidiary of the bank (Slab) would lend R96.4 million to NWK Ltd.
- 2) NWK would then repay the subsidiary ('Slab') by delivery of 109 315 tons of maize after a period of 5 years.
- 3) NWK would be under the obligation to pay interest on the R96.4 million loan, at a rate of over 15% annually for 5 years and the interest payment would be by issuing promissory notes to Slab to recover the interest.
- 4) The subsidiary would then sell bank notes to the bank
- 5) The subsidiary would again sell its right to accept delivery of the maize to a division of the bank for R45.8 million.
- 6) NWK Ltd then purchased the right to take delivery of the maize from the bank division for R46.4 million.
- 7) NWK Ltd claimed a tax deduction of the interest of R74.7 million on the R96.4 million loan for the period of 5 years according to the agreement (Haupt, 2017:660).

The Commissioner contended that the agreement between the said parties did not reveal the actual intention, but was designed to disguise and conceal the actual loan of R50 million but to reflect the R96.4million.

The Commissioner further contended that the series of understandings had the effect of avoiding or reducing NWK's liability for tax.

The third contention was that the subsidiary (Slab) had no real role in the arrangement, but was brought in to facilitate the increase of the trade expense in the form of interest expense for the main purpose of decreasing the taxable income. The previous section 103(1) was administered on this case. If the current section 80A to 80L was to be applicable, it would have examined the dominant purpose test as well as the element of impermissibility.

The Court found that there was at no point in time when NWK Ltd and the other party had the intention to deliver and, or receive maize. It concluded that the agreement was a 'fictitious' way to claim interest deductions by NWK Ltd and so the transaction was abnormal and therefore entered into mainly for the purpose of obtaining a tax benefit. The Court held that the loan was a simulated transaction and the taxpayer was liable for tax plus the interest as envisaged by the Commissioner.

In *Hicklin v Secretary for Inland Revenue* (1980 AD) 41 SATC 179, the facts of the transaction are the following:

Hicklin and his two co-shareholders sold their dormant company to a dividend stripping company. The purchase price was identical to the net assets of the company (Haupt, 2017:648), and thereafter the dividend stripping company deregistered the company.

The court held that:

"Where persons involved in a scheme are acting at arm's length, there is a presumption that the rights and obligations between them are normal"

The court gave consideration to the dominant intention of the parties. The substance over form of an arrangement, operation or scheme was again reaffirm in this case.

In this case it could be seen that, the fact that tax avoidance was one of the dominant purposes of the sale, section 103(1) could not be applied because the arrangement between the seller and the buyer was an arm's length and each party to the arrangement was determined to gain the extreme possible advantage from the transaction, operation or scheme (Haupt, 2017:653). It is surprisingly worth noting that the mere fact that the taxpayer deliberately arranges his business transactions to fall outside the provisions of GAAR, does not warrant the transaction to be simulated (Olivier & Honiball, 2008:387).

The facts of each case will be considered separately and every step or part of the arrangement will be viewed separately to determine the true intention of the parties to the transaction, operation or scheme.

In *Commissioner of Customs & Excise v Randles Brothers and Hudson Ltd*, (1941) AD 369, the court found that,

“in essence it is a dishonest transaction; dishonest, in as much as the parties to it do not really intend it to have, inter parts, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. Such a transaction is in fraudem legis”.

Taxpayers can enter into very complex arrangements that may result to a reduction or postponement of their tax liability. In such circumstances under Section 80A the court will view each individual arrangement separately (Act No, 58 of 1962), to determine whether any part of the arrangement contains an element of tax avoidance or if the transaction has resulted to a tax benefit.

In *Meyerowitz v CIR* (1963 (3) SA 863 (A), 25 SATC 287, 1963 Taxpayer 126, the special court held that:

“In regard to the profits accruing from the sale of the legal works, there was a scheme, including the formation of company B; that it had the effect of avoidance of tax; that it created abnormal rights: and that the taxpayer had the purpose of tax avoidance”

The substance over form doctrine was further emphasized in the following cases:

- 1) “*Commissioner for Inland Revenue v Saner*, 1927 TPD 162”,
- 2) “*Secretary for Inland Revenue v Hartzenberg* 1966 (1) SA 405 (H)”,
- 3) “*Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530” and
- 4) “*Zanberg v Van Zyl* (1910 AD 302”).

In the latter case, the court indicated that:

“In a disguised transaction, the parties give it a name or shape it with the intention of not giving it its real or true nature. But when the Court is called to decide on the rights accruing under such arrangement, it will do so by giving effect to what the transaction really is, and not what in form (disguised) it represents to be”

It is clear from the above that the Courts or the Commissioner shall not be betrayed by the form of the arrangement, but the factual nature of such an arrangement will be revealed to determine any impermissible avoidance arrangement. However, the

Commissioner had from time to time misinterpreted the terms of a transaction which have resulted in SARS being defeated in a Court of Law.

In *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A), 58 SATC 229, and the court was of the opinion that:

“The series of inter-related lease agreements could be regarded as one and the same, one could not occur without the other. Although every taxpayer is thus free to arrange his or her affairs in order to minimise the tax burden, but the agreement has to reflect the true intention of the parties”

The fact that supporting documents exist is not enough to convince the Commissioner, evidence must exist that reflects the dominant intention of the parties to the transaction. Regarding the above transaction, the court found that:

“The true intention of the parties, or of the agreement between them, was that a right to have improvements effected to the land had indeed accrued to the landlord and that he was liable for tax on the value of the improvements due” (Stiglingh, Koekemoer, Schalkwyk, Wilcocks, & Swardt, 2014:822).

In the Case of *Mariana Bosch and Ian McClelland v Commissioner for the South African Revenue Service* (Case no A94/2012),

SARS contended and considered the transaction to be a simulated scheme to avoid the liability for tax, but the view of the Tax Court was that the scheme was to empower and keep employees in their employment for as long as possible, so therefore did not contain any element of simulation.

The Courts have considered the commercial substance of the understanding to be the real intention of the agreement between the parties and nothing else. The Court rend aside the veil in which the understanding the wrapped or structured and scrutinise its dominant nature (Williams, 2005:564).

The principle of the doctrine of substance over form transactions was again reaffirmed in this case. This principle was previously laid down in the case of *CIR v Conhage (Pty) Ltd* regarding the sale and leaseback transaction. The Court was of the view that

even though sale and lease back arrangements may not be considered as normal in a business transaction, in the particular case, the sole or main purpose of the transaction was to obtain the loan capital and not the tax benefit. The Court took the stand that...

“That it was not Tycon’s sole or main purpose to secure a tax benefit. That its overriding intention for entering into the relevant transactions was the obtaining of the necessary capital to expand its business activities”.

2.10 The definition of “Arrangement”

The Income Tax Act defines an ‘arrangement’ as meaning any “transaction, operation, scheme, agreement or understanding, including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property” (Act No, 58 of 192).

An arrangement and an understanding are used interchangeably. The term “arrangement” encompasses transaction, operation and associated with words of wide meaning and were intended to suppress the mischief (Haupt, 2017). The following are considered as agreements which are not legally binding:

- 1) “An agreement between parties to agree in future on reasonable terms and conditions to effect a merger”,
- 2) “The so-called gentleman’s agreement between parties which set out the intended result the parties wish to achieve but which is not necessarily legally binding”
- 3) “An agreement binding in honour only, in conscience, letter of intent and the like” (Draft Comprehensive guide to the GAAR, 2010).

The following was stated in the case relating Glen Anil Development Corporation Limited v SIR (37 SATC 319, 1975 (A) SA 715 (A) that:

“Even if the rules relating to the interpretation of the fiscal legislation differ from those ordinary applicable to all legislation (they do not differ inasmuch as the intention of the legislature is always the paramount consideration), no such difference applies to the interpretation of the Act”

In the process of establishing the meaning of arrangement in any case involving SARS and any taxpayer, the interpretation of the Court on its meaning will be of paramount. The Court will examine the steps or individual parts or the entire arrangement for the presence of an impermissible arrangement or a tax benefit.

Section 80B under the current GAAR, has empowered and states that the Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party (Act No, 58 of 1962), by:

- (a) “Disregarding any steps or parts of the impermissible avoidance arrangement”;
- (b) “Disregarding any accommodating or tax-indifference party as one person”;
- (c) “Treating the impermissible avoidance arrangement as if it had not been entered into or carried out” (Act No, 58 of 1962). The Commissioner could set aside the transaction, operation or scheme by disregarding any arrangement involving the parties. This allows the Commissioner to determine the actual intention (substance) of the taxpayers, and not the form of the arrangement.

“Avoidance arrangement” means any arrangement that results in a tax benefit (Act No, 58 of 1962).

“Impermissible avoidance arrangement” means any arrangement whose main or sole purpose was to obtain a tax benefit (Act No, 58 of 1962).

The Commissioner may attack an arrangement if in his opinion it contains elements of avoidance arrangement in part or in whole, impermissible avoidance arrangements or has led to a tax benefit.

In the case involving Meyerowitz v CIR, the court interpreted the phrase “scheme” as having a wide scope and enormously wide enough to cover series of transactions and the transactions must be connected with the dominant purpose of obtaining a tax benefit (Meyerowitz v CIR, 1963).

“As a result of this series of transactions the income which the appellant would have received for his work and labour was transferred to his children, and the effect of the transaction was to avoid liability by the appellant for tax on that income”.

The same or similar approach was used by the Court in the case involving Commissioner for Inland Revenue v Louw (1983) (3) SA 551 (A), 45 SATC 113, 1983 Taxpayer 145. The word “scheme” was interpreted as wide enough to cover other situations (CIR v Louw, 1983). And Williams (2006) reaffirms the wideness of the phrase by stating that: “the state has no choice but to garner revenue to finance its expenditure: therefore, tax which is avoided by one taxpayer must be collected from another” (Williams, 2006:798).

The legislation has placed a wide meaning on the terms arrangement, operation and scheme and so it has become difficult for taxpayers to escape the catch all trap due to its wide nature.

2.11 Steps or Parts of an Arrangement

The inclusion of “steps or parts constituting an arrangement” is a current inclusion to the new Section 80A-80L. The definition of an “arrangement” in the new section 80L of the Act includes “*all steps therein or parts thereof*”. The implication is that the various steps of the arrangement will be examined by the tax authority if it contains an impermissible avoidance arrangement or if the transaction has resulted in a tax benefit. The previous Section 103(1) warrants the authorities to investigate the entire arrangement whether it comprises an avoidance arrangement. The inclusion of this provision in the recent Act makes it difficult for taxpayers to actually enter into a sham transaction and get away with it without being challenged by the Commissioner.

In CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) (1999) (4) SA 1149 (SCA). 61 SATC 391, the court held that;

“It would consider the whole of the transaction, as opposed to reviewing its individual steps to ascertain if tax avoidance has taken place”.

Section 80H provides that the Commissioner may apply the general anti-avoidance provision (GAAP) to steps in or parts of an arrangement (Haupt, 2017:643).

It would be safe to conclude that if section 80A-80L was to be administered to the case of Conhage (Pty) Ltd, the taxpayer would have been held liable for income tax. This is because individual steps or parts of the arrangement would have been examined to determine if any element of a tax benefit does exist in the arrangement.

In ITC 1636 (1998) 60 SATC 267, the court took the stand that all four requirements of the provision of GAAR must be present before section 103(1) can be applicable to the particular transaction (ITC, 1998). The enquiry that remains largely is, would the decision be different with the introduction of (Section 80A-80L) THE new GAAR?

2.12 The abnormality of a transaction, operation or scheme

2.12.1 Abnormality test of an arrangement

The last requirements with which a transaction, operation or scheme must comply for the GAAR to apply is the following;

The arrangement must be abnormal or contains elements of abnormality, or misuse or abuse of the provision of GAAR. Sections 80A and 80C of the Act, contain three different stages of abnormality. In the background of commercial transactions;

- i) *“the transaction was entered into or carried out by means of or in a manner which would not normally be employed for a bona fide business purpose, other than obtaining a tax benefit” (Act No, 58 of 1962),*

- ii) *“It lacks commercial substance in whole or in part, taking into account the provisions of section 80C. An arrangement will lack commercial substance if it would result in a significant tax benefit for a party but does not have a significant effect upon either the business risks or the net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained, and”*

- iii) *“It has created rights or obligations that would not normally be created between persons dealing at arm’s length or it would result directly or indirectly in the misuse or abuse of the provision of the Income Tax Act”.*

In the process of determining if a commercial arrangement is in harmony with the provisions of Section 80A – 80L of the Act, the tax authorities will give consideration to the commercial substance of the transaction (Haupt, 2017:633). The question is, whether it is possible to test an arrangement objectively to establish if it contains an element of a tax benefit (Dachs & Du Plessis, 2013).

According to the SARS's interim response (2006) on GAAR regarding the traditional common law "substance over form" doctrine, Section 103(1) was found to be inadequate to combat complex commercial arrangements undertaken by taxpayer for the main purpose of avoiding liability for tax (Interim Response, 2006).

Due to the insufficiency of Section 103(1) of the Act to combat these complex arrangements, Section 80C (2)(a), was promulgated into action to prevent taxpayers from entering into technical and complex arrangements. Section 80C (2)(a) of the Act states that:

"An arrangement lacks commercial substance if the legal substance or effect of the arrangement differs significantly from the legal form of the steps" (Act No, 58 of 1962).

Section 102 of the Tax Administration Act (Act No, 28 of 2011), places the burden of proof on SARS (Commissioner) to prove based on the imposition of the abnormality requirement that the parties to the arrangement have misused or abused any Tax Provisions and which has the outcome of tax avoidance.

The second provision of the abnormality test states that: "a transaction would lack a commercial substance if it results in a significant tax benefit" (Act No, 58 of 1962). It is still not clear what in the opinion of the Commissioner is considered a significant tax benefit. Section 80C may be lacking to adequately hold the taxpayer accountable for liability of tax if the arrangement results in an insignificant tax benefit but was entered into with the dominant purpose of avoiding tax.

2.12.2. Abnormality test requirement

The term abnormality is regarded as unacceptable acts by the Act, and at the same time the courts have in the past established the context of abnormality based on the circumstances of each arrangement. In the situation where taxpayers have merge

their businesses transactions and the dominant purpose for doing so was not the avoidance of tax liability, Section 80A will not be applied. The rule is that even if the Commissioner finds the arrangement to be abnormal in his opinion, the parties cannot be held accountable for tax liability based on the abnormality of the arrangement.

For the GAAR to apply, the transaction must have given rise to in a tax benefit to either of the party to the arrangement and the arrangement must have resulted in the misuse or abuse of any tax provision of the Tax Act. In *Hicklin v SIR*, the court held:

“What may be normal because of the presence of circumstances surrounding the entering into or carrying out of an agreement in one case may be abnormal in an agreement of the same nature in another case because of the absence of such circumstances”

In the case where the taxpayer cannot successfully defend himself in the Court of Law based on the abnormality of an arrangement and of the rights or obligations accruing from the arrangement and of the means and manner of drafting business contracts. The taxpayer can resort to the next option of the GAAR, this option is the sole of main purpose of the parties engaging into the arrangement (Kruger & Scholtz, 2008:233).

The requirements of Section 103(1) of the Act, needs be established for any avoidance arrangement to occur and it reads as follows:

“There is an arrangement entered into or carried out and which has the effect of avoiding or postponing liability for tax on income or reducing the amount thereof; and has created rights or obligations which would not normally be created between persons dealing at arm’s length”

One could draw from the above that if an arrangement is abnormally worded but does not lead to a tax benefit to any party to the arrangement, the provisions of GAAR will not be applicable. Therefore it could be safe to interpret that the Commissioner can attack an arrangement mainly on the basis of tax avoidance and not of an abnormality of the arrangement. An arrangement that is abnormal or contains elements of

abnormality but without tax avoidance nor tax benefit is not subject to attack by the provisions of the GAAR.

2.12.3. Abnormality in the context of business

One of the starting points for the Commissioner to begin an inquiry into an agreement is to determine if the taxpayers have any special relationship. Special relationship would include but not limited to the third degree of consanguinity prior to entering into the arrangement. The second leg is to determine whether the transaction entered into is at arm's length. Where there is a special relationship that exists between the parties, such as where a partnership business is sold to a company of which the former partners are the directors and shareholders, the court cannot ignore this special relationship (Emslie, Davis, Hutton and Olivier (2001:891). It is abnormal, within the meaning of section 103(1), to divert business income from one person to the other. According to Williams (2005), he found it abnormal "for a person to arrange for the fruits of his labour to accrue to someone else". If this is done with the dominant intent of avoiding tax, it will infringe section 103(1) (Williams, 2005:574).

In SIR v Geustyn, Forsyth and Joubert, the court held that;

"Even though there is a special relationship between the parties (sale of partnership business to the unlimited company), the transaction, operation or scheme had commercial purpose, and that the reduction or postponement of tax was not a factor which was taken into consideration by the partners in deciding to practice as an unlimited company"

Emslie et al (2001), stated that it is not abnormal in a commercial sense to transfer an existing partnership business to a company, indeed, such a transaction may fairly be regarded as acceptable and normal in today's commercial world (Emslie, Davis, Hutton & Olivier. 2001: 922). If parties in a special relationship enter into the arrangement and the arrangement has commercial purpose, the provisions of section 80A -80L cannot be applicable on the grounds that a tax benefit has been derived by any party.

Therefore the enquiry would be further extended to determine whether the transaction entered into is at arm's length.

In ITC 1712, 63 SATC 499, it was found that it is normal in the context of business to set up a rent structure that large amounts be paid during the first year of assessment and the rest of the rents spread over the subsequent years taking account of the interest rate. The court found no abnormality in such a business transaction, it was found to be normal for parties to enter into such a transaction and it was considered as a transaction at arm's length. It was further reiterated that a taxpayer who changes his investment so that the resulting income from which is not taxable is not engaged in an abnormal transaction, operation or scheme (Silke, Divaris & Stein, 1975:948). This can be done merely to legally plan or structure his business affairs to minimize his income and consequently his tax liability.

2.12.4 Commercial purpose test of the arrangement

Section 80C of the GAAR affords a rule of enquiry to establish if an arrangement lacks commercial substance (Act No, 58 of 1962) and as well as other indicators based on the structuring of the contract to determine a lack of commercial substance in an arrangement (Jordaan, 2014). If the Commissioner suspects any transaction of tax avoidance, the first step is to test for commercial purpose of the arrangement.

(a) in the context of business-

The meaning of the term "lack of a commercial substance" shall be established in relation to the provisions of Section 80C of the GAAR. The provisions of the new GAAR would be applied to any part of or individual steps in an arrangement or transaction to determine if it contains tax avoidance elements (Olivier & Honiball, 2008:401).

The section is divided into two subsections, sub-sections 80C (1) and 80C (2) (Haupt, 2016:643). Subsection 80C(1) of the GAAR is drafted to indicate that an arrangement would result to a lack commercial substance if it leads to a significant tax benefit for one party to the arrangement but does not have a significant effect on the business transactions of the other party to the transaction (Section 80C).

The term 'significant tax benefit' is not clear in the Act, but Haupt (2017), is of the opinion that the broad definition of "tax benefit" is essential when establishing the dominant purpose of an arrangement (Haupt, 2017:638). It will seem though as if the determination of significant and insignificant tax benefit has entirely been left on the discretion of the tax authorities to impose the tax consequences to any party found to have contradicted the provision of GAAR.

This provision should be made clear to the taxpayers on what constitutes a significant tax benefit in a commercial arrangement.

Subsection 80C (2) of the GAAR contains the following requirements:

- 1). "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"
- 2). "The inclusion or presence of elements that have the effect of offsetting or cancelling each other"

The question as to whether the legal substance of the arrangement of a commercial transaction as a whole will differ significantly from the lawful form of its individual parts has been questioned by tax experts (Olivier & Honiball, 2008:402). Evidence has been established that in every circumstances of a tax avoidance, it is clear that the Court will give consideration to the legal substance as opposed to its legal form.

In the tax case involving the CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) 1999 (4) SA 1149 (SCA). 61 SATC 391.

The court was of the view that:

"The fact that the taxpayer has derived a tax benefit from structuring the arrangement in a sale and leaseback does not detract from the commercial purpose of the transaction. It is acceptable and normal for a taxpayer to structure his commercial affairs to the best advantage if no misuse or abuse of the legislature is caused" (CIR v Conhage, 1999). In this particular case, Lord Wright stated as follows;

"The true nature of the legal obligation and nothing else is the substance of the transaction" (Goldberg, 2006).

In the above case, it was held that, apart from the tax advantages of the sale and lease back, there were other commercial reasons for the arrangement (Williams, 2006), section 103(1) was held not to be applicable in this particular arrangement.

2.13 The Main purpose test of an arrangement

The Courts have in the past defined 'mainly' in the case of Secretary for Inland Revenue v Lourens Erasmus (Edms) Bpk (1966), SA 434, 28 SATC 233 in a quantitative terms to mean more than 50% (Marais and Erasmus, 2015). This provision could hold true on the old section 103(1) of the Act which required that the main purpose of the entire arrangement must have been to obtain a tax benefit by the taxpayer. The provision under section 80A-80L compels the Commissioner to critically analyse the separate parts of the arrangement to determine the real intent of the persons to the transaction. It implies that if less than 50% of the arrangement according to the Courts is found to have been entered into with the intention of obtaining a reduction in the tax liability, the provision of section 80A-80L will not be applicable.

Under Section 80A to 80L which replaces section 103(1), an arrangement will be considered an impermissible avoidance arrangement if the main purpose of parties entering into the agreement was the obtaining a tax benefit (Act No, 58 of 1962). If parties in an arrangement have derived a tax benefit, the next arm for the application of the GAAR is that the "sole or main purpose" test of the arrangement to establish if the main purpose of the parties was the obtaining of such a tax benefit.

To determine the leading purpose of the arrangement, the true intention of the taxpayers will be put to the test. According to Haupt, (2017), the enquiry is usually based on the substance of the transaction and not its form (Haupt, 2017:633).

A Ltd v Commissioner for the South African Revenue Service (12697) (2012)

A Ltd repurchased its own shares from its subsidiary company and in 2004 had claimed exemptions from dividends in terms of section 64B (5) (f) of the Act (The High Court, 2012). The Commissioner contended that, regarding the repurchase of A Ltd's own shares, the dominant purpose was the avoidance of tax liability and the claim of

exemption from dividends as the avoidance to pay standard tax on company (STC) as it was then.

The Court held that the repurchase of its own shares by A Ltd was thought of as a good investment and the exemption was in line with section 64B (5) (f) of the Act.

The Commissioner failed to prove on the basis of the case in question that the transaction was entered with the dominant or main purpose of obtaining a tax benefit. Section 103(1) became applicable in this particular case because at the time of the arrangement, it was in existence and not section 80A-80L. Should the current Section 80A-80L be brought to test on the above case, the outcome of the judgement would not have changed, in my opinion. The transaction of the repurchase of own shares and the exemption of local dividends is in line with the Tax Act

2.14 Conclusion

Drawing from the abnormality context of business arrangements, Section 80A-80L has enormously covered this provision on business arrangements regarding the steps or individual parts of a transaction, unlike the previous Section 103(1) that considered the entire arrangement for the abnormality context to apply. Under Section 80A-80L, the Commissioner would view the separate parts of a transaction or operation for the existence of abnormality in a transaction, operation or scheme. The impermissible tax avoidance provision (section 80A) will also be invoked if the Commissioner found that a transaction has been entered into in a means or manner not normally engaged in commercial contracts or arrangements.

The new provisions contained in Section 80A-80L come as a wake-up call for taxpayers to be conscious when entering into any arrangement because even if a step in or part of the transaction does not comply with the provisions of the GAAR, the Commissioner will raise the impermissible avoidance provision. The main resolution of the introduction of the steps or parts examination of the arrangement, is to overcome the shortcomings under section 103(1). In my opinion, it would seem though as if the provision on the abnormality context of the business transaction of the provision is drafted to prescript the manner in which business arrangements or transactions should be crafted by persons involving any business activities.

CHAPTER THREE

Misuse or abuse of any legal provision by the taxpayer

3.1 Introduction

The current GAAR of the Tax Act has been drafted to combat every complex commercial arrangements which taxpayers had in the past entered into with the intent of achieving tax benefit. The tax Laws have adopted principles that empower the South African Revenue Authority to deny taxpayers the advantage of engaging in transactions that result in impermissible avoidance arrangements (PWC October, 2016).

The struggle by the tax authorities to clamp down on tax avoidance schemes will seem impossible without the genuine support of tax advisers and practitioners. Many researchers are of the view that each time the tax legislation was reviewed to combat avoidance arrangements, the tax experts have improved their creativity and became more perfected at plans geared towards avoiding taxes (Goldberg, 2014). To combat tax avoidance schemes, professional tax advisers have to be drawn on to the playing field otherwise it will seem a fruitless exercise by the tax authorities.

3.2 Sale and leaseback transactions

Sale and leaseback transactions have been considered as abnormal arrangements in the business context by the Commissioner. To this end such arrangements have often come under attack by the avoidance provision.

In the case involving Commissioner of Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) (1999), the taxpayer (Conhage (Pty) Ltd), followed the principle which allowed taxpayers to arrange their commercial transactions to end up in a tax efficient manner. A background of the case is as follows:

“The taxpayer (Conhage (Pty) Ltd) entered into an agreement with the bank for the sale and leaseback of its manufacturing plant and equipment. As a result, the taxpayer sought to deduct the rentals paid in terms of the leaseback as expenditure incurred in the production of income under Section 11 (a) of the Act” (CIR v Conhage, 1999).

The Commissioner disagreed with the deduction stating that the transaction has resulted in a tax benefit. The Commissioner’s contention was based on the grounds

that, despite the form of the transaction, the taxpayer did not in actual fact sell and assets, but in substance borrowed the purchase price from the bank (The Supreme Court, 1999)

The Court held that:

“The agreement of the sale and leaseback provided the taxpayer with the opportunity of the loan capital and at the same time being awarding the tax benefit derived from the transaction, operation or scheme. The sole or main purpose of the transaction was found to be the obtaining of the loan capital and not the tax benefit”.

The Court followed a similar approach in ITC 1636 (60 SATC 267) in a sale and lease back transaction. The taxpayer had wished to expand the manufacturing operations of its enterprise. The company entered into a sale and leaseback transaction with a bank. The manufacturing plant of the company was sold to the bank and leased back to the company by the bank (SAICA, 1999). The wear-and-tear allowances on this plant and equipment had been previously written off and the sale was at market value. The sale would have attracted a taxable recoupment as a result of the allowances previously claimed by the taxpayer, but instead it was claimed as a deductible lease cost by the taxpayer.

The Commissioner contested the transaction on two grounds: firstly that the transaction was a loan but disguised as a sale and leaseback and secondly, that the transaction could be ignored based on Section 103(1) of the Act if found to be abnormal or its main purpose was to avoid tax liability.

The Court found that there had been a genuine and valid commercial transaction between the parties and that the sale was at market value as determined by independent parties and therefore a transaction at arm's length. Based on the abnormality of the transaction raised by the Commissioner, the Court observed that each of the party to the transaction was striving to obtain the maximum commercial advantage from the agreement and that tax benefit was not the main purpose of the transaction, operation or scheme. The main purpose was the raising of funds to expand the manufacturing operations.

Even though sale and leaseback transactions by their very nature encompass characteristics not normally found in modest sale agreements. In these particular cases, the sale and leaseback arrangements, the Courts considered both transactions as one and the same (SAICA, 2000). Even though cases of sale and lease back have not been brought into the lime light of SARS or the Courts, the principle laid down in the cases of Conhage (Pty) Ltd and ITC 1636 (60 SATC 267) has been very profound in addressing lease back relating to tax avoidance transactions, operations or schemes.

3.3 The meaning of a significant tax benefit

The term "tax benefit" was introduced into Section 80A-80L in its amendment of Section 103(1) and is defined as "including any avoidance, postponement or reduction of any tax, duty or levy imposed by the Income Tax Act or any other law administered by the Commissioner" (Act No, 58 of 1962).

For a tax benefit to accrue to a taxpayer, it must be found that his conduct in an arrangement resulted in a favourable tax outcome (tax insights, 2016). It implies that the arrangement must have resulted in a lesser amount of income included in assessable income or a greater deduction allowed from income. Both these amounts of income or deduction would not normally have been included or allowed if the transaction was conducted at arm's length.

The legislation is still limiting regarding the meaning of a significant tax benefit or the extent to which a taxpayer could be considered to have benefited significantly tax-wise from a transaction. The question that needs clarity is, should a transaction that resulted in an insignificant tax benefit, but has elements of impermissible tax avoidance arrangement be ignored because of its insignificant tax benefit? The view is that the legislation should assign a percentage of income or deduction to quantify the meaning of a significant tax benefit. As usual, it could be presumed that the legislation has left this responsibility to the Courts to decide and determine the extent of a significant "tax benefit" in a transaction, operation or scheme.

3.4 Round trip financing

Section 80D of the Income Tax Act defines Round Trip Financing as “including any avoidance arrangements in which funds are transferred between or among the parties to a transaction, operation or scheme” (Act No, 58 of 1962), and the transfer of the funds between them would have resulted in a tax benefit to one or both parties to the arrangement (Kanamugire, 2013). This provision seems to have over-empowered the Commissioner to attack almost all arrangements entered into by taxpayers when transfer of funds is involved. This could be seen in the cases of *Ackermans Ltd v CSARS* and *CSARS v NWK Ltd* to name a few of the cases that involved the transfer of funds amongst the parties to the arrangements.

The Committee on Finance in Parliament noted that transactions subject to a GAAR continue to be undertaken by taxpayers and challenged by tax administrations (The Committee on Finance in Parliament, 2016).

This provision has been met with numerous calls from the public to the Commissioner to ignore the interest and tax relation to the round trip financing. The penalty should not apply if an impermissible arrangement is deemed to have been committed because of the round trip financing by parties to the transaction (section 80D) or a tax-indifferent or accommodating party (section 80E). It is argued that these rules are fairly wide and can trigger an impermissible arrangement even if the main purpose of the parties to the transactions, operations or schemes cannot be explicitly proven to be a tax benefit (taxation Law Amendment Bill, 2016). The second reason proposed for the non-application of the penalty is that if based on the misuse or abuse of the tax provision, it is said to be wholly untested within the South African Law context, it is regarded as the Canadian context of Law.

It could be argued that the provision of the new section (80D of the Act) has not yet been put to teste in our Court of Law and may be misleading within the South African context of Law. As a deterrent to combat impermissible avoidance arrangements, the provision should be accompanied by an interpretation note to further strengthen its application.

3.5 Use in the alternative

Section 80I of the Act, permits the Commissioner the use of this provision in the substitute for or in addition to any other means for raising any assessment for tax liability (Act No, 58 1962). The view of commentators on this provision was that an Interpretation Note should have been issued simultaneously with the enactment of the new section 80I to help ensure its proper and consistent application by tax authorities and to provide additional information and guidance to taxpayers and practitioners (interim response, 2006).

This may have over empowered the Commissioner to use any alternative in the tax legislation in assessing the taxpayer and at the same time provides the taxpayer with no alternative interpretation note on which to base his argument.

3.6 Notice (S80J) and interest (S80K) charge by the Commissioner

These two provisions are set out to determine the procedure and manner on which the Commissioner is obliged to approach a party to a tax avoidance arrangement. Section 80J allows the Commissioner to notify and provide reasons of his intention to attack the arrangement entered into by the parties.

The Act allows the party to a transaction a period of sixty business days or such longer period as determined by the Commissioner, after he/it receives the notice from the Commissioner to respond to the Commissioner giving the reasons why the provisions should not be applicable. Part 3 of this provision empowers the Commissioner within one hundred and eighty days upon receipt or expiry of the period of sixty days to demand for additional information from the party or determine the liability of tax to that party.

In *Ackermans Ltd v CSARS – HG 16408-2013 NG* (20 February 2015), Ackermans Ltd was indebted to Pepkorfin (Pty) Ltd to the amount of R191.3 million. In October 1997, the taxpayer borrowed R185.6 million from Mettle Ltd and instructed Mettle to transfer the funds to Pepkorfin Ltd. The taxpayer then entered into a series of interrelated agreements of sale of shares, promissory notes, subscriptions and Swaps agreements with Mettle Ltd in an attempt to service the debt (Sait, 2015).

On this note, SARS requested additional documents and information from Ackermans Ltd in 2003. The notice of the intention from SARS to issue an additional assessment

was received on 6 July 2006. The letter of finding from SARS as to the reasons for the additional assessment was only issued on 9 November 2011 (Sait, 2015).

The Act has not provided any remedy to the taxpayer nor established an explanatory note to that effect in the case where the Commission fails to respond within the 180 days upon receipt of the additional information and documents as stipulated in part 3 of the said provision.

Section 80J (1) of the Act states that....

“The Commissioner must, prior to determining any liability of a party for tax under section 80B, give the party notice that he or she believes that the provisions of this part may apply in respect of any arrangement and must set out in the notice his or her reasons thereof”

In the CSARS v NWK Ltd, the Commissioner levied a penalty of up to 200 per cent and additional interest on the deductions claimed by NWK Ltd from the period 1999 to 2003. This penalty was as a result of the excess interest on the amount above the R50 million actual loan capital as assessed by the Court (Supreme Court of Appeal, 2010).

The Court took a contrary view to that of the Commissioner on the 200 per cent penalty imposition by the Commissioner. The Court reduced it to 100 per cent penalty; 200 per cent was found to have been excessive for the wrong committed by NWK Ltd and the Commissioner accepted the 100 per cent as appropriate liability by the taxpayer.

In Relier (Pty) Ltd v CIR (1997) ZASSCA 105 SA 183A, the Commissioner assessed the taxpayer on the capital accrual of the building.

A brief story of the scenario.

The taxpayer (Economic Data Processing (Pty) Ltd), erected a building for its business purposes. The company was solely owned by Mr. Holloway who had land available for the construction of the building. The taxpayer entered into an arrangement with Relier (Pty) Ltd, a dormant company owned by a Provident Fund. This Provident Fund was controlled by the National Acceptance Fund and the adviser of Mr. Holloway was

the then managing director of National Acceptance (Supreme Court of Appeal, 1997). Relier (Pty) Ltd became the owner of the property. The intention was that this would be a temporary arrangement and an option was arranged with the Holloway Family to then purchase all the shares of Relier at their nominal value.

The Commissioner contended that the building cost formed gross income of Relier (Pty) Ltd. An additional assessment regarding the lease premium of R988 425 was issued, but the Court held a contrary view. The amount was reduced by the Court to R820 000

Even though the tax Act allows the Commissioner the right to notify and impose liability for tax in circumstances where the taxpayer is found to have abused or misuse any tax provision, the Court would always ascertain if the penalty or interest thereof is appropriate to the wrong committed by the taxpayer.

3.7 Presumption of purpose by 80G (1)

Section 80G (1) states that;

“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 fact and circumstances, obtaining a tax benefit was not the main purpose of the avoidance arrangement”

The presumption of purpose provision is invoked by the Commissioner and the burden is on the taxpayer to prove on the balance of probability that indeed the main purpose of the transaction was not a tax benefit (Act No, 58 of 1962).

In CIR v Conhage (Pty) Ltd, the Court had this to say:

“That the taxpayer did not approach the bank in order to alleviate its tax burden; it did so because it was in need of capital and this plainly remained the sole and main purpose of the transactions” (Supreme Court of Appeal, 1999).

The taxpayer was free of the presumption of purpose, but the Court took a different view in the case of Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue 1996(3) SA 942 (A) at 950I-952C. The Court established that:

“The same commercial outcome can be achieved in various ways, if the parties decide to enter into the type of transaction which leads to less tax” (Erf 3183/1 Ladysmith and Another, 1996). But, when considering whether by arranging the commercial transaction, the taxpayer has succeeded in avoiding tax liability, or whether the transaction has resulted to an impermissible avoidance arrangement, the court does not require a statutory warrant to disregard a disguised transaction, will base their findings on the true intent of the parties and substance of the transaction and not the form of the arrangement (Williams, 2006:773).

When the Commissioner presumes that a tax benefit has been obtained by a taxpayer by entering into the transaction, operation or scheme, the burden then shifts to the taxpayer to ascertain that the main purpose of entering into the arrangement was not to obtain a tax benefit but for a genuine commercial purpose.

Section 80A-80L has been drafted in such a manner that it will be difficult for the taxpayer to escape the arms of the Commissioner when he/she or it is involved in an impermissible avoidance arrangement. The Commissioner will base his arguments on either the whole arrangement or on parts of the arrangement. It could be said that Section 80G of the Act, (Act No, 58 of 1962), has been adequately drafted to combat tax avoidance schemes.

3.8 Misuse or abuse of any legal provision by the taxpayer

The previous section 103(1) indicated that one of the main purposes of the provision was the ‘frustration’ it will cause to any taxpayer who engages into any arrangement with the intent of avoiding tax liability. This section of the Act was replaced by Section 80A(c), (Act No, 58 of 1962), which reads as follows;

(i) “If the transaction, operation or scheme results directly or indirectly in the misuse or abuse of the provisions of any Act (including the provisions of this part)”,

The misuse or abuse of avoidance schemes may be found in most aggressive operations, transactions or schemes entered into by parties to an arrangement (Discussion Paper on GAAR, 2005). Impermissible tax avoidance arrangements are viewed by many professionals as encouraging disrespect and abuse of the tax system. This was evident when Harold R. Handler, (1999) of the New York State Bar

Association describes the abuse caused by impermissible tax avoidance arrangements as;

“The constant promotion of these frequently artificial transactions breeds significant disrespect for the tax system, encouraging responsible corporate taxpayers to expect this type of activity to be the norm, and to follow the lead of other taxpayers who have engaged in tax advantaged transactions”.

The misuse or abuse of the provision could be linked to transactions or arrangements entered into by taxpayers for the sale of companies with assessed losses. Section 103(2) of the Act, (Act No, 58 of 1962), was designed to combat these forms of abuses if the Commissioner determines that the utilization of an assessed loss was the sole or main purpose of a particular arrangement. An arrangement could be abusive if it “cannot reasonably be regarded as a reasonable course of action”, in a business transaction taking into consideration all the circumstances surrounding the transaction, operation or scheme. This could be termed as the “double reasonableness” test (Chance, 2013).

It is for some of these reasons that the legislation has empowered the Commissioner to disregard transactions entered into by taxpayers that results in tax benefits as if these were not entered into and to also impose penalties when deemed necessary. Simulating or disguising an arrangement mainly to shield its true nature, intent and purpose will not be of any assistance to the taxpayer, as the “substance over form” rule empowers the Commissioner and the Courts to establish the true intent of the parties to the transaction, operation or scheme.

As yet, there has not been any South African (SA) case law which has dealt with any case relating misuse or abuse of a provision (SARS News and Administration, 2012). The view is that its implementation will cause many a sleepless night for tax advisers, SARS officials and the judiciary. It could be stressed that the abuse or misuse provision may further lead to more confusion on the application of the new Section 80A-80L which is already drafted on the general (wide) provision. It has been advocated by some tax experts that the impermissible avoidance provision should have been drafted on a specific provision.

3.9 Accommodating or tax-indifferent parties

Section 80E of the Act (Act No, 58 of 1962), states that;

“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”;

When accommodating or tax-indifferent party takes place, it will result in the following benefits by one party to the arrangement:

- 1) “An amount of income or accrual that would have been included in the gross income of one party would now be considered as a capital receipts to the other party”
- 2) “An amount which constitutes a non-deductible expenditure or loss in the hands of one party would be treated as a deductible expenditure in the hands of the other party”
- 3) “An amount which would have been considered as taxable income to one party would be exempt from normal tax by the other party to the arrangement”
- 4) “The participation of the parties to an arrangement results in the prepayments of amounts which has the effect of allowing for a deduction as expenditure by the other party” (Act No- 58 of 1962).

The new GAAR is drafted in such a manner that impermissible avoidance arrangements will be attacked by the Commissioner even if they were drafted in a manner that lacked commercial arrangements. And finally, in any other tax context, Section 80A (c) (i) is worded as follows:

“If the arrangement must have created rights or obligations that would not normally be created between parties dealing at arm’s length, or would directly or indirectly result in the misuse or abuse of the provisions of the Income Tax Act” (Act No, 58 of 1962).

The provisions of the new GAAR have been drafted in a manner that taxpayers may not have had any option left from being attacked from many sides on any arrangement that seems to have resulted in a “tax benefit”.

The provision on the treatment of connected persons relating to the accommodation or tax-indifferent parties (Section 80F) (Act No, 58 of 1962), to some extent may be limiting taxpayers from arranging a transaction, operation or scheme to their favour without resorting to a tax avoidance scheme.

3.9.1 Treatment of connected persons

Section 80F allows the Commissioner to set aside the connected person relationship. In determining whether or not an arrangement has resulted in a tax benefit to any party to a transaction, the Commissioner has two options;

(1) “To treat parties who are connected persons in relation to each other as one and the same person”;

(2) “Disregard any accommodating or tax-indifferent party or treat any accommodating or tax-indifferent party and any other party as one and the same person”

The remedy for a Commissioner if connected taxpayers are found to have entered into a tax avoidance arrangement is that the transaction may be exposed to a risk of adjustments in terms of Section 80B to re-allocate amounts amongst parties involved (SAICA, 2014). Secondly, the Commissioner may regard the transaction as if it was not entered into for income tax purposes.

This principle was executed in MEYEROWITZ v CIR (1963 AD) 25 SATC 287, in which the taxpayer diverted income due to him to a trust. The tax authorities found that the sole beneficiaries of the said trust were his children.

The facts are that the taxpayer was awarded the right to share in the profits of publications. He then formed a company jointly owned by him and his wife. The company formed a trust in which their children were beneficiaries thereof. The profits were ceded by the company to the trust (Haupt, 2017:648). The court found it to be abnormal for the taxpayer to charge low editorial fees to the trust and considered the taxpayer, trust and company to be one and the same person. The diverted income was correctly assessed in the father's hands. The Commissioner is said to have

applied the second option of the provision which warrants him to regard the transaction as if it was not entered into by the parties.

With regards to the provision of connected persons entering into an arrangement, Section 80F of the Act, has made it clear to all parties that the arrangement must be a transaction at arm's length, otherwise the impermissible avoidance provision will be invoked.

3.10 Conclusion

The question and most difficult task is, how then does the tax authority bring the tax advisers to participate in the drafting of the GAAR? The notion of considering sale and leaseback transactions as abnormal in the business context have been dealt with extensively. It is not always the case that sale and leaseback transactions are entered into with the main purpose of reducing tax liability. To this extent, the Courts have laid down solid grounds for determining the substance over form transactions as the norm for detecting the real intent of the taxpayers to the arrangement. The attention of the arm of the Law will not be distracted by the forms of the arrangement, but the true intention of parties will be investigated and brought to light.

The provision of the GAAR on the meaning of a significant tax benefit in the legislation has left room for the tax payer to successfully argue on what entails a significant tax benefit. It is still unclear if the taxpayers' main purpose of entering into an arrangement is to receive a reduction of tax liability, but the outcome was an insignificant tax benefit and so the provision would not be applicable. An interpretation note is required to clearly state what in the understanding of the tax authorities would constitute a significant tax benefit and further provide an explanation of what the outcome would be should the investigation result in an insignificant tax benefit.

The provision on round trip financing seems to detect the manner in which business transactions should be conducted. Any transaction or arrangement involving the transfer of funds from one party to another and, or involving a series of agreements with other parties would invite attack by the Commissioner. The view is that, this provision is too wide to provoke the impermissible avoidance arrangement even when the main purpose of the transaction is not for a tax benefit.

Section 80I of the GAAR is presumed to have provided the Commissioner all alternatives available to raise an assessment if a tax payer is found to have breached the tax avoidance provision. At the same time, there is a call for an interpretation note to be issued for consistency in the application of the alternative provision.

The provision is not clear regarding the remedy to the taxpayer in the instance where the Commissioner fails to respond within 180 days of receiving additional information and documents from the taxpayer. The rule established by the Commissioner is that if connected persons are found to have entered into an arrangement that results in the avoidance arrangement, the arrangement will be regarded as if it was not entered into or the tax liability spread amongst the parties.

CHAPTER FOUR

4. Findings, Recommendations and Conclusion

4.1 Findings

The findings from the study indicate that the new GAAR (Section 80A-80L) is a long and complex piece of legislation and is based on a general anti-avoidance provision instead of a specific provision. This complexity could further lead to misinterpretation of the provisions by the Commissioner and the Courts and the taxpayer alike. Tax experts have criticized the GAAR on the bases that it is unacceptable and unwarranted to formulate an effective GAAR too elaborate to effectively combat impermissible avoidance arrangements entered into by taxpayers. The view is that the new GAAR is an extensive and composite piece of legislation and substantial vagueness followed its enactment.

It is certain that if a taxpayer received a significant tax benefit from a transaction, operation or scheme, the commission would prompt an investigation into the arrangement. But on the contrary, the same Act has failed to establish what should be considered a significant or insignificant tax benefit. This has placed the burden onto the South African Courts to determine the bounds of significant and insignificant tax benefit in every situation. The application by the Courts on the meaning of significant tax benefit may not be consistently applied.

The legislation (provision on GAAR) has further failed till this day to ascertain what should be regarded as a significant tax benefit.

► should it be compared to the level of income that would have been earned should the avoidance scheme not been engaged in? Or

► should it be based on the amount of expenditure that would have been incurred by any party to the arrangement?

And if so, what percentage of these amounts should the tax benefit be determined from? For more clarity on this, an interpretation note should be established to provide measurable terms on a significant tax benefit.

Even though the GAAR has widely covered complex transactions, operations and schemes entered into by taxpayers, there are still loopholes in the provision. Taxpayers are now exploiting these gaps to their advantage. Evidence of this could be drawn from the draft taxation Law Amendment Bill of 2016, which is proposing its amendment to a specific anti-avoidance provision of Section 7c to curb the tax-free transfer of income to interest-free loans. Sooner or later, we may see an amendment of the general anti-avoidance rule due to its wide and complex nature.

4.2 Recommendations

An interpretation note is required to clearly state what in the opinion of the Court and Commissioner would constitute a significant tax benefit and further provide an explanation of what the outcome would be should the investigation lead to the conclusion that the main purpose of an arrangement results in tax avoidance but the tax benefit is regarded as insignificant.

Further research needs to be conducted to determine whether a specific rather than a general anti-avoidance rule would assist in clamping down complex tax avoidance schemes entered into by taxpayers.

4.3 Conclusion

The recent enactment of the new GAAR, seems to have increased the complexity of transactions or operations undertaken by taxpayers. One could conclude that highly complex legislation may contain inherent loopholes that may be exploited for successful tax avoidance schemes. The CSARS v NWK Ltd case made it clear that when taxpayers enter into complex transactions, they should be mindful of the substance over form content of the arrangement. The law will base its findings on the substance and not otherwise of the transaction.

The provisions of the new GAAR are drawn from the status of the previous Section 103(1). Nevertheless, many new aspects have been inserted in the new provision to enable the defeat of the complex avoidance schemes initiated by taxpayers. This could be seen in relation to the sole or main purpose test of a transaction, operation of scheme. Currently, the individual parts of an arrangement will be viewed separately to

determine any element of a tax avoidance as opposed to the previous section 103(1) which required the entire transaction to be scrutinized for the existence or presence of a tax avoidance.

The Court of Law has taken a firm stand on sale and lease back transactions. They had based their findings on the true intention of the sale and lease back arrangement. In the cases of Conhage and ITC 1636 (60 SATC 267), the Court held that the agreement of the sale and leaseback provided the taxpayers with the opportunity of the loan capital and at the same time awarding the tax benefit derived from the arrangement. The view of the Court in both cases was that the main purpose of the transactions was found to be the obtaining of the loan capital and not the tax benefit. The case of Conhage would have contributed to the amendment of section 103 (1). This is as a result of the court considering the entire arrangement as opposed to reviewing its separate steps or individual parts to determine if tax avoidance was the main purpose of the arrangement. To this effect, the current provision would examine steps or individual parts of the arrangement for the existence of tax benefit.

The provision allows the commissioner to attack a transaction on the basis that it contains element of abnormality, but if the transaction does not contain a tax benefit or misuse or abuse of any tax provision then the taxpayer cannot be held accountable for tax liability. Due to the wide nature of the GAAR, the commissioner is alert to attack any transaction where the parties are related (connected) in one way or the other. The provision seems to determine the manner in which business transactions should be structured and with whom taxpayers conduct business activities. The complex nature of the new provision seems to limit taxpayers from exploiting available business opportunities.

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