

**THE SOUTH AFRICAN GENERAL ANTI-TAX AVOIDANCE RULE AND  
LESSONS FROM THE FIRST WORLD: A CASE LAW APPROACH**

A thesis submitted in fulfilment of the  
requirements for the degree of

DOCTOR OF PHILOSOPHY

of

RHODES UNIVERSITY

by

**Teresa Michelle Calvert Pidduck**

December 2017

## ACKNOWLEDGEMENTS

Though only my name appears on the cover of this thesis, a great many people have contributed to its life. I owe my gratitude to all those people who have made this thesis possible and because of whom my research experience has been one that I will cherish forever.

Firstly, I would like to thank my supervisor, Prof Lilla Stack, who accepted me as her PhD student without any hesitation and under whose leadership I have developed immensely as a researcher and academic. Her influence has left a permanent mark on me as a researcher and academic.

I especially thank my mom and dad who gave me the first push into academic study. My hard-working parents have sacrificed their lives for my brother and myself and provided unconditional love and care. I love them so much, and I would not have made it this far without them.

I also thank my friends and colleagues at Monash (too many to list here but you know who you are!) for providing support and friendship that I needed. Your support was both calming and uplifting. Without you this would have been harder, much harder.

Last but not least, I am greatly indebted to my devoted husband Brett Pidduck and our daughters. They form the backbone and source of my happiness. They provided me with love and support without any complaint or regret and have enabled me to complete this PhD project. I owe my every achievement to the three of them.

## ABSTRACT

Tax avoidance has been a concern to revenue authorities since the time that the concept of tax was first introduced. Revenue authorities worldwide constantly strive to ensure taxpayer compliance, while combating impermissible tax avoidance. South Africa uses a general anti-avoidance rule (GAAR) as part of its arsenal to combat the increasingly innovative ways in which taxpayers seek to minimise their tax. However, the GAAR has been the source of much criticism and its effectiveness in combatting impermissible tax avoidance is untested in the courts. Therefore, the use of hindsight to criticise the GAAR is not possible.

This study applied a qualitative approach to compare the South African, Australian and Canadian GAARs in order to propose changes which are intended to improve the efficacy of the South African GAAR. This research was performed by first comparing the three GAARs using a doctrinal research methodology and then applying the South African GAAR to the facts of selected cases from Australia and Canada in the form of reform-oriented research. In order to apply the South African GAAR to the facts of the cases a framework was developed in phase 1 of the research in order to ensure consistency in the application. This allowed for a more reliable analysis to be made regarding the areas where the South African GAAR could be improved. The convergence of results from the two research methodologies validated many of the suggestions made for the improvement of the South African GAAR.

This thesis examined the GAARs in South Africa, Australia and Canada with a view to identifying if there are any lessons to be learned for their application and interpretation, in order to suggest improvements which can be made to the South African GAAR. Further, relevant Australian and Canadian case law was found to be instructive as to the approach that could be adopted for purposes of applying the South African GAAR.

The findings of the research revealed that while the South African, Australian and Canadian GAARs differ in their structure, each is directed to achieve the same end. The results of the study identified two types of improvements to the South African GAAR. Firstly, the South African GAAR should be consolidated into a three-part enquiry instead of the current four-part enquiry. In doing so the tainted elements (previously the abnormality requirement) could be used to inform an objective test of purpose. Secondly, guidance on areas of uncertainty regarding the application of the South African GAAR needs to be provided in order

to prevent possible inconsistent judicial interpretations that may limit the efficacy of the GAAR whilst still protecting the right for taxpayers to legitimately minimise their tax burdens.

One additional cause for concern highlighted in this research is the use of provisions from other jurisdictions without guidance on the application in the South African context. The use of similar provisions to that of its much-criticised predecessor has also introduced areas of uncertainty regarding the application of the South African GAAR. These areas of weakness and uncertainty arguably prevent the South African GAAR from being an effective deterrent to tax avoidance and many could be addressed by the legislature.

**Key words:** taxation, general anti-avoidance legislation, general anti-avoidance rules, tax avoidance schemes, tax evasion

## Contents

<b>CHAPTER 1: INTRODUCTION.....</b>	<b>1</b>
<b>1.1 BACKGROUND TO AND RATIONALE FOR THE STUDY .....</b>	<b>1</b>
<b>1.2 GOAL/PURPOSE OF THE RESEARCH.....</b>	<b>6</b>
<b>1.3 RESEARCH OBJECTIVES.....</b>	<b>6</b>
<b>1.4 SELECTION OF JURISDICTIONS FOR COMPARISON .....</b>	<b>7</b>
<b>1.5 SCOPE AND LIMITATIONS.....</b>	<b>8</b>
<b>1.5.1 REFERENCES TO GENDER.....</b>	<b>9</b>
<b>1.6 RESEARCH METHODOLOGY .....</b>	<b>9</b>
<b>1.7 STRUCTURE OF THE STUDY .....</b>	<b>10</b>
<b>CHAPTER 2: TAX AVOIDANCE AND TAXPAYER RIGHTS .....</b>	<b>13</b>
<b>2.1 INTRODUCTION.....</b>	<b>13</b>
<b>2.2 UNDERLYING CONCEPTS OF TAX AVOIDANCE.....</b>	<b>14</b>
<b>2.2.1 TAX .....</b>	<b>14</b>
<b>2.2.2 TAX AVOIDANCE AND TAX EVASION .....</b>	<b>15</b>
<b>2.3 TAX AVOIDANCE .....</b>	<b>16</b>
<b>2.4 PERMISSIBLE AND IMPERMISSIBLE TAX AVOIDANCE.....</b>	<b>18</b>
<b>2.5 THE MORALITY OF TAX AVOIDANCE.....</b>	<b>22</b>
<b>2.6 THE RIGHT TO AVOID TAX .....</b>	<b>24</b>
<b>2.7 THE COMMON LAW AND SUBSTANCE OVER FORM.....</b>	<b>29</b>
<b>2.8 THE ROLE OF GENERAL ANTI-AVOIDANCE RULES.....</b>	<b>32</b>
<b>2.9 CONCLUSION .....</b>	<b>36</b>
<b>CHAPTER 3: RESEARCH METHODOLOGY AND CASE LAW SELECTION.....</b>	<b>39</b>
<b>3.1 INTRODUCTION.....</b>	<b>39</b>
<b>3.2 RESEARCH PARADIGM.....</b>	<b>40</b>
<b>3.2.1 GOAL/PURPOSE OF THE RESEARCH.....</b>	<b>40</b>
<b>3.2.2 RESEARCH OBJECTIVES.....</b>	<b>40</b>
<b>3.3 RESEARCH METHODOLOGY .....</b>	<b>43</b>
<b>3.3.1 DOCTRINAL RESEARCH.....</b>	<b>46</b>
<b>3.3.2 REFORM-ORIENTED RESEARCH.....</b>	<b>47</b>
<b>3.3.3 CASE ANALYSIS.....</b>	<b>48</b>

<b>3.4</b>	<b>INTERPRETATION OF THE SOUTH AFRICAN GAAR.....</b>	<b>51</b>
<b>3.5</b>	<b>SOURCES OF DATA.....</b>	<b>53</b>
<b>3.6</b>	<b>LIMITATIONS OF THE RESEARCH.....</b>	<b>54</b>
<b>3.7</b>	<b>VALIDITY, RELIABILITY AND OBJECTIVITY OF THE RESEARCH .....</b>	<b>55</b>
<b>3.8</b>	<b>SELECTION OF CASE LAW .....</b>	<b>56</b>
<b>3.9</b>	<b>CONCLUSION .....</b>	<b>58</b>
	<b>CHAPTER 4: THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE.....</b>	<b>60</b>
<b>4.1</b>	<b>INTRODUCTION.....</b>	<b>60</b>
<b>4.2</b>	<b>BACKGROUND TO THE SOUTH AFRICAN GAAR.....</b>	<b>61</b>
<b>4.2.1</b>	<b>SECTION 90 AND THE ORIGINS OF THE GAAR .....</b>	<b>61</b>
<b>4.2.2</b>	<b>SECTION 103(1) BEFORE THE 1996 AMENDMENTS.....</b>	<b>63</b>
<b>4.2.3</b>	<b>SECTION 103(1) AFTER THE 1996 AMENDMENTS.....</b>	<b>65</b>
<b>4.3</b>	<b>WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAAR.....</b>	<b>69</b>
<b>4.3.1</b>	<b>NOT AN EFFECTIVE DETERRENT TO TAX AVOIDANCE .....</b>	<b>69</b>
<b>4.3.2</b>	<b>ABNORMALITY REQUIREMENT .....</b>	<b>71</b>
<b>4.3.3</b>	<b>PURPOSE REQUIREMENT .....</b>	<b>72</b>
<b>4.3.4</b>	<b>ABNORMALITY AND PURPOSE REQUIREMENTS TOGETHER.....</b>	<b>72</b>
<b>4.3.5</b>	<b>PROCEDURAL AND ADMINISTRATIVE ISSUES.....</b>	<b>73</b>
<b>4.3.6</b>	<b>CONCLUSION ON WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAARs .</b>	<b>74</b>
<b>4.4</b>	<b>THE CURRENT SOUTH AFRICAN GAAR.....</b>	<b>75</b>
<b>4.4.1</b>	<b>ARRANGEMENT AND AVOIDANCE ARRANGEMENT.....</b>	<b>77</b>
<b>4.4.2</b>	<b>TAX BENEFIT.....</b>	<b>79</b>
<b>4.4.3</b>	<b>SOLE OR MAIN PURPOSE OF THE ARRANGEMENT .....</b>	<b>82</b>
<b>4.4.4</b>	<b>TAINTED ELEMENTS .....</b>	<b>84</b>
<b>4.4.4.1</b>	<b>ABNORMALITY ELEMENT .....</b>	<b>85</b>
<b>4.4.4.2</b>	<b>LACK OF COMMERCIAL SUBSTANCE ELEMENT .....</b>	<b>86</b>
<b>4.4.4.3</b>	<b>CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH ELEMENT.....</b>	<b>98</b>
<b>4.4.4.4</b>	<b>MISUSE OR ABUSE OF THE ACT ELEMENT .....</b>	<b>99</b>
<b>4.5</b>	<b>FRAMEWORK FOR APPLYING THE SOUTH AFRICAN GAAR.....</b>	<b>102</b>
<b>4.6</b>	<b>CONCLUSION .....</b>	<b>105</b>

<b>CHAPTER 5: THE AUSTRALIAN GENERAL ANTI-AVOIDANCE RULE.....</b>	<b>106</b>
5.1 INTRODUCTION.....	106
5.2 BACKGROUND TO THE AUSTRALIAN GAAR.....	107
5.2.1 THE DEMISE OF SECTION 260 OF THE INCOME TAX ASSESSMENT ACT.....	111
5.2.2 THE INTRODUCTION OF PART IVA OF THE INCOME TAX ASSESSMENT ACT	111
5.3 THE CURRENT AUSTRALIAN GAAR.....	113
5.4 SCHEME .....	116
5.5 DOMINANT PURPOSE .....	118
5.6 TAX BENEFIT.....	121
5.7 RECONCILING GAAR WITH THE RIGHT TO AVOID TAX .....	123
5.8 CONCLUSION .....	124
<b>CHAPTER 6: THE CANADIAN GENERAL ANTI-AVOIDANCE RULE.....</b>	<b>126</b>
6.1 INTRODUCTION.....	126
6.2 TAXPAYER RIGHTS AND BACKGROUND TO THE CANADIAN GAAR.....	127
6.2.1 THE RIGHT TO AVOID TAX .....	127
6.2.2 BACKGROUND TO THE GAAR IN CANADA .....	128
6.3 THE CANADIAN GAAR .....	130
6.3.1 TRANSACTION AND AVOIDANCE TRANSACTIONS.....	131
6.3.2 TAX BENEFIT AND TAX CONSEQUENCES .....	132
6.3.3 AVOIDANCE TRANSACTION .....	133
6.3.3.1 SERIES OF TRANSACTIONS.....	134
6.3.4 TAX PURPOSE .....	135
6.3.5 MISUSE OR ABUSE.....	137
6.4 CONCLUSION .....	141
<b>CHAPTER 7: COUNTRY COMPARATIVE ANALYSIS.....</b>	<b>143</b>
7.1 INTRODUCTION.....	143
7.2 DATA-PROCESSING METHOD.....	144
7.3 OVERVIEW OF THE DIFFERENCES BETWEEN THE GAARS.....	145
7.4 SUMMARY OF THE DIFFERENCES .....	149
7.4.1 ARRANGEMENT, SCHEME OR TRANSACTION .....	149

<b>7.4.2</b>	<b>TAX BENEFIT RESULTING FROM THE ARRANGEMENT, SCHEME OR TRANSACTION .....</b>	<b>150</b>
<b>7.4.3</b>	<b>THE ELEMENT OF PURPOSE.....</b>	<b>152</b>
<b>7.4.4</b>	<b>THE ELEMENT OF ABNORMALITY, ABUSE OR TAINING .....</b>	<b>154</b>
<b>7.5</b>	<b>RECOMMENDATIONS FOR IMPROVEMENT OF THE SOUTH AFRICAN GAAR.</b>	<b>158</b>
<b>7.6</b>	<b>RECOMMENDATIONS ADDRESSING THE WEAKNESSES OF THE PRECEDING SOUTH AFRICAN GAAR .....</b>	<b>162</b>
<b>7.7</b>	<b>CONCLUSION .....</b>	<b>165</b>
	<b>CHAPTER 8: AUSTRALIAN CASE LAW IN RELATION TO GAAR.....</b>	<b>168</b>
<b>8.1</b>	<b>INTRODUCTION.....</b>	<b>168</b>
<b>8.2</b>	<b>SELECTION OF CASES.....</b>	<b>170</b>
<b>8.3</b>	<b><i>COMMISSIONER OF TAXATION v PEABODY</i>.....</b>	<b>172</b>
<b>8.3.1</b>	<b>FACTS OF THE CASE.....</b>	<b>172</b>
<b>8.3.2</b>	<b>ARRANGEMENT .....</b>	<b>174</b>
<b>8.3.3</b>	<b>TAX BENEFIT.....</b>	<b>175</b>
<b>8.3.4</b>	<b>SOLE OR MAIN PURPOSE .....</b>	<b>177</b>
<b>8.3.5</b>	<b>TAINTED ELEMENTS.....</b>	<b>179</b>
<b>8.3.6</b>	<b><i>PEABODY</i> CASE CONCLUSION .....</b>	<b>185</b>
<b>8.4</b>	<b><i>COMMISSIONER OF TAXATION v SPOTLESS SERVICES</i>.....</b>	<b>187</b>
<b>8.4.1</b>	<b>FACTS OF THE CASE.....</b>	<b>187</b>
<b>8.4.2</b>	<b>ARRANGEMENT .....</b>	<b>188</b>
<b>8.4.3</b>	<b>TAX BENEFIT.....</b>	<b>188</b>
<b>8.4.4</b>	<b>SOLE OR MAIN PURPOSE .....</b>	<b>189</b>
<b>8.4.5</b>	<b>TAINTED ELEMENTS.....</b>	<b>192</b>
<b>8.4.6</b>	<b><i>SPOTLESS SERVICES</i> CASE CONCLUSION.....</b>	<b>196</b>
<b>8.5</b>	<b><i>COMMISSIONER OF TAXATION v CONSOLIDATED PRESS HOLDINGS LTD</i>.....</b>	<b>197</b>
<b>8.5.1</b>	<b>FACTS OF THE CASE.....</b>	<b>197</b>
<b>8.5.2</b>	<b>ARRANGEMENT .....</b>	<b>200</b>
<b>8.5.3</b>	<b>TAX BENEFIT.....</b>	<b>201</b>
<b>8.5.4</b>	<b>SOLE OR MAIN PURPOSE .....</b>	<b>202</b>
<b>8.5.5</b>	<b>TAINTED ELEMENTS.....</b>	<b>204</b>



8.5.6	<i>CONSOLIDATED PRESS HOLDINGS CASE</i> CONCLUSION .....	208
8.6	<i>COMMISSIONER OF TAXATION v HART</i> .....	209
8.6.1	FACTS OF THE CASE.....	209
8.6.2	ARRANGEMENT .....	211
8.6.3	TAX BENEFIT.....	212
8.6.4	SOLE OR MAIN PURPOSE.....	213
8.6.5	TAINED ELEMENTS.....	215
8.6.6	<i>HART CASE</i> CONCLUSION.....	218
8.7	SUMMARY OF APPLIED CASES .....	221
8.7.1	HIGHLEVEL FINDINGS.....	223
8.7.2	DETAILED ANALYSIS .....	224
8.8	CONCLUSION .....	231
CHAPTER 9: CANADIAN CASE LAW IN RELATION TO GAAR .....		235
9.1	INTRODUCTION.....	235
9.2	SELECTION OF CASES.....	237
9.3	<i>CANADA TRUSTCO MORTGAGE COMPANY v CANADA</i> .....	239
9.3.1	FACTS OF THE CASE.....	239
9.3.2	ARRANGEMENT .....	241
9.3.3	TAX BENEFIT.....	241
9.3.4	SOLE OR MAIN PURPOSE.....	242
9.3.5	TAINED ELEMENTS.....	243
9.3.6	<i>CANADA TRUSTCO</i> CASE CONCLUSION .....	248
9.4	<i>MATHEW v CANADA</i> .....	250
9.4.1	FACTS OF THE CASE.....	250
9.4.2	ARRANGEMENT .....	253
9.4.3	TAX BENEFIT.....	253
9.4.4	SOLE OR MAIN PURPOSE.....	254
9.4.5	TAINED ELEMENTS.....	255
9.4.6	<i>MATHEW</i> CASE CONCLUSION.....	260
9.5	<i>LIPSON v CANADA</i> .....	261
9.5.1	FACTS OF THE CASE.....	261

9.5.2	ARRANGEMENT .....	263
9.5.3	TAX BENEFIT.....	263
9.5.4	SOLE OR MAIN PURPOSE .....	264
9.5.5	TAINTED ELEMENTS.....	264
9.5.6	<i>LIPSON</i> CASE CONCLUSION .....	268
9.6	<i>COPTHORNE HOLDINGS v THE QUEEN</i> .....	270
9.6.1	FACTS OF THE CASE.....	270
9.6.2	ARRANGEMENT .....	271
9.6.3	TAX BENEFIT.....	271
9.6.4	SOLE OR MAIN PURPOSE .....	272
9.6.5	TAINTED ELEMENTS.....	273
9.6.6	<i>COPTHORNE</i> CASE CONCLUSION .....	277
9.7	SUMMARY OF APPLIED CASES .....	279
9.7.1	HIGH-LEVEL FINDINGS .....	281
9.7.2	DETAILED ANALYSIS .....	281
9.8	CONCLUSION .....	287
	CHAPTER 10: FINDINGS AND PROPOSED CHANGES.....	290
10.1	INTRODUCTION.....	290
10.1.1	DOCTRINAL RESEARCH RECOMMENDATIONS .....	291
10.1.2	REFORM ORIENTED RESEACH RECOMMENDATIONS.....	300
10.2	WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAAR ADDRESSED.....	302
10.3	STRUCTURE OF AN IMPROVED GAAR.....	308
10.4	ADDITIONAL OBSERVATIONS FOR THE SUCCESS OF GAAR.....	311
10.4.1	IDENTIFYING THE ARRANGMENT.....	311
10.4.2	ARRANGEMENT AND THE SOLE OR MAIN PURPOSE .....	312
10.4.3	SOLE OR MAIN PURPOSE AND ALTERNATIVE ARRANGEMENTS.....	312
10.4.4	PRESUMPTION OF PURPOSE AND SECTION 80G OF THE INCOME TAX ACT. 312	
10.4.5	GAAR COMITTEES AND PANELS .....	313
10.5	CONCLUSION .....	314
	CHAPTER 11: CONCLUSION.....	317
11.1	INTRODUCTION.....	317

<b>11.2</b>	<b>ACHIEVEMENT OF THE RESEARCH OBJECTIVES .....</b>	<b>319</b>
<b>11.2.1</b>	<b>THE PRIMARY WEAKNESSES OF THE GAAR.....</b>	<b>320</b>
<b>11.2.2</b>	<b>AREAS REQUIRING AMENDMENT.....</b>	<b>321</b>
<b>11.3</b>	<b>CASE OUTCOMES AND ADDITIONAL CONSIDERATIONS .....</b>	<b>325</b>
<b>11.4</b>	<b>CONTRIBUTION OF THE RESEARCH.....</b>	<b>328</b>
<b>11.5</b>	<b>LIMITATIONS.....</b>	<b>328</b>
<b>11.6</b>	<b>FURTHER RESEARCH.....</b>	<b>329</b>
<b>11.7</b>	<b>CONCLUSION .....</b>	<b>330</b>
	<b>REFERENCES.....</b>	<b>331</b>
	<b>APPENDIX A – PEABODY CASE.....</b>	<b>349</b>
	<b>APPENDIX B – SPOTLESS SERVICES CASE.....</b>	<b>350</b>
	<b>APPENDIX C – CONSOLIDATED PRESS HOLDINGS CASE .....</b>	<b>351</b>
	<b>APPENDIX D – HART CASE .....</b>	<b>352</b>
	<b>APPENDIX E – FRAMEWORK FOR THE SOUTH AFRICAN GAAR - CASE SUMMARIES (AUSTRALIA) .....</b>	<b>353</b>
	<b>APPENDIX F - CANADA TRUSTCO MORTGAGE COMPANY CASE.....</b>	<b>359</b>
	<b>APPENDIX G - MATHEW CASE.....</b>	<b>360</b>
	<b>APPENDIX H – LIPSON CASE.....</b>	<b>361</b>
	<b>APPENDIX I – COPTHORNE HOLDINGS CASE .....</b>	<b>362</b>
	<b>APPENDIX J – FRAMEWORK FOR THE SOUTH AFRICAN GAAR – CASE SUMMARIES (CANADA).....</b>	<b>363</b>

## Figures

<b>Figure 1 Structure of the Study .....</b>	<b>12</b>
<b>Figure 2 Research problem and objectives.....</b>	<b>41</b>
<b>Figure 3 Research Methodology .....</b>	<b>45</b>
<b>Figure 4 Case Analysis.....</b>	<b>50</b>
<b>Figure 5 Phase 1 chapter relationships .....</b>	<b>60</b>
<b>Figure 6: Section 103(1) before the 1996 amendments.....</b>	<b>63</b>
<b>Figure 7 Section 103(1) after the 1996 amendments.....</b>	<b>67</b>
<b>Figure 8 Section 80A.....</b>	<b>77</b>
<b>Figure 9 Phase 1 chapter relationships .....</b>	<b>106</b>
<b>Figure 10 Part IVA of the Income Tax Assessment Act (before the 2012 amendment).....</b>	<b>112</b>
<b>Figure 11 Part IVA of the Income Tax Assessment Act (After the 2012 amendment) .....</b>	<b>116</b>
<b>Figure 12 Phase 1 chapter relationships .....</b>	<b>126</b>
<b>Figure 13 Section 245 of the Canadian Income Tax Act .....</b>	<b>131</b>
<b>Figure 14 Phase 1 chapter relationships .....</b>	<b>143</b>
<b>Figure 15 The South African GAAR (Section 80A of the Income Tax Act).....</b>	<b>145</b>
<b>Figure 16 The Australian GAAR (Part IVA of the Income Tax Assessment Act) .....</b>	<b>146</b>
<b>Figure 17 The Canadian GAAR (Section 245 of the Canadian Income Tax Act) .....</b>	<b>147</b>
<b>Figure 18 Research Methodology .....</b>	<b>168</b>
<b>Figure 19 Research Methodology .....</b>	<b>235</b>
<b>Figure 20 Research Methodology .....</b>	<b>290</b>
<b>Figure 21 Case Analysis.....</b>	<b>301</b>
<b>Figure 22 High-level Proposed GAAR structure .....</b>	<b>309</b>
<b>Figure 23 Detailed proposed GAAR structure.....</b>	<b>310</b>
<b>Figure 24 Research problem and objectives.....</b>	<b>319</b>
<b>Figure 25 Detailed proposed GAAR structure.....</b>	<b>324</b>

## Tables

<b>Table 1 Australian Cases Applied in Phase 2.....</b>	<b>58</b>
<b>Table 2 Canadian Cases applied in phase 2.....</b>	<b>58</b>
<b>Table 3 Framework for South African GAAR.....</b>	<b>102</b>
<b>Table 4 Progress of the <i>Commissioner of Taxation v Peabody</i> case .....</b>	<b>174</b>
<b>Table 5 Progress of the <i>Commissioner of Taxation v Spotless Services Ltd</i> case.....</b>	<b>188</b>
<b>Table 6 Progress of the <i>Commissioner of Taxation v Consolidated Press Holdings</i> case.....</b>	<b>200</b>
<b>Table 7 Progress of the <i>Commissioner of Taxation v Hart</i> case.....</b>	<b>211</b>
<b>Table 8 Framework for South African GAAR – High-level Case Summaries (Australia).....</b>	<b>222</b>
<b>Table 9 Progress of the <i>Canada Trustco Mortgage Company v Canada</i> case .....</b>	<b>240</b>
<b>Table 10 Progress of the <i>Mathew v Canada</i> case .....</b>	<b>253</b>
<b>Table 11 Progress of the <i>Lipson v Canada</i> case .....</b>	<b>263</b>
<b>Table 12 Progress of the <i>Copthorne Holdings v The Queen</i> case .....</b>	<b>271</b>
<b>Table 13 Framework for South African GAAR – High-level Case Summaries (Canada) .....</b>	<b>280</b>

## **ABBREVIATIONS AND ACRONYMS**

South African Revenue Service (SARS)

General anti-avoidance rule (GAAR)

Income Tax Act, 58 of 1962 (Income Tax Act)

Tax Administration Act, 28 of 2011 (Tax Administration Act)

Income Tax Assessment Act of 1936 (Income Tax Assessment Act)

Canadian Income Tax Act RSC 1985, C. 1 (5th Supp) (Canadian Income Tax Act)

Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Discussion Document)

## **CHAPTER 1: INTRODUCTION**

### **1.1 BACKGROUND TO AND RATIONALE FOR THE STUDY**

Since the time that the concept of taxation was introduced, people have constantly been seeking ways in which to minimise their tax burdens (Olivier, 1996). The use of impermissible tax avoidance schemes has been described as a threat to the integrity of tax systems and government revenues worldwide (Barker, 2009; OECD, 2010). The harmful effects of impermissible tax avoidance include loss of revenue, inequitable allocation of tax liabilities, increased complexity of taxation legislation, impunity of taxation legislation, distortion of competition, reduction of taxpayer compliance and impairment of governments' ability to implement economic policy through tax legislation (SARS, 2005; McMechan, 2013). As a result of these threats, revenue authorities worldwide are engaged in a constant struggle to ensure taxpayer compliance in an attempt to combat tax avoidance. While some countries use non-legislative measures to curb impermissible tax avoidance, such as judicial anti-avoidance doctrines (India and Russia, for example), others use General Anti-Avoidance Rules (GAAR). South Africa is no exception and the South African tax legislation includes a GAAR as well as various specific anti-avoidance provisions. The flexibility with which transactions can be structured and the imaginative methods taxpayers can use to minimise their tax burdens makes it difficult to combat tax avoidance through specific anti-avoidance legislation in isolation and even the most well-drafted specific anti-avoidance legislation can never cover all the conceivable transactions that a taxpayer may enter into to avoid tax (Eustice, 2002; SARS, 2005; National Treasury, 2006).

The need for often complex anti-avoidance legislation is compounded by subjectivity in interpreting the, often, subtle difference between the concepts "tax evasion" and "tax avoidance". Tax avoidance can be defined as an attempt to minimise a tax liability using legal means, while tax evasion may be described as a means of reducing a tax liability using ways that are contrary to the law (Asprey, 1975; Haupt, 2013). The South African Revenue Service (referred to as "SARS") has defined impermissible tax avoidance as "artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived 'loopholes' in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament" (SARS, 2005:4). Notwithstanding this, there is a fine line between legal transactions designed to avoid or reduce taxes and tax evasion and can be described

as the difference between legitimate tax planning and impermissible tax avoidance. This is illustrated in the case *IRC v Duke of Westminster* ((1936) 19 TC 490), where Lord Tomlin stated that any taxpayer is entitled to arrange his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. The principle was confirmed in South African courts by Centrives CJ in his minority judgment in *Commissioner for Inland Revenue v Estate Kohler* ((1953) 18 SATC 354), as well as in the judgment in *Hicklin v Secretary for Inland Revenue* ((1980) 1 All SA 301 (A)).

In *Commissioner of Taxes v Ferera* ((1976) 2 All SA 552 (RA)), by contrast, MacDonald JP (at 554) referred to the statements made by Lord Tomlin when stating that there “are *dicta* in judgments in English income tax cases which are open to the construction that the avoidance of income tax should properly be regarded as a respectable contest between the *fiscus* and the taxpayer concerned, should not ‘strictly speaking’ attract ‘moral censure’ and, by necessary implication, should not be regarded as an evil”. In this case the judge (at 554) expressed the opinion that the avoidance of tax is an evil because it also placed an additional burden on those taxpayers who made no attempt to escape tax.

South Africa has followed international trends by including a GAAR in its taxation legislation, as opposed to the use of specific anti-avoidance provisions in isolation. Unlike specific anti-tax avoidance legislation, a GAAR operates on the basis of conceptual principles used to address tax avoidance, as opposed to addressing specifically defined transactions that may provide taxpayers with the “loopholes” for impermissible tax avoidance (SARS, 2005:38). A GAAR, unlike specific anti-avoidance legislation, is not a charging provision, but is used to prevent the impermissible avoidance schemes used by taxpayers for the avoidance of tax and therefore aids in protecting the tax base in South Africa (Ralph, 1998:1).

In the South African context, a GAAR has been present in Income Tax Acts since 1941 and has been amended several times, to enable the powers of the legislator to combat tax avoidance to remain intact in an ever-changing economic environment. The most recent and significant of these amendments are the amendments of 1996 and 2006. The GAAR, after the promulgation of the 1996 amendments, is discussed briefly below.

The previous GAAR as set out in section 103(1) of the Income Tax Act, 58 of 1962 (referred to as the “Income Tax Act”), included four key requirements as summarised below:



- there must be a transaction, operation or scheme;
- that results in the avoidance, reduction or postponement of tax;
- that was entered into or carried out in a manner not normally employed for business purposes, other than obtaining a tax benefit (commonly referred to as the “abnormality” requirement); and
- the transaction must have been entered into solely or mainly for the purpose of obtaining a tax benefit (commonly referred to as the “purpose” requirement).

The need for the amendment of this earlier version of the GAAR was recognised by the Minister of Finance: “What we can’t accommodate is a rule which is intended to limit avoidance that is so abused and tatty with wear” (National Treasury, 2005:3). Shortly after this statement, SARS released a document entitled “Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962” (referred to as the “Discussion Document”) in which it identified that “the [GAAR] has proven to be an inconsistent and at times, ineffective deterrent to the increasingly complex and sophisticated tax ‘products’ that are being marketed by banks, ‘boutique’ structured finance firms, multinational accounting firms and law firms” (SARS, 2005:1). In highlighting the weaknesses of the previous GAAR, SARS made reference to case law, books, dissertations, international commentary, journal articles and Commissions of Inquiry, etc., in which an analysis of the anti-avoidance legislation revealed that the earlier version of the GAAR suffered from the following inherent weaknesses:

- **Not an effective deterrent to tax avoidance** – the GAAR frequently failed to stand up to the rigours of court and the significant amount of time and resources committed to detecting and combating these schemes was costly. Lengthy battles over the true nature of transactions had a negative impact on the relationship between SARS and taxpayers (Olivier, 1996:378; SARS, 2005:42). The abnormality and purpose requirements were identified as the most crucial areas of weakness and in addition to the individual problems noted in each of these cases, the effectiveness of the GAAR was further reduced by the fact that the transaction would need to satisfy both criteria before the GAAR would apply. Therefore, by the taxpayer disproving only one of the requirements, the GAAR would fail to stand up to the rigours of the courts (SARS, 2005:43).
- **The “abnormality” requirement** – the Margo Commission (1988) criticised the abnormality requirement due to the fact that if a particular transaction was widely used, it became normal through the extensive use of such transactions (Williams, 1997; SARS, 2005; Werksmans, 2006). More

recently, these criticisms have again been noted (despite amendments since 1986) because the commercial acceptability of a transaction would result in the abnormality test not being satisfied, regardless of the fact that the transaction may have been entered into solely for the avoidance of tax (Olivier, 1997:742). This in essence rendered the GAAR an ineffective deterrent of tax avoidance (Williams, 1997; SARS, 2005).

- **The “purpose” requirement** - the purpose requirement was similarly criticised since obtaining a tax benefit would need to be the sole or main purpose of the transaction (Brincker, 2001:163). The relative ease with which taxpayers were able to justify the commercial purpose of transactions left SARS in the difficult position of having to prove that the dominant purpose of the transaction would be to obtain a tax benefit (SARS, 2005:43).
- **Procedural and administrative issues** - additional concerns raised relate to the uncertainties with regard to the scope of the GAAR. Firstly, there was uncertainty about the extent to which the GAAR could be applied to individual steps in a larger transaction. Secondly, there was uncertainty as to whether the Commissioner had authority to apply the GAAR in the alternative where another provision in the Income Tax Act applied (SARS, 2005:44).

In light of the weaknesses referred to above, the 2006 amendments to the GAAR were introduced with the intention of ensuring that the new GAAR would be “broad enough to reach as many forms of impermissible tax avoidance as possible and strong enough to be an effective deterrent against them” (Stretch and Silke, 2006). The 2006 amendments have resulted in the GAAR provisions in the South African Income Tax Act today. In identifying the necessary amendments to the previous GAAR, legislation from six different countries: Australia, Canada, New Zealand, Spain, the United Kingdom and the United States of America, was examined in order to incorporate relevant principles from their respective legislation into the South African equivalent (SARS, 2005:27).

The main requirements of the current GAAR, after the Revenue Laws Amendment Act 20 of 2006 was promulgated, are summarised briefly below (sections 80A to 80L of the Income Tax Act).

- A transaction, operation or scheme must be present.
- The transaction, operation or scheme must result in a “tax benefit”.
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit.

- The arrangement must be abnormal, lacking in commercial substance, carried out in a manner not normally employed for *bona fide* business purposes, create rights and obligations not normally arising between parties dealing at arm's length or be abusive of the provisions of the Act.

It is evident that, although additional indicators have been included, both the abnormality and the purpose requirements are still present in the current anti-avoidance regime. Despite the amendments, no cases have yet been brought before the courts in order to test whether the weaknesses identified in the previous GAAR have been adequately addressed by the amendments.

In a recent study entitled “*An analysis of the 2006 amendments to the General Anti-Avoidance Rules: A case law approach*”, the effectiveness of these amendments was tested using cases heard under the earlier GAAR (Calvert, 2011). In this study, the current GAAR was applied to the facts of cases which were previously brought before the courts under the previous GAAR, where the GAAR failed to stand up to the rigour of the interpretation of the courts. The study indicated that “on a balance of probabilities, none of the cases would be held in favour of the Commissioner if they were brought to the courts today on the same grounds that they were attacked at the time” (Calvert, 2011:136). “These findings thus indicate that the use of such similar (often identical) wording of the purpose test as in the previous GAAR, as well as the use of the purpose test in conjunction with the abnormality test, still result in a GAAR that may be an ineffective deterrent to tax avoidance. In addition to this, the amendments to the previous abnormality requirement may not have added to the strength of the GAAR and may in fact have introduced additional areas of concern” (Calvert, 2011:147).

Despite the ongoing debate relating to anti-avoidance legislation, the research conducted in South Africa prior to 2017 centred on critical theoretical analyses of the GAAR after it failed to stand up to the interpretation of the courts. These studies focused on analysing and interpreting the legislation and related literature, in order to identify weaknesses and/or areas for improvement. Prior to the study conducted in 2011 (Calvert, 2011) these studies did not consider the impact of changes to the legislation on previous court decisions or apply the principle of hindsight to evaluate the effectiveness of the legislation .

The present research could not be conducted in the current South African context as no cases have yet been brought before the courts to test the GAAR. Similarly, when recommending amendments to the GAAR in line with international legislation, there is a dearth of research on applying these amendments

to the facts of cases previously heard by the courts, in order to determine the effectiveness of the proposed amendments on a practical basis before their promulgation and implementation.

Only one study (Calvert, 2011) has placed emphasis on applying proposed amendments to the GAAR using actual cases heard by the courts before amendments were legislated. This study concluded that the 2006 amendments to the GAAR were not effective in resolving the weaknesses of its predecessor and that further research was required in order to determine how international legislation can be incorporated effectively into the GAAR with a view to addressing the existing weaknesses of the current GAAR. As a result, the present research originated from the observation that further amendments to the GAAR require research in an international context with the use of international case law. By applying the current South African anti-avoidance legislation to the facts of international case law and comparing these results with the actual outcomes of the cases, this study fills a gap in the anti-avoidance research and aims to determine what amendments can be made to the current GAAR to address its weaknesses. This research thus aims at determining if there are any lessons that can be learnt in South Africa from its Australian and Canadian counterparts to improve the efficacy of the South African GAAR.

## **1.2 GOAL/PURPOSE OF THE RESEARCH**

The goal of the research is to analyse and compare the GAAR in South Africa, Canada and Australia from a case law perspective in order to identify how the existing deficiencies in the South African GAAR could be overcome. This investigation will determine the amendments to the South African GAAR that would result in more robust anti-avoidance legislation. This research culminates with recommendations for the formulation and drafting of a new, more robust GAAR.

## **1.3 RESEARCH OBJECTIVES**

Two levels of improvements to the current GAAR are identified in this study:

- provisions in the GAAR that should be removed due to weaknesses will be identified; and
- provisions that should be added to the GAAR, using principles from Australia and Canada, will be identified.

In order to achieve the goals of the study, the research necessitates a three-phased approach described in more detail in Chapter 3. The research objectives pursued in addressing the goal of the research are formulated as follows:

1. to identify the primary weaknesses of the GAAR in South Africa (Phase 1: Chapter 4);
2. to analyse the Australian and Canadian GAAR for the purpose of describing and comparing its elements with the South African GAAR (Phase 1: Chapters 5, 6 and 7);
3. to apply the GAAR in South Africa to the facts of the cases selected from Australia and Canada and therefore determine which provisions require amendment when comparing the results to the judgments in these jurisdictions (Phase 2: Chapters 8 and 9); and
4. to recommend amendments to improve the effectiveness of the South African GAAR (Phase 3: Chapters 7, 10 and 11).

The scope of the research as described in the goal/purpose of the research and research objectives are limited to specific jurisdictions. The justification for the use and comparability of these jurisdictions is discussed below.

#### **1.4 SELECTION OF JURISDICTIONS FOR COMPARISON**

In order to maintain a manageable scope for this research, the study is confined to the jurisdictions of South Africa, Canada and Australia. The basis of selection is as follows:

- South Africa is selected as the primary jurisdiction for study as the writer, as a resident in this jurisdiction, has in-depth knowledge of South African tax legislation and has conducted research in relation to GAAR in South Africa. In addition, there have been a number of recent significant developments in the South African GAAR, the most recent of which occurred in 2006 when this rule was amended with reference to developments in other jurisdictions, including Australia and Canada. These amendments have not yet been tested in court and there is a gap in the research in this area.

- Canada and Australia are selected for comparison to South Africa as their legal systems and legislation also have their origins in English law. Furthermore, both these jurisdictions were referred to in the Discussion Document released by the South African Revenue Service (SARS) in 2005, which led to the 2006 amendments.

This study fills a gap in the anti-avoidance research in South Africa and aims to determine what amendments can be made to the current GAAR to address any weaknesses, with reference to the developments in the other jurisdictions. Therefore the research aims to determine if there are any lessons that can be learnt in South Africa from its Australian and Canadian counterparts to improve the efficacy of the South African GAAR.

Tax avoidance, however, is a complex area of law and the transactions addressed in its jurisprudence are often intricate and multifaceted. A certain degree of detail is therefore necessary in considering the manner in which tax avoidance transactions are approached by the courts. Every effort is made to identify recurring themes in each jurisdiction for comparison with the South African GAAR. Further scope and limitations as well as the research methodology used to achieve this goal, are described below.

## **1.5 SCOPE AND LIMITATIONS**

This study builds on earlier research carried out by the researcher (Calvert, 2011), which established the need for further research. In the course of the present thesis, reference is occasionally made to this earlier research.

This study is limited to income tax avoidance and to the jurisdictions of Australia, Canada and South Africa. It does not aim to include all possible cases that may have come before the courts in South Africa, Australia and Canada, but provides some insight into the practical workings of the GAAR in South Africa as applied to the selected cases. Any findings from these cases must therefore be interpreted in their context in order to determine if these results will find application for future cases where different facts and circumstances exist. This study does not deal with the psychology of taxation and refers only briefly to tax morality. The research is restricted to the legal principles applying to tax avoidance.

### **1.5.1 REFERENCES TO GENDER**

References to a male gender in the text should be read as including a female gender, where applicable.

### **1.6 RESEARCH METHODOLOGY**

An interpretative research approach is adopted for the study as it seeks to understand, describe and explain (Babbie and Mouton, 2009). The research methodology applied can be described as doctrinal and is concerned with the formulation of legal doctrines through the analysis of legal rules (Knight and Ruddock, 2008). This methodology is selected to critically analyse documentary data in order to reach conclusions and propose changes to the existing legislation, if and where appropriate. The doctrinal research methodology is considered to be appropriate given the intended goals of the research.

This methodology provides a systematic exposition of the rules governing a particular legal category (in the present case the legal rules relating to the GAAR), analyses the relationships between the rules and explains areas of difficulty and ambiguity in the rules (Pearce, Campbell and Harding, 1987; McKerchar, 2008). This qualitative research methodology is adopted as it is based almost purely on documentary data that does not involve statistical analysis (McKerchar, 2008; Razak, 2009).

The documentary data used for the research consists of:

- South African, Australian and Canadian tax legislation;
- South African, Australian and Canadian case law relevant to the tax legislation;
- media statements, Interpretation Notes, regulations, notices, binding rulings and any relevant material in the public domain concerning the general anti-avoidance rule (GAAR) in South Africa, Australia and Canada;
- National Treasury budget speeches, discussion papers and explanatory memoranda or their equivalent in South Africa, Australia and Canada; and
- journal articles, textbooks, theses and other research by acknowledged authors and tax experts.

The data is analysed and interpreted in pursuance of the research objectives and is presented in the form of an extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions are ensured by:

- adhering to the rules of the statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent or which is of persuasive value (primary data) and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

As the documentary data used for this research is publicly available, there are no ethical considerations relating to its use.

In light of the research design selected, it might be difficult to generalise the outcomes of the study. However, there is an argument that “the case investigated is a microcosm of some larger system or of a whole society: that what is found there is some larger symptomatic of what is going on more generally” (Gomm, Hammersley and Foster, 2000:99; Yin, 2009). Similarly, the interpretation of legislation in Australia, Canada and South Africa may inherently have included subjectivity due to differences in the interpretation of legislation and its meaning by the courts and thereby introduced an inherent limitation. However, it is important to note that subjectivity is inherent to this field of study as decisions regarding the application of the legislation are derived from the views of the judiciary. In view of the limitations identified above, the validity and reliability of research are important to any research project, and the measures implemented to ensure the validity, reliability and objectivity of this study are explained in the research methodology chapter (Denscombe, 2007).

## **1.7 STRUCTURE OF THE STUDY**

To adequately achieve the research objectives the research is structured as follows:

**Chapter 1** - introduction

**Chapter 2** – important concepts are defined and analysed, such as tax, tax avoidance, tax evasion and the right to avoid tax. This chapter also provides an analysis of anti-avoidance measures employed in South Africa, including specific anti-avoidance rules, the common law principle of substance over form and a brief discussion of the South African GAAR.



**Chapter 3** – a description is given of the research methodology and the basis for the selection of case law in both Australia and Canada, which was used when applying the South African GAAR to their facts.

**Chapters 4, 5 and 6** – phase 1 of the study includes a literature study of the South African, Australian and Canadian GAARs. While it is customary to present a literature review in a separate chapter or chapters, in the present thesis the literature reviews relating to the various jurisdictions are presented separately in Chapters 4, 5 and 6. The comparative analysis of these jurisdictions is included in Chapter 7 and integrated into Chapter 10.

**Chapter 7** – the comparative analysis of the three jurisdictions is presented and the relative differences between the three GAARs are identified in order to determine the relative strengths and weaknesses of each, on a theoretical basis.

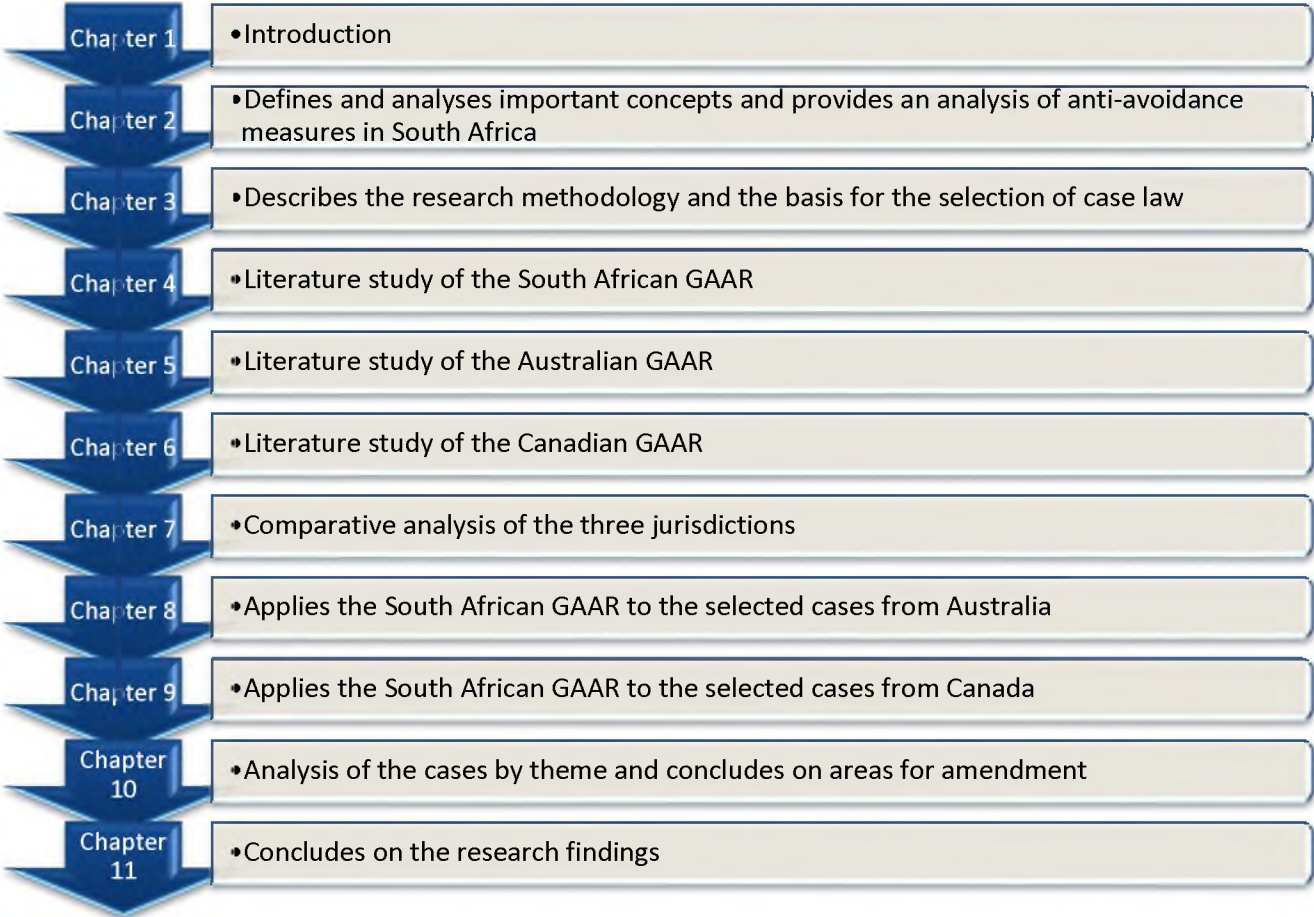
**Chapter 8 and 9** – in phase 2 of the study, the South African GAAR is applied to selected cases from both Australia and Canada. The results of this practical analysis are also presented in Chapter 10 for comparison with the research conducted in phase 1 of the study.

**Chapter 10** – in phase 3 of the study, the cases are analysed by theme and aspects to be amended in the South African GAAR are identified to enhance its efficiency. The results of the research performed in phase 1 of the study are also included in this analysis.

**Chapter 11** – the conclusion of the research findings is presented and areas for future research are identified.

The structure of the study is represented in Figure 1 below:

FIGURE 1 STRUCTURE OF THE STUDY



Source: Own design

## **CHAPTER 2: TAX AVOIDANCE AND TAXPAYER RIGHTS**

### **2.1 INTRODUCTION**

“Oh what a tangled web we weave, when first we practice to deceive” is a quote from Walter Scott that is often used by tax advisors when warning their clients of the dangers of tax planning, evasion and avoidance (Feinstein, 1998:1). Chapter 1 provided an introduction and background to the GAAR in South Africa, the goal/purpose of the research and research objectives as well as a brief methodological overview of the study. The goal of this research is to analyse and compare the GAAR in South Africa to other jurisdictions in order to identify deficiencies and propose amendments which would result in more robust anti-avoidance legislation.

The overarching aim of this chapter is to initiate the investigation into the efficiency of the GAAR in South Africa by analysing whether the factors that are commonly used to identify impermissible tax avoidance sufficiently distinguish between permissible and impermissible tax avoidance. This will provide an understanding of the role and contribution of GAAR to the South African taxation legislation so that the context of the study is understood before an in-depth analysis is undertaken in the remainder of the study.

In order to achieve these objectives this chapter provides an opportunity to identify the components of tax avoidance that must be understood in order to gain a perspective on the complexities of tax avoidance and taxpayer rights. The underlying concepts and principles included for discussion are “tax”, “tax avoidance”, “tax evasion”, “permissible” and “impermissible” tax avoidance. This analysis contributes to establishing how the GAAR deals with the uncertainty regarding the distinction between both permissible and impermissible tax avoidance.

In addition, this chapter also provides an opportunity to understand the importance of and role played by GAAR in the South African context. In order to understand the complexities of tax avoidance, this chapter also includes a discussion of the right of taxpayers to avoid tax, the morality of tax avoidance and the common law remedies that can be used by SARS to combat tax avoidance.

## **2.2 UNDERLYING CONCEPTS OF TAX AVOIDANCE**

To obtain a basic understanding of tax avoidance, the underlying concepts that may impact on this understanding must first be explained. The underlying concepts discussed below are “tax”, “tax avoidance” and “tax evasion”.

### **2.2.1 TAX**

In understanding the concept of tax avoidance for purposes of this thesis, it is first necessary to understand the definition of tax. In the Oxford Dictionary and Thesaurus tax is defined as a “compulsory contribution to state revenue, levied by the government on workers’ income and business profits, or added to the cost of some goods, services, and transactions” (Waite and Hawker, 2009). In the context of accounting dictionaries, tax is defined as a “charge imposed by a government body on personal and corporate income, estates, gifts or other sources to obtain revenue for the public good” (Wanjialin, 2004:385). Tax is defined in dictionaries in the law discipline as “a compulsory contribution to the state’s funds” that “is levied either directly on a taxpayer ... or indirectly through tax on purchases of goods and services” (Martin and Law, 2009:541). The writings of accountants, economists and many judicial decisions contain variants of these definitions. Though these definitions may vary slightly, they identify common characteristics of tax, which can be listed as follows:

- Tax is a compulsory levy on individuals and businesses or companies.
- Tax is one of the means by that a government raises revenue.
- Tax is used to fund public expenditure.

In the South African context, the collection of tax is provided for in section 213 of the Constitution of the Republic of South Africa, 1996, and is the foundation for the right of the government to levy tax in South Africa. The Constitution therefore indicates that tax is compulsory. The problem arises from the fact that humanity has constantly been seeking ways to minimise their tax burdens since the time that the concept of taxation was introduced (Olivier, 1996:378).

### 2.2.2 TAX AVOIDANCE AND TAX EVASION

The attempts of taxpayers to minimise their tax burdens creates an additional challenge when the way in which taxpayers set out to achieve this is examined, as not all the methods used to minimise their tax burdens fall foul of the legislative requirements. The challenge facing the revenue authority is managing the distinction between the concepts “tax avoidance” and “tax evasion”.

The distinction between the two concepts has been aptly described by the former Chancellor of the Exchequer in the United Kingdom, Denis Healy, who stated that “the difference between tax avoidance and tax evasion is the thickness of a prison wall” (Elliffe, 2011:3). An additional distinction was described by Lord Templeman in the case of *Commissioner for Inland Revenue v Challenge Corporation* (1987) AC 155 (at 561) where he noted that “[e]vasion occurs when the Commissioner is not informed of all the facts relevant to an assessment of tax. Innocent evasion may lead to a reassessment. Fraudulent evasion may lead to a criminal prosecution as well as reassessment.” This presumably indicates that tax evasion is a criminal offence because it involves fraud, whereas tax avoidance is not. Tax avoidance is described by De Koker and Williams (2015:par.19.1) as “stratagems which are *prima facie* lawful, that is to say, which are lawful unless proscribed by the Act”. Lymer and Oats (2009-2010:40) describe tax avoidance as the arranging of one’s affairs in a manner that will reduce the tax payable. This is contrasted with tax evasion, which “connotes inherently unlawful methods, such as incorrect statements in income tax returns ... and sham or disguised transactions” (De Koker and Williams, 2015:par.19.1).

In examining the difference between tax evasion and tax avoidance, the comments made by MacDonald JP in his judgment in the case of the *Commissioner of Taxes v Ferera* ((1976) 2 All SA 552 (RA)) are relevant. The judge in this case recognised (at 554) that there “are *dicta* in judgments in English income tax cases that are open to the construction that the avoidance of income tax should properly be regarded as a respectable contest between the *fiscus* and the taxpayer concerned, should not ‘strictly speaking’ attract ‘moral censure’ and, by necessary implication, should not be regarded as an evil.” The judge also commented (at 554) on the predictable effect these *dicta* had on taxpayers, as they encouraged taxpayers “by the exercise of ‘astuteness’ and ‘ingenuity’, to ‘walk outside the lines’ and recognition of the evils inherent in tax avoidance was only expressed in the English Courts at a later date. No doubt, with the passage of time, it was realised that the earlier *dicta* were a superficial assessment of the effect of the

practice of tax avoidance.” Notwithstanding this, his views were expressed strongly in his judgment (at 555) in the following statement:

I endorse the opinion expressed that the avoidance of tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making his proper contribution to the *fiscus*, but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set up the necessary tax-avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent arguments that it is only the rich, the astute and the ingenious who prosper in it and that ‘good citizens’ will always fare badly. While undoubtedly the short term effects of the practice are serious, the long term effects could be even more so.

In light of these comments it is evident that, although tax avoidance may not fall foul of legislation, opinions vary regarding the morality of avoiding tax even though it may not amount to tax evasion.

In addition to the distinctions made between the concepts “tax avoidance” and “tax evasion”, a further distinction can be made in the concept “tax evasion”, namely intentional and unintentional tax evasion. Olivier and Honiball (2008:381) describe intentional tax evasion as the wilful and conscious action of violating tax legislation, and unintentional tax evasion as the situation where a taxpayer negligently or recklessly violates tax legislation. Olivier and Honiball (2008:381) observe that the distinction between these two concepts lies in the manner in which the tax is evaded, whether or not the act is deliberate. Although unintentional tax evasion, unlike its intentional counterpart, is not deliberate, both are illegal in the sense that they both constitute a breach of legislation.

### **2.3 TAX AVOIDANCE**

The concept of tax avoidance is not as easily defined as tax evasion and there is a general lack of consensus in this regard. This is obvious from the differences in the definition of tax avoidance by different committees in different countries, some of which are as follows:

- In Australia the Asprey Committee defines tax avoidance as a legal act that results in splitting income between persons, thereby reducing a taxpayer’s taxable income (Asprey, 1975:par 11.1).

- In the United Kingdom the Radcliff Committee defines tax avoidance as an act in which taxpayers arrange their affairs in order to pay less tax than they would have paid without such an arrangement (Royal Commission on the Taxation of Profits and Income., 1955:1024).
- In Canada the Carter Commission defines tax avoidance as “every attempt by legal means to reduce tax liability that would otherwise be incurred by taking advantage of some provision or lack of provision in the law” (Carter, 1966:538).
- In South Africa the Discussion Document defines tax avoidance as the use of “artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived ‘loopholes’ in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament” (SARS, 2005:4).

The definition provided by the Radcliff Committee in the United Kingdom is similar to that expressed by the Asprey Committee in Australia, but it does not refer to legality. This definition may present difficulties because it may also include tax evasion, as a taxpayer may arrange his affairs illegally in order to pay less tax. The definition provided by Canada’s Carter Commission does refer to the legality of the arrangement, but also infers that taxpayers may avoid tax by interpreting the provisions of the legislation in a way that may be inconsistent with the purpose of the provisions of the legislation (Carter, 1966:538).

The definitions provided in the reports referred to above indicate that tax avoidance is in essence the minimisation of one’s tax burden by means that are within the letter of the law, even if it goes against the intent of the law it purports to follow (OECD, 2015). Definitions of tax avoidance from various authors similarly show that tax avoidance is a legal act resulting in monies liable to be taxed being reduced (Wheatcroft, 1955:209; Thuronyi, 2003:156; Barker, 2009:242). The consequence of these definitions means that taxpayers may avoid tax seemingly legally, but the robustness and interpretation of the relevant statutes in each specific jurisdiction, should the revenue authorities dispute the act, will determine if the taxpayer will succeed in the courts. This ultimately results in a distinction being made between permissible tax avoidance (where the taxpayer is likely to succeed) and impermissible tax avoidance (where the revenue authority is likely to succeed). However, “a taxpayer may genuinely believe that what he has done was ‘lawful’ tax avoidance but a court may later rule that it amounted to ‘unlawful’ tax evasion; hence,

the category into that particular conduct falls may be known only in hindsight” (De Koker and Williams, 2015:par.19.1).

## **2.4 PERMISSIBLE AND IMPERMISSIBLE TAX AVOIDANCE**

The notion that there is a difference between permissible and impermissible tax avoidance as introduced above is recognised in various countries, despite being labelled differently. According to Evans (2008:4), whichever term is used, tax avoidance is often contrasted with tax evasion, and also with tax planning/mitigation. The descriptions of impermissible tax avoidance vary in different countries as follows:

- In Australia the term “aggressive tax planning” is used (Australian Tax Office, 2008:3; Evans, 2008:4).
- In the United Kingdom and New Zealand the term “unacceptable tax avoidance” is used (Evans, 2008:4).
- In the United States of America the term “tax abusive shelters” is used (Evans, 2008:4).
- In South Africa the term “impermissible” or “abusive” tax avoidance is used (SARS, 2005:4; Evans, 2008:4).

Despite the recognition that there is a difference between these concepts there remains no consensus on the precise boundaries of these terms. In Australia the Ralph Review attempted to describe it as “a misuse or abuse of the law” that “is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament, but also includes the manipulation of the law and a focus on form and legal effect rather than substance” (Ralph, 1999:243). Lord Templeman described (at 561-562) impermissible tax avoidance in *Commissioner for Inland Revenue v Challenge Corporation* (1987) AC 155: the taxpayer “reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction” and therefore “does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.” Lord Templeman also described permissible tax avoidance as the situation where the taxpayer claims a deduction after having incurred the expenditure that qualified him for the deduction. In the case of *Craven (Inspector of Taxes) v White and Related Appeals* (1988) 3 All ER 495, he similarly characterised an impermissible tax



avoidance transaction as one that serves no business purpose apart from the avoidance of tax. In explaining the characteristics of impermissible or artificial tax avoidance, Lord Templeman (in *Matrix–Securities Ltd v Inland Revenue Commissioners* (1994) 1 All ER 769) noted that each of these schemes would involve a trick or pretence that the revenue authority would be required to unravel so that the courts would ignore the pretence.

In this regard SARS (2005:16) has attempted to describe the main goals of impermissible tax avoidance as:

- the deferral of a tax liability;
- the conversion of the character of an item (for example, from revenue to capital or, in more aggressive products, the conversion of a taxable item such as interest to a tax-exempt one such as dividends);
- the permanent elimination of a tax liability; and/or
- the shifting of income (for example, from a taxpayer subject to the highest marginal rates to a taxpayer subject to a lower (or zero) rate of tax).

In analysing these goals it is evident that all four can also be considered to be goals of permissible tax avoidance and therefore it would be misleading to conclude that they are solely attributable to impermissible tax avoidance. For instance, the deferral of income to a future year of assessment may be required in terms of legitimate contractual agreements entered into without any tax considerations (*WH Lategan v Commissioner for Inland Revenue* (1926) CPD; *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* (1990) (2) SA 353 (A)). With regard to the conversion of the character of an item, this is a well-established principle that is not always indicative of a tax avoidance motive (De Koker and Williams, 2015:par3.10). Similarly, Kruger and Scholtz (2003:3) note that the elimination of a tax liability and the shifting of income may occur due to transactions undertaken in the normal course of the operations of a taxpayer's business, where no regard to the tax liabilities has been had and are therefore also not indicative of a tax avoidance motive. This is illustrated in the case of *African Life Investment Corporation (Pty) Ltd v Secretary for Inland Revenue* (1969) (4) SA 259 (A) where the shifting of income was done for purposes of administrative convenience with no tax avoidance purpose.

Notwithstanding the inconsistencies noted in the goals of impermissible tax avoidance as described above, the definitions for impermissible tax avoidance may include the following characteristics:

- abuse of a statute;
- the lack of a business purpose;
- artificial or contrived transactions; and
- claiming deductions without incurring expenditure or losses.

The definitions and characteristics of impermissible tax avoidance usually arise in response to transactions or schemes entered into by taxpayers to avoid tax. Notwithstanding the worldwide attempts to define this act, no universal consensus on the term “impermissible tax avoidance” has been reached. Furthermore, the wide varieties of transactions or schemes entered into by taxpayers have resulted in a similar wide variety of definitions and the increasingly complex and sophisticated tax “products” that are being developed by taxpayers to succeed in avoiding tax may result in an ever-changing definition of this term (SARS, 2005:1).

From the definitions and characteristics of impermissible tax avoidance it is evident that they blur the distinction between tax evasion and tax avoidance on the basis of their legality. This is due to the fact that impermissible tax avoidance schemes may still be defeated by the courts by using general anti-avoidance legislation. However, even if such a transaction or scheme is struck down by the courts using general anti-avoidance legislation, it still does not constitute tax evasion as it does not constitute “inherently unlawful methods, such as incorrect statements in income tax returns ... and sham or disguised transactions” (De Koker and Williams, 2015:par.19.1).

In this regard it is evident that impermissible tax avoidance exists where the taxpayer attempts to avoid tax in a manner that is or that subsequently turns out to be inconsistent with the purpose of the legislation, including specific anti-avoidance legislation, without any concealment of income. Therefore, tax evasion has criminal connotations and overtones, and evaders can be subjected to fines and/or imprisonment. Impermissible tax avoidance is not criminal and its consequences are provided for in general anti-avoidance legislation (such as section 80B of the Act), and entails disregarding the transaction and taxing the taxpayer as if the transaction was not entered into.

The methods employed by taxpayers to achieve impermissible tax avoidance are also relevant in this context, as they shed light on the characteristics that may be present. These methods contain features that have been identified from known impermissible tax avoidance schemes. The characteristics listed by SARS in its Discussion Paper (SARS, 2005:19) include:

- the lack of economic substance (usually resulting from pre-arranged circular or self-cancelling arrangements);
- the use of tax-indifferent accommodating parties or special purpose entities;
- unnecessary steps and complexity;
- inconsistent treatment for tax and financial accounting purposes;
- high transaction costs; and
- fee variation clauses or contingent fee provisions.

Each of these characteristics can be criticised on the basis that they are not always indicative of impermissible tax avoidance schemes. For instance, many legitimate transactions may have high transaction costs even where tax avoidance is not a motive for the transaction. Therefore, although these characteristics may be helpful in identifying schemes that may constitute impermissible tax avoidance schemes, it would be misleading to conclude that these are only present with such schemes.

It is evident that impermissible tax avoidance worldwide is a much-debated topic with varying definitions, features and characteristics. The spectrum of arguments related to its permissible counterpart is equally subject to considerable speculation and opinion. Permissible tax avoidance is not subject to legislative sanction, and this distinguishes it from impermissible tax avoidance, which is subject to the application of anti-avoidance legislation such as GAARs and subsequent scrutiny by the courts. Debate and opinions regarding the morality of avoiding tax still arise, even though it may not be considered to be tax evasion or impermissible tax avoidance, and are discussed below.

## 2.5 THE MORALITY OF TAX AVOIDANCE

There is a good deal of judicial authority suggesting that the legal and moral lines between different modes of tax minimisation are the same (Prebble and Prebble, 2010:718). The issue that arises as a result of these views is that moral principles are normative in the sense that they tell us how we should act or behave and these principles are not prescriptive and may be considered vague (Prebble and Prebble, 2010:734). Though the acceptance of vague moral norms is necessary in a complex society, convention and social pressure may play a part in the views of the individual wishing to avoid tax. However, convention and social pressure are often not sufficient to define or to enforce particular moral requirements and there is an argument that the law should fulfil this determinative role in society (Honoré, 1981:49; Honoré, 1993:11).

Prebble and Prebble (2010:707) accept that evasion and avoidance cannot be separated from a moral perspective and it follows that tax avoidance cannot be defended morally. The authors (at 712) also note that if an avoidance arrangement cannot achieve a tax benefit without secrecy, it is hard to see it as legal in any robust sense. In this context Christians (2014:39) notes that “a turn to morality to avoid delineating in law between that which is illegal (evasion) and that which is not (avoidance) is counterproductive to the pursuit of coherent tax policy in the long run.” In expanding on this comment, the author recognises that using social pressure to curb tax injustice is dangerous as it confirms the legitimacy of a century-old tradition of using non-legal, “soft law” to push tax policy. This implies that punishment will be meted out randomly, because judgments on taxpayer behaviour will be made outside of the sphere of statute and will constitute a court of public opinion (Christians, 2014:55). Christians (2014:40) suggests that the solution lies in managing taxpayer behaviour using the law rather than social sanction because it has the best chance of driving tax policy toward greater coherence. While a taxpayer may appreciate this, in many cases tax measures will not evoke a visceral moral response to the law’s demands (Regan, 2013:332). Possibly, however, both a tax policy and social sanctions to influence taxpayer behaviour may be necessary.

This is difficult terrain to navigate and many activists and tax lawyers contend that making tax avoidance a question of morality is simply absurd (Prebble and Prebble, 2010:715; Christians, 2014:48). If one supports this assertion, it creates an argument that the legal and moral lines are the same. In this context if one considers that the one quality that differentiates tax avoidance from evasion is its legality, then by deduction tax avoidance must be “moral” (Prebble and Prebble, 2010:701; Regan, 2013:330). Those

supporting the view that tax avoidance is moral often articulate that taxpayers are assumed not only to have the legal ability to avoid tax liability, but also a corresponding moral entitlement to do so (Prebble and Prebble, 2010:714). Lawyers and taxpayers who see tax avoidance as not only legal but also respectable tend wholeheartedly to agree with judges like Lord Tomlin who established the principle that every taxpayer is entitled to arrange his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be (Prebble and Prebble, 2010:715). The media often promote this stance and express the view that taxpayers have a legal and moral right to arrange their affairs to pay as little tax as possible (Prebble and Prebble, 2010:715).

An alternate view can be articulated in understanding that the assertion that tax avoidance is not morally wrong perhaps relies to a certain extent on an assumption that it is not really very harmful conduct as it is difficult or impossible to identify a direct victim (Prebble and Prebble, 2010:723). This assertion is often countered by the argument that where one taxpayer chooses to pay less tax, others will need to contribute more to the *fiscus* to compensate for this loss. The victim of tax avoidance can thus be said to be society in general. This confirms the comments made by MacDonald JP (at 555) in his judgment in the case of *Commissioner of Taxes v Ferera* ((1976) 2 All SA 552 (RA)) who stated that this dilemma creates a situation that can be described as “evil”.

The distinction between these arguments is not clear cut and in commenting on this, Lord Denning famously remarked (at 783) that tax avoidance “may be lawful, but it is not yet a virtue” (*Weston's Settlements* (1968) 3 W.L.R. 786 (H.L.) (Eng.)). This comment indicates that there may be more issues to consider before promoting the view that the legal and moral lines are the same. One of these issues is that by supporting the view that tax avoidance is legal and moral also says something about tax evasion. In this context it has been noted that the ingredients and effect of tax avoidance and tax evasion are factually similar, and they are divided from one another by a line drawn according to law, not according to the facts of the case. If this statement is accepted, it can then be deduced that if these two actions are factually similar, they can be considered morally similar as well (Prebble and Prebble, 2010:728). This is a contentious issue and no conclusive view on the topic can be made. This is not the case with the moral distinction between illegally evading tax on the one hand and donating to charity and receiving a deduction on the other. In this circumstance few would dispute that acceptable tax mitigation like charitable giving is moral and that tax evasion is immoral (Prebble and Prebble, 2010:715).

In light of the above, the morality of tax avoidance should lie somewhere between acceptable tax mitigation and tax evasion. This observation leads to the belief that there are several possibilities as to where the moral line lies. Prebble and Prebble (2010:715) contend that this line cuts less neatly through avoidance itself, so that some tax avoidance is morally acceptable, and some is not. The task is then to define exactly where the moral line is drawn.

Some have tried to address this issue by categorising different types of tax avoidance as “aggressive”, “unacceptable”, “abusive” or, alternatively, “impermissible” forms of tax avoidance (SARS, 2005:4; Australian Tax Office, 2008:3; Evans, 2008:4; Christians, 2014:48). The attempt to categorise different forms of avoidance in this way is precarious as it involves drawing a line that governments themselves have failed to draw adequately. This approach also places blame squarely on the taxpayer for behaviour that is later deemed to have fallen on the wrong side of this line based on a rudimentary idea about what the politicians who wrote the law “intended” (Christians, 2014:48). Lawyers and taxpayers who wish to engage in tax avoidance tend to agree with using a strict interpretation approach as this is important for the success of tax avoidance schemes (Prebble and Prebble, 2010:713; Regan, 2013:322). Though the views on the morality of tax avoidance are varied, the principle that taxpayers have a right to avoid tax is still entrenched in taxation. The following section deals with taxpayer rights in this regard.

## **2.6 THE RIGHT TO AVOID TAX**

De Koker and Williams (2015:par.19.1) note that the parameters of a taxpayer’s liability for normal tax are laid down in tax statutes, as interpreted by the courts. Therefore, if a taxpayer’s receipts and accruals fall outside the ambit of the charging provisions of the statute, the taxpayer will incur no liability for tax. In this context there is no principle that allows the court to impose liability on the basis that any of those amounts fall in the spirit of the legislation (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A); *IRC v Duke of Westminster* (1936) 19 TC 490). Lord Clyde was explicit on this point in his judgment in *Ayrshire Pullman Motor Services and DM Ritchie v IRC* (1929) 14 TC 754 when commenting (at 763) that “[n]o man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores.”

The morality of permissible tax avoidance, tax planning and tax mitigation has been debated throughout the discourse on taxation. The right of taxpayers to avoid tax has long been accepted as a legitimate activity that taxpayers are entitled to pursue. The United Kingdom judgment in *IRC v Duke of Westminster* (1936) 19 TC 490 is often cited in South Africa, in which Lord Tomlin established the entitlement of every taxpayer to arrange his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. The principle was confirmed in South African courts by Centlivres CJ in his minority judgment in *Commissioner for Inland Revenue v Estate Kohler* (1953) 18 SATC 354, as well as the judgment in *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A). This is distinctly different from using fraud to perpetrate such tax minimisation and is also distinct from the instance where a taxpayer will avoid tax in such a manner that it is in contravention of the tax law, including specific anti-avoidance legislation. De Koker and Williams (2015:par19.1) argue that:

[t]he question whether a taxpayer has succeeded in arranging his affairs so as to fall outside of the charging provisions of a taxing Act often raises complex questions as to the interpretation and scope of its provisions. The difficulty facing taxpayers and their advisers in predicting how a court will interpret a statutory provision in tax legislation, or interpret a particular contract in relation to a taxing Act, is compounded by the fact that the Commissioner is permitted, in his discretion, to decline to give an advance tax ruling in relation to the application or interpretation of any general or specific anti-avoidance provision or doctrine.

In light of this, where legislation is not explicitly contravened, the scheme may still be considered by the revenue authority to constitute impermissible tax avoidance to which the GAAR may be applied. In *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) the court recognised that tax avoidance legislation should not be interpreted in such a manner that absurdities are introduced into the legislation. In explaining this Watermeyer CJ noted (at 190) that a taxpayer could avoid tax:

if he abstains from earning any income and acquires none in any other way. This abstention from earning an income can be brought about by many kinds of operations or transactions. A man can for instance simply close down his business or resign from his employment but it is absurd to suppose that the Legislature intended to impose a tax upon a man who enters into such a transaction or operation as if he had an income, which in fact he has not got, merely because his purpose was to avoid exposing himself to liability for taxation by having an income.

In his judgment in *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) Watermeyer CJ further noted (at 191) that “there are many other ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income.” Watermeyer CJ provided examples (at 191) of such “ordinary” and “legitimate” transactions, some of which are as follows:

- A man can sell investments which produce income subject to tax, and in their place make no investments at all.
- A man can sell shares in companies which pay high dividends and invest in securities which return him a lower but safer and more certain income.
- A man might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation.
- A man may reduce his fees or work for nothing.
- If he is a trader he may reduce his rate of profit or sell his goods at a loss in order to earn a smaller income.
- A man can also secure deductions from the amount of his gross income, for example by insuring his life.

It is evident that the examples described above all have the effect of reducing the taxable income of a taxpayer but appear to be ordinary and legitimate transactions. However, in commenting on the intention of introducing a GAAR into the legislation, Watermeyer CJ noted (at 191) that

it cannot be imagined that Parliament intended by the provisions of sec 90 [the predecessor to the current general anti-avoidance rule] to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out. Moreover the problem of deciding what the income of such persons for the tax year would have been if they had not carried out such operations would appear to be insoluble in some cases, if the countless possibilities of what they might otherwise have done with their capital or their labour are borne in mind.



From this observation by the court, it is evident that where the GAARs are thought to be applicable to an arrangement, the approach used in applying this legislation should not lead to absurdities. This leads to the conclusion that taxpayers do have the right to arrange their affairs in a manner that attracts less tax without being subjected to the GAAR, should its effect lead to absurdities being introduced into the interpretation of the legislation. The notion that taxpayers have a right to arrange their affairs in a manner that may be described as tax planning, tax mitigation or permissible tax avoidance introduces the idea that there should be individual liberty in taxation. This idea of individual liberty in taxation has been both criticised and commended. For instance, Barker (2009:234) notes that this idea is supported by the freedom of the individual from state intervention, freedom of property and freedom to contract. However, in expanding upon these comments, Barker (2009:234) notes that the hidden goal of the promotion of the freedom to avoid tax is the placement of a higher tax burden on other taxpayers. He does admit that the intention to place a higher tax burden on other taxpayers by avoiding tax is debatable.

Those disputing the right to avoid tax state that this right is a “truism” of tax law and that when trying to curtail impermissible tax shelters, it should not be assumed that this right exists (Weisbach, 2002:5). In expanding on this Weisbach (2002:7) explains that the right to avoid tax cannot be found in any statute and “does not, for example, rank with the freedom of thought, speech, association, religion, or other principles supported by moral philosophers.” He further explains that “[t]here is in short, no basis for a right to tax plan other than statements made up out of thin air by a few judges using questionable theories of statutory interpretation” (Weisbach, 2002:7). In referring to his point raised on “questionable theories of statutory interpretation”, Weisbach presumably refers to the judgment in *IRC v Duke of Westminster* (1936) 19 TC 490. The judgment in this case has often been blamed for promoting the conformance of taxpayers to the literal provisions contained in the statute as opposed to the intention of the legislature.

In response to the comments made by Weisbach (2002:7) that there is no right to avoid tax provided for in a statute, it can be noted that this may not be so clearly defined in the South African context. Although the right to avoid tax is not expressly provided for, the Constitution of the Republic of South Africa, 1996, does provide for the right to property in terms of section 25. This section provides that a person may not be deprived of property, except in terms of law. The Constitution further provides that this law may not allow any arbitrary deprivation of property. If money is considered to be property, then the payment of tax is the deprivation of a person’s property by law. In section 36 of the Constitution it is evident that the

levying of taxes is necessary to enable government to fund its operations and is thus an authorised deprivation of property. However, if the tax infringes these property rights in terms of a general application that is arbitrary, it would be considered to be unconstitutional. It is clear, therefore, that if a taxpayer uses legal means to avoid taxes, it would not be considered to be unconstitutional. It can then be concluded that taxpayers have the right to transact in a manner that does not fall foul of the anti-avoidance legislation, as they have the right to avoid tax using legal means.

In taking this concept further, it has been confirmed that where the same commercial result can be achieved by implementing transactions by two or more available methods, the taxpayer has the right to choose the method that attracts the least tax (*CIR v Conhage (Formerly Tycon)* (1999) (4) SA 1149 (SCA); *Craven (Inspector of Taxes) v White and Related Appeals* (1988) 3 All ER 495; *Gregory v Helvering* (1935) 293 US 465; *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A); *IRC v Brebner* (1967) 1 All ER 779; *IRC v Wesleyan Assurance Society* (1948) 1 All ER 555 HL).

Therefore, despite the arguments to the contrary, the right to avoid tax has been confirmed in many jurisdictions. However, there is an argument that the purposive approach as described by Goldswain (2008:109) should be considered in this context. In describing this approach, Goldswain (2008:119) notes that the South African courts have explained that the golden rule of interpretation is to arrive at the intention of the legislature. Therefore, interpretation must have regard to the words used and giving them, unless specifically defined, their ordinary grammatical meaning (Freedman, 2011:635). However, if giving them such a meaning would lead to absurdities or anomalies, which could not have been contemplated by the legislature, the legislature's intention must be considered of paramount importance in order to remain within the bounds of the Constitution. The idea that the purposive approach should be followed in interpreting statute was confirmed in the courts in (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A) and *Income Tax Case No 1396* (1984) 47 SATC 141.

Notwithstanding this, even in jurisdictions such as the United States of America, where the purposive approach has been adopted, the right to avoid tax is still recognised (*Gregory v Helvering* (1935) 293 US 465). In addition to the opinions expressed about the interpretation of the legislation, there are also relevant arguments related to the interpretation of the transaction in question. In this regard there are a number of decisions of the courts dealing with the question of whether tax may be levied by interpreting a transaction in relation to its substance as opposed to its form and considering the principle of fiscal nullity.

## 2.7 THE COMMON LAW AND SUBSTANCE OVER FORM

Fiscal nullity is a common law principle that was first articulated by Lord Wilberforce in *WT Ramsay Ltd v Inland Revenue Commissioners* (1981) 1 All ER 865 (HL) (at 323). This principle was described by Lord Brightman in *Furniss v Dawson* (1984) 1 All ER 530 (HL) (at 543) as follows:

First, there must be a preordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end.... Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax – not ‘no business effect’. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.

From the above it is evident that where steps have been inserted into a transaction that have no commercial business purpose other than the avoidance of tax, the offending steps should be disregarded, and the final result of the transactions will attract the necessary tax in terms of the statute. In investigating this principle further it is important to remember that it has not led to a conclusion that an arrangement that lacks commercial substance can never, on that account, be a fiscal nullity (De Koker and Williams, 2015:par.19.2). It merely provides for a purposive construction to be used in applying the statute and does not simply disregard transactions that have no commercial purpose.

The fiscal nullity principle is significant in the United Kingdom as it does not include a GAAR in its tax legislation. Tax avoidance transactions are addressed using common law principles, including the principle of fiscal nullity (De Koker and Williams, 2015:par.19.2). This is not the case in South Africa, where a GAAR is included in its tax legislation and the contribution of common law principles to the countering of unacceptable tax schemes in South Africa is confined to “sham” or “disguised” transactions, where the courts will give effect to the real transaction and will have regard to substance rather than form (De Koker and Williams, 2015:par.19.2).

A “sham” or “simulated” transaction is described as a transaction where the parties to a transaction have “purposefully disguised the true nature of the transaction between them through the adoption of a form that is at variance with their actual intentions” (Olivier, 1997:726; De Koker and Williams, 2015:par.26.7). Simulation is described by Williams (2005:562) as a situation where the “parties to an agreement do not

honestly intend to give effect to it or to some of its terms, and have an ascertainable and different ‘real agreement’....” The courts have defined principles that should be applied to simulated transactions, as described by Wessels ACJ in his judgment in the case *Kilburn v Estate Kilburn* (1931) AD 501 when commenting (at 507) that “[c]ourts of law will not be deceived by the form of a transaction; it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance.” Even in the case of *IRC v Duke of Westminster* (1936) 19 TC 490, which is often considered to be the seminal case establishing taxpayer rights with regard to the payment of taxes, Lord Tomlin stated (at 520) that “[t]he Court may ignore the legal position and regard what is called the substance of the matter....”

In a South African context, the unanimous judgment in the case of *Zandberg v Van Zyl* (1910) AD 302 (at 309) is relevant, where the court noted that “as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have.” In adding to this Innes J recognised (at 309) the following:

Not infrequently, however either to secure some advantage which otherwise the law would not give; or to escape some disability which otherwise the law would impose, the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature.

Innes J (at 309) went further to provide guidance on how the courts should deal with such transactions:

[W]hen a court is asked to decide any rights under such an agreement, it can only do so by giving effect what the transaction really is: not what in form it purports to be. The maxim then applies *plus valet quod agitur quam quod simulate concipitur*. But the words of the rule indicate its limitations. The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that the contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.

The maxim *plus valet quod agitur quam quod simulate concipitur* has been translated by different sources as follows:

- “What is actually done is more important than that which seems to have been done” (Claassen, 2014:sv "plus valet quod agitur quam quod simulate concipitur").
- “Greater value is attached to what is done than what appears to be done” *BC Plant Hire CC t/a BC Carriers v Grengo (SA) (Pty) Ltd* (2004) 1 All SA 612 (C) at 621.
- “Greater weight is attached to what is done than to what is purportedly done” *Be Bop A Lula Manufacturing and Printing CC v King Tex Marketing (Pty) Ltd* (2006) ZAWCHC 72 at 9.

In simple terms this means that the substance of a transaction carries more weight than the form of the transaction. In terms of this *plus valet quod agitur quam quod simulate concipitur* rule, a court would therefore not give effect to the form of an agreement if it does not reflect the true intention of the parties (Olivier, 1997:726). In commenting on this Lewis JA in *CSARS v NWK Ltd* (2011) 2 All SA 347 (SCA) cautioned (at 357) that a taxpayer is entitled to manage his affairs in a manner that reduces the tax, but that simulated transactions would make the exercise impermissible:

It is trite that a taxpayer may organize his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective. But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law.

In this case the court needed to find that the transaction entered into by the taxpayer was simulated before applying the substance over form rule, thereby ignoring the transaction. Lewis JA also commented (at 361) that the test should go further and would

require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.

The most notable conclusion by the court in this regard is the fact that even if the transaction is given effect to, it is insufficient to exclude the application of the substance over form rule. As a result of this case, when the substance over form rule is applied to transactions in a taxation setting, the commercial sense of the transaction must be considered. It is submitted that, in essence, this requires the courts to consider the commercial substance and purpose tests when the substance over form rule is applied. Because the GAAR includes similar tests, it seems that the judgment in this case may have inadvertently led to the creation of a broader anti-avoidance rule. If this is indeed the case, it may result in the Commissioner preferring the use of the substance over form rule as opposed to the GAAR.

As a result of the judgment in *CSARS v NWK Ltd* (2011) 2 All SA 347 (SCA), commentators have predicted that the role of the substance over form principle in a taxation context may allow the revenue service to take action against complex financial structures without invoking the GAAR. It can do this by merely showing that the structures lack commercial substance, without having to prove that they involve a “disguise” in the sense that the parties did not honestly intend to give effect to the arrangement according to its tenor (De Koker and Williams, 2015:par.19.3). This raises the question as to the role of GAAR in South Africa.

## **2.8 THE ROLE OF GENERAL ANTI-AVOIDANCE RULES**

In a South African context the Commissioner is only empowered to assess the taxpayer on the basis of a deemed or notional transaction by means of specific and general anti-avoidance provisions (De Koker and Williams, 2015:par.19.3). Common law, on the other hand, will empower the Commissioner to disregard a disguised or sham transaction and give effect to the real transaction. In this context common law cannot be used to deem the taxpayer to have derived an amount of income or capital that he did not in fact derive, or to have incurred less expenditure than he actually incurred (De Koker and Williams, 2015:par.19.3). Specific anti-avoidance rules regulate or prohibit tax avoidance in specific situations or in relation to specific transactions and these rules are scattered throughout the tax legislation. It is beyond the scope of this thesis to discuss all these sections, but their role is to provide rules related to the taxation of transactions with certain defined characteristics and as such their scope is limited.

Specific anti-avoidance rules in the legislation have an important role to play and these rules are most commonly included in the legislation with the intention of closing loopholes that are exploited by

taxpayers by using specifically defined transactions. However, specific anti-avoidance legislation can never deal with all the increasingly innovative methods that a taxpayer may use to achieve tax avoidance, and this is further compounded by the flexibility of transactions that form part of a taxpayer's arsenal. This makes it difficult to combat innovative transactions designed to exploit these loopholes through specific anti-avoidance legislation alone. In this regard it has also been recognised that even the most well-drafted tax laws will never encompass all the conceivable transactions that a taxpayer may enter into to avoid tax. This is the primary reason why the inclusion of a GAAR is thought to be necessary as it adds to the specific requirements created by specific anti-avoidance rules and creates a general requirement not confined to specifically defined transactions. The main difference between specific and general anti-avoidance rules is that the GAARs are not charging provisions and are intended to aid in protecting the tax base in South Africa (Ralph, 1998:1). The comments made by Richardson P on the role of GAAR in the case of *Commissioner of Inland Revenue v BNZ Investments* (2002) 1 NZLR 450 are relevant:

[A GAAR] is perceived legislatively as an essential pillar of the tax system designed to protect the tax base and the general body of taxpayers from what are considered to be unacceptable tax avoidance devices. By contrast with specific anti-avoidance provisions which are directed to particular defined situations, the legislature through [the GAAR] has raised a general anti-avoidance yardstick by which the line between legitimate tax planning and improper tax avoidance is to be drawn. Line drawing and the setting of limits recognise the reality that commerce is legitimately carried out through a range of entities and in a variety of ways; that tax is an important and proper factor in business decision making and family property planning; that something more than an existence of a tax benefit in one hypothetical situation compared with another is required to justify attributing a greater tax liability; that what should reasonably be struck at are artifices and other arrangements which have tax induced features outside the range of acceptable practice ... The function of [the GAAR] is to protect the liability for the income tax established under the other provisions of the legislation.

This description indicates that the GAAR should be used to prevent artificial transactions, while still allowing a taxpayer to arrange his affairs to legitimately avoid tax. This statement confirms the difference between permissible and impermissible tax avoidance as discussed earlier. Fundamentally, GAARs are intended to draw the line between these two concepts and provide certainty on the attributes of both permissible and impermissible tax avoidance.

The form of GAAR differs in different legal jurisdictions, but Cooper (2001:111) notes that most have certain common characteristics:

- A transaction, operation, arrangement or scheme must exist in the instance under dispute.
- There should be a tax benefit derived from this transaction, operation, arrangement or scheme. This requirement can be implied as it would be impossible to avoid tax if there were no tax benefit to be derived by the taxpayer by entering into the transaction, operation, arrangement or scheme.
- The sole or main purpose for entering into the transaction, operation, arrangement or scheme must be to avoid tax. This is a critical characteristic as its absence would allow the revenue authority to apply the GAAR to a transaction that has no tax avoidance purpose, thereby expanding the scope of the rule beyond that intended by the relevant legislature.

Given these basic criteria, read together with the criteria of the legal framework of each legal jurisdiction with regard to determining the impermissibility of the transaction, a GAAR is born. Therefore there is no uniform design of a GAAR and each jurisdiction designs it in response to perceived and real risks specific to their country or jurisdiction in the light of structural differences in the legislation that call for more targeted approaches (Orow, 1998:57).

The main differences between the GAARs in these differing jurisdictions are those related to determining the impermissibility of the transaction. Two main approaches have been adopted in determining this factor. The first focuses on the acceptability of the form of the transaction in the context of the taxpayer's ultimate objective, and the second focuses on the taxpayer's purpose for entering into the transaction (Cooper, 1997:32-39; Dabner, 2000:232). In the second instance, if it is found that the purpose of the transaction, when determined objectively, is to avoid tax, it can be said that impermissible tax avoidance is present; however, if there is a commercially motivated purpose, it can be concluded that the tax was avoided permissibly (Cooper, 1997:32-39). A third approach has been noted by scholars that attempts to define tax avoidance in terms of defeating the intention of the legislature, which is often referred to as the "purposive approach" (Dabner, 2000:233). The use of this approach has come under criticism where dual purposes existed, but this has been countered by an argument that the dominant purpose should be determined in these cases (Dabner, 2000:237).



The three characteristics of GAARs (transaction, tax benefit and sole or main purpose) form the fundamental basis for determining the impermissibility of transactions, but they need additional elements in order to isolate the impermissibility. The function of these additional elements would be to limit the application of the rule and to provide boundaries for taxpayers who wish to exercise their right to avoid tax. The question in this regard is not whether the tax has been purposely avoided, but whether it has been done in a manner that is impermissible.

However, the ability to include elements in the GAAR that provide the boundaries for taxpayers is much debated, given that there is no universal consensus on the term *impermissible tax avoidance*. Further, as previously noted, the wide varieties of transactions or schemes entered into by taxpayers, coupled with the increasingly complex and sophisticated tax “products” that are being developed by taxpayers to avoid tax, may result in an ever-changing definition of this term (SARS, 2005:1). In commenting on this, Cooper (1997:26) questions whether legislative text can be drafted for a rule that has no clear target and raises the following question: “How can the drafter prepare a weapon against something that in the opinion of some cannot be adequately defined and certainly cannot be defined ex ante?”

It is therefore evident that GAAR will always involve an inherent uncertainty, given the uncertainty regarding the term “impermissible tax avoidance”. This may be the reason why GAARs are often not seen as successful and why the likelihood of achieving greater success in their design and implementation is questionable (Dabner, 2000:250; Cooper, 2001:86). Furthermore, even if such a GAAR is developed, the wide varieties of transactions or schemes entered into by taxpayers and increasingly complex and sophisticated tax “products” that are being developed by taxpayers may once again give rise to uncertainties in applying the rule. This has also been recognised in South Africa in the Discussion Document, where it is noted that “[t]he GAAR nevertheless reflects a fundamental recognition that even the best drafted, best designed tax legislation cannot anticipate every possible nuance and circumstance that may arise, let alone every scheme that may later be devised in response to it” (Cooper, 1997:13; SARS, 2005:6-7).

The question that may then be raised as a result of this paradox is whether GAARs should be used as a tool to combat tax avoidance at all. Cooper (1997:13) calls for more certainty to be provided in GAARs to make them more effective, but there is an alternative view that providing this certainty would provide

a target for tax planning activities undertaken by taxpayers (Freedman, 2004:345-357). However, certainty is described as one of the fundamental principles of a tax system by Smith (1776:644) as follows:

The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experiment of all nations, is not near so great as a very small degree of uncertainty.

It can therefore be argued that any GAAR should be designed to be as certain as is reasonably possible, while absolute certainty would be impossible. This would allow reasonable planning opportunities for taxpayers when exercising their right to avoid tax.

## **2.9 CONCLUSION**

This chapter initiated the investigation of the efficiency of the GAAR in South Africa by an analysis of whether the factors that are commonly used to identify impermissible tax avoidance sufficiently distinguish between permissible and impermissible tax avoidance. In doing so the underlying concepts and principles that were discussed included “tax”, “tax avoidance”, “tax evasion”, “permissible” and “impermissible” tax avoidance. The analysis of these concepts revealed that while the concept of tax evasion is easily defined, there is a general lack of consensus regarding the term “tax avoidance”. This has resulted in a further distinction being made between the terms “permissible” and “impermissible” tax avoidance. Despite the recognition that there is a difference between these concepts, there remains no consensus on the precise boundaries of these terms. Attempts have been made to define characteristics or goals of impermissible tax avoidance, but no universal consensus has been reached as it has been contended that it would be misleading to conclude that these are solely attributable to impermissible tax avoidance as they may be present in their permissible counterpart.

The conflicting views present with regard to tax avoidance, permissibility and legality also extend to the arguments made regarding the morality of tax avoidance. Research indicates that there are several possibilities as to where the moral line lies and that this line should lie somewhere between acceptable tax mitigation and tax evasion. Though the views on the morality of tax avoidance are varied, the right of taxpayers to avoid tax has long been accepted as a legitimate activity that taxpayers are entitled to pursue. However, even where such avoidance does not explicitly contravene legislation, the scheme may be considered by the revenue authority to constitute impermissible tax avoidance to which the GAAR may be applied. This clarifies the role that the GAAR is intended to fulfil in legislation, but also highlights the importance of distinguishing its parameters so that the rule may achieve its intended objectives. The interpretation of the GAAR is an important consideration when distinguishing these parameters and using the purposive approach should prevent absurdities from being introduced when applying the GAAR.

The presence of GAAR in South African legislation does not, however, prevent the revenue authority from employing the common law to address tax avoidance. Two such principles used in common law are fiscal nullity and the principle of substance over form. The use of the fiscal nullity principle merely provides for a purposive construction to be used for applying the statute and does not simply disregard transactions that have no commercial purpose. The importance of these common law principles in a South African context is diminished by the inclusion of the GAAR, which is intended to fulfil an important role in combatting impermissible tax avoidance. Therefore, the common law principles are considered to be confined to the dealings of “sham” or “disguised” transactions where the courts will give effect to the real transaction and will have regard to substance rather than form.

It is therefore evident that the GAAR should be used to prevent artificial transactions, while still allowing taxpayers to arrange their affairs to legitimately avoid tax. However, the question in this regard is not whether the tax has been purposely avoided, but whether it has been done in a manner that is impermissible. Therefore, the GAAR will inherently involve an element of uncertainty, given the uncertainty regarding the term “impermissible tax avoidance”. It is recognised, however, that the GAAR should be designed to be as certain as is reasonably possible to provide planning opportunities for taxpayers when exercising their right to avoid tax.

This chapter provided the context in understanding the uncertainties, role and contribution of the GAAR in South African taxation legislation. The next chapter deals with the research methodology applied in this study and forms a precursor to the first phase of the study.

## **CHAPTER 3: RESEARCH METHODOLOGY AND CASE LAW SELECTION**

### **3.1 INTRODUCTION**

This chapter outlines the research methodology and design followed to achieve the research objectives of the study and provides a framework for describing the applicability of these to the phased approach described in Chapter 1. In this context this study aimed to analyse and compare the GAAR in South Africa, Canada and Australia in order to identify how the existing deficiencies in the South African GAAR could be addressed. The study further aimed to determine what amendments to the South African GAAR would result in more robust anti-avoidance legislation so that a more robust GAAR can be proposed.

In the previous chapter the lack of consensus on the meaning of terms in the field of tax avoidance was highlighted, but the necessity for a GAAR as a tool to combat tax avoidance was identified. However, a GAAR should be designed that still allows a taxpayer to arrange his affairs to legitimately avoid tax. Given this context and the uncertainties regarding impermissible tax avoidance, any GAAR will inherently involve an element of uncertainty.

As discussed in Chapter 1, this study is conducted qualitatively in the field of tax law. For this reason, this study is interpretive in nature as it attempts to understand and interpret how the deficiencies in the South African GAAR should be addressed, as well as to determine what amendments should be made to improve its efficiency. This research is described as exploratory and is based on a doctrinal research methodology that aims to obtain a detailed understanding of the different dimensions and aspects of the GAAR from both a theoretical and practical perspective.

In addition, why the jurisdictions are selected for analysis and comparison in phase 1 of the study is discussed. How cases heard in these jurisdictions were selected for application in phase 2 of the study is outlined. The measures undertaken to ensure validity, reliability and objectivity in the study throughout each of the phases are also outlined.

The overarching aim of this chapter is to describe how the research methodology and design are appropriate to successfully meet the objectives of the study as outlined in Chapter 1. Therefore, it is important to understand the research paradigm and approach taken to achieve these objectives, as described below.

## **3.2 RESEARCH PARADIGM**

The paradigm in which this study is situated was chosen with reference to the research problem and objectives. Therefore, it is necessary to understand the goal/purpose of the research and research objectives in order to contextualise these in the research methodology and design. The goal/purpose of the research and related research objectives are repeated below for this purpose.

### **3.2.1 GOAL/PURPOSE OF THE RESEARCH**

The goal/purpose of the research was defined in Chapter 1 as follows:

To analyse and compare the GAAR in South Africa, Canada and Australia from a case law perspective in order to identify how the existing deficiencies in the South African GAAR could be overcome. This investigation results in determining the amendments to the South African GAAR that would result in more robust anti-avoidance legislation. This research culminates with recommendations for the formulation and drafting of a new, more robust GAAR.

It is therefore evident that the research is essentially of an exploratory nature and therefore statistical hypothesis testing is not used. In order to address the goal/purpose of the research, two main types of improvement are defined in relation to the South African GAAR. These two types of improvements and their related research objectives are discussed below.

### **3.2.2 RESEARCH OBJECTIVES**

The types of improvements to be achieved in this study consist of two levels:

- provisions in the GAAR that could be removed due to weaknesses; and
- provisions that could be added to the GAAR, based on principles from Australia and Canada.

In order to achieve the goals of the study, the research necessitates a three-phased approach described in more detail below. The research objectives pursued in addressing these goals were formulated in Chapter 1 as follows:

1. to identify the primary weaknesses of the GAAR in South Africa (Phase 1: Chapter 4);
2. to analyse the Australian and Canadian GAAR with the purpose of describing and comparing its elements with that of the South African GAAR (Phase 1: Chapters 5, 6 and 7);
3. to apply the GAAR in South Africa to the facts of the cases selected from Australia and Canada and therefore determine which provisions require amendment when comparing the results to the judgments in these jurisdictions (Phase 2: Chapters 8 and 9); and
4. to recommend amendments to improve the effectiveness of the GAAR (Phase 3: Chapters 7, 10 and 11).

The relationship between the goal/purpose of the research and research objectives are represented in Figure 2 below:

**FIGURE 2 RESEARCH PROBLEM AND OBJECTIVES**



Source: Own design

In view of the relationship between the research objectives and the research problem, the study is approached from an interpretive paradigm as described by Eriksson and Kovalainen (2008:18-20). This interpretative approach is sometimes called the constructivist or post-positivist approach (Leedy and Ormrod, 2005:94). This paradigm is concerned with subjective and shared meanings and is interested in how social events or settings are interpreted or understood (Eriksson and Kovalainen, 2008:19).

If considered in context, the study aims to gain a detailed understanding of the different dimensions and aspects of the topic in both a theoretical and practical context (Leedy and Ormrod, 2005:133; Creswell, 2007:40). In this study, the detailed theoretical and practical understanding and dimensions will be focused on GAAR in South Africa, Canada and Australia. De Vos (2011:311) and Babbie and Mouton (2009) describe this interpretive research approach as one that seeks to understand, describe and explain so that the solution can be discovered by means of a systematic methodological approach. Following these observations, it is evident that the present study is situated in the interpretive paradigm as a result of the following:

- Taxation law is a construct of the human mind and is socially constructed through language and shared meanings (Eriksson and Kovalainen, 2008:19).
- The focus of the research is concerned not only with the contents of empirical data, but also with how the contents are produced through language and practices (Eriksson and Kovalainen, 2008:20). In the present study it is recognised that the GAAR and its effect on impermissible avoidance schemes are a result of the language used in the statutes as well as practical case law.
- The research is conducted in a manner that seeks to focus on the full complexity of the issue and many interpretations of the topic are meaningful (Eriksson and Kovalainen, 2008:20). In the present study the interpretation of the GAAR may have many interpretations within and across jurisdictions, depending on the context.

The research undertaken in this study is therefore conducted from an interpretive orientation. The ontological assumption underpinning this research is the subjective nature of the study due to the fact that it is subject to uncertainties, perceptions and experiences that change over time and in different contexts (Eriksson and Kovalainen, 2008:13). The epistemological foundation that must be considered as part of this study is that the researcher was part of the knowledge production process (Eriksson and Kovalainen,



2008:20) The researcher in the present study is part of the knowledge production process and provides the interpretation and application of the South African GAAR to previously decided tax cases. The present results of the analysis and interpretation of these cases would not exist independently had the researcher not undertaken the research. The epistemology and methodology are closely related as the methodology describes how the knowledge is produced from a practical point of view. The research methodology is discussed below.

### **3.3 RESEARCH METHODOLOGY**

As described in Chapter 1, a qualitative research methodology is adopted in this study in order to analyse the theoretical differences and practical effect of the South African GAAR when applied to the facts of cases selected from other jurisdictions. The epistemology of this study is directly related to a qualitative methodology as the knowledge gained from this study arises from the understanding of the symbols and meaning derived from the subject matter (De Vos, 2011:311). In this case the subject matter consists of the tax law in each jurisdiction.

The qualitative research methodology is selected because the data is in the form of doctrine consisting of words, sentences and paragraphs. In understanding that qualitative research is typically the collection of “thick” data and that the data helps to explore the complexity of the research problem and build an understanding or interpretation, it follows that the qualitative design is appropriate to achieve the objectives of this study (McKerchar, 2008:15). Therefore, since tax avoidance is a complex area of law and may include intricate and multifaceted components, the collection and use of “thick data” is necessary. In addition to this, a greater depth of understanding and interpretation is required than a quantitative research approach would have provided (Leedy and Ormrod, 2005:133). This greater depth is results from the application of legislation to facts of selected case law.

The qualitative methodology selected for this study makes use of a combination of two different methodological approaches in order to achieve the research objectives:

- doctrinal research (also referred to as “black-letter law”); and

- reform-oriented research (this study applies a case-law analysis methodology for the purpose of evaluating the adequacy of the existing South African GAAR).

In employing this mixed approach, the research is carried out in three phases. Doctrinal research is used in phase 1 and reform-oriented research in phase 2. The use of the two approaches has the advantage of allowing knowledge gained in phase 1 to be compared with the knowledge gained in phase 2. More significantly, since the results of the two phases converged, there is strong validation of the findings on the GAAR in phase 3 of the study. The three-phased approach is discussed below:

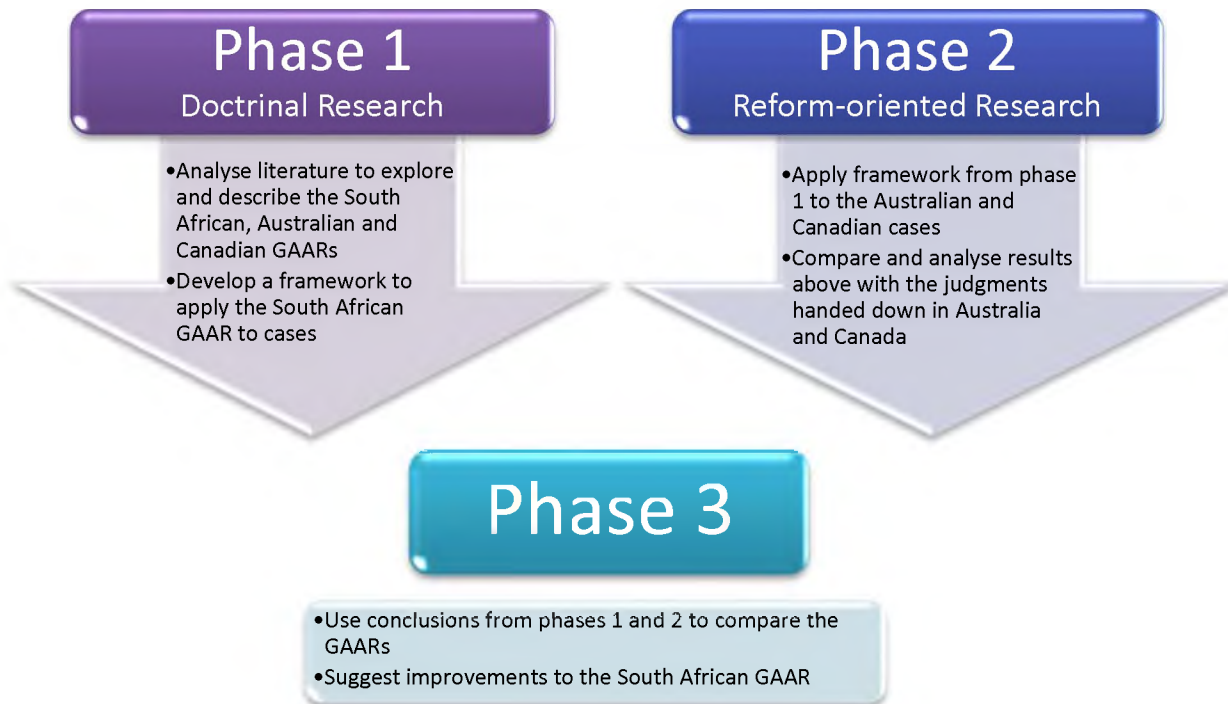
- **Phase 1:** The first phase includes a comprehensive analysis of the literature to explore and describe the components of the South African, Australian and Canadian GAARs. This literature review comprises “[a] critical analysis of the existing research literature, theoretical and empirical” relating to the subject matter (Walter, 2010:485). In this study the subject matter consists of the GAARs in South Africa, Australia and Canada and in the process of the analysis of the South African GAAR, a framework is developed to apply this GAAR to selected case law in phase 2. This is based on an interpretive approach that is used by the judiciary for interpreting legislation in South Africa. The literature review includes an analysis of how each of the GAARs is interpreted in their respective jurisdictions and their implications when brought before the courts. This is carried out using authoritative bodies of work, *inter alia* case law, books, reports and journals. Thereafter, a critical analysis of these GAARs is included in order to draw comparisons between these rules in all three jurisdictions. The literature review is thus in the form of a conceptual study and comparative analysis and is consistent with the purpose of the study.
- **Phase 2:** The second phase of the study uses the framework developed in phase 1 to apply the South African GAAR to the facts of cases in both Australia and Canada. This allows the researcher to identify the following:
  - which aspects of the South African GAAR are effective and should remain intact;
  - which aspects of the South African GAAR are ineffective and should be amended;
  - which aspects of the Australian GAAR are effective and should be included in its South African counterpart; and
  - which aspects of the Canadian GAAR are effective and should be included in its South African counterpart.

In conducting the research, records are obtained from selected case law to set the context of the transactions undertaken by the various taxpayers. The South African GAAR is then applied to the facts of these cases using the framework developed. The application of this framework to the facts of the cases ensures a consistent method and a criterion for application of the South African GAAR for all the cases selected and improves the objectivity for the study. The results can then be compared with the outcomes of the cases when presented before the courts in their respective jurisdictions.

- **Phase 3:** The third and final phase of the study uses the theoretical comparison of the three GAARs in phase 1 and the results from the practical case studies in phase 2 to suggest improvements to the South African GAAR. Due to the qualitative nature of the study and depth and breadth of phases 1 and 2 outlined above, a substantial body of information and detail precedes phase 3. During this phase a redrafted GAAR for insertion into the South African legislation is formulated.

The three-phased research methodology is represented in Figure 3 below:

**FIGURE 3 RESEARCH METHODOLOGY**



Source: Own design

A discussion on the use and application of both the doctrinal research and reform-oriented research in the study is given below.

### **3.3.1 DOCTRINAL RESEARCH**

The research approach applied in phase 1 of the study can be described as doctrinal research and is concerned with the formulation of legal doctrines through the analysis of legal rules (Knight and Ruddock, 2008). Doctrinal research methodology (also referred to as “black-letter law”) is defined by Salter and Mason (2007:113) as “a research methodology that concentrates on seeking to provide a detailed and highly technical commentary upon, and systematic exposition of, the content of legal doctrine.” Employing doctrinal research in this study enables the researcher to explain, make coherent or justify a segment of the law (the GAAR) as part of a larger system of law (Hutchinson and Duncan, 2012:84).

The doctrine in question in this study includes legal concepts and principles established in various ways, including case law, statutes and rules (Hutchinson and Duncan, 2012:84) and is a suitable method to be employed to achieve the objectives of phase 1 of the study. As suggested by Kuhn (1996:11-46), this research approach lies within the paradigm of law and is a distinct area of scholarship. Therefore doctrinal research is a unique research method in the field of law (Hutchinson and Duncan, 2012:84) and can be used successfully to achieve the research objectives of phase 1 of the study. This research methodology is selected to critically analyse documentary data in order to reach conclusions and propose alterations to the existing legislation, if and where appropriate, on a theoretical basis.

In undertaking doctrinal research it is important to understand that the research process is one of analysis rather than data collection (Hutchinson and Duncan, 2012:100). Therefore this approach provides a systematic exposition of the rules governing a particular legal category (in the present case the legal rules relating to the GAAR), analyses the relationships between the rules and explains areas of difficulty and ambiguity in the rules (Pearce *et al.*, 1987:9.10-9.15; McKerchar, 2008). This research approach is adopted as it is based almost purely on documentary data and does not involve statistical analysis of data (McKerchar, 2008; Razak, 2009).

In addition, Hutchinson and Duncan (2012:84-85) note that doctrinal research is closely linked with the doctrine of precedent and legislation (including GAAR), and takes on the quality of being doctrinal because it is meant to be applied consistently and evolves organically and slowly. It therefore follows that the doctrinal research undertaken in this study is suited to the research conducted on the law and legal concepts of tax avoidance with specific reference to the GAAR and the ontological approach of the study. In view of this, this doctrinal research approach is considered appropriate for phase 1 of the study, given the intended goals of the research.

The doctrinal research employed in the first phase of this study involves a rigorous analysis and creative synthesis, the making of connections between seemingly disparate doctrinal strands and the challenge of extracting general principles from an inchoate mass of primary materials (Council of Australian Law Deans, 2005:3). It was specifically suited to the research undertaken in this phase with a view to achieving the research objectives.

The limitations of using comparative doctrinal research are that it may be time-consuming and difficult to timetable accurately, and access to primary sources may be limited. As a result of this, it may lead to a reliance upon secondary sources such as articles and textbooks that may be out of date (Salter and Mason, 2007:189). An additional risk is that the critical analysis of policy lessons may be overlooked in favour of a point-by-point comparison of the details of positive law in the jurisdictions compared (Salter and Mason, 2007:190). However, for purposes of this study, the comparative method provides a useful means of deriving shared lessons across the three jurisdictions. The research methodologies applied in phases 2 and 3 of the study are discussed below.

### **3.3.2 REFORM-ORIENTED RESEARCH**

The research approach applied in phases 2 and 3 of the study is described as research that “intensively evaluates the adequacy of existing rules and that recommends changes to any rules found wanting” (Pearce *et al.*, 1987:9.10-9.15; Hutchinson and Duncan, 2012:101). It is therefore evident that this research approach is aptly suited to achieve the research objectives, as recommendations for amendments to the South African GAAR are presented at the end of phase 3.

Similarly, in commenting on reform-oriented research, McKerchar (2008:19) notes that it is “designed to accomplish change in the law, and theoretical research is that which fosters a more complete understanding of the conceptual bases of legal principles.” In addition to this description, Alley and Bentley (2008:129) note that reform proposals rely on making connections across comparative and international legal concepts and “are also finely nuanced as they require critical understanding of context across diverse jurisdictions and simultaneous appreciation of the implications of developments in the different international fields to take advantage of what is possible.” In this context, the phased approach used in this study results in proposed amendments to be made to the South African GAAR by using the research performed in phases 1 and 2 of the study. Therefore, the reform-oriented research applied in phases 2 and 3 is suitable to achieve the research objectives.

The case analysis used in phase 2 of the study is described in more detail below.

### **3.3.3 CASE ANALYSIS**

Case analysis is chosen for implementation in phase 2 of the study and is consistent with the qualitative paradigm. It is chosen in order to apply the South African GAAR to the facts of the cases presented before the courts in both Australia and Canada. Case analysis is appropriate to achieve the research objectives of the study.

The purpose of using case analysis is to draw conclusions on the efficacy of the South African GAAR when compared to the outcomes of the cases presented before the courts in their respective jurisdictions. This allows analytical generalisations to be made about the efficacy of the South African GAAR compared to its international counterparts. This is done in order to determine the differences in the outcomes of the cases compared with their original judgment (McKerchar, 2004:10).

It may be argued that a comparison of this nature can be made by applying the South African GAAR to only one case in each jurisdiction. However, this approach would have the following impact on the outcomes of the study:

- Generalisations that could be made about the efficacy of the rule would be limited, as the facts of the case analysed might only have highlighted certain aspects for consideration, which in turn would lead to other aspects not being identified or considered.
- The limited facts used for analysis would reduce the scope of the study so that results of the study could only be applicable to cases where similar facts existed. This would fundamentally impact on the ability of the study to suggest amendments to the South African GAAR as these amendments would be suitable only for cases with similar facts. Therefore, if amendments were to be proposed on this basis, it would effectively convert the GAAR into a specific anti-avoidance rule.
- Amendments proposed would specifically cater for a transaction with certain facts and not for cases with other facts.

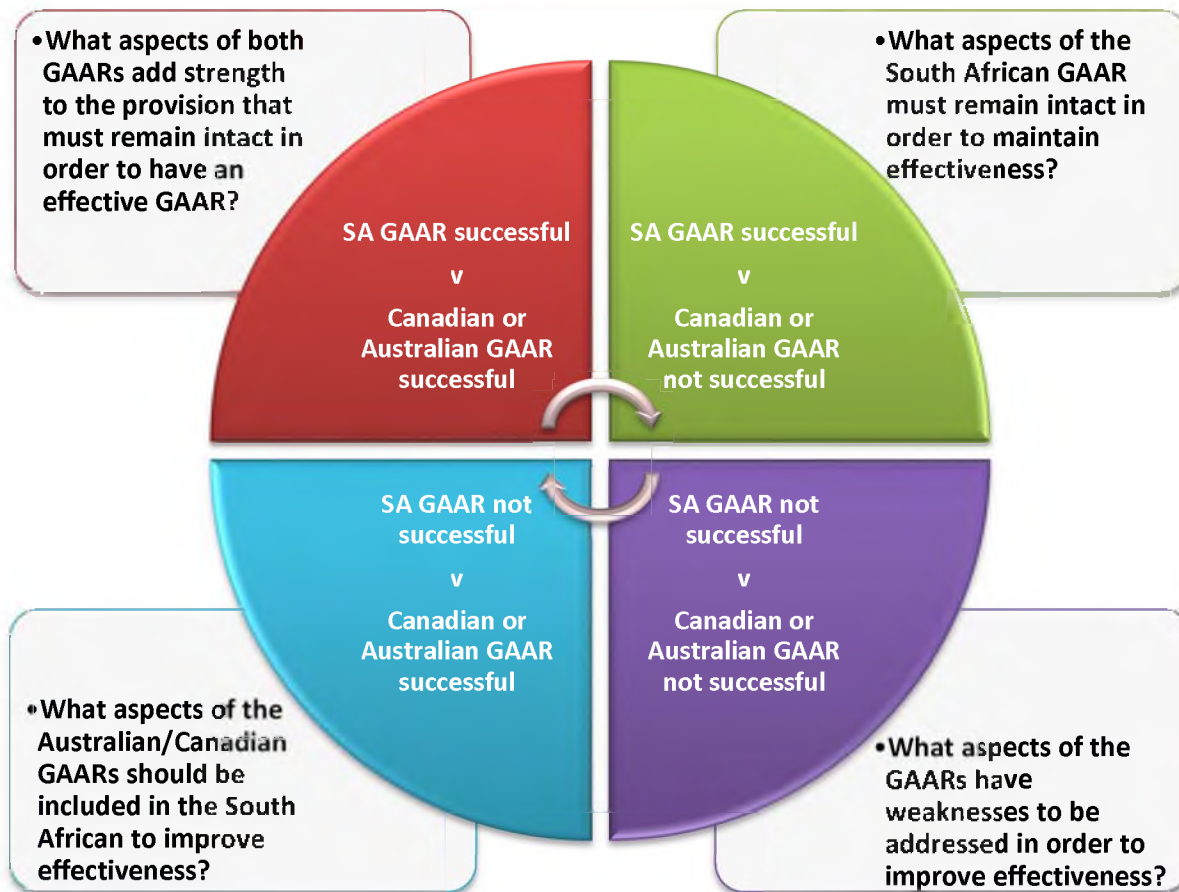
In light of the above, it would not be prudent to use only one case from each jurisdiction and a variety of cases are therefore identified. Applying the South African GAAR to multiple cases in each jurisdiction with varying facts has the following result:

- Cross case patterns can be identified, which strengthens the internal validity of the study (McKerchar, 2004:10).
- More areas for improvement of the South African GAAR can be identified as different facts would inherently highlight additional areas of strengths and weaknesses in the rule.
- Any proposed amendments will be made by considering the impact such amendments will have on all the cases selected, adding strength to the proposed amendments. This also prevents the proposed amendments from changing the GAAR into a specific anti-avoidance rule.

The selection of multiple cases from each jurisdiction is therefore imperative to achieve the research objectives effectively and incorporate rigour into the research undertaken. In addition to the above, it is evident that the South African GAAR should be applied consistently to ensure that no bias is introduced, and the use of the framework developed in phase 1 is critical in this regard. Furthermore, the methodology allows the process to be repeated by other researchers and increases the external validity of the findings, as other researchers can review the data objectively and reach the same conclusions (McKerchar, 2004:10). Therefore, the use of this framework for applying the South African GAAR to the facts of the cases facilitates repeated studies in different contexts and increases the external validity of the findings.

The case analysis used in this study is represented in Figure 4 below:

FIGURE 4 CASE ANALYSIS



Source: Own design

Consequently, the multiple case analysis strategy that is selected is the most appropriate strategy as it can provide indications of areas of both strengths and weaknesses in the South African GAAR compared to the other jurisdictions. This type of strategy as described by Yin (2009) has previously been used successfully in compliance literature, but on a significantly smaller scale.

One area identified that could be affected by subjectivity or bias is the use of the facts included in the case law documentation, in that the full facts and details of the case needs to be studied so that an informed analysis can be performed. In order to prevent only certain facts from being considered, the full case law documentation is obtained from the South African Tax Cases Reports, Canadian Legal Information Institute (CanLII) database and Westlaw AU database (that are all considered to be primary sources).



A limitation of this strategy is that it may be difficult to generalise the outcomes of the study. However, the use of multiple case analysis addresses the impact of this limitation. External validity could be problematic in the use of this strategy, as the cases are selected without applying probability sampling and, as such, no statistical generalisations can be made about the population. However, the combined research approach allows for a strengthening of the external validity of the study (McKerchar, 2004:10). In addition, there is an argument that “the case investigated is a microcosm of some larger system or of a whole society: that what is found there is some larger symptomatic of what is going on more generally” (Gomm et al., 2000:99; Yin, 2009).

Nevertheless, the interpretation of legislation in Australia, Canada and South Africa may inherently include subjectivity due to differences in the interpretation of legislation and its meaning by the courts and thereby introduces an inherent limitation. However, it is important to note that subjectivity is inherent to this field of study as decisions regarding the application of legislation are derived from the views of the judiciary. In order to prevent bias in the manner in which the South African GAAR is interpreted when applied to the cases, and to ensure that the findings and interpretation maintain a high level of objectivity, a standardised method for interpreting the rule is developed. The method used to interpret the South African GAAR is explained below.

### **3.4 INTERPRETATION OF THE SOUTH AFRICAN GAAR**

“Interpretation, in the context of fiscal legislation, is the cornerstone on which the revenue authorities can assess and collect taxes and correspondingly, the foundation on which a taxpayer’s rights are built” (Goldswain, 2008:107). Legislation is made up of words and language and correct interpretation of the legislation is critical in order to successfully apply the South African GAAR to the facts of the cases selected from Australia and Canada. Consequently, the method for interpreting the legislation is critical to achieve the research objectives. A standardised framework for interpreting the South African GAAR is developed in order to prevent unnecessary bias and errors in interpretation and thus ensure consistent application of the South African GAAR.

In interpreting fiscal legislation, the courts have explained that the golden rule of interpretation is to arrive at the intention of the legislature (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue*

(1975) (4) SA 715 (A); *Income Tax Case No 1396* (1984) 47 SATC 141). This approach is referred to as the purposive approach (Goldswain, 2008:109). According to Goldswain (2008:109), this must be done by having regard to the words used and giving them, unless specifically defined, their ordinary grammatical meaning. He adds that if giving them such a meaning would lead to absurdities or anomalies, which could not have been contemplated by the legislature, the legislature's intention must be considered of paramount importance in order to remain within the bounds of the Constitution (*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A)).

The principles outlined above do not take cognisance of the *contra fiscum* rule, which states that where the law is ambiguous, the fiscal legislation must be interpreted in a manner that favours the taxpayer. However, in commenting on this rule, Goldswain (2008:116) notes that the *contra fiscum* rule still remains a part of our common law and it complements the principles underpinning the Constitution by ensuring that inequitable decisions are not made by inadequate interpretation of fiscal legislation. Though the *contra fiscum* rule has traditionally been viewed as applicable in instances where there is ambiguity in the wording of fiscal legislation, the purposive approach is more appropriate in addressing this research so that the underlying intention of the section is considered, instead of just the wording of the legislation (Goldswain, 2008:116). This view is consistent with a recent case decided in the Supreme Court of Appeal, where the method to be used to interpret fiscal legislation was considered (*Commissioner for South African Revenue Service v Airworld CC and another* (2008) 2 All SA 593 (SCA)). In this case the purposive approach was applied as it was held to be the appropriate tool to be used to interpret fiscal legislation. This view has similarly been held in other courts, *inter alia* *Commissioner for Inland Revenue v Delfos* (1933) 6 SATC 92 (A), *Kommissaris van die Suid-Afrikaanse Inkomdiensdienste v Botha* (2000) 62 SATC 264 (O) and *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A), where the view was taken that “even in the interpretation of fiscal legislation the true intention of the Legislature is of paramount importance, and, I should say, decisive.” However, the interpretation of anti-avoidance legislation adds an additional consideration in that it must be interpreted widely to suppress the mischief and advance the remedy of the Commissioner, but must also not stretch the meaning beyond what the language permits (*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA)).

In light of the above considerations, it was important to reduce the impact of bias in the interpretation of the South African GAAR. By applying the aforementioned principles, the following process is undertaken:

- Where a word, sentence or piece of legislation has already come before the courts (in a similar context and with a similar intention) the interpretation used by the courts is used. This method of interpreting the legislation in a similar context aids in reducing bias in the study. This method is applied where the word, sentence, or piece of legislation has been interpreted by the courts using the purposive approach (i.e. where the intention of the legislator has been considered).
- Alternatively, where the legislation was not previously interpreted by the courts, the ordinary grammatical meaning of the word is used in conjunction with the purpose of the legislation (i.e. using the purposive approach), thereby attempting to determine what the courts would find in applying this word, sentence or piece of legislation.

The aforementioned method of interpretation is applied to create the framework that is used to analyse the case studies in phase 2 of the study. The sources of the data used in the study are discussed below.

### **3.5 SOURCES OF DATA**

In undertaking the research, documentary data from various sources is required in both phases 1 and 2 of the study. The documentary data used for the research consists of:

- South African, Australian and Canadian tax legislation;
- South African, Australian and Canadian case law relevant to the provisions of the tax legislation;
- media statements, Interpretation Notes, regulations, notices, binding rulings and any relevant material in the public domain concerning the general anti-avoidance rule from the relevant tax authority in South Africa, Australia and Canada;
- National Treasury budget speeches, discussion papers and explanatory memoranda or their equivalent in South Africa, Australia and Canada; and
- journal articles, textbooks, theses and other research by acknowledged authors and tax experts.

The data is analysed and interpreted in pursuance of the research objectives and takes the form of an extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions is ensured by:

- adhering to the rules of statutory interpretation, as established in terms of statute and common law in each jurisdiction;
- placing greater evidential weight on legislation, case law that creates precedent or that is of persuasive value (primary data) and the writings of acknowledged experts in the field relevant for each jurisdiction;
- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

As all the documentary data described above are publicly available, there are no ethical considerations relating to their use.

### **3.6 LIMITATIONS OF THE RESEARCH**

Due to the nature of the research and the number of cases analysed, it is difficult to generalise the outcomes of the study (Yin, 2009:38). However, there is an argument that the results from the analysis of the case are “a microcosm of some larger system or of a whole society: that what is found there is some larger symptomatic of what is going on more generally” (Gomm et al., 2000:99). This study therefore does not aim to address all possible schemes that may come before the courts, but may provide some insight into the practical workings of the South African GAAR. In addition, any findings are interpreted in their context in order to determine if these principles may be applied to other cases where different facts/circumstances exist.

The following additional limitations of the study are identified:

- The study is South African specific. It is limited to the 2006 amendments of the GAAR in a South African context and is thus of limited use in other jurisdictions/countries.
- The interpretation of statutes in the context of this study may inherently include subjectivity. Measures employed to limit this subjectivity or bias are described in paragraph 3.5. However, it is important to note that many decisions in court are based on the views of judges, where subjectivity may also be introduced. This subjectivity is thus inherent to the interpretation of legislation, but by using a detailed literature review the study provides insight into the workings of the South African GAAR on a consistent basis using the framework described in paragraph 3.5.

It is important to note that the first limitation does not affect the validity, reliability and objectivity of the study. The measures taken to ensure that the validity and reliability of the research are explained below.

### **3.7 VALIDITY, RELIABILITY AND OBJECTIVITY OF THE RESEARCH**

The following measures are taken to maintain the highest level of validity, reliability and objectivity in applying the South African GAAR to the facts of the cases:

- Subjectivity or bias in interpreting legislation is a cause for concern. Subjectivity in this area may impact upon the results of the application of the South African GAAR to the facts of the cases. A phased approach is thus applied to address this concern. This approach, which aids in reducing subjectivity, is described below:
  - **Phase 1:** The literature is analysed comprehensively to explore and describe the weaknesses of the predecessors to the South African GAAR, the Australian GAAR and the Canadian GAAR. This analysis provides tools to aid in interpreting each of the requirements of the South African GAAR. This analysis is conducted using authoritative bodies of work from case law, books and journals. In addition to this, the method used to interpret the South African GAAR is employed as described in paragraph 3.5 in order to develop a framework that is used consistently to apply the South African GAAR to the cases. The development of the framework aids in maintaining the validity, reliability and objectivity of the study.
  - **Phase 2:** Records obtained from cases in Australia and Canada set the context of the transactions. The South African GAAR is then applied to the facts of these cases using the framework developed in phase 1 of the study. The application of this framework ensures a consistent method and criteria of application for all the cases and promotes the objectivity of the study.
  - **Phase 3:** The results of phase 1 (theoretical comparison of the South African, Canadian and Australian GAAR) and phase 2 (practical application of the South African GAAR to selected cases) are used to suggest improvements to the South African GAAR. This allows for both the theoretical and practical analyses to contribute to the suggested improvements

to the South African GAAR. The use of both a theoretical and practical analysis assists in maintaining the reliability and validity of the study.

- The sample of cases used in phase 2 of the study is identified as an area where subjectivity and bias may be introduced. This is due to the observation that the selection of a case on a subjective basis may introduce subjectivity in the results of the study. In order to address this concern, predefined objective criteria are used to eliminate bias in the selection of cases. The criteria for the selection of the cases are described in paragraph 3.8.
- The final area identified as a concern is the quality of the documentation of the cases to ensure that the full facts and details of the case can be used to facilitate an informed analysis. The case law documentation is thus obtained from the judgments of the Canadian Legal Information Institute (CanLII) database and the Westlaw AU database (primary sources and therefore reliable).

As noted above, predefined objective selection criteria are used to select the cases for phase 2 of the study. The approach is explained below.

### **3.8 SELECTION OF CASE LAW**

The selection of case law used in the second phase of the study is identified as an area where subjectivity and bias may be introduced, in that the mere selection of a case on a subjective basis could negatively impact on the findings of the study. In order to address this concern, predefined objective criteria are used to eliminate bias in the selection of cases that could impact upon the findings of the study.

Creswell (2007:75) notes that purposeful maximal sampling selects cases that show different perspectives of a problem because they are chosen in order to meet the requirements needed to answer the research problem. Another rationale for the selection of a case is if such a case represents a critical case in the study (Yin, 2009:47). For the purposes of this study both purposeful maximal sampling in conjunction with cases that are considered critical are used for selection purposes as discussed below.

The population of case law, which provides the platform from which the case law is selected, is from impartial primary sources as at April 2016 as follows:

- Australia, i.e. Westlaw AU database
- Canada, i.e. Canadian Legal Information Institute (CanLII) database.

These sources are independent databases containing that the actual record of the judgments and include all the most relevant case law on the GAARs in Australia and Canada, thus eliminating bias in determining which cases should be available for selection.

Therefore the population is determined by identifying the cases that applied the anti-avoidance rules and excludes cases presented before the courts on other bases. Based on this criterion, 294 cases are available in Australia and 145 cases are available in Canada.

In further applying the principles of the selection of critical case law described by Creswell (2007:75) and Yin (2009:47), the following qualitative criteria are used to eliminate case law with the aim of refining the selection of cases:

- Only those cases included in the two databases that had come before Canadian and Australian courts are selected. Therefore, all those cases reported under other jurisdictions such as New Zealand are excluded from the selection in order to maintain the scope and focus of the study.
- Tax cases that reported on the anti-avoidance rules in relation to tax legislation not included in the Income Tax Assessment Act and Canadian Income Tax Act are excluded from the selection. This criterion focused on the income taxing legislation of each country.
- All those cases presented before the courts, on the basis of the revenue authority's belief that a tax benefit was present, that were not in the context of normal tax (i.e. estate duty and value-added tax) are excluded on the basis that the Commissioner may only make an adjustment in terms of section 80B of the South African GAAR for normal tax (Meyerowitz, 2008:par29-6). Therefore, case law presented before the courts on the avoidance of any tax other than normal tax is excluded in order to remain within the scope of the study.
- All case law occurring under section 260 of the Income Tax Assessment Act in Australia and section 245 of the Canadian Income Tax Act are selected, due to the nature and number of amendments made to the GAARs in each of these jurisdictions since then. Case law occurring prior to the 2012 amendments to the Australian GAAR is not excluded on the basis that the core components of the GAAR remained intact.

Applying the above qualitative elimination criteria to the cases identified in the population aids in impartially selecting cases that are critical for making comparisons between the judgment by the courts and the analysis conducted in phase 2. However, in applying the principles of purposeful maximal sampling, only those cases are selected that represent the highest level of judicial precedence (i.e. those cases appearing before the High Court of Australia and the Supreme Court of Canada). Tables 1 and 2 below reflect the cases used in phase 2 of the study.

**TABLE 1 AUSTRALIAN CASES APPLIED IN PHASE 2**

<b>Australian Case Reference</b>
<i>Commissioner of Taxation v Hart</i> (2004) HCA 26
<i>Commissioner of Taxation v Consolidated Press Holdings Ltd</i> (2001) HCA 32
<i>Commissioner of Taxation v Spotless Services Ltd</i> (1996) HCA 34
<i>Commissioner of Taxation v Peabody</i> (1994) HCA 43

**TABLE 2 CANADIAN CASES APPLIED IN PHASE 2**

<b>Canadian Case Reference</b>
<i>Lipson v. Canada</i> (2009) SCC
<i>Canada Trustco Mortgage Company v Canada</i> (2005) SCC 54
<i>Mathew v Canada</i> (2005) SCC
<i>Copthorne Holdings Ltd v The Queen</i> (2011) SCC 63

### **3.9 CONCLUSION**

In this chapter the research methodology and design applied in this study are discussed. In this qualitative interpretive study two different approaches are used in the form of doctrinal research for phase 1 and reform-oriented research for phases 2 and 3. The three-phased approach enables the achievement of the research objectives with adequate measures to increase the validity, reliability and objectivity of the study.



Phase 1 of the study is designed to include a comprehensive analysis of the literature relating to the GAARs in South Africa, Australia and Canada. This phase also facilitates the formulation of a framework used in phase 2 to apply the South African GAAR to the facts of cases in both Australia and Canada. During phase 3, results of phases 1 and 2 are used to suggest improvements to the South African GAAR. This phased approach allows the theoretical and practical analyses to contribute to the suggested improvements to the South African GAAR. The use of both a theoretical and practical analysis aids in maintaining the reliability and validity of the study.

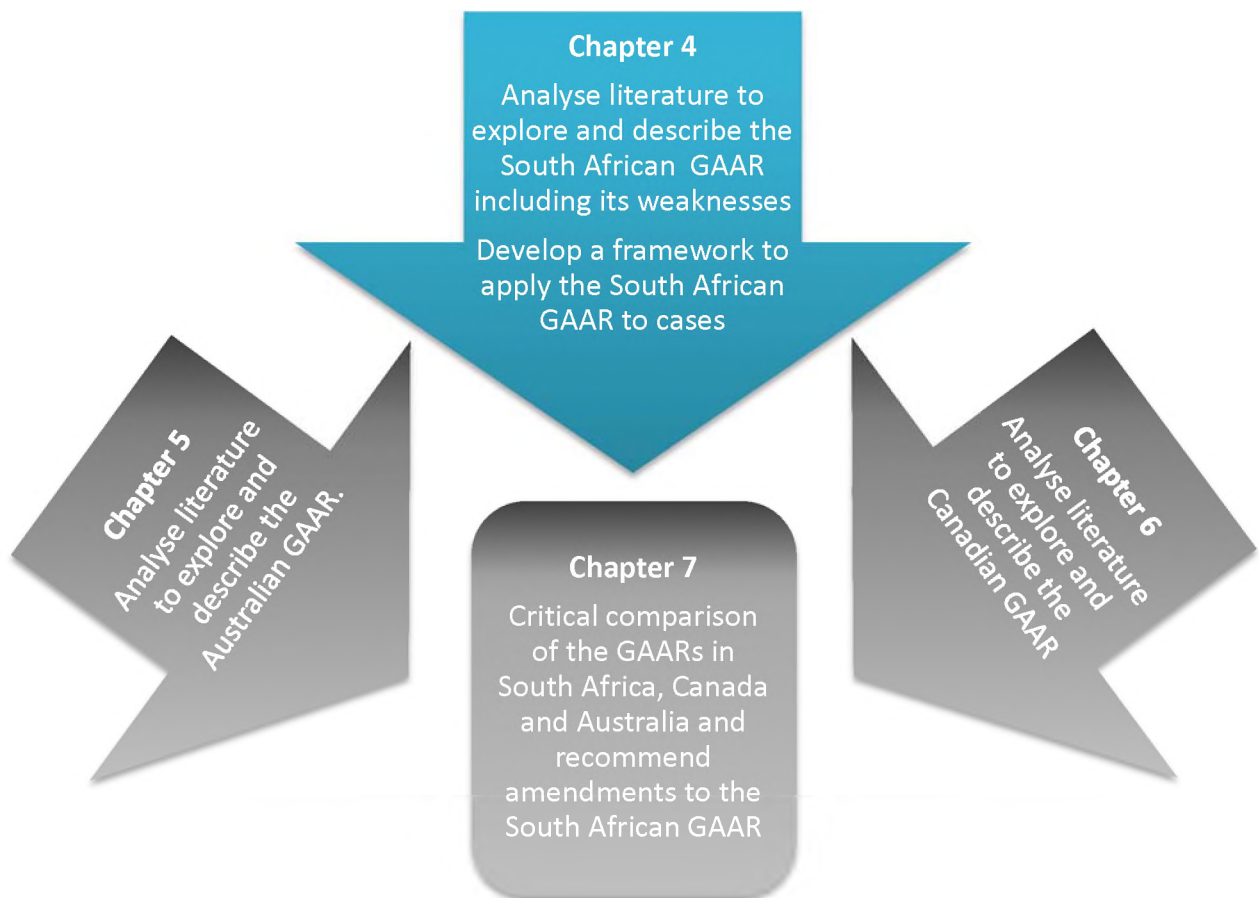
In addition, an explanation is provided in this chapter of how purposeful maximal sampling is used to select the cases for phase 2 of the study in order to achieve the research objectives. The case selection criteria allow the research to be rigorous and address concerns about the subjectivity of the study. Measures are discussed that are taken to ensure validity, reliability and objectivity of the study when considering the selection of the methodology, approach and designs used for the various phases of the study. The next four chapters form phase 1 of the study, and the remaining chapters form phases 2 and 3 of the study.

## CHAPTER 4: THE SOUTH AFRICAN GENERAL ANTI-AVOIDANCE RULE

### 4.1 INTRODUCTION

Chapter 1 provided an introduction to the GAAR in South Africa, the research question and objectives as well as the methodological approach of the study. Chapter 4 initiates phase 1 of the study, the aim of which is to explore and describe the components of the South African GAAR. This literature review is in the form of a critical analysis and provides an opportunity to analyse the components of the previous and current GAARs of South Africa. Phase 1 of the study is continued in Chapters 5 and 6 where the Canadian and Australian GAARs will be analysed. The relationship between Chapters 4, 5, 6 and 7 are represented in Figure 5 below:

FIGURE 5 PHASE 1 CHAPTER RELATIONSHIPS



Source: Own design

The first research objective is achieved in this chapter through an analysis of each component of the GAAR and identification of the primary weaknesses of the South African GAAR. Based on this analysis a framework is developed for application of the South African GAAR to the facts of the cases selected in Chapters 8 and 9. The framework is developed on the basis of the interpretive approach that is used by the judiciary to interpret legislation in South Africa, as described in Chapter 3.

## **4.2 BACKGROUND TO THE SOUTH AFRICAN GAAR**

There have been three GAARs to date in the South African tax law. The first was included in section 90 of the Income Tax Act 31 of 1941, while the second was included in section 103(1) of the Income Tax Act. The GAAR is found in its current form in sections 80A to 80L of the Income Tax Act and applies to any arrangement entered into after 2 November 2006. Though the first two GAARs have been repealed, a discussion of these is critical to gaining an understanding of their legacy with regard to the judicial interpretations of the current GAAR. This legacy arises from the fact that the current GAAR has borrowed many terms from its predecessors and when the courts seek to interpret these terms they will inevitably turn to previous interpretations for guidance (De Koker and Williams, 2015:par.19.4).

### **4.2.1 SECTION 90 AND THE ORIGINS OF THE GAAR**

Section 90 was introduced after the legislature's dissatisfaction with the judgment in *Hiddingh v Commissioner for Inland Revenue* (1941) AD 111. In this case the term "accrual" in the definition of gross income was strictly interpreted and allowed the taxpayer to reduce his tax liability by assigning income to another before accrual had occurred. The adoption of this strict interpretation method by the court therefore limited the tax base (Stewart, 1970:173). Watermeyer CJ (at 165) confirms this assertion and similarly suggests that section 90 was enacted to prevent a taxpayer from avoiding liability by means of assignment of income to others (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A)). Similarly, this interpretation approach as adopted in the *Hiddingh* case was considered a tool for eroding the tax base in the absence of a GAAR (Kujinga, 2013:63).

Section 90 of Income Tax Act, 31 of 1941, provided that:

[w]hensoever the Commissioner is satisfied that any transaction or operation has been entered into or carried out for the purpose of avoiding liability for payment of any tax imposed by this Act, or reducing the amount of any such tax, any liability for any such tax, and the amount thereof, may be determined, and the payment of the tax chargeable may be required and enforced, as if the transaction or operation had not been entered into or carried out....

The wide scope of this section did not cater for the distinction between permissible and impermissible tax avoidance as was discussed in Chapter 2. Therefore section 90 could be used to attack transactions that would be considered permissible under the current GAAR. Furthermore, section 90 did not satisfactorily specify the degree of purpose required, as it allowed the Commissioner to attack transactions where the tax avoidance purpose was not the sole or main purpose for entering into the transaction. These two weaknesses led to the conclusion that the scope of the GAAR as provided in section 90 was too wide and would lead the courts to restrict its interpretation.

In *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) these two issues were addressed by the court. The statements made in this case by Schreiner JA (at 199) substantially contributed to the development of GAAR in South Africa in its current form when he concluded that the GAAR was too broad and required an indicator of impermissible tax avoidance to be introduced in the form of an “abnormal or unnatural” transaction. Shortly thereafter section 90 was amended to include the “sole or main purpose” requirement and an “abnormality” requirement. However, the introduction of this abnormality requirement was criticised by MacDonald JP (at 557-558) in *Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA):

[i]t would be absurd to suggest that the Legislature, in attacking this evil, could possibly have intended to leave unscathed taxpayers who frankly admit that the transaction, operation or scheme had as its sole or main purpose the avoidance, postponement or reduction of tax.... if the means or the manner employed to avoid, postpone or reduce tax was a means or manner normally employed for this purpose.

These comments highlight the fact that the use of the two tests in such a manner would lead to absurd results that would not fulfil the intention of the legislature. When the new Income Tax Act (58 of 1962) was enacted, section 103(1) replaced section 90 as amended but retained the wording of its predecessor.

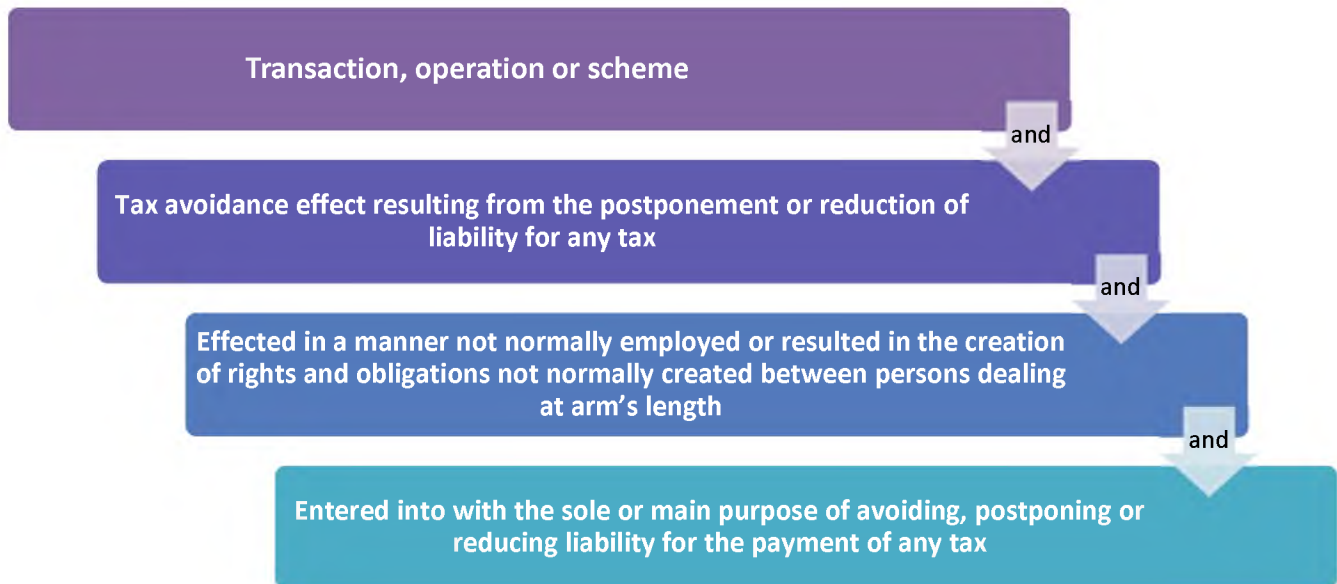
#### 4.2.2 SECTION 103(1) BEFORE THE 1996 AMENDMENTS

In terms of section 103(1), before the 1996 amendments, the Commissioner had to be satisfied that:

- the transaction, operation or scheme was initiated or effected,
- the transaction, operation or scheme had a tax avoidance effect resulting from the postponement or reduction of liability for any tax imposed by the Income Tax Act,
- and considering the circumstances under which the transaction, operation or scheme was initiated or effected, it was effected in a manner not normally employed or resulted in the creation of rights and obligations not normally created between persons dealing at arm's length,
- and was entered into with the sole or main purpose of avoiding, postponing or reducing liability for the payment of any tax imposed by the Income Tax Act.

However, where the transaction was found to have the effect of avoiding tax there was a rebuttable presumption that the transaction had a tax avoidance purpose in terms of section 103(4) of the Income Tax Act. Section 103(1) before the 1996 amendments is presented in Figure 6 below:

FIGURE 6: SECTION 103(1) BEFORE THE 1996 AMENDMENTS



Source: Own design

The abnormality requirement in section 103(1) was included without defining the term “normal”. Therefore section 103(1) placed significant reliance on judicial interpretation to provide this guidance and ultimately relied on the courts to identify impermissible tax avoidance transactions. This reliance on the courts created scope for uncertainty and introduced the possibility for inconsistent interpretations of the concept of impermissible tax avoidance where the abnormality was not blatant. The judgments in *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A) and *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A) provided guidance on the abnormality requirement, finding in favour of the taxpayer in each case. Although the findings of these two cases may indicate that there were inherent deficiencies in the abnormality requirement, there were other cases that found in favour of the revenue authority in this regard (*Commissioner for Inland Revenue v Louw* (1983) 2 All SA 291 (A), *ITC1496* (1990) 53 SATC 229 and *ITC1582* (1994) 57 SATC 27). The distinguishing feature between the cases that found in favour of the Commissioner is that the transactions were clearly contrived and abnormal. This leads to the conclusion that the abnormality requirement included in section 103(1) was only effective in a blatantly abnormal transaction and did not find application in less obviously abnormal transactions.

The inclusion of the sole or main purpose requirement was evidence that the comments made by Schreiner JA (at 198) in the *King* case were taken into consideration. However, the provision was structured in such a manner that if a transaction was seen to have the effect of avoiding, postponing or reducing liability for the payment of any tax, the onus was on the taxpayer to prove that the transaction did not have a tax avoidance purpose. Therefore, if a taxpayer could rebut the presumption of purpose, it indicated that a tax avoidance effect would not necessarily imply that the transaction had a tax avoidance motive.

In addition, the opinions expressed with regard to using the purpose requirement as a subjective or objective test were contradictory. In the *Geustyn* case a factual enquiry using an objective enquiry was advocated, whereas in *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A) a subjective approach was advocated. Notwithstanding this, the courts are not obliged to accept what the taxpayer says and may consider the objective factors surrounding the case to support or reject the taxpayer’s testimony (*Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A)). The *Gallagher* case was also significant as it identified a weakness of section 103(1), which referred to “the payment of any tax, duty or levy imposed by this Act.” This provision resulted in the Commissioner’s appeal being dismissed as

the taxpayer sought to avoid estate duty and not a tax contained in the Income Tax Act. This judgment was a significant set-back for the Commissioner as the transaction met all the requirements of the GAAR in all other respects. This case resulted in the amendment of section 103(1) soon thereafter to include any law administered by the Commissioner (Williams, 2005:570).

Two additional cases confronted the courts with another question with regard to the purpose requirement. In *Income Tax Case No 1606* (1995) 58 SATC 328, Terbutt J (at 339-340) noted that the manner in which the transaction was effected led the courts to believe that the purpose of avoiding tax had overtaken the business purpose of the transaction. This principle was also considered by the courts in *Income Tax Case No 1636* (1997) 60 SATC 267 (that was upheld on appeal in *Commissioner for Inland Revenue v Conhage (Formerly Tycon)* (1999) (4) SA 1149 (SCA)), but the court noted that it was acceptable business practice to enter into a genuine commercial transaction in a tax effective manner. The distinction between the acceptability of entering into a tax motivated transaction or entering into a transaction in a tax effective manner were not clarified by the courts and the judgments did not provide guidance on where the line between these two concepts lay.

#### **4.2.3 SECTION 103(1) AFTER THE 1996 AMENDMENTS**

Section 103(1) of the Income Tax Act was amended by section 29 of the Revenue Laws Amendment Act, 36 of 1996. These amendments were made because tax avoidance schemes had become more widespread since 1985 and to enable the Commissioner to overcome the difficulties experienced with the abnormality requirement (Margo, 1988:par.27.28; Katz, 1996:par.11.2.2; Kolitz, 1999:105; Kolitz, 2000:31). After the 1996 amendments, section 103(1) of the Act read as follows:

Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property) –

- a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or 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 transaction, operation or scheme in the context of business, in a manner which would normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit; and

bb) in the case of a transaction, operation or scheme being a transaction, operation or scheme not falling within the provisions of item (aa) by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question;  
or

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

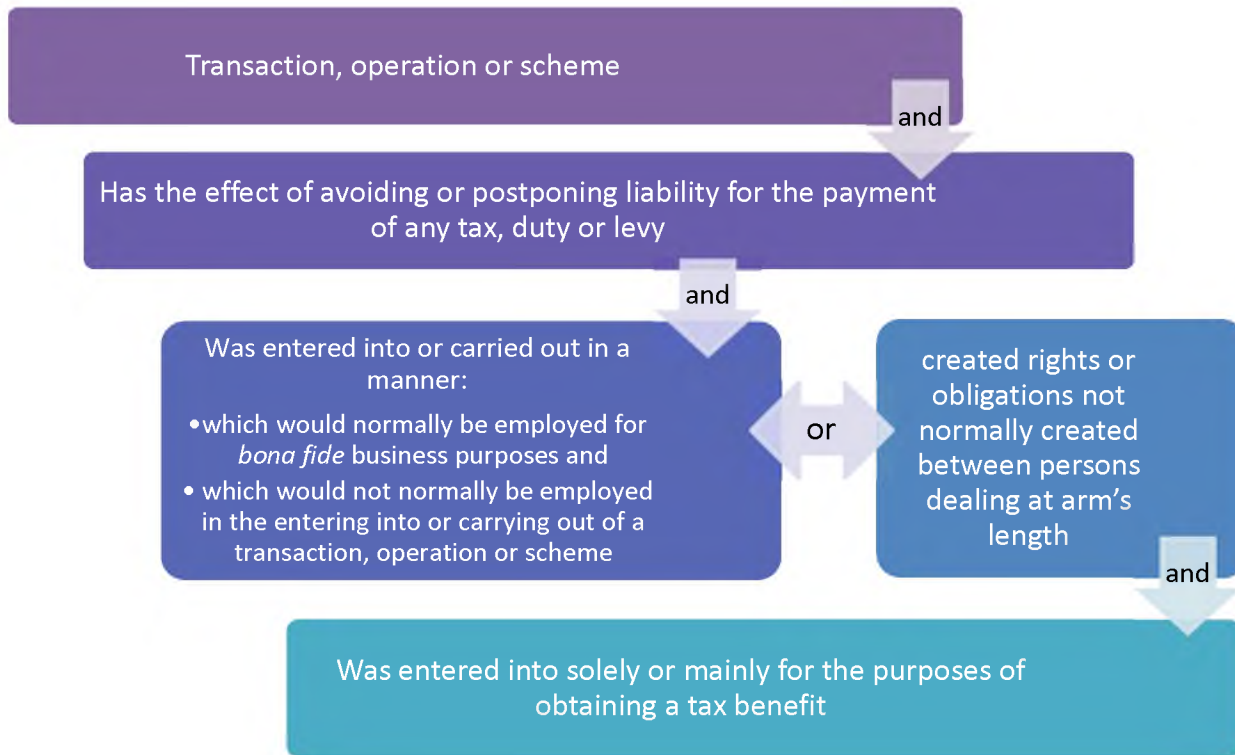
c) was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit;

the Commissioner shall determine the liability for any tax, duty or levy imposed by this Act, and the amount thereof, as if the transaction, operation or scheme had not been entered into or carried out, or in such a manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction

Section 103(1) after the 1996 amendments is represented in Figure 7 below:



FIGURE 7 SECTION 103(1) AFTER THE 1996 AMENDMENTS



Source: Own design

From this it is evident that the 1996 amendments introduced a business purpose test and focused on the manner in which the transaction was carried out as opposed to the transaction itself. The amendments did make the GAAR more effective as it made it more difficult for a taxpayer to structure a tax avoidance scheme that could withstand attack under the provisions of the amended GAAR, but identical schemes where no tax benefit was derived would be able to withstand attack (Kolitz, 2000:35).

In addition, the business purpose test also prevented a taxpayer from entering into a scheme that was entered into solely or mainly for the purpose of tax avoidance because it would not have been entered into for a *bona fide* business purpose other than to obtain a tax benefit (Kolitz, 2000:35). This also had the effect of calling the normality of the scheme into question as it could not have been entered into in a manner normally employed for *bona fide* business purposes other than to obtain a tax benefit (Kolitz, 2000:35). Notwithstanding, the abnormality requirement remained undefined in the Income Tax Act and reliance was thus placed on the interpretation provided by the courts.

In commenting on the 1996 amendments, Olivier (1997:744) noted that while the amendments were intended to clarify the legislation, they instead “created even more problems.” These concerns are summed up eloquently by Pickup (2008:14) as follows:

In brief, South Africa has had a GAAR since 1941. However by 2005 it had lost confidence in the then current text, and its ability to successfully litigate GAAR cases. Its key problem was that it was for SARS to prove that a transaction had been entered into in an abnormal manner. Since most schemes utilize techniques that were developed for *bona fide* business purposes, and have at least some purported business purpose, how was abnormality to be demonstrated? In addition, if a particular scheme is being widely used, can what is being done be described as abnormal? A second major concern was that the purpose test...was a subjective, not an objective, test. These and other technical difficulties were compounded by SARS being outgunned on the expert evidence needed for litigation, since most experts in South Africa were already committed to the taxpayer’s cause.

In light of the observations made by both Olivier and Pickup, it comes as no surprise that despite the 1996 amendment many schemes were marketed and continued to be marketed long thereafter (SARS, 2005:41). In addition to this, the 1996 amendments were never judicially considered partly due to the judgment in *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) 61 SATC 391 (referred to as “*Conhage case*”) that “effectively emasculated the legislation” (Liptak, 2008:23). In this case Hefer JA (at 393) noted that even though section 103(1) was designed to “enable the Commissioner to deal effectively with tax avoidance schemes, it operated only in the circumstances stipulated in the section itself” and the section empowered the Commissioner to “determine a taxpayer’s liability for income tax and other taxes by disregarding any abnormal transaction which the latter has entered into for the purpose of avoiding or postponing his tax liability or reducing the amount thereof.”

To summarise the application of section 103(1), the initial onus was on the Commissioner to satisfy himself that the transaction, operation or scheme was one where these provisions would apply. Until proved to the contrary, it was assumed that such transactions were entered into or carried out solely or mainly for the purpose of avoiding, postponing or reducing the amount of any tax payable. Similar to its predecessors, all four of the requirements had to be met before the Commissioner was entitled to determine the amount of tax liability as if the transaction had not been entered into or carried out. However, it was left to the courts to formulate the norms and standards by which to determine if the transaction was normal,

as no standards were defined in the legislation. Section 103(1) could only be applied to a transaction as a whole and not to individual steps in the transaction. In the judgment of *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A) this view was supported by Corbett JA (at 124) when it was held that “[t]o pick out particular features of a transaction as being not ‘normal’, is to miss the wood for the trees” (Main, 2001:30-38). This feature of section 103(1) was identified as an area of weakness that was addressed by the current GAAR. A discussion of the weaknesses of the previous GAAR is included below.

### **4.3 WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAAR**

Sections 80A to 80L of the Income Tax Act apply to any arrangement entered into after 2 November 2006 and replaced section 103(1). This amendment was introduced in order to prevent a taxpayer from receiving a tax benefit from entering into what the Income Tax Act refers to as an “impermissible avoidance arrangement” by addressing weaknesses of its predecessors. The weaknesses of the previous GAAR, referred to in Chapter 1, are discussed in more detail below in order to gain a perspective of the current GAAR.

#### **4.3.1 NOT AN EFFECTIVE DETERRENT TO TAX AVOIDANCE**

The first weakness noted in the Discussion Document released by SARS before the 2006 amendments was that the GAAR was not an effective deterrent to abusive avoidance schemes and other impermissible forms of tax avoidance. This resulted in the GAAR frequently failing to stand up to the rigours of court due to aggressive and increasingly sophisticated schemes entered into by taxpayers (Olivier, 1996:378). This had the effect that government was required to commit significant time and resources to detecting and combating these schemes. This investment of time and resources proved costly and the lengthy battles over the nature of transactions had a negative impact on the relationship between SARS and taxpayers (SARS, 2005:42). The abnormality and purpose requirements were identified as the most critical areas of weakness of the GAAR that resulted in the ineffectiveness of the previous GAAR.

After the 1996 amendments to section 103(1) Williams (1997:682) argued that the GAAR could only apply where the transaction was without any *bona fide* business purpose at all or to “highly artificial tax schemes.” This observation validates the views expressed by SARS in its Discussion Document.

Arguments have been raised that the claim that the GAAR is not an effective deterrent to impermissible tax avoidance is misleading. Broomberg (2007b:1) identified that in other jurisdictions where the case is decided in favour of the revenue authority, the GAAR allows the imposition of penalties. The author further notes that in the South African context the GAAR is not considered to be a penalty provision, but merely forces the taxpayer to pay the taxes that should have been paid if the case is decided in favour of the Commissioner. In light of this, the GAAR should act as a deterrent to impermissible tax avoidance. However, taxpayers are able to benefit from the tax benefits associated with schemes if they are not successfully attacked under the GAAR. Alternately, if the scheme is successfully attacked under the GAAR, there is no financial consequence other than possible interest levied by the Commissioner, as the taxpayer is only expected to pay tax as if the scheme had not been entered into. This is by no means a deterrent to impermissible tax avoidance as the taxpayer does not risk any significant financial loss in the form of penalties, if a scheme is successfully attacked under the GAAR, but is able to achieve financial benefits if it is not successfully attacked.

Despite the fact that the GAAR is not a penalty provision, the repealed sections 80M – 80T of the Income Tax Act established reporting rules for transactions that contained indicators of tax avoidance. Since 2011 these reporting rules are now contained in Part B of Chapter 4 of the Tax Administration Act, 28 of 2011 (referred to as the “Tax Administration Act”). The SARS Media Release (SARS, 2008:1) on new reportable arrangements (referred to as the “Media Release”) identifies that these special reporting rules would provide SARS with an early warning of arrangements that were potentially tax driven. This early warning would aid in improving response times in identifying possible impermissible avoidance arrangements. The Media Release (SARS, 2008:1) provides insight into the intention of the legislature for these special reporting rules as it is designed to link them to the indicators of lack of commercial substance (included in section 80C) of the GAAR. Notwithstanding, it specifically excludes low value arrangements or arrangements where the sole or main purpose was not to achieve the tax benefit. In terms of these reporting rules a participant may be liable to a penalty of R1 million for failure to disclose the required information or furnish information. However, should there be uncertainty or subjectivity regarding the interpretation of the indicators of lack of commercial substance or deficiencies in the interpretation of the sole or main purpose requirement the reporting rules would also be compromised. The results in the first 25 months that the legislation was in force in 2006 were disappointing, and fewer than 150 transactions, most of them involving well known hybrid instruments, were reported (SARS, 2008:1). Some taxpayers

raised technical points to avoid reporting or restructured their transactions to avoid the triggers for reporting. This indicates that it is possible that there may be uncertainties that taxpayers are able to use to their advantage, and that the penalty for not reporting may not be enough to deter taxpayers from entering into these arrangements.

#### **4.3.2 ABNORMALITY REQUIREMENT**

The abnormality requirement received considerable commentary by critics both before and after the 1996 amendment. The most prominent criticisms are those noted by the Margo and Katz Commissions (undertaken before the 1996 amendments to GAAR) where amendments to the abnormality requirement were suggested in order to make it clear that if a particular form of transaction was commercially acceptable, due to the fact that it was widely used, this did not mean that the abnormality test was passed (Margo, 1988:par27:28; Katz, 1996:par11.2.2). This was also confirmed in various cases including the *Conhage case*, *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A) and *Income Tax Case No. 1636* (1997) 60 SATC 267.

Despite the acceptance of the criticisms noted by the Margo and Katz Commissions by the legislator prior to the 1996 amendments, these criticisms remained valid after the 1996 amendments since it seemed that the “legislator did not grasp the problem” (Olivier, 1997:741). The suggestions made in the Katz Commission were that the abnormality test be amended to include a *bona fide* business purpose test, as opposed to a normality test, when the transaction, operation or scheme was undertaken in the context of business. The 1996 amendments did include the words “*bona fide* business purposes” but the word “normal” was left intact, which perpetuated the problems with the GAAR and aided in rendering the GAAR an ineffective deterrent for tax avoidance (Olivier, 1997:742; Williams, 1997:677; SARS, 2005:39; Werksmans, 2006:1). Similarly, these criticisms were noted in the Discussion Document released by SARS in 2005 almost a decade after the 1996 amendments were effected (SARS, 2005:41-44), indicating that SARS had, in fact, recognised that the 1996 amendments had not addressed the purpose that they were intended to address.

### **4.3.3 PURPOSE REQUIREMENT**

The purpose requirement also received extensive criticism, as even though there may have been a tax purpose for entering into a transaction, it would not have resulted in the transaction falling foul of GAAR if this tax purpose were not the sole or main purpose of the transaction (Brincker, 2001:163; SARS, 2005:41-44). Essentially a transaction, the main purpose of which was commercial or business related, would be sanctioned by the courts because the taxpayers were entitled to structure the transaction in the most beneficial manner, thus supporting the principles defined in *IRC v Duke of Westminster* ((1936) 19 TC 490). More recently, the judgment in the *Conhage* case confirms this approach, where it was held that a transaction entered into with a dual purpose did not fall foul of the purpose requirement if the main reason for entering into such a transaction was business or commercially oriented.

The impact of this judgment was widespread as it led tax consultants to feel vindicated “on the basis that, for as long as a transaction has a business or commercial purpose, it does not matter in what manner the transaction is in fact structured” (Brincker, 2001:165). In fact, the Discussion Document recognised that taxpayers had argued with relative ease that the raising of capital was the purpose of an arrangement, following the *Conhage* case (SARS, 2005:44). Brincker (2001:158) subsequently noted that the judgment in the *Conhage* case made it essential in tax planning to ensure that a business or commercial reason could be provided for a transaction as the first three requirements of the GAAR were often present. The impact of this is that taxpayers were able to justify a commercial purpose of a transaction with relative ease while leaving SARS in the difficult position of having to prove that the dominant purpose of the transaction would be to obtain a tax benefit and rendering GAAR an ineffective deterrent to these types of transactions (SARS, 2005:43; Werksmans, 2006:1).

### **4.3.4 ABNORMALITY AND PURPOSE REQUIREMENTS TOGETHER**

The two weaknesses discussed above with regard to the abnormality and purpose requirements are compounded when it is considered that they both needed to be present to fall foul of the GAAR at the time. SARS (2005:44) identified this problem and quoted Williams in the 2005 Discussion Document as follows:

A taxpayer could with impunity enter into a transaction with the (subjective) sole purpose of avoiding tax, provided that there was no (objective) abnormality in the means or manner or in the rights and

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

This weakness was also identified by Leach J (at 78) in the case of *Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd* (1999) 62 SATC 65:

Therefore if the scheme is not abnormal in the sense envisaged, [the GAAR] cannot apply even if such scheme has the effect of tax avoidance and this was the taxpayer’s main purpose ... Similarly, if tax avoidance is not the sole or main purpose of the taxpayer, [the GAAR] cannot be applied even if the scheme has the effect of tax avoidance and is abnormal as one of the essential requirements (viz tax avoidance being the sole or main purpose of the taxpayer) is absent.

Similarly, Broomberg and Kruger (1998:252) were of the opinion that

the taxpayer can nakedly and unashamedly confess to having applied these three requirements but then pip the Commissioner, if he can demonstrate to the Commissioner that the transaction, operation or scheme was entered in a manner that would normally be employed for *bona fide* business purposes, and it did not manifest any abnormalities in respect of the rights and obligations which were created.

Therefore the structure of the GAAR, requiring both the purpose and abnormality provisions to be present before a transaction could fall foul of the legislation, placed the taxpayer in a powerful position of being able to avoid the application of GAAR by justifying either the abnormality or purpose requirements with relative ease when planned with sufficient foresight.

#### **4.3.5 PROCEDURAL AND ADMINISTRATIVE ISSUES**

The final weakness of the GAAR as identified in the Discussion Document was described under the “procedural and administrative issues” heading (SARS, 2005:44):

- uncertainty about the extent to which GAAR could be applied to individual steps within a larger transaction; and
- uncertainty as to whether the Commissioner had authority to apply GAAR in the alternative where another provision was also in dispute.

The first uncertainty stemmed from the realisation that if a transaction in its entirety did not fall foul of GAAR, individual steps in such a transaction may have been entered into solely or mainly for the purpose of avoiding tax and in a manner that was abnormal. This realisation originated from the judgment in the *Conhage* case and effectively robbed the Commissioner of the opportunity to question an individual part of the transaction when considered from the much broader perspective of the transaction in its entirety (Olivier, 1997:736). The inclusion of section 80H of the Income Tax Act in respect of the current GAAR addresses this by providing that “the Commissioner may apply the provisions of this Part to steps in or parts of an arrangement.”

The second uncertainty was a direct result of the judgment handed down in *Income Tax Case No. 1625* (1996) 59 SATC 383, where it was held that if specific expenditure was argued to be non-deductible, the Commissioner would not be able to rely in the alternative on section 103(1), as he could not be satisfied of the presence of tax avoidance, as required by the previous GAAR regime (Louw, 2007:41). In commenting on this Calvert (2011:20) notes that

if a taxpayer was brought before the courts on the basis of the fact that an item of expenditure was thought by the Commissioner to be non-deductible, the Commissioner would not be able to apply the GAAR to this transaction on the basis of the fact that the tax benefit requirement would not be met. Therefore, the Commissioner would have to choose one argument, and proceed with that argument, and would not be entitled to use section 103(1) of the Act if that argument failed to stand up to the rigours of court.

This concern has been addressed by the insertion of section 80I of the Income Tax Act, which provides that “the Commissioner may apply the provisions of this Part in the alternative for or in addition to any other basis for raising an assessment.”

#### **4.3.6 CONCLUSION ON WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAARS**

Weaknesses of the previous South African GAARs have been highlighted since the inception of the first GAAR in 1941. Each amendment to the GAAR was intended to improve the efficacy of the GAAR, the most recent of which occurred in 2006. The weaknesses identified in the current GAAR’s predecessor were intended to be addressed by the 2006 amendments and have been discussed and analysed above. The uncertainty raised regarding the application of the GAAR to individual steps within the arrangement has



been addressed by section 80H of the current GAAR. Similarly, the uncertainty raised with regard to the use of the GAAR in the alternative has been addressed by the insertion of section 80I of the current GAAR. The main weaknesses investigated in this study are those that have received the most extensive criticism and are those mentioned in the context of the purpose and abnormality requirements. Therefore, for purposes of meeting the research objectives, this study focused on these weaknesses as the procedural and administrative uncertainties have been addressed by specific sections in the current GAAR.

#### **4.4 THE CURRENT SOUTH AFRICAN GAAR**

The weaknesses identified in the previous GAAR, as discussed above, resulted in the amendment of the GAAR in 2006. As a result of the 2006 amendments, the GAAR is now encapsulated in sections 80A to 80L of the Income Tax Act. The most pivotal provision in these sections is section 80A, which defines the term “impermissible avoidance arrangement”. The remaining provisions expand on this provision, provide for the remedies of the Commissioner and deal with related procedural and administrative aspects. Section 80A of the Income Tax Act reads as follows:

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

(a) in the context of business—

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

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

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

(c) in any context—

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

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

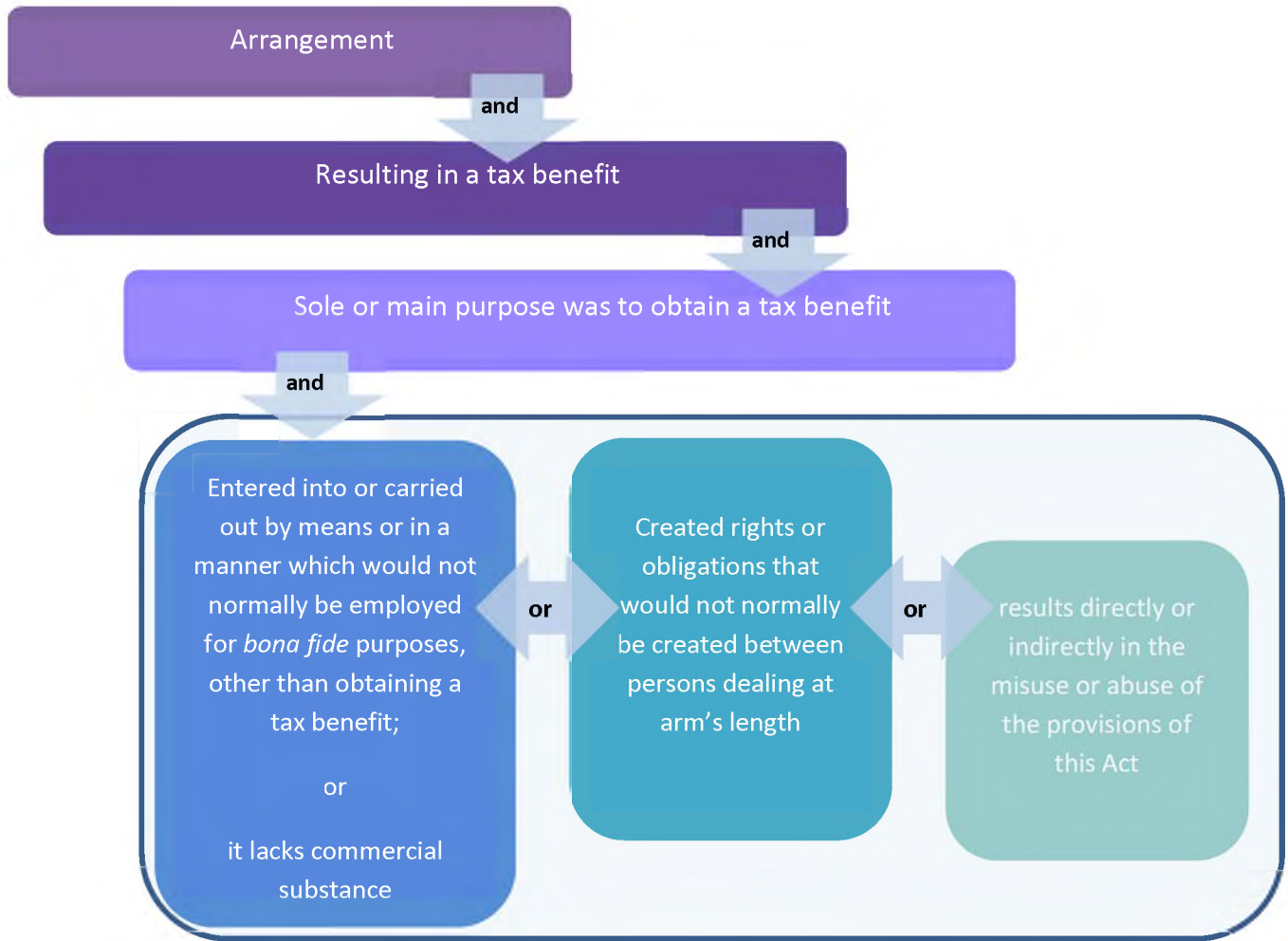
A comparison of the provisions of the GAAR to its predecessor reveals that although additional indicators have been incorporated, both the abnormality and the purpose requirements are still essentially present in the GAAR (De Koker and Williams, 2015:par.19.33). Similarly, the purpose and abnormality tests must both be satisfied before a transaction, operation or scheme is determined to fall foul of the GAAR. Section 80A contains the basic requirements of the GAAR and certain terms that are defined in the other sections constituting the GAAR (sections 80B – 80L). It can be argued that splitting the tainted elements into different contexts (section 80A(a) – (c)) is unnecessary because they all apply in both business and non-business contexts, with the exception of the commercial substance element, which is not required in a context other than business.

The main requirements of the GAAR are summarised briefly below:

- A transaction, operation or scheme must be present.
- The transaction, operation or scheme must result in a “tax benefit”.
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit.
- The arrangement must be abnormal, lacking in commercial substance, carried out in a manner not normally employed for *bona fide* business purposes, create rights and obligations not normally arising between parties dealing at arm’s length or be abusive of the provisions of the Income Tax Act.

Section 80A is represented in Figure 8 below:

FIGURE 8 SECTION 80A



Source: Own design

Each requirement of the GAAR will be discussed individually in order to create the framework that was applied when analysing the cases in phase 2 (Chapter 8) of the study.

#### 4.4.1 ARRANGEMENT AND AVOIDANCE ARRANGEMENT

The first element that must be present for the provisions of GAAR to apply is the presence of an arrangement. An arrangement is defined in section 80L of the Income Tax Act as

any transaction, operation or 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 words “transaction, operation or scheme” have been widely interpreted by the judiciary as is evident from the case of *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A) where it was held by Beyers JA (at 300) that “[t]he word ‘scheme’ is a wide term and I think that there can be little doubt that it is sufficiently wide to cover a series of transactions.” More recently, the courts have omitted any reference to a “transaction, operation or scheme” as is evident in the case of *Commissioner for Inland Revenue v Bobat and Others* (2003) 67 SATC 47. Broomberg (2007c:1) notes that the definition of an arrangement serves the purpose of identifying “precisely the transaction, operation or scheme, or to which steps or parts of a scheme, the Commissioner has applied the general anti-avoidance rule.” He also indicates that no cases have been reported where the Commissioner has failed on the basis that there was no arrangement.

The wide interpretation of these words is aligned with the purpose of GAAR, so that they can be applied to any possible transaction or scheme to avoid tax in order to advance a remedy of the Commissioner. The interpretation of the words “transaction, operation or scheme” as suggested in *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A) was used in the framework for application in phase 2 of the study.

Steps within larger arrangements are also included in the definition and would thus allow the Commissioner to apply the GAAR to individual steps within larger arrangements. This is specifically provided for in section 80H: “[t]he Commissioner may apply the provisions of this Part to steps in or parts of an arrangement.” The inclusion of this provision is intended to prevent taxpayers from inserting steps with a tax savings effect into a larger arrangement that, as a whole, has a non-tax purpose. In the past, decisions by the judiciary have been inconsistent in their determination of whether parts of a transaction could be isolated for the purpose of GAAR (Kujinga, 2013:106). In *Hicklin v Secretary for Inland Revenue* ((1980) 1 All SA 301 (A)) the court isolated part of a larger transaction when applying the GAAR, but this was not the case in *CIR v Conhage (Formerly Tycon)* (1999) (4) SA 1149 (SCA) where the court determined that the GAAR was applicable to the larger composite transaction.

It can be argued that the isolation of a step within a transaction may be considered an unfair intrusion into the taxpayer's right to avoid tax, but the Draft Comprehensive Guide to the General Anti-Avoidance Rule explains the concept as follows (SARS, 2010:25):

In this regard, section 80H clarifies that the Commissioner has the discretion to isolate the offending step or part and apply the remedies available to such step or part. Therefore, the effect of tax-driven steps or parts, which have no commercial purpose, or which are abnormal or which misuse or abuse a provision of the Income Tax Act and have been inserted into an otherwise seemingly innocent or normal arrangement may now be neutralised, without having regard to the purpose of the composite arrangement.

Based on this, the isolation of a step in a larger transaction is not decisive in the application of GAAR as it must still be characterised by one of the tainted elements. A crucial question has been raised by Broomberg (2007c:1), namely whether the Commissioner can apply the GAAR to a step or part of an arrangement if the "step or part so selected loses its commercial substance when considered in isolation." Section 80G(2) further complicates the matter because it stipulates that "[t]he purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole." Broomberg (2007c:1) holds the view that this can be used by the taxpayer to his advantage as the taxpayer would be able to gain clarity on the argument of the Commissioner when the Commissioner sets out the reasons for his attack. The impact of this provision must still be tested in court to gain further clarity.

#### **4.4.2 TAX BENEFIT**

An impermissible avoidance arrangement can only be present if the arrangement constitutes an "avoidance arrangement" as defined in section 80L of the Income Tax Act. Section 80L of the Income Tax Act defines an avoidance arrangement as "any arrangement that ... results in a tax benefit." Therefore, the presence of a tax benefit derived from the arrangement is a critical requirement regardless of the amount of tax benefit. The terms "tax" and "tax benefit" are defined in section 80L and section 1 of the Income Tax Act as follows:

- The term "tax" is defined as "any tax, levy or duty imposed by this Act or any other law administered by the Commissioner."

- Tax benefit is defined to include “any avoidance, postponement or reduction of any liability for tax.”

The term “tax” therefore includes all taxes (e.g. income tax), levies or duties (e.g. estate duty) administered by SARS. The term “tax benefit” is widely defined and could be interpreted to include any transaction undertaken by a taxpayer as part of his normal day-to-day business operations that has the effect of reducing his tax liability. However, such a wide interpretation of tax benefit could not have been the intention of the legislature. This view is supported by the words of Watermeyer CJ (at 191) in *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A), which remain valid even though specifically relating to section 90 of the Income Tax Act 31 of 1941 (De Koker and Williams, 2015:par.19.37):

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

The above view may be considered an extreme example of the absurdities that may be introduced into the GAAR if such a wide interpretation is employed. Notwithstanding this, it is clear that the remaining requirements of the GAAR have the impact of reducing such a wide application so that not all such transactions that may be included in the definition are subject to GAAR. The courts have considered the concept of tax benefit and these views can be used to interpret this term in the GAAR as follows:

- Watermeyer CJ (at 190) determined that a tax benefit only arises if a taxpayer avoids an anticipated liability for tax (*Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A)). This can be contrasted with avoiding an existing liability for tax that is a debt owed to SARS and this would

constitute tax evasion and not tax avoidance. Avoiding an anticipated liability for tax would therefore constitute tax avoidance and not tax evasion. An anticipated liability for tax may vary from an imminent, certain prospect, to a vague, remote possibility, before the liability has been determined (De Koker and Williams, 2015:par.19.37). The courts have declined to articulate where the dividing line should be drawn and this is thus open to interpretation (De Koker and Williams, 2015:par.19.37).

- Steyn CJ (at 2) interpreted this concept in the *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A) case and held that a tax benefit will arise where the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability.
- The courts have also determined that the “but for” test should be applied in determining whether a tax benefit exists. This test requires the following question to be asked: Would the taxpayer have suffered tax but for the transaction? (*Income Tax Case No. 1625* (1996) 59 SATC 383; *Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A); *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A)).

De Koker and Williams (2015:par.19.37) are of the opinion that the Commissioner would need to show what arrangement would otherwise have been entered into to produce the same commercial result and the tax consequences thereof in order to prove what tax benefit results from the arrangement entered into. The authors further note that it is not sufficient that the Commissioner simply contend that there is a tax benefit, but that the tax benefit must be quantified when compared to the alternative arrangement.

When applying the tax benefit requirement to the cases analysed in phase 2 of the study, all taxes as defined in section 80L are considered as these already reflect the intention of the legislator unambiguously. In order to establish whether an arrangement results in a tax benefit, an interpretive approach is used to apply the GAAR, which reflects the intention of the legislature as explained in paragraph 3.5 of this study. Therefore, if one considers that the purpose of GAAR is to prevent the mischief of taxpayers without leading to absurdities or anomalies and should be interpreted widely, then the term “tax benefit” must similarly be interpreted widely. In light of this, the first test included in the framework (paragraph 4.5) asks whether the taxpayer escaped or prevented an anticipated liability for tax that would have arisen from the transaction. The second test included in the framework (paragraph 4.5) applies the “but for” test.

#### 4.4.3 SOLE OR MAIN PURPOSE OF THE ARRANGEMENT

Once it has been determined that the avoidance arrangement has resulted in a tax benefit, the arrangement can only be successfully attacked by the GAAR if its sole or main purpose was to obtain the tax benefit. The wording used by the legislator in drafting this provision, namely “sole or main purpose”, is similar to that used in its predecessor. Therefore, the findings of our courts in the past should apply *mutatis mutandis* to the sole or main purpose of an arrangement in terms of the present GAAR. The difference between the sole or main purpose requirement, when compared to its predecessor, arises from section 80G of the Income Tax Act:

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

This section creates a presumption that the sole or main purpose of the arrangement is the obtaining of a tax benefit. Therefore, the mere assertion that a taxpayer’s sole or main purpose was not the avoidance of tax is insufficient to discharge this onus. A taxpayer must provide affirmative or conclusive evidence to discharge this onus that satisfies a court upon a balance of probability and “reasonably considered in light of the relevant facts and circumstances” that the obtaining of the tax benefit was not the sole or main purpose of the arrangement (De Koker and Williams, 2015:par.19.38). In this investigation, the credibility and intent of the taxpayer is arguably irrelevant and the purpose of the transaction should speak for itself (De Koker and Williams, 2015:par.19.38).

Historically, case law determined that an enquiry into the purpose of an arrangement is a subjective test, as held by Corbett JA (at 48) in *Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A). In delivering this judgment Corbett JA referred to two other cases that had also applied the test subjectively, namely *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A) and *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A). The judgment in *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A) similarly supports this subjective premise. While the case law referred to above established that the purpose requirement was a subjective test, the alternative view, which some tax practitioners and academics subscribe to, describes this as an objective test (Meyerowitz, 2008:par.29-12; De Koker and Williams, 2015:par.19.38).



Applying the sole or main purpose requirement objectively would require the effect of the arrangement to be tested rather than the intention of the taxpayer. De Koker and Williams (2015:par.19.38) hold the view that in the context of the GAAR's predecessor "it was held that the onus was discharged if the court had no reason to disbelieve the taxpayer and if his testimony was not contradicted by objective facts" (*Commissioner for Inland Revenue v Middelman* (1989) 52 SATC 323 and *Income Tax Case No 1607* (1995) 58 SATC 340). This approach provides a taxpayer with a factual, objective means to discharge the onus referred to earlier, rather than a subjective statement of his intent.

As a result of the conflicting views on an objective or subjective application of this test, which is as yet untested legislation, it is impossible to be certain about the manner in which the sole or main purpose requirement should be applied. Therefore, both the objective test (in respect of the effect of the transaction) and the subjective test (the stated intention of the taxpayer) were included in the framework applied in phase 2 of the study (paragraph 4.5). In applying this test in phase 2 it becomes of paramount importance to consider the stated intention of the taxpayer/s in each specific factual circumstance to ensure consistency. The taxpayer's stated intention is then measured against the objective effect of the factual circumstances. Arendse (2006:1) notes that an attitude has emerged that, in the absence of a plausible non-tax business purpose, the courts will most probably rule in favour of the *fiscus*. The above view is consistent with the intention of the legislator in respect of anti-avoidance legislation and the purposive approach as outlined in paragraph 3.5.

For purposes of phase 2 of the study, when applying the purpose requirement, the following principles are also considered:

- When the court applies the purpose test, it will take cognisance of the judgment in the *Conhage* case. In this case, Hefer JA (at 392) held that "a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If e.g. the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax."
- In the same case Hefer JA (at 393) also noted that the special court was correct in its earlier judgment when stating that "the agreements ... served the dual purpose of providing respondent with capital and to take advantage of the tax benefits to be derived from that type of transaction but the raising of finance was the *fons et origo* of the transactions and it remained the underlying and basic purpose thereof."

- Hefer JA (at 393) also held that “even if the particular type of transaction was chosen solely for the tax benefits, it would be wrong to ignore the fact that, had the respondent not needed capital, there would not have been any transaction at all.”

Accordingly, it is clear that the courts support the view that a taxpayer may enter into an arrangement motivated by normal commercial objectives and, in doing so, choose to structure the transaction in a manner that will attract the least amount of tax. In this instance the courts would not necessarily find that the sole or main purpose for entering into the arrangement was one of tax avoidance. This view is supported in *R Ltd and K Ltd v Commissioner of Taxes* (1983) 45 SATC 148 (ZH) and *Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd* (1999) 62 SATC 65. In applying the purpose requirement to the cases in phase 2, it is not assumed that a transaction was entered into solely or mainly to avoid tax when it also has a commercial purpose. Similarly, if one considers that the GAAR is intended to prevent the mischief of tax avoidance without leading to absurdities or anomalies, the subjective test is also considered in phase 2 of the study, but only if corroborated by the facts and circumstances (Kujinga, 2013:110). Therefore, the stated intention is tested against the objective effect of the arrangement.

#### **4.4.4 TAINTED ELEMENTS**

An avoidance arrangement must contain one or more of the so-called tainted elements in order to be subjected to GAAR. This is essentially an updated version of the previous abnormality requirement of its predecessor. The onus of proving that one of these tainted elements is present lies with the Commissioner, and sections 80C to 80E of the Income Tax Act contain guidelines and definitions that the Commissioner may rely on to discharge this onus (Meyerowitz, 2008:par.29-11; Kujinga, 2013:111). Section 80A of the Income Tax Act provides that a tainted element will be present if:

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

- In a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose other than the obtaining of a tax benefit (section 80A(b)).
- In any context:
  - it has created rights or obligations that would not normally be created between parties dealing at arm's length (section 80A(c)(i)); or
  - it would result directly or indirectly in the misuse or abuse of the provisions of the Act (section 80A(c)(ii)).

In comparing the previous abnormality requirement to its current form, it is evident that the main components that have been added are the lack of commercial substance test and the direct or indirect misuse or abuse of the Act test. Because of the similarities between the remaining tainted elements and the previous GAAR, case law relating to the remaining tainted elements remains relevant in interpreting the GAAR. The four tainted elements are discussed separately below.

#### **4.4.4.1 ABNORMALITY ELEMENT**

The previous abnormality test has been at the centre of a great deal of controversy and was highlighted in many authoritative texts, including the Margo and Katz Commissions and the Discussion Document discussed earlier (Margo, 1988:par27:28; Katz, 1996:par11.2.2; SARS, 2005:41-44). The abnormality requirement included in the predecessors to the current GAAR contained wording similar to that of the abnormality element contained in the current GAAR and the fundamental contextual components have been retained. Therefore, the precedents set by the South African courts under the much criticised abnormality requirement would remain relevant. However, the changes to this test now indicate that this abnormality requirement should be an objective test due to the absence of the words “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” (SARS, 2005:56). Kujinga (2013:112) argues that because “normal” is not defined it will be left to the courts to determine what is normal, which may lead to inconsistent judicial decisions and standards that may limit the efficacy of the GAAR. Furthermore, this highlights the fact that the legislature has failed to rectify the problems of section 103(1) as there is still no guidance on normality. De Koker and Williams (2015:par.19.39) are of the view that the *bona fide* business purpose test is the result of “poor

draftsmanship and invites confusion.” The authors submit further that this test is intended to refer to the method or means or manner in which the taxpayer has entered into the transaction and not the purpose of the arrangement.

Notwithstanding, subsection 80A(a)(i) provides that a tainted element will be present in the context of business “if it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit”. In this way it may be concluded that it may be possible for a business to have a *bona fide* purpose of reducing its tax costs, but such a tax motive cannot be used by a taxpayer as an argument to prevent the application of the GAAR. Therefore, by excluding “obtaining a tax benefit” from the abnormality requirement, the legislature has effectively recognised that this may be a *bona fide* business purpose, but that this would allow the GAAR to become self-defeating should a taxpayer use this as an argument. Therefore, it can be concluded that the GAAR recognises that the obtaining of a tax benefit may be considered a *bona fide* business purpose, but specifically excludes a tax benefit from this requirement. By excluding tax purposes from the *bona fide* business purpose it prevents a taxpayer from arguing that the manner adopted in the arrangement is normal if the tax benefits to be obtained are considered. Kujinga (2013:112) is of the opinion that this “prevents the GAAR from defeating itself, by barring taxpayers from arguing that tax benefits amount to business purpose in defence against a GAAR that seeks to deny the very same tax benefits”.

In *Income Tax Case No 1712* (2000) 63 SATC 499, Cloete J (at 501) accepted the Commissioner’s view that this test encompasses a comparison between a normal transaction entered into by a taxpayer and a transaction entered into for *bona fide* business purposes, in the absence of a tax consideration (Louw, 2007:27). When applying this abnormality element in phase 2 of the study, the arrangement was compared to a normal business transaction entered into for a consideration other than a tax benefit. This approach is consistent with the intention of the provision as it does not give rise to absurdities or anomalies. However, should the transaction be concluded in the context of business, the lack of commercial substance element must be considered, which is discussed below.

#### **4.4.4.2 LACK OF COMMERCIAL SUBSTANCE ELEMENT**

The second tainted element concerns a lack of commercial substance that applies to arrangements concluded in the context of business. This test may be considered to be an extension of the business

purpose test, which is divided into a general test (section 80C(1)) and a list of indicators (section 80C(2)). Sections 80C to 80E of the Income Tax Act provide guidance on the term “lack of commercial substance” and the general test included in section 80C(1) contemplates the lack of commercial substance element as follows:

...if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.

This subsection is also known as the “presumptive” commercial substance test and the burden of proving that an arrangement lacks commercial substance lies with the Commissioner in terms of section 82 of the Income Tax Act (now section 102 of the Tax Administration Act, 28 of 2011) (SARS, 2010:25). In discharging this onus Meyerowitz (2008:par.29-11) notes that the Commissioner will be assisted to the extent that he is able to point to the indicators contained in sections 80C to 80E of the Income Tax Act. Broomberg (2007a:9) is of the opinion that in terms of section 80C(1) an arrangement that derives a significant tax benefit may either have a significant effect upon the net cash flows or business risks, or it may not. If there are no significant effects on the net cash flows or business risks, it would be considered an impermissible avoidance arrangement. It would therefore be necessary for the economic or commercial benefits to exceed the tax benefits of the arrangement so that the arrangement would have existed without such a tax benefit (Kujinga, 2013:112). Furthermore, Broomberg (2007a:9) is of the opinion that this test is in essence the inclusion of the “economic substance doctrine” into the GAAR. This means that if there has been no significant effect upon the net cash flows or business risks resulting from the arrangement, there is no commercial reason to have entered into the arrangement except for the tax benefits. This approach is consistent with the intention of the provision and is included in the framework (paragraph 4.5) for application in phase 2 of the study.

It is not, however, evident how the courts will determine the meaning of the term “significant” in this context. The question raised by Kujinga (2013:112) is relevant when he asks:

Does it mean that an arrangement cannot be said to lack commercial substance if its tax benefit is not significant?

In commenting on the principle of significance in the context of GAAR, Clegg and Stretch (2015:par.26.3.5) are of the view that

[t]he application of this presumptive test is problematic since there is no indication of what would constitute a ‘significant’ tax benefit. Presumably the benefit must be significant in the context of the particular taxpayer’s financial affairs in general. The same difficulty applies to determining whether there is a ‘significant effect’ on business risk or net cashflow. The provision has the potential to strike down commercial arrangements where the parties have gone out of their way to hedge their commercial risks. No room exists to rebut this presumption.

Olivier, Davis and Uruquhart (2009:par.80C-2) note that it may be possible to define this term as “material” and “relevant” to a particular taxpayer. SARS (2010:26) indicates that an arrangement will lack commercial substance if there is

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

The differences in interpretation of these subjective terms that are now included in the GAAR may inevitably lead to confusion and lack of clarity regarding the provision. However, in determining if an arrangement lacks commercial substance, the Commissioner will be assisted by the indicators contained in section 80C(2) as follows:

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

- (a) the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or
- (b) the inclusion or presence of—
  - (i) round trip financing as described in section 80D; or

- (ii) an accommodating or tax indifferent party as described in section 80E; or
- (iii) elements that have the effect of offsetting or cancelling each other.

Section 80C(2) lists specific characteristics that indicate that an arrangement lacks commercial substance. In interpreting this subsection (i.e. the indicative characteristics of a lack of commercial substance) it is important to note that the list is not exhaustive and thus provides guidance but does not limit the interpretation of the term “lack of commercial substance”. In commenting on how the general test (section 80C(1)) and the list of indicators (section 80C(2)) are applied, Broomberg (2007a:16) regards them as separate tests (i.e. if the transaction fails the general test or the list of indicators, it would result in the transaction lacking in commercial substance). These provisions are therefore applied as separate tests in the framework in phase 2 of the study. As each of the listed indicators in section 80C(2) are subject to interpretation, they will be discussed separately below.

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

There is no definition in the Income Tax Act of the phrase “legal substance or effect ... is inconsistent with, or differs significantly from, the legal form”. De Koker and Williams (2015:par.19.39) are of the opinion that this indicator is “ill-considered and ill-drafted” and that “it strings together a series of terms that the GAAR does not define and the meaning of which is far from clear.” However, if the intention of the legislator is to be established, then the Explanatory Memorandum (National Treasury, 2006) and Draft Comprehensive Guide to the General Anti-Avoidance Rule (SARS, 2010) may provide guidance in this regard. The Explanatory Memorandum does not provide a detailed explanation of this term, but rather explains that this provision is intended to expand the scope of the narrow common law doctrine of substance over form and include it in the scope of the GAAR (National Treasury, 2006:64). The Draft Comprehensive Guide to the General Anti-Avoidance Rule confirms that the term “legal substance or effect” has been the subject of considerable debate and provides guidance by stating that the word “effect” includes “economic, commercial or practical effect” (SARS, 2010:par.6.4.3).

As a result of the reference to the common law doctrine of substance over form in the Explanatory Memorandum, the principles relating to the common law doctrine of substance over form must be explored. This doctrine, as enshrined by the South African courts, requires an inquiry as to whether an arrangement reflects the true intention of the parties, or whether the parties disguised the arrangement in

a legal form that is different from the real or true intention with the use of simulated or disguised transactions (Olivier, 1997:737). Olivier (1997:737) notes that this requires an inquiry into the principles relating to simulated or disguised transactions and whether an arrangement reflects the true intention of the parties or whether the parties have disguised the arrangement in a legal form that is different from the parties' real intentions. The author further concludes that the Commissioner will be able to attack a simulated transaction in terms of common law and will not be required to do so using GAAR should an arrangement not reflect the true intention of the parties. Therefore, simulated transactions will be regulated under common law and need not be regulated under GAAR. However, in *Commissioner for South African Revenue Service v NWK Ltd* (2011) 2 All SA 347 (SCA), Lewis JA (at 349) differed from this view where it was held that GAAR could be invoked as an alternative ground for assessment regardless of the presence of a genuine or simulated transaction. The common law remedies available to the Commissioner also recognise that it is not a prerequisite for a disguised transaction to have a sinister or dishonest flavour (*Conhage* case) as was confirmed in *Nedcor Bank Limited v ABSA Bank Limited* (1998) (2) SA 830 (W). While it would tend to be viewed as an exception, our courts do accept that parties in good faith may have recorded their real intentions erroneously. In such instances the courts will disregard the legal agreements that recorded rights and obligations and effect will be given to the true intention of the parties (*Relier v Commissioner for Inland Revenue* (1997) 60 SATC 1 (A); *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A); *Maize Board v Hart* (2006) JOL 16857 (SCA); *Maize Board v Jackson* (2005) JOL 15614 (SCA)).

In *Commissioner of Customs and Excise v Randles Bros & Hudson Ltd* (1941) 33 SATC 48 (AD) De Wet CJ (at 67) held that the purpose of a disguised transaction

is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be in *fraudem legis*, and is interpreted by the courts in accordance with what is found to be the real agreement or transaction between the parties.



In commenting on this Louw (2007:31) contends that the

substance over form principle should have been completed prior to considering whether the GAAR provisions are applicable or not, resulting in the GAAR to be applied to the true rights and obligations of the parties.

Therefore, it can be concluded that in the case of disguised or simulated transactions, where the true intention of the parties is not reflected in the legal form of the arrangement, these should be regulated under common law and should not be regulated under GAAR.

In determining how the substance over form principle should be applied in the context of GAAR, the intention of the legislator must be considered and the intention is to attack those transactions where the “taxpayer remains insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary” (SARS, 2005:20). Lewis JA (at 361) noted that the court should give effect to what the transaction really is and not in what form it purports to be. In doing so, the court must be satisfied that there is real intention, definitely ascertainable, which differs from the simulated intention (*Commissioner for South African Revenue Service v NWK Ltd* (2011) 2 All SA 347 (SCA)). Lewis JA (at 361) further held that

if the purpose of a transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated.

Based on the views expressed above, the test that is included in the framework for application in phase 2 of the study is to determine if the risks and rewards resulting from the arrangement are those that can be expected from such an arrangement. Furthermore, where the risks and rewards are not consistent with the legal form of the arrangement, the arrangement is considered to be simulated. This approach to applying the indicator reflects the intention of the legislator.

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

The presence of round trip financing is an indicator that an arrangement lacks commercial substance. The term “round trip financing” is defined in section 80D of the Income Tax Act as a transaction that includes

(1) ... any avoidance arrangement in which—

(a) funds are transferred between or among the parties (round tripped amounts); and

(b) the transfer of the funds would—

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

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

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

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

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

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

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

In order to determine whether an arrangement is tainted by the presence of round trip financing, the arrangement would have to meet the requirements listed in section 80D(1)(a) and 80D(1)(b) above. The first of these requirements refers to two terms, “among” and “between”, which have not been defined in the Income Tax Act. The courts would be required to interpret these terms in the context of the GAAR and are likely to do so in accordance with the ordinary and natural meaning of these words. The definition of these terms in various dictionaries is listed below:

- The Shorter Oxford English Dictionary (Trumble and Stevenson, 2002) defines these words as follows:
  - “among” is “the assemblage of, surrounded by and grouped with ... surrounded by the separate members, components or particles of”; and
  - “between” is a “reciprocal action or relation involving two or more agents individually”.

- The Collins English Dictionary (Butterfield, Summers, Holmes, Daintith, Isaacs, Law and Martin, 2003) defines these words as follows:
  - “among” is “in the midst of ... with one another within a group; by the joint action of”; and
  - “between” is “in combination; together ... indicating reciprocal relation or comparison”.
- Webster’s II New College Dictionary (Berube, Jost, Severynse and Ellis, 1995) defines the words as follows:
  - “among” is “in the group, number, or class of ... in the company of ... By the joint action of ... With one another”; and
  - “between” is “by the combined effect or effort of”.

These definitions indicate that the funds would have to be transferred between parties through some type of reciprocal action. Support for this submission is to be found in subsection 80D(2) and (3), which requires aspects of tracing, timing, sequencing, the means or manner of transfers or receipts to be ignored. This interpretation would meet the purposive approach and the intention of the legislator and is included in the framework for application in phase 2 of the study.

The second requirement requires the transfer of funds to directly or indirectly result in the tax benefit. This means that for section 80D to apply, the transfer of funds must directly or indirectly result in a tax benefit even if the tax benefit for the arrangement as a whole has already been determined. In addition, the second requirement refers to three distinct terms, specifically “reduce”, “offset” and “eliminate”. This means that the reduction, offsetting or elimination of the business risk must also be as a result of the transfer of the funds.

The concept of significant business risks as introduced in this section has not been defined in the Income Tax Act and has also not been interpreted by the courts. This once again may introduce a level of subjectivity in future cases brought before the judiciary. It is therefore necessary to interpret the term “significant” in this context:

- The Shorter Oxford English Dictionary (Trumble and Stevenson, 2002) defines significant as “important, notable; consequential.”
- The Collins English dictionary (Butterfield et al., 2003) and Webster’s II New College Dictionary (Berube et al., 1995) define the word “significant” as “momentous” or “important”.

These definitions lead to the conclusion that, in the context of section 80D, the term “significant” can be interpreted to mean a notable or large reduction of the business risks as a result of a transaction. Accordingly, if a reduction in business risk results from the transfer of funds, it must first be determined if such reduction is consequential or large before the section will apply. Business risk is an additional term that is not defined in the Income Tax Act and interpretation based on the ordinary grammatical meaning of these words is again required. The definition of these terms in various dictionaries is listed below:

- The Shorter Oxford English Dictionary (Trumble and Stevenson, 2002) defines these words as follows:
  - “business” is “a habitual occupation, a profession, a trade ... commercial transactions or engagements”; and
  - “risk” is “endanger, put at risk, expose, the chance to injury or loss”.
- The Collins English dictionary (Butterfield et al., 2003) and Webster’s II New College Dictionary (Berube et al., 1995) define these words as follows:
  - “business” is a trade or profession, an industrial, commercial, or professional operation, establishment, the occupation and work or trade in which one is engaged.
  - “risk” is the possibility of incurring harm, misfortune or loss; hazard or an element involving uncertain danger.

In the context of section 80D of the Income Tax Act, this can be interpreted to mean the possible danger or increased chance of loss. Deloach (2000:50) confirms this interpretation when defining business risk as “the level of exposure to uncertainties that the enterprise must understand and effectively manage as it executes its strategies to achieve its business objectives and create value.” Consequently, a transfer of funds (as part of an avoidance arrangement) that does not reduce the risk to a significant extent would not fall foul of section 80D of the Income Tax Act. De Koker and Williams (2015:par.19.39) add to this assertion when commenting that the intention of section 80D is to prevent a taxpayer from entering into arrangement that is not genuine by trying to conjure up a tax benefit through sleight of hand. In this case De Koker and Williams (2015:par.19.39) note that section 80D is intended to prevent a situation where “[m]oney is made to appear to pass between the participants by way of a commercial consideration, but the funds simply travel in a circle and, when all is said and done, everyone is financially in the same

position as they were in the beginning, save for the creation of a tax benefit and the payment of fees to the intermediaries.” It is submitted that this interpretation reflects the intention of the legislator.

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

The third characteristic identified by section 80C(2) that indicates a lack of commercial substance is the inclusion or presence of an “accommodating or tax-indifferent party” as defined in section 80E of the Income Tax Act. The reason for the inclusion of this indicator was provided by SARS in its Discussion Document when it was explained that tax-indifferent parties are often used in avoidance arrangements by design to work to disable and defeat the balance between tax deductibility in the hands of one party and taxable income in the hands of another (SARS, 2005:21). The reference to tax-indifferent parties in the GAAR is thus intended to prevent the use of these tax-indifferent parties in tax avoidance schemes.

When describing tax-indifferent parties SARS (2005:21) contends that they are often aptly referred to as “washing machines”. This describes the roles that these parties fulfil in avoidance arrangements as they “typically receive a fee (often in the form of an above-market return on investment) for the service of absorbing income or otherwise selling their tax-advantaged status to the other participants in the scheme” (SARS, 2005:21). It is therefore clear that the description of the term “tax-indifferent party” in this context would reflect the intention of the legislator and be in line with the method of interpretation adopted for purposes of this study, which complies with the purposive approach to interpretation. The characteristics of an accommodating or tax-indifferent party are defined in section 80E(1) of the Income Tax Act as follows:

A party to an avoidance arrangement is an accommodating or tax-indifferent party if—

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

(i) not subject to normal tax; or

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

(b) either—

(i) as a direct or indirect result of the participation of that party an amount that would have—

(aa) been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts or accruals of a capital nature of that party; or

(bb) constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party; or

(cc) constituted revenue in the hands of another party would be treated as capital by that other party; or

(dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or

(ii) the participation of that party directly or indirectly involves a prepayment by any other party

As can be seen from the sub-section above, the term “tax-indifferent party” is widely defined and does not include the words “are not limited to” as in section 80C when listing indicators for the term “lack of commercial substance”. De Koker and Williams (2015:par.19.39) contend that this list is exhaustive. Section 80E(2) contributes to the understanding of accommodating or tax-indifferent parties by providing that the tax-indifferent or accommodating party is not required to be a party who is a connected person in relation to any party of the arrangement. In essence, those parties who sell their tax advantages to others are included in the definition of a tax-indifferent party, regardless of their relationships with any of the contracting parties. Despite this widely defined term, section 80E(3) of the Income Tax Act specifically excludes certain parties from being classified as a tax-indifferent party. De Koker and Williams (2015:19.39) refer to this as the “safe harbour” provisions. Section 80E(3) of the Income Tax Act specifically excludes the provisions of the section if either

(a) the amounts derived by the party in question are cumulatively subject to income tax by one or more spheres of government of countries other than the Republic which is equal to at least two-thirds

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

(b) the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months: Provided these activities must be attributable to a place of business, place, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment as defined in section 9D (1) if it were located outside the Republic and the party in question were a controlled foreign company.

Section 80E is not ambiguous and the ordinary meaning of the words of the section adequately reflects the intention of the legislator.

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

Section 80C(2)(b)(iii) of the Income Tax Act provides the GAAR with the fourth indicator of the lack of commercial substance. This section refers to the presence of elements in an arrangement that have the effect of offsetting or cancelling each other. This element was introduced because the presence of this factor indicates that the arrangement or part thereof has no fiscal consequence and becomes of consequence only if the arrangement in question had a sole or main purpose of obtaining a tax benefit (De Koker and Williams, 2015:par.19.39). It can be said that the presence of offsetting or cancelling elements indicates that these elements are contrived. Section 80C(2)(b)(iii) is not ambiguous and its interpretation may then be based on the ordinary meaning of the words of the section. However, the size of the offsetting or cancelling elements is not specified in the Income Tax Act and De Koker and Williams (2015:par.19.39) are of the view that the presence of this indicator need not be expressed in monetary terms, but could be rights or obligations that have the effect of offsetting or cancelling each other. The authors refer to this as a “self-neutralising mechanism” that draws upon precedent in the United Kingdom that gave rise to the so-called fiscal nullity doctrine (discussed earlier in paragraph 2.7). It is therefore evident that this indicator is aligned with the purpose of GAAR, in that it has been interpreted to prevent the mischief achieved by tainting a transaction where cancelling or offsetting has occurred and no change exists other than that of a tax benefit.

#### **4.4.4.3 CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH ELEMENT**

The non-arm's-length rights and obligations provision is the third tainting element of GAAR. This element has been retained from the predecessor of the present GAAR and when interpreting this element, it is again possible to use the interpretation by the judiciary from earlier decided cases. Trollip JA (at 16) interpreted this provision in *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A), when he stated that the term "between persons dealing at arm's length" connotes that "each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself." Trollip JA (at 16) and Thomson CJ (at 120) further interpreted the term "arm's length" in the context of rights and obligations as what unconnected persons would have done in the same situation (*Geustyn case; Hicklin case supra*). The method for interpreting this subsection reflects the intention of the legislator and is included in the framework for application in phase 2 of the study.

It can therefore be concluded that if the parties to a transaction were independent of each other and the transaction was designed to be at market value (i.e. supply and demand), it would be indicative that the parties had transacted at arm's length. This subsection is not ambiguous, and interpretation based on the ordinary meaning of the words is used in the framework for application in phase 2 of the study.

Notwithstanding the method of interpretation and the maintenance of the arm's length principle in its previous form, it is important to note that the test must be applied using objective means as opposed to subjective means (SARS, 2010:par.6.2). This objective stance is a result of the removal of the reference to the circumstances under which the transaction was entered into. This change from subjective to objective was introduced in order to address the weaknesses of the abnormality requirement discussed in paragraph 4.3.2. The Draft Comprehensive Guide to the General Anti-Avoidance Rule confirms that the test is objective in light of the removal of the words "under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question", but it also notes that "the surrounding circumstances" will nonetheless be considered in determining the normality of the arrangement. This has introduced uncertainty into the interpretation of this subsection as the surrounding circumstances cannot be considered if the test is objective. This conflicting assertion leads one to believe that the principles laid down in the case of *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A) remain relevant where Corbett JA (at 131) noted that



[i]n such a case should the court, in applying the ‘normality’ yardstick, take account of the special relationship between the erstwhile partners and the company which they have formed, or ignore it and apply the yardstick as though the company were a stranger?

When applying the arm’s length element to the facts of cases analysed in phase 2 of the study, the test of whether unconnected persons would have done the same in this situation is applied. This test reflects the intention of the legislator unambiguously. However, where a special relationship between the parties does exist, the context of this relationship must be considered in order to interpret the GAAR widely and to suppress the mischief, without leading to absurdities or anomalies (De Koker and Williams, 2015:par.19.39).

#### **4.4.4.4 MISUSE OR ABUSE OF THE ACT ELEMENT**

The “misuse or abuse” element was not present in either of the predecessors of the present GAAR, section 90 or section 103(1), and has also not been defined in the Income Tax Act. Due to the lack of guidance on interpreting this element, it would need to be interpreted in terms of the ordinary and natural meaning of these words.

- The Shorter Oxford English Dictionary (Trumble and Stevenson, 2002) defines these words as follows:
  - “misuse” is “Use (something) in the wrong way or for the wrong purpose”; and
  - “abuse” is “Use (something) to bad effect or for a bad purpose; misuse”.

These definitions indicate that both these terms have similar meanings. Cilliers (2008:87) concurs with this view and notes further:

- It is doubtful whether these words have materially different meanings.
- In using both these words the legislature probably acted *ex abundanti cautela* (used an abundance of caution).
- It would seem that when interpreting this element, one would need to disregard the presumption that each and every word in a statutory provision must be given an independent meaning and effect.
- Further the legislature did not wish to denote two distinct concepts, but tried to ensure that the concept being expressed was clearly understood.

While the use of both these words in the GAAR may be seen to be redundant, there are other debates regarding the intention of the legislature in inserting this provision. De Koker and Williams (2015:par.19.39) assert that this element was inserted into the GAAR in order to provide SARS with a last-resort argument where none of the other criteria for an impermissible avoidance arrangement can be shown to apply. The authors also contend that the structure of the GAAR is such that even if such a misuse or abuse is established, it has no fiscal consequences unless the arrangement itself had a sole or main purpose of obtaining a tax benefit. This argument then leads to the conclusion that this, in itself, introduces an anomaly into the GAAR, as any misuse or abuse of the Income Tax Act should not be tolerated, irrespective of the purpose of the arrangement.

The introduction of this element has also been the topic of extensive controversial debate because the test was designed to bring the GAAR into line with international standards and practice, with specific reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Despite these intentions, guidance with regard to the application of this element is lacking. De Koker and Williams (2015:par.19.39) contend that there are many unanswered questions that may be raised with regard to this element including:

- What are the criteria that determine the legitimate ‘use’ of the provisions of the Income Tax Act by a taxpayer?
- If a provision of the Act is on the statute book, surely it is there to be ‘used’?
- If a taxpayer’s actions are within the scope of a provision of the Act, in what sense could those actions ever be an ‘abuse’ or ‘misuse’ of the kind that s 80A(c)(ii) seems to contemplate?
- Or does the intent of an Act extend beyond its language?
- Does the inquiry into the ‘abuse’ or ‘misuse’ of the Act turn on the subjective intent of the taxpayer or is it (like the test for a sole or main purpose in the opening words of s 80A) a purely objective test?

These relevant questions lead one to believe that the interpretation of this element by the judiciary may be problematic when brought before the courts. One source for explaining this element is the Final Report of the Review of Business Taxation in Australia, which describes it as

the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of the law and a focus on form and legal effect rather than substance (Australia., 1999:par.6.2c).

This explanation may not provide a full interpretation of the element in the South African context, but McLachlin CJ and Major J (at 62) provide the context of a similar provision in the Canadian legislation in the Canadian case of *Canada Trustco Mortgage Company v Canada* (2005) SCC 54:

The GAAR may be applied to deny a tax benefit only after it is determined that it was not reasonable to consider the tax benefit to be within the object, spirit or purpose of the provisions relied upon by the taxpayer ... [T]his means that a finding of abuse is only warranted where the opposite conclusion – that the avoidance transaction was consistent with the object, spirit or purpose of the provisions of the Act that are relied on by the taxpayer – cannot be reasonably entertained. In other words, the abusive nature of the transaction must be clear. The GAAR will not apply to deny a tax benefit where it may reasonably be considered that the transactions were carried out in a manner consistent with the object, spirit or purpose of the provisions of the Act, as interpreted textually, contextually and purposively.

It is therefore relevant to note that the primary difference between the South African and Canadian misuse and abuse element is that in Canada this element is stated in the negative by providing that the GAAR would not apply where the transaction would not result in a misuse or abuse of the provisions of the legislation. In analysing the Canadian counterpart, the Supreme Court of Canada has indicated that the words “misuse or abuse” imply frustrating or exploiting the purpose of the legislation relied on by the taxpayer (van Schalkwyk and Geldenhuys, 2009:19). This interpretation in a South African context is thus synonymous with the phrase “frustrate the purpose of any provision” (van Schalkwyk and Geldenhuys, 2009:19). The intention of the legislation in each case must thus be understood to determine whether the purpose of the arrangement was to exploit, frustrate or manipulate the legislation on which the taxpayer relied, in order to achieve a result not intended by the legislator. This approach considers the intention of the legislator and is included in the framework developed for application in phase 2 of the study.

#### 4.5 FRAMEWORK FOR APPLYING THE SOUTH AFRICAN GAAR

Each of the requirements of the GAAR have been analysed in the preceding paragraphs and each of these requirements has been included in a framework. This framework, set out below, is used to apply the South African GAAR to the facts from the cases selected in phase 2.

TABLE 3 FRAMEWORK FOR SOUTH AFRICAN GAAR

**Table 3: Framework for applying sections 80A – 80L to the facts of previous case law**

##### **1 - Is there an arrangement?**

- Is there a transaction, operation or scheme that has been entered into by the taxpayer? This will be widely interpreted in terms of section 80L of the Act and the *Meyerowitz* case.

##### **2 - Does the transaction/operation/scheme result in a tax benefit?**

The definition of tax in section 80L is applied to the cases.

- Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability? (*Smith* case; *King* case)
- Would a tax liability have existed but for this transaction (the but for test)? (*Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case and *Louw* case)

##### **3 - Is the sole or main purpose to obtain such tax benefit?**

In applying the sole or main purpose requirement of the GAAR to the facts and circumstances of the case studies, the following factors are considered:

- Subjective test – Is it the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (*Gallagher* case)
- Objective test – Does the actual effect of the arrangement support the stated non-tax benefit intention of the arrangement? (*Meyerowitz* (2008:par.19-12); *De Koker* and *Williams* (2015:par.19.38) and *Ovenstone* case)

In applying the objective and subjective tests, the following principles may be considered:

- If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement to obtain the tax benefit? (*Conhage* case); or
- If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, this does not indicate that obtaining a tax benefit was the sole or main purpose of the arrangement (*Conhage* case); or
- If the dominant subjective purpose of the avoidance arrangement was to achieve some non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (i.e. determine what was in the mind of the taxpayer who entered into the transaction).

#### 4 - Tainted elements requirement

- One of the following with regard to business transactions:

- *Entered into in a manner not normal for bona fide business purposes?*

- Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration? (Louw, 2007:27)

- *Does the transaction lack commercial substance?*

In order to determine whether an arrangement lacks commercial substance, the following are applied:

- *General lack of commercial substance test*: Does the arrangement have no significant effect upon the net cash flows or business risks? (Section 80C definition and Broomberg, 2007:9)
- *Substance over form test*: Is the true intention of the parties reflected in the agreement (i.e. are the risks and rewards resulting from the transaction those that can be expected from such a transaction)? Has the taxpayer remained insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary? Or is the purpose of a transaction only to achieve an object that achieves the avoidance of tax? (Then it will be

regarded as simulated and the mere fact that parties do perform in terms of the contract does not show that it is not simulated.)

- *Round trip financing test*: Has funding been transferred between parties, through some type of reciprocal action, resulting directly or indirectly in a tax benefit?
- *Tax-indifferent party test*: Is there a party who effectively transferred its tax advantage to others, irrespective of its relationship with any of the contracting parties?
- *Offsetting or cancelling test*: Are there elements within the transaction that have the effect of offsetting or cancelling each other? (This indicates that such parts of the transaction were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance.)

**- The following with regard to transactions not in the context of business:**

**- *Has the arrangement been entered into in a manner not normal for bona fide purposes?***

- Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration? (Louw, 2007:27)

**- One of the following with regard to transactions in any context:**

**- *Has the arrangement created rights and obligations that are not at arm's length?***

The non-arm's-length rights or obligations element will not be met if one of the following factors is present:

- Each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves? (*Hicklin* case)
  - Unconnected persons would not have done the same in this situation? (*Hicklin* case)
- *Is there misuse or abuse of provisions of the Act?***
- Does the arrangement frustrate, exploit or manipulate the purpose of any of the provisions of the Act, or does the arrangement use provisions of the Act to achieve a result not intended by the legislator?

## **4.6 CONCLUSION**

This chapter analysed the components of the South African GAAR. The primary weaknesses of the GAAR were identified as the purpose and abnormality requirements. The purpose requirement was identified as a primary weakness due to the fact that a taxpayer is able to justify a commercial purpose of an arrangement with relative ease. Similarly, the abnormality requirement was identified as a primary weakness because, if a particular form of an arrangement was commercially acceptable due to its wide use, this does not mean that the abnormality test is passed. A further weakness was identified with reference to the fact that both of these tests must be used in conjunction with each other. This places the taxpayer in the powerful position of being able to avoid the application of GAAR by justifying either the abnormality or purpose requirements with relative ease when planned with sufficient foresight.

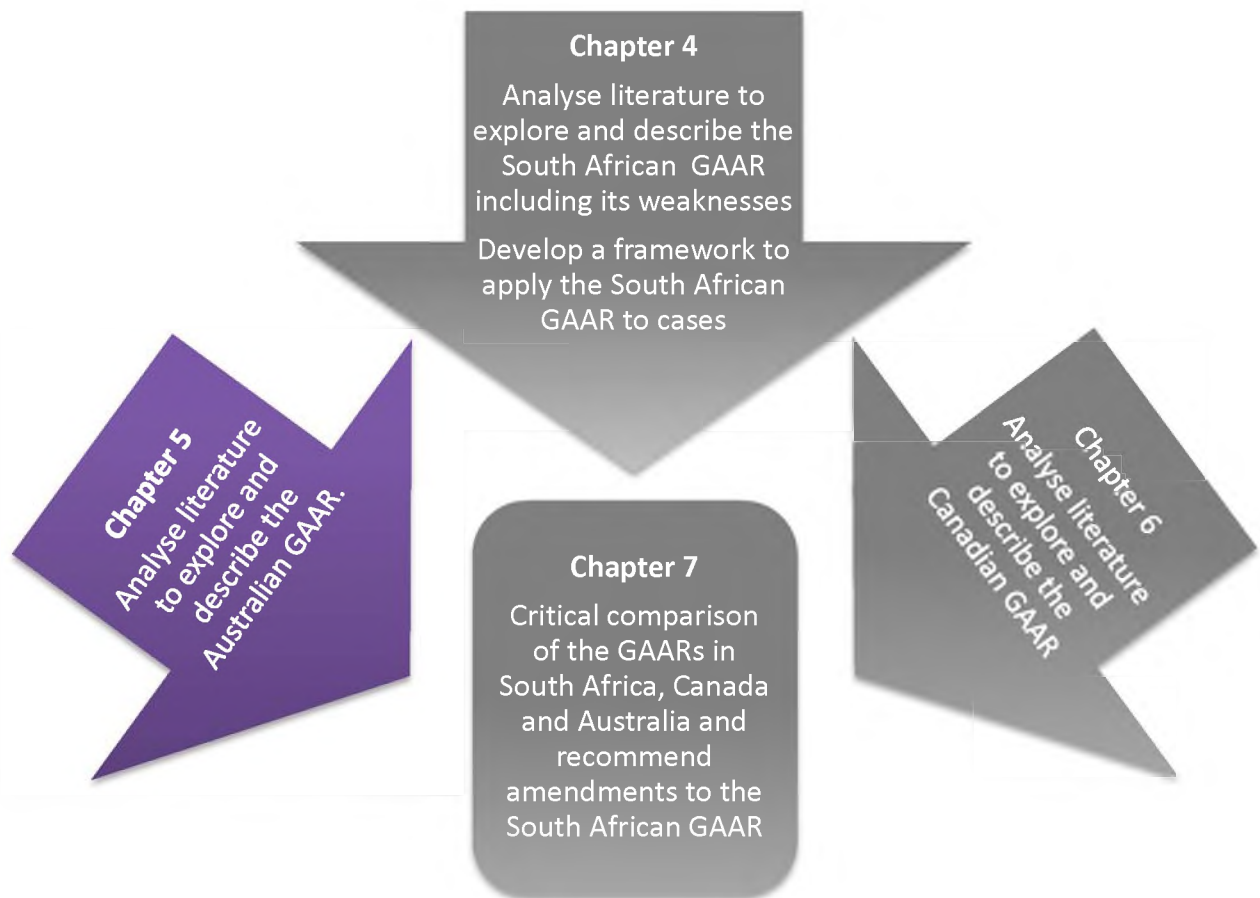
Each element of the South African GAAR was discussed with reference to case decisions, the views of commentators and views from other countries. This discussion culminated in the development of a framework for applying the GAAR to facts of cases. The analysis reported on in phase 2 applies this framework to the facts of cases selected from Australia and Canada. In the following two chapters the Canadian and Australian GAARs are analysed for the purpose of comparison to their South African counterpart.

## CHAPTER 5: THE AUSTRALIAN GENERAL ANTI-AVOIDANCE RULE

### 5.1 INTRODUCTION

Chapter 4 initiated phase 1 of the study, which comprised a review of the GAAR in South Africa and concluded with a framework with which to apply the South African GAAR to selected cases heard in Australia and Canada. This chapter continues phase 1 of the study with a review of the Australian GAAR. The relationship between Chapters 4, 5, 6 and 7 is represented in Figure 9 below:

FIGURE 9 PHASE 1 CHAPTER RELATIONSHIPS



Source: Own design

In this chapter the components of the Australian GAAR are described and critically analysed. This provides an opportunity to examine in detail the components of the Australian GAAR. This includes an analysis of how the Australian GAAR is interpreted and the implications of this when cases are brought



before the courts. The remainder of phase 1 of the study is continued in Chapters 6 and 7, where the Canadian GAAR is analysed and a critical comparison is made of the GAARs in the three jurisdictions. The comparative analysis of these jurisdictions in Chapter 7 is integrated into Chapter 10.

This chapter will contribute to achieving research objectives 2 and 3 by identifying which aspects of the Australian GAAR could be included in its South African counterpart to improve its effectiveness.

## **5.2 BACKGROUND TO THE AUSTRALIAN GAAR**

GAAR has had a long history in Australia, starting with section 53 of the Commonwealth Income Tax Act of 1915 (Brown, 2012:37). Later it reappeared in a similar form in section 260 of the Income Tax Assessment Act of 1936 (referred to as the Income Tax Assessment Act) when first enacted. In 1981 the GAAR underwent a redraft and reappeared in Part IVA of the Income Tax Assessment Act.

More recently the GAAR was significantly reformed in 2013 in order to remove certain structural flaws that had been brought to light in recent court decisions where the Commissioner had not succeeded (Dabner, 2013:1; Payne, 2013:1). In order to gain a thorough understanding of the current GAAR in Australia, it is necessary to understand its history and the efficacy of its predecessors so that this historical knowledge may provide an understanding of the impact on the current GAAR.

Historically, section 260 of the Income Tax Assessment Act voided any contract, agreement or arrangement that had the effect (directly or indirectly) of:

- a) altering the incidence of any income tax;
- b) relieving any person from liability to pay any income tax or to make any return;
- c) defeating, evading or avoiding any duty or liability imposed on any person by the Income Tax Assessment Act; or
- d) preventing the operation of the Act in any respect.

This rule was wide in its application and, unlike its present South African counterpart, it did not draw a line between permissible and impermissible tax avoidance. In fact, the rule only required that the transaction have a tax avoidance effect, regardless of any *bona fide* purpose of the transaction. Therefore any avoidance transaction could be attacked under this rule. The courts recognised the effect of this literal

interpretation. A similar wide interpretation was found in its predecessor, section 53 of the Commonwealth Income Tax Act of 1915, and in the case of the *DFC of T v Purcell* (1921) 29 CLR 464, Knox CJ (at 466) concluded that:

[t]he section, if construed literally, would extend to every transaction whether voluntary or for value which had the effect of reducing the income of any taxpayer; but, in my opinion, its provisions are intended to and do extend to cover cases in which the transaction in question, if recognised as valid, would enable the taxpayer to avoid payment of income tax on what is in truth *his* income. It does not extend to the case of a *bona fide* disposition by virtue of which the right to receive income arising from a source which theretofore belonged to the taxpayer is transferred to and vested in some other person. The section is intended to protect the revenue against any attempted evasions of the liability to income tax imposed by the Act...and the *bona fide* gift or sale by a taxpayer of assets producing income is therefore in no sense an attempt to evade his liability to income tax (Barkoczy, 2010:886).

Therefore, the court was left to decipher the true intent of the provision in order to curtail its width and application. In light of the fact that the provisions of section 53 reappeared in section 260 without amendment, the opinion of the High Court with regard to section 53 would similarly apply to section 260. When commenting on the wide application of section 260, the courts attempted to give the section proper meaning and limit its scope with the use of the predication test (Kujinga, 2013:138).

### ***The predication test***

The predication test was promoted by the Privy Council in *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1 where their Lordships (at 8) held that:

In order to bring the arrangement within the section you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section. Thus, no one, by looking at a transfer of shares cum dividend, can predicate that the transfer was made to avoid tax. Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Div 7 tax...

In light of this judgment it is submitted that the predication test must be applied before a transaction can be struck down by the section. Therefore, it should be possible to predict that the manner in which the transaction was implemented was one that avoided tax, without consideration of the motives of the individuals. This required an objective test with regard to the transaction. This test allowed taxpayers to arrange their affairs in a manner that was considered to be a normal business method, which attracted less tax, without the risk of being struck down by the GAAR.

Following this judgment, the predication test was considered in numerous cases including *Peate v Federal Commissioner of Taxation* (1963) ALR 354, and *Hancock v Federal Commissioner of Taxation* (1959) 7 AITR 582. In the former case Kitto J (at 469) noted as follows:

But the question remains, whether the overt acts that were done under the plan are fairly explicable without an inference being drawn that tax avoidance is a purpose of the arrangement as a whole.

This stopped any commercial objectives or family dealings from preventing the application of section 260. Similarly, in the latter case the predication test was objectively applied and Dixon CJ (at 279) noted that:

[i]t is sufficient that by steps the parties reached and carried out the arrangement and that it answered a description covered by s 260.

The results of these cases effectively supported the view that the section was too widely defined, and any transaction attacked under the section should be objectively tested in order to prevent absurdities from being introduced into its application. However, the courts did not introduce the predication test in isolation. They also considered that section 260 was too wide and that a taxpayer should be allowed to take advantage of tax incentives without the transaction being struck down by the GAAR. This limitation on the GAAR was known as the “choice doctrine”.

### ***The choice doctrine***

The choice doctrine was promoted by the *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66 case, where Dixon CJ, McTiernan, Kitto J and Taylor J (at 68) held that:

[w]hatever difficulties there may be in interpreting s.260, one thing at least is clear: the section intends only to protect the general provisions of the Assessment Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them. The very

purpose or policy of Div 7 of Pt. III of the Assessment Act is to present the choice to a company between incurring the liability it provides and taking measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat, evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act, the choice being one which the Act contemplates and allows.

This choice doctrine had the effect of preventing certain transactions that took advantage of legitimate tax incentives from being attacked under the GAAR. However, the establishment of the choice doctrine, and subsequent application of the doctrine in other cases, led to taxpayers creating transactions solely for the purpose of using tax incentives, as was found in the case of *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290, where Barwick CJ (at 298) noted that:

[t]he Court has made it quite plain in several decisions that a taxpayer is entitled to create a situation to which the Act attaches taxation advantages for the taxpayer. Equally, the taxpayer may cast a transaction into which he intends to enter in a form which is financially advantageous to him under the Act.

In light of the above, the taxpayer was able to create transactions that were not connected to the ordinary business of the taxpayer, in order to take advantage of the deduction. But the transaction was not struck down by the GAAR due to the statement made by Barwick CJ above. Kujinga (2013:141) submits that this statement weakened the scope of section 260 by substantially widening the scope of the choice doctrine, as taxpayers could now “create” conditions that were required to exist before a tax incentive was exploited. Following the judgment in *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290, the cases of *Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314, and *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330, applied this principle even though they acknowledged that the transactions in some cases were not aligned with the taxpayer’s business. Kujinga (2013:143) asserts that the expansion of the choice doctrine in these cases led to the demise of section 260 and the introduction of impermissible transactions in terms of Part IVA of the Income Tax Assessment Act. In addition to the choice doctrine, *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290 also introduced another doctrine called the “antecedent transactions” doctrine.

### *The antecedent transactions doctrine*

The antecedent transactions doctrine allowed the application of the GAAR, where a transaction was initially subjected to taxation, but was subsequently altered by the taxpayer in order to avoid the tax. Therefore, if a taxpayer did not adequately consider the tax implications resulting from a transaction before initiating the transaction, and subsequently changed course to avoid the tax, the transaction could be subjected to section 260.

#### **5.2.1 THE DEMISE OF SECTION 260 OF THE INCOME TAX ASSESSMENT ACT**

The demise of section 260 was arguably a result of the limitations on its application imposed by the courts in the creation of the predication test, antecedent doctrine and choice doctrine. The creation of these doctrines arose because of the uncertainty of section 260 due to its wide application. Arguably the section was drafted in a manner that allowed wide application, but the consequence of this was the ultimate erosion of the effectiveness of the GAAR due to the limitations imposed upon it by the courts for the purpose of creating certainty for taxpayers. In commenting on the concept of certainty, Lehmann (1983:115) was of the opinion that the section was superficially attractive but:

fails to take into account the numerous basic issues of income tax law which cannot be defined with unambiguous clarity.

This view was supported by Dixon CJ (at 333) in the case of *Federal Commissioner of Taxation v Hancock* (1961) AITR 328, when he described the inexhaustible resourcefulness of ingenious minds to avoid revenue laws. Despite these views, there was no widespread judicial acceptance of the wide application of section 260. In fact, the main response from the judiciary was one of limiting the section in order to create certainty. This was certainly not the vision that was adopted by the legislature in drafting the legislation, but supports the contention that a broad GAAR is likely to invite restrictive interpretation by the courts (Kujinga, 2013:146).

#### **5.2.2 THE INTRODUCTION OF PART IVA OF THE INCOME TAX ASSESSMENT ACT**

The problems experienced with section 260 resulted in the introduction of section 177A – G (Part IVA) into the Income Tax Assessment Act by the Income Tax Laws Amendment Act No. 2 of 1981. This

amendment removed section 260 and made section 177A – G applicable to transactions entered into after 27 May 1981. In commenting on the change in legislation, Stephenson (1997:1) notes that Part IVA was introduced to overcome the limitations of section 260 of the Income Tax Assessment Act, by striking down “blatant”, “artificial” or “contrived” arrangements (Treasury: Australian Government, 1981a:9552). Stephenson (1997:1) also notes that Part IVA was drafted in wide terms that give

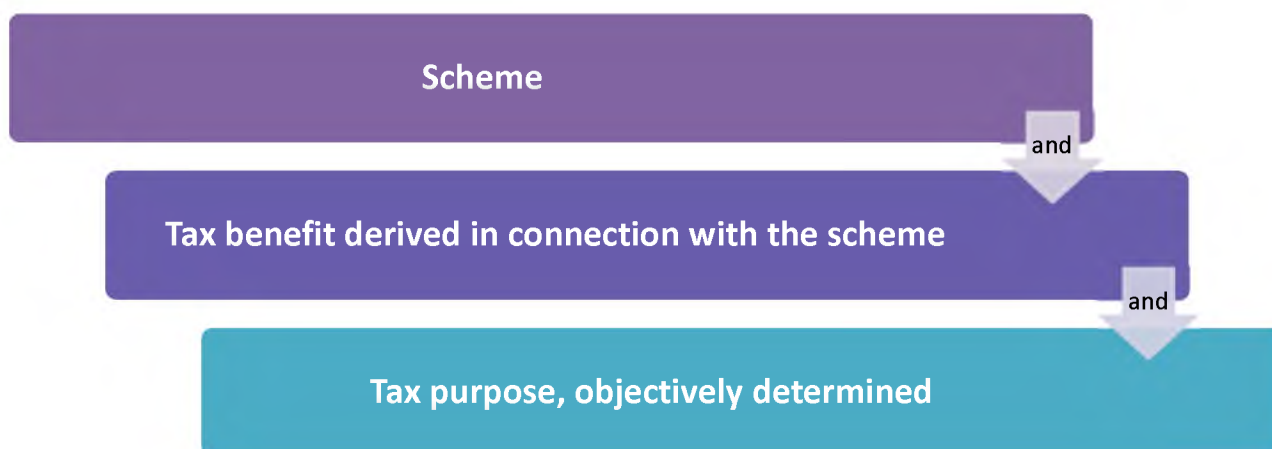
a large degree of discretion to the Commissioner of Taxation to disregard an arrangement and either include an amount in a taxpayer's assessable income or to disallow a deduction.

Further, Stephenson (1997:1) comments that the section was intended to prevent the erosion of the income tax base, while also ensuring that the GAAR was not an impediment to genuine commercial and financial transactions entered into with a view to making profits. In brief, Part IVA of the Income Tax Assessment Act consisted of three basic elements:

- A scheme;
- A tax benefit; and
- A tax purpose, objectively determined.

All three of these requirements had to be fulfilled before the GAAR could be applied to deny a tax benefit. Part IVA is represented in Figure 10 below:

**FIGURE 10 PART IVA OF THE INCOME TAX ASSESSMENT ACT (BEFORE THE 2012 AMENDMENT)**



Source: Own design

In addition to these three basic requirements, Part IVA of the Income Tax Assessment Act provided a list of eight factors that could be used when objectively assessing the scheme's purpose. If any of these eight elements were found to be present, the dominant purpose could be inferred. Stephenson (1997:1) notes that these eight elements were the only matters that could be considered in determining the objective tax purpose of the scheme and any subjective purpose or intent of a person to obtain a tax benefit was not referred to and was irrelevant.

The introduction of Part IVA into the Income Tax Assessment Act was clearly intended to address the problems experienced with its predecessor, section 260, specifically with regard to the predication test, antecedent doctrine and choice doctrine. But the predication test played an important role in the creation of Part IVA because it was drafted in a way that effectuated the predication test that originated in *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1 as the concept of the "reasonable expectation" (Treasury: Australian Government, 1981a:9553; Wardell-Johnson, 2014:123). Given this background to the Australian GAAR, the following discussion is an analysis of the individual components of the current Australian GAAR.

### **5.3 THE CURRENT AUSTRALIAN GAAR**

Part IVA of the Income Tax Assessment Act was amended in 2012 and applies to schemes that were entered into on or after 16 November 2012. The Explanatory Memorandum (Treasury: Australian Government., 2013:par.1.1-1.2) describes the principal role of Part IVA as:

to counter arrangements that, objectively viewed, are carried out with the sole or dominant purpose of securing a tax advantage for a taxpayer. Broadly speaking, Part IVA operates to counter such arrangements by exposing the substance or reality of the arrangements to the ordinary operation of the income tax law.

This description of the purpose of the amendments is followed by providing the context for the need for changes to the GAAR as follows (Treasury: Australian Government., 2013:par.1.4):

Some recent decisions of the Full Court of the Federal Court concerning the way in which Part IVA determines whether or not a tax advantage has been obtained in connection with an arrangement have

revealed a weakness in the capacity of Part IVA to effectively counter arrangements that, objectively viewed, have been carried out with a relevant tax avoidance purpose.

This description of the context for the changes to the GAAR in 2012 confirms the view that the judiciary had limited the scope of the GAAR in a manner that reduced its efficacy. The Explanatory Memorandum (Treasury: Australian Government., 2013:par.1.16-1.17) provides further legislative history relevant to the understanding of the GAAR as follows:

The High Court has confirmed on a number of occasions that Part IVA will apply to an arrangement if the particular form in which the arrangement is implemented evinces the requisite tax avoidance purpose (see *Federal Commissioner of Taxation v Spotless* (1996) 141 ALR 92 (*Spotless*) at pp 97-98 and 105, and *Hart* (2004) 206 ALR 207 at [16] [52] and [94]).

More particularly, as Callinan J observed in *Hart* (2004) 206 ALR 207 at [94], ‘an aspect of’ the direction in Part IVA to consider the ‘form and substance’ of a scheme ‘is whether the substance of the transaction (tax implications apart) could more conveniently, or commercially, or frugally have been achieved by a different transaction or form of transaction.’

This indicates that the changes to Part IVA were driven by the way in which the courts determined whether a tax benefit was obtained in connection with a transaction. Therefore, though there may have been alternative ways in which to achieve the same commercial objective, if the dominant purpose of entering into the transaction was to obtain a tax advantage, the transaction could be struck down by the GAAR. In order to determine this, it would be necessary to look at the form and substance of the transaction objectively without regard to the subjective purpose of the transaction as stated by the taxpayer. Furthermore, how the scheme was implemented and the nature of the connection between the taxpayer and any other parties to the transaction should be considered in determining the dominant purpose of the transaction objectively.

Given this introductory guidance in the Explanatory Memorandum, the following discussion provides an analysis of the individual components of the Australian GAAR as set out in section 177D(1) of the Income Tax Assessment Act, which reads as follows:



This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of:

- a) enabling a taxpayer (a relevant taxpayer) to obtain a tax benefit in connection with the scheme;
- or
- b) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit in connection with the scheme;

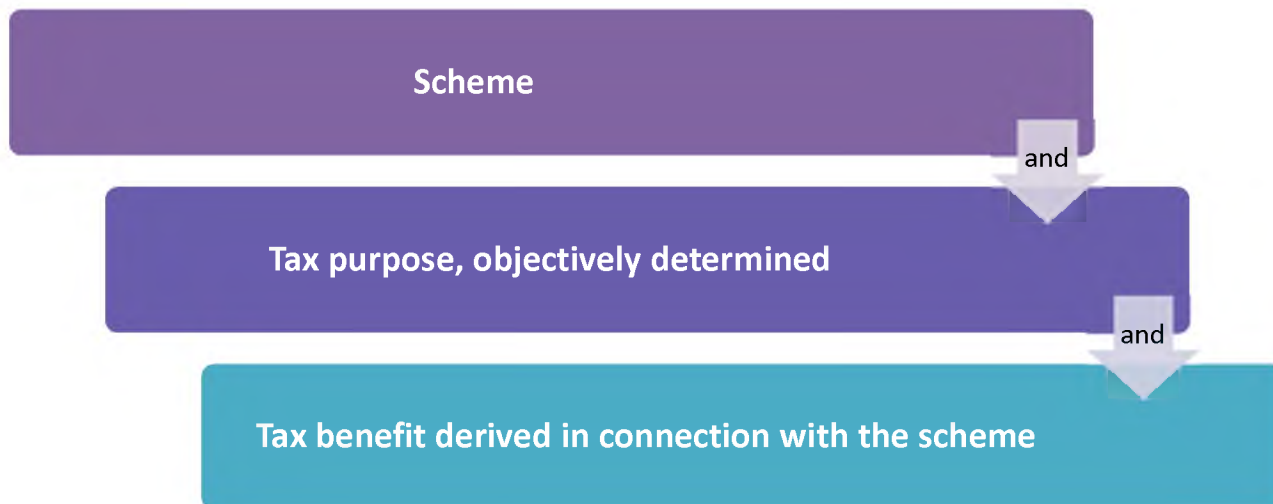
whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers.

In light of the above extract it is evident that Part IVA (section 177A-177D) of the Income Tax Assessment Act still consists of three basic elements:

- a scheme (as defined by section 177A(1) and (3));
- a tax benefit derived in connection with the scheme (as defined in section 177C); and
- a dominant tax purpose, objectively determined.

All three of these requirements must still be fulfilled before the GAAR can be applied to deny a tax benefit. Similarly, all three of these components must be determined objectively. However, the order of the requirements was amended in 2012 so that the dominant purpose test appears before the tax benefit requirement. Due to these 2012 changes, Part IVA can be represented in Figure 11 below as follows:

FIGURE 11 PART IVA OF THE INCOME TAX ASSESSMENT ACT (AFTER THE 2012 AMENDMENT)



Source: Own design

In order to understand the Australian GAAR, each of the components should be understood before reading the part as a whole. The term “scheme” is defined in the Income Tax Assessment Act and is discussed below.

#### 5.4 SCHEME

The first element that must be present for the provisions of the GAAR to apply is a scheme (*Commissioner of Taxation v Ashwick (Qld) No 27 Pty Ltd* (2011) FCAFC 49). The term “scheme” is defined in section 177A(1) of the Income Tax Assessment Act as follows:

- a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings;  
and
- b) any scheme, plan, proposal, action, course of action or course of conduct.

This definition is broad and can include any manner of transaction, similar to the South African GAAR. However, the definition is broadened by both section 177A(3) and 177A(5).

- Section 177A(3) includes unilateral undertakings in the definition of a scheme:

The reference in the definition of scheme in subsection (1) to a scheme, plan, proposal, action, course of action or course of conduct shall be read as including a reference to a unilateral scheme, plan, proposal, action, course of action or course of conduct, as the case may be.

- Section 177A(5) includes schemes entered into for two or more purposes:

A reference in this Part (other than section 177DA) to a scheme or a part of a scheme being entered into or carried out by a person for a particular purpose shall be read as including a reference to the scheme or the part of the scheme being entered into or carried out by the person for 2 or more purposes of which that particular purpose is the dominant purpose.

From the above extracts it is evident that part of a scheme is included in the definition of a scheme. Furthermore, if there are two or more purposes of a scheme, it also falls into the definition of a scheme. However, when isolating part of a scheme as a scheme for the purposes of Part IVA, the judgment in *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, is important. In this case, Mason CJ (at 384) stated that a scheme within a scheme will only qualify as a scheme, for purposes of Part IVA, if it can stand independently, without losing its practical meaning. Though in this instance the court (at 384) rejected the sub-scheme approach, it did state that it “does not mean that if part of a scheme may be identified as a scheme in itself the Commissioner is precluded from relying upon it as well as the wider scheme”. In this regard Cassidy (1995:208) is of the opinion that “while certain provisions in Part IVA make reference to ‘part of the scheme’, these references are included for specific reasons, unrelated to the ultimate question of whether the dominant purpose for entering into the scheme was to obtain a tax benefit”. She further asserts that this provision merely serves to provide that a person participating in a part of a scheme may have a dominant purpose of obtaining a tax benefit, but this does not have any impact on establishing whether the scheme as a whole had a dominant purpose of obtaining a tax benefit (Cassidy, 1995:208).

It is therefore evident that in the decision in the case of *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, the court took into account the taxpayer’s right to avoid tax. This is evident because it held that while part of a scheme could be identified as a scheme by the Commissioner, it could not be used to determine the dominant purpose of the scheme as a whole if it would result in the loss of the practical meaning of the scheme in isolation. Despite this judgment, in the courts did not apply this principle consistently and in the case of *Federal Commissioner of Taxation v Hart* (2004) 55 ATR 712,

this principle was questioned. However, the *Ashwick (Old) N 127 Ltd v Commissioner of Taxation* (2009) ATC 20, judgment advanced the principle in *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, by introducing the coherent course of conduct approach. In essence, the court required a scheme to be part of a coherent course of conduct, which advances this principle because if a scheme cannot stand on its own, then it cannot be considered to be coherent. The ability to isolate part of a scheme was also considered in the more recent case of *RCI Pty Ltd v Federal Commissioner of Taxation* (2011) 84 ATR 785, where the Commissioner successfully identified the scheme as a narrower scheme or, in the alternative, a wider scheme.

The differences in interpretation of the isolation of part of a scheme as a scheme for purposes of Part IVA have caused controversy over Part IVA. However, it is submitted that the ability to isolate one part of a large scheme was intended to prevent taxpayers from using commercial transactions to undertake impermissible tax avoidance transactions. It is also submitted that the ability to isolate a part of a scheme prevents a taxpayer from using the purpose of the larger scheme as a defence for a specific part of the scheme. Kujinga (2013:155) is of the view that the approach taken in *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, should be followed as it allows a balance between the taxpayer's rights and the legislature's concerns.

Notwithstanding, it is important to understand the definition of a scheme as the identification of the parameters of the scheme allows the identification of any tax benefits derived from the scheme, which may be cancelled by the Commissioner. Further, though it has been recognised that the definition of a scheme is wide, the issue is whether it is a scheme to which Part IVA applies. This is determined by the dominant purpose requirement, which requires a determination of whether the dominant purpose was to obtain the tax benefit in connection with the scheme. The term "dominant purpose" as used in Part IVA of the Income Tax Assessment Act is discussed below.

## **5.5 DOMINANT PURPOSE**

The core requirement of Part IVA is that a scheme must be entered into for the sole or dominant purpose of obtaining a tax benefit. This requirement is described as the "fulcrum" or "pivot" around which Part IVA operates. The 2012 changes to Part IVA emphasise the importance of the dominant purpose requirement as this requirement now appears before the tax benefit requirement in the section (Treasury:

Australian Government., 2013:par.1.71). In interpreting the meaning of this requirement, the courts (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183, at 192) have held that the dominant purpose of a scheme is the “most influential and prevailing or ruling purpose”.

Despite the clarity provided by the courts on the meaning of the dominant purpose requirement, it is not yet clear how this test will operate when brought before the courts, as there cannot be a dominant purpose in the absence of a tax benefit.

The dominant purpose requirement effectively excludes those transactions that were undertaken for genuine commercial purposes and allows the Commissioner to attack schemes that it believes were entered into for the purpose of obtaining a tax benefit (Treasury: Australian Government., 2013:par.1.64). Section 177D(1) provides additional guidance by stating that at least one of the persons who entered into or carried out the scheme or any part of the scheme did so for the purpose of obtaining the tax benefit. Therefore, the dominant purpose requirement can be met if any party (other than the taxpayer) has the dominant purpose of obtaining the tax benefit.

In deciding if the sole or dominant purpose for entering into the scheme was to obtain the tax benefit, the eight factors listed in section 177D(2) should guide the determination of a particular scheme’s sole or dominant purpose. Notwithstanding this, the dominant purpose of the scheme must be determined with reference to the whole transaction and not just the narrower scheme identified by the Commissioner (*Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 47 ATR 229).

Section 177D(2) stipulates eight objective factors that determine whether Part IVA should be applied:

177D(2) For the purpose of subsection (1), have regard to the following matters:

- a) the manner in which the scheme was entered into or carried out;
- b) the form and substance of the scheme;
- c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;

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

The eight criteria listed above ensure that the taxpayer's subjective intention for carrying out a scheme is irrelevant because they enable an objective conclusion to be drawn as to the taxpayer's dominant purpose. In using these eight factors to determine the dominant purpose of the scheme, it is important to weigh the scheme's commercial and tax features, as the courts have in cases denied the application of Part IVA even where the scheme contained some elements of reducing the tax payable (refer to *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359; *WD & HO Wills (Aust) Pty Ltd v Commissioner of Taxation* (1996) 32 ATR 186; *Eastern Nitrogen Ltd v Commissioner of Taxation* (2001) 108 FCR 27; *Federal Commissioner of Taxation v Metal Manufactures Ltd* (2001) 108 FCR 150; *Commissioner of Taxation v Mochkin* (2003) 52 ATR 198; *Commissioner of Taxation v News Australia Holdings Pty Ltd* (2010) 79 ATR 461; *Commissioner of Taxation v Ashwick (Qld) No 27 Pty Ltd* (2011) FCAFC 49).

However, the courts have also identified schemes where the tax purpose outweighed the commercial purpose assigned to the scheme (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183; *Pridecraft Pty Ltd v Commissioner of Taxation* (2004) 58 ATR 210).

The courts have provided additional guidance on the meaning of some of these criteria:

- **The manner in which the scheme was entered into or carried out** includes a consideration of the method or procedure used to carry out the scheme, including a consideration of how the scheme in question was established (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183).
- **The time at which the scheme was entered into and the length of the period during which the scheme was carried out** includes a consideration of a possible "flurry of activity" undertaken at the year-end of the taxpayer, indicating a possible tax motive (*Federal Commissioner of Taxation v Sleight* (2004) 55 ATR 555).

Despite the guidance provided by the courts in relation to the use of the eight factors, the legislation does not provide guidance on how to weigh these factors in determining the dominant purpose of a scheme. Inevitably this is left to the courts to decide and introduces the opportunity for inconsistent interpretation. In addition to a discussion of the complexities of the dominant purpose requirement, the final requirement of Part IVA that must be discussed, a “tax benefit”, is dealt with below.

## **5.6 TAX BENEFIT**

The final step of Part IVA requires the determination of a tax benefit. The provisions of section 177C define what constitutes a tax benefit obtained in connection with a scheme. The first step in this inquiry would be to determine if the taxpayer obtained one of the benefits listed in section 177C(1). In terms of section 177C(1) of the Income Tax Assessment Act, the following qualify as tax benefits:

Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

- (a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out; or
- (b) a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out; or
  - (ba) a capital loss being incurred by the taxpayer during a year of income where the whole or a part of that capital loss would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out; or
- (bb) a foreign income tax offset being allowable to the taxpayer where the whole or a part of that foreign income tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or

- (bba) an exploration credit being issued to the taxpayer where the whole or a part of that exploration credit would not have been issued, or might reasonably be expected not to have been issued, to the taxpayer if the scheme had not been entered into or carried out; or
- (bc) the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out.

In light of the above, it is evident that the key tax benefits listed in section 177C(1) are:

- a) not including an amount in assessable income;
- b) incurring a deduction;
- c) creating a capital loss;
- d) obtaining a foreign income tax offset; and
- e) avoiding a withholding tax.

Should the Commissioner be successful in applying the GAAR to the scheme, section 177F allows the Commissioner to cancel the entire or part of the tax benefit obtained or to be obtained. Notwithstanding this, any tax benefit resulting from exercising a statutory choice expressly provided by the Income Tax Assessment Act would not be included in the definition of a tax benefit for the purposes of the GAAR, unless the taxpayer carried out the scheme in a manner that created the conditions necessary to exercise the choice (as provided by section 177C(2)). Therefore, section 177C(2) does not protect any tax benefit obtained if the taxpayer created the conditions necessary to qualify for the tax benefit provided for in the Income Tax Assessment Act. Kujinga (2013:157) is of the opinion that the rationale behind this exclusion is that if a taxpayer is not within the circumstances envisaged by the legislature when providing for a certain tax benefit, then that taxpayer cannot be allowed to create a scheme that puts him within those circumstances.

The second step in the inquiry into a tax benefit is provided by section 177CB and requires a determination of whether the tax benefit would not have arisen in the absence of the scheme. This second step allows a quantification of the tax benefit resulting from the scheme. In this third and final step into determining the tax benefit, the amount of the tax benefit will be calculated as the difference between the tax effect of the scheme and the identified alternative. The court has the obligation to decide which alternative transaction is the most likely from the alternative postulates presented by the Commissioner, the taxpayer or the court



itself. Where a taxpayer's assertion that the alternative scheme would not have been entered into is reasonable, this will be considered by the courts if it is proven to be a reasonable assertion.

The judgment in *RCI Pty Ltd v Federal Commissioner of Taxation* (2011) 84 ATR 785, provided additional guidance on the use of this alternative postulate when Edmonds J, Gilmore J and Logan J (at 786-787) held that the most likely alternative transaction is an objective determination of what the taxpayer might have done in the absence of the scheme in question.

## 5.7 RECONCILING GAAR WITH THE RIGHT TO AVOID TAX

The Australian GAAR, like its South African counterpart, recognises the right of a taxpayer to avoid tax. However, given the evolution of the Australian GAAR since its inception in section 53 of the Commonwealth Income Tax Act of 1915 (Brown, 2012:37) to the current Part IVA of the Income Tax Assessment Act, the right to avoid tax has changed fundamentally. To illustrate this point, it is now evident that, unlike section 260, Part IVA only targets those transactions with a tax benefit as a dominant purpose, as opposed to all tax avoidance transactions. Even before the 2012 amendments to Part IVA, the courts supported the view that taxpayers could exercise their right to avoid tax as long as this was not the sole or dominant purpose of the transaction (*Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359; *Eastern Nitrogen Ltd v Commissioner of Taxation* (2001) 108 FCR 27; *Federal Commissioner of Taxation v Metal Manufactures Ltd* (2001) 108 FCR 150; *Commissioner of Taxation v Mochkin* (2003) 52 ATR 198).

In substantiating this point, the judgment in *Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183 (at 183-184) is most relevant:

Part IVA is to be construed and applied according to its terms, not under the influence of muffled echoes of old arguments concerning other legislation. It is as much part of the tax statute as any other provision thereof. The principle that taxpayers are entitled to order their affairs to minimise tax has no significance in the present case...

...A taxpayer may have a particular objective or requirement to be met or pursued by a transaction. The shape of that transaction need not necessarily take only one form. The adoption of one particular form over another may be influenced by tax consideration. A particular course of action may be both

tax driven and bear the character of a rational commercial decision. The presence of a rational commercial decision does not determine whether a person entered into or carried out a scheme for the dominant purpose of enabling the taxpayer to obtain a tax benefit.

Therefore, while the courts effectively dismissed the principles laid down by the Duke of Westminster, they also showed an appreciation for a taxpayer's right to avoid tax by entering into transactions with commercial objectives in a tax-effective manner. This assertion is supported by Krever (1997:124) when he states that:

the application of the general anti-avoidance principles must be reconciled with the long standing doctrine that the taxpayers cannot be penalised for choosing a tax effective option when it is available.

In expanding on this view Krever (1997:123) highlights that the courts would only view a scheme as impermissible if the scheme is complex, well-conceived and marketed on the basis of its ability to create tax benefits. Similarly, Krever (1997:123) notes that in *Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183, the taxpayer did not choose the most tax-efficient option from an array of options. Lastly, Krever (1997:123) maintains that no transaction would have been entered into without consideration of the tax benefits and the tax benefit was a crucial element of the transaction.

Despite the progress made, Part IVA still includes elements of uncertainty, such as the question of: how complex a scheme would need to be in order to fall foul of the GAAR. The decision in *Spotless Services Ltd* (1996) 34 ATR 183, did, however, show that the Australian GAAR will operate as intended where the dominant purpose is to achieve a tax benefit, as opposed to transactions that are just blatantly artificial and contrived. Therefore, while taxpayers have the right to structure commercial transactions in a tax-efficient manner, any transaction that is dominated by a tax benefit purpose should be struck down by the GAAR.

## **5.8 CONCLUSION**

In this chapter the requirements of Part IVA of the Income Tax Assessment Act (Australian GAAR) were analysed, contributing to phase 1 of the study. The review was in the form of a critical analysis and provided an opportunity to analyse the components of the Australian GAAR for purposes of comparison to its South African counterpart, which will be done in Chapter 7.

In performing the analysis, it became evident that section 260 was so widely defined that the courts imposed limitations on its interpretation in the form of the predication test, antecedent doctrine and choice doctrine. Currently the GAAR is found in Part IVA of the Income Tax Assessment Act and the crux of the GAAR is centred on the dominant purpose requirement. Therefore, the Commissioner is able to attack schemes under Part IVA that it believes were entered into for the dominant purpose of obtaining a tax benefit. In order to determine this, the form and substance of the transaction should be assessed objectively without regard to the subjective purpose of the transaction as stated by the taxpayer. In deciding if the dominant purpose for entering into the scheme was to obtain the tax benefit, section 177D(1) provides that the eight factors listed in section 177D(2) should guide the determination of a particular scheme's sole or dominant purpose. However, there is uncertainty on how to weigh these factors in determining the dominant purpose of a scheme. Inevitably this is left to the courts to decide and introduces the opportunity for inconsistent interpretation.

While not the crux of the GAAR, it is also important to identify the scheme under attack. In this regard, while the Commissioner is allowed to identify part of a scheme as a scheme, this cannot be used to determine the dominant purpose of the scheme as a whole if it would result in the loss of the practical meaning of the scheme in isolation.

Lastly, the tax benefit requirement is determined by comparing the tax effect of the transaction undertaken by the taxpayer, and the tax effect of the most likely alternative. Notwithstanding this, any tax benefit resulting from exercising a statutory choice expressly provided by the Income Tax Assessment Act would not be included in the definition of a tax benefit for the purposes of GAAR, unless the taxpayer carried out the scheme in a manner that created the conditions necessary to exercise the choice.

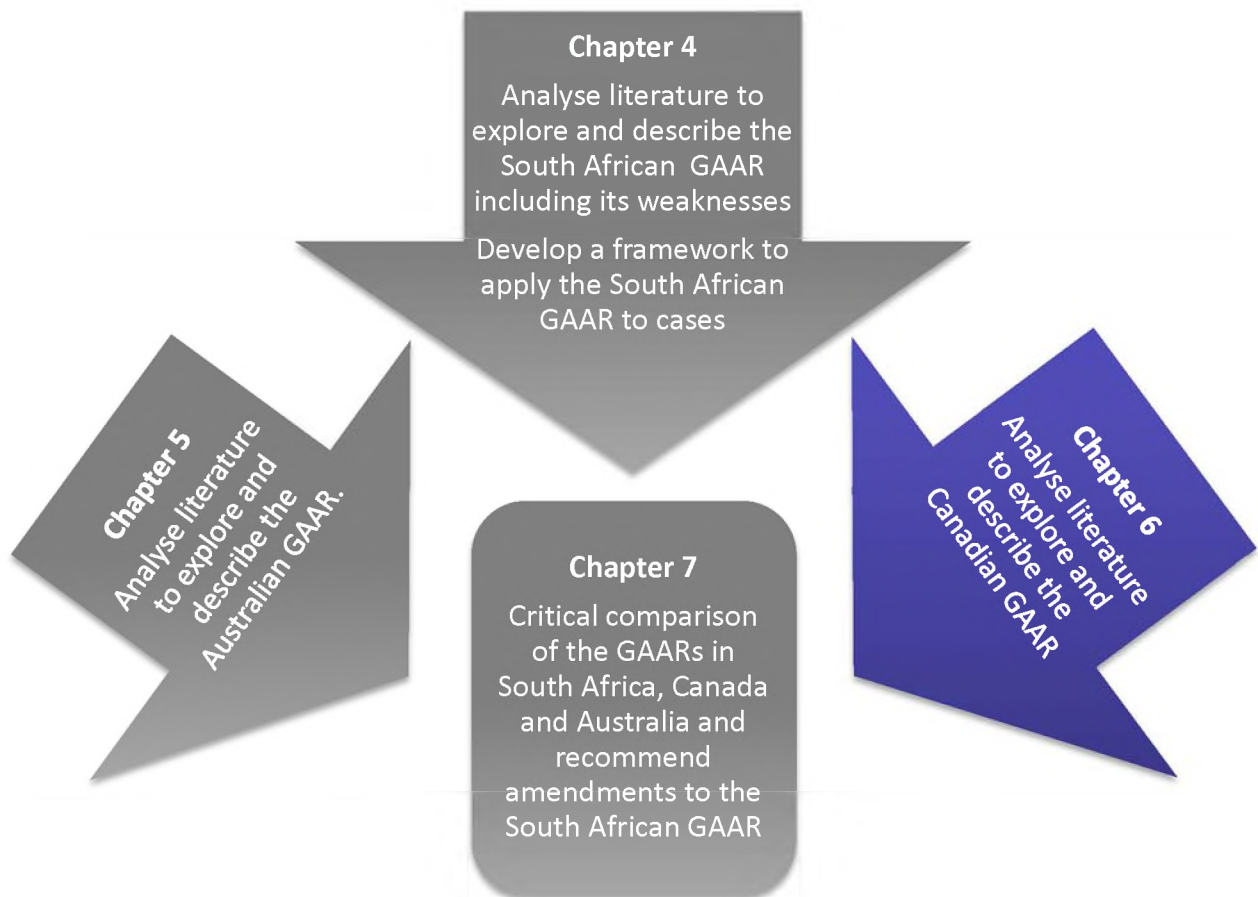
In conclusion, the components of the Part IVA of the Income Tax Assessment Act were analysed in this chapter, including any areas of concern and uncertainty. In the following chapter the Canadian GAAR will similarly be analysed in order to allow for a theoretical comparison of all three jurisdictions (South Africa, Canada and Australia), to contrast their differences and to identify which provisions of the Australian and Canadian GAARs could be used to improve the effectiveness and efficiency of the South African GAAR.

## CHAPTER 6: THE CANADIAN GENERAL ANTI-AVOIDANCE RULE

### 6.1 INTRODUCTION

Chapters 4 and 5 formed part of phase 1 of the study, which comprised a review of the GAARs in South Africa and Australia. Chapter 4 also concluded with a framework to be used to apply the South African GAAR to selected cases in Australia and Canada. This chapter continues phase 1 of the study and the aim is to describe and analyse the components of the Canadian GAAR. The relationship between Chapters 4, 5, 6 and 7 is represented in Figure 12 below:

FIGURE 12 PHASE 1 CHAPTER RELATIONSHIPS



Source: Own design

This review is in the form of a critical analysis and provides an opportunity to analyse the components of the Canadian GAAR. It includes an analysis of how the Canadian GAAR is interpreted and the

implications when brought before the courts. The remainder of phase 1 of the study is continued in Chapter 7, where a critical comparison of the GAARs of the three jurisdictions is presented in order to highlight the differences between the GAARs in South Africa, Australia and Canada. The comparative analysis of these jurisdictions will be integrated into Chapter 10.

This chapter will contribute to achieving research objectives 2 and 3, by identifying which aspects of the Canadian GAAR could be included in its South African counterpart to improve its effectiveness.

## **6.2 TAXPAYER RIGHTS AND BACKGROUND TO THE CANADIAN GAAR**

Canada has relied on GAAR to combat impermissible tax avoidance since its enactment in 1988 and the GAAR is currently found in section 245 of the Canadian Income Tax Act RSC 1985, C. 1 (5th Supp) (referred to as the Canadian Income Tax Act) (Canada Revenue Agency, 2013:1; Kujinga, 2013:174). Despite the short history of GAAR in the Canadian tax legislation, Canada has had considerable experience with GAAR due to the number of cases that have been referred to the General Anti Avoidance Rule Committee (Canada Revenue Agency, 2014:1).

### **6.2.1 THE RIGHT TO AVOID TAX**

Canadian tax law, like that of South Africa, recognises the right of a taxpayer to avoid tax within the permitted bounds. According to Krishna (2002:849), it is a:

fundamental principle of Canadian tax law that a taxpayer is entitled to arrange his or her affairs to minimise tax. Tax avoidance implies the reduction of tax payable by lawful means. Thus we start with the premise that the avoidance of tax is perfectly legitimate, and indeed even moral. A government should intervene in the economy only if it must deliver essential services at a cost or price that is lower than equivalent private sector comparables....as world economies interlink, cross border transactions increase, and tax rates take an increasing slice of the income, tax planning assumes greater importance.

The courts have entrenched this principle in case law and one such example is found in *Cophorne Holdings Ltd v The Queen* (2011) SCC 63, where Rothstein J (at 65) referred to the principles articulated in Duke of Westminster case and stated that:

[t]axpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability.

In light of this, the role of GAAR is to limit the tax avoidance schemes to those that do not abuse the provisions of the Canadian Income Tax Act. The courts expressed the relationship between a taxpayer's right to avoid tax and the GAAR in the case of *Lipson v. Canada* (2009) SCC 1 where LeBel J (at 2) stated as follows:

It has long been a principle of tax law that taxpayers may order their affairs so as to minimize the amount of tax payable (*Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.)). This remains the case. However, the Duke of Westminster principle has never been absolute, and Parliament enacted s. 245 of the ITA, known as the GAAR, to limit the scope of allowable avoidance transactions while maintaining certainty for taxpayers.

However, despite the relationship between a taxpayer's rights and the GAAR being clarified, the GAAR should be applied fairly and as a last resort (*Cophorne Holdings Ltd v The Queen* (2011) SCC 63; *Canada Trustco Mortgage Company v Canada* (2005) SCC 54). Therefore, should uncertainty be introduced as a result of the GAAR, which would cast doubt over the applicability of the GAAR, the courts will find in favour of the taxpayer in order to maintain certainty (Kujinga, 2013:204). It is therefore of the utmost importance to limit any uncertainties in order to improve the efficiency of GAAR.

### **6.2.2 BACKGROUND TO THE GAAR IN CANADA**

The Canadian GAAR is grounded on an abusive indicator, which in itself shows the importance of analysing the Canadian GAAR because a similar indicator has been included in its South African counterpart. Before its enactment in 1988, Canada was influenced by the United Kingdom approach: "the strict interpretation of fiscal legislation and an attendance to legal substance of transactions" to combat impermissible tax avoidance (Alarie, 2010:626-627). However, when the Supreme Court of Canada put an end to an emerging *bona fide* business purpose doctrine in *Stuart Investments Ltd v The Queen* (1984) CTC 294 in 1984, the federal government embraced the possibility that a Canadian GAAR was necessary (Alarie, 2010:626). Shortly thereafter in 1987, specific anti-avoidance rules received criticism from the Canadian Department of Finance, which stated that "we no sooner get the stuff out and the ink gets dry than there is a way to beat the rules" (Krishna, 1990:21; Kujinga, 2013:174).

In the Canadian context it is submitted that the judgment in the *Stuart* case had completely negative connotations for curbing impermissible tax avoidance and resulted in some advisors proposing that any transaction with a sole purpose to obtain tax benefits was permissible tax avoidance (Kujinga, 2013:177). In this case the court considered the business purpose test used in the United States and the United Kingdom, but determined that this was not applicable in Canada as it was a violation of a taxpayer's right to avoid tax. In arriving at their decision Beetz J, Estey J and McIntyre JJ (at 536-537) stated that "a transaction cannot be disregarded for tax purposes solely on the basis that it was entered into by a taxpayer without an independent or *bona fide* business purpose". In confirming the right of a taxpayer to avoid tax, Estey JJ (at 552) made the following comments:

What then is the law in Canada as regards the right of the taxpayer to organise his affairs so as to reduce his tax liability without breaching any express term in the statute? Historically the judicial response is found in *Bradford (Borough of) v Pickles* [1895] A.C. 587 where it was stated

If it was a lawful act, however ill the motive might be, he had a right to do it. If it was an unlawful act, however good his motive might be, he would have no right to do it. [Lord Halsbury L.C. 594]

No use of property, which would be legal if due to a proper motive, can become illegal because it is prompted by a motive which is improper or even malicious [Lord Watson 598].

Following this, the court made reference to the principles laid down in *IRC v Duke of Westminster* (1936) 19 TC 490 and acknowledged (at 557) the impact that the GAAR would have on this right as follows:

The presence of a provision of general application to control avoidance schemes looms large in the judicial approach to the taxpayer's right to adjust his sails to the winds of taxation unless he thereby navigates into legislatively forbidden waters. The legislature has provided the standards of unacceptable avoidance procedures, and there being no other limit imposed by the Act, the Court found itself under no duty, nor indeed possessed of any authority, to legislate new limits.

Notwithstanding the above observations made by the courts, it is evident that hereafter the courts favoured a purposive approach, as described by E.A. Driedger (in Duff: 2006:22), that was seen as a positive step in interpreting the tax legislation. This "modern rule" was described by Driedger (Duff, 2006:22) as follows: "the words of an Act are to be read in their entire context and in their grammatical and ordinary

sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament”. In light of this, the fact that the GAAR subsequently mandated a purposive approach to interpretation shows that the response to the judgment in the *Stuart* case reversed entirely every aspect of the decision in the case. Given this background to the interpretation of the GAAR in Canada, the following discussion is an analysis of the individual components of the Canadian GAAR.

### 6.3 THE CANADIAN GAAR

The Canadian GAAR is contained in section 245(2) of the Canadian Income Tax Act and reads as follows:

Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

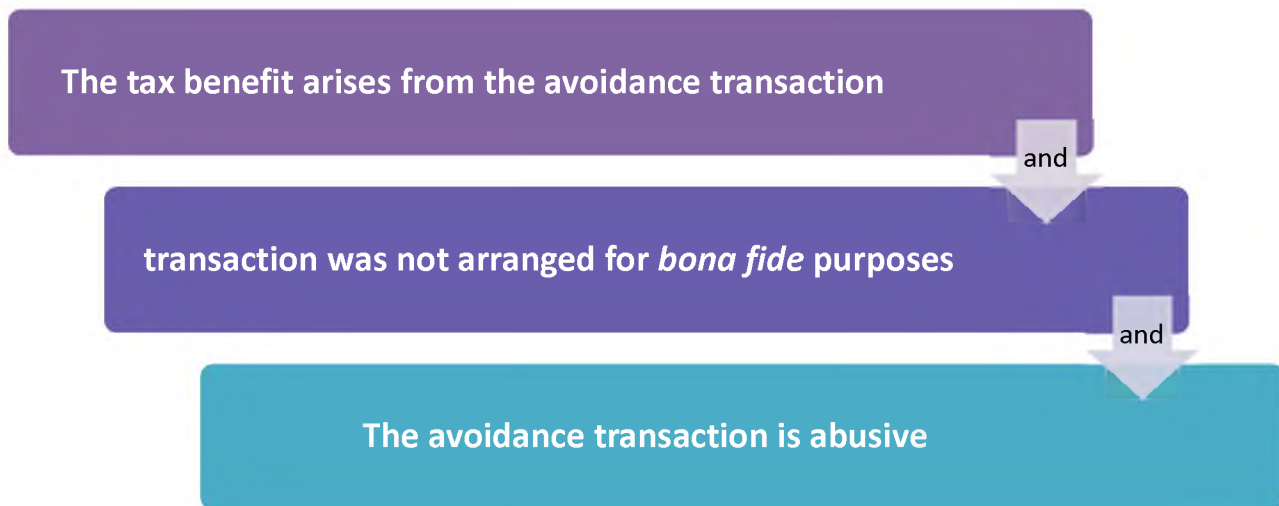
At first glance it seems that this contains two requirements:

- determining whether there is a “tax benefit” arising from a “transaction”; and
- determining if the transaction was arranged for *bona fide* purposes other than obtaining the tax benefit.

However, section 245(4) of the Canadian Income Tax Act provides that section 245(2) is only applicable to a transaction if it is abusive. Therefore, the Canadian GAAR contains three requirements as opposed to two. The first requirement entails determining whether there is a tax benefit arising from a transaction. The second entails determining if the transaction was arranged for *bona fide* purposes other than obtaining the tax benefit. The third and final requirement entails determining if the transaction was abusive. All three of these requirements must be fulfilled before the GAAR can be applied to deny a tax benefit. Section 245 is represented in Figure 13 below:



FIGURE 13 SECTION 245 OF THE CANADIAN INCOME TAX ACT



Source: Own design

The burden of proof for first two requirements lies with the taxpayers, whereas the last one is on the tax authority (Kujinga, 2013:179; Liang, 2013:20). Following this, the Minister must prove that the avoidance transaction is abusive and constitutes a misuse of the provisions of the Canadian Income Tax Act as a whole. This abusive requirement is crucial because if the abusive nature of the avoidance transaction is unclear, then the taxpayer will receive the benefit of the doubt (Kujinga, 2013:179; Liang, 2013:20). In order to understand the Canadian GAAR, each of the components should be understood before reading the text as a whole. The terms “transaction”, “avoidance transaction”, “tax benefit” and “tax consequences” are defined in the Canadian Income Tax Act and discussed below.

### 6.3.1 TRANSACTION AND AVOIDANCE TRANSACTIONS

The first element that must be present for the provisions of the GAAR to apply is the presence of a transaction and more specifically an avoidance transaction. In terms of section 245(1) of the Canadian Income Tax Act “a transaction includes an arrangement or event”. However, the term “avoidance transaction” is used in section 245(2) of the Canadian Income Tax Act and is defined in section 245(3) as follows:

An avoidance transaction means any transaction

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

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

From the above definition it is evident that the concept of a tax benefit is central to the definition of an avoidance transaction in the Canadian Income Tax Act and therefore it is important to understand the meaning of a tax benefit in order to determine if there is an avoidance transaction (Liang, 2013:19). The term “tax benefit” as used in the Canadian Income Tax Act is discussed below.

### **6.3.2 TAX BENEFIT AND TAX CONSEQUENCES**

The terms “tax benefit” and “tax consequences” are both defined in section 245(1) of the Canadian Income Tax Act as follows:

- Tax benefit is defined as a “reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty”.
- Tax consequences for a person are defined as “the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount”.

It is therefore evident that both concepts are succinctly defined, but have wide application (Kujinga, 2013:180; Liang, 2013:19). In essence, a tax benefit refers to a reduction, avoidance or deferral of tax, but it also includes an increase of tax refundable under the Canadian Income Tax Act. The decision in *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, clarified the term somewhat when McLachlin CJ and Major J (at 19) stated that “[w]hether a tax benefit exists is a factual determination, initially by the

Minister and on review by the courts, usually the Tax Court. The magnitude of the tax benefit is not relevant at this stage of the analysis”. However, the court further explained that in certain cases the existence of a tax benefit is clear (i.e. if a deduction is claimed, it will result in a lower taxable income), but also noted that:

it may be that the existence of a tax benefit can only be established by comparison with an alternative arrangement. For example, characterization of an amount as an annuity rather than as a wage, or as a capital gain rather than as business income, will result in differential tax treatment. In such cases, the existence of a tax benefit might only be established upon a comparison between alternative arrangements. In all cases, it must be determined whether the taxpayer reduced, avoided or deferred tax payable under the Act.

Therefore, a comparison of alternatives available to the taxpayer should be used to determine the existence of a tax benefit. Once the tax benefit has been identified, the determination of whether an avoidance transaction exists can commence.

### **6.3.3 AVOIDANCE TRANSACTION**

An avoidance transaction is not the mere receipt of a tax benefit by a taxpayer as a result of a transaction but in terms of section 245(3), includes an assessment of whether the transaction was undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. The wording and structure of this section lead to the conclusion that it is targeted at those transactions that are arranged or undertaken for tax purposes.

The courts again provided some guidance in interpreting this provision when Beaubier JTCC (at 28) in *Husky Oil Ltd v Canada* (1998) 99 DTC 308 (TCC) stated that the facts surrounding the transaction provided the business reasons necessary for entering into the transaction, which proved that it was “the only feasible legal route by which to proceed”. This indicates that the courts will consider the facts and real circumstances of the transaction, rather than considering the tax results in isolation. The facts of the case will also be considered where a transaction occurs as part of a series of transactions in terms of both section 245(2) and 245(3) of the Canadian Income Tax Act, which are discussed below.

### 6.3.3.1 SERIES OF TRANSACTIONS

Section 245(2) and 245(3) of the Canadian Income Tax Act makes reference to a series of transactions. It is submitted that the legislature has recognised that many tax avoidance arrangements involve complex transactions that may have many parts and have catered for this by including the reference to a series of transactions. Arnold (2004:493) supports this opinion and notes that “if a series of transactions results in a tax benefit, the GAAR will apply to each transaction in the series unless the transaction has a primary non-tax purpose”. In *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, this was interpreted by McLachlin CJ and Major J (at 34):

If at least one transaction in a series of transactions is an “avoidance transaction”, then the tax benefit that results from the series may be denied under the GAAR. This is apparent from the wording of s. 245(3). Conversely, if each transaction in a series was carried out primarily for bona fide non-tax purposes, the GAAR cannot be applied to deny a tax benefit.

It can therefore be concluded that the purpose behind the inclusion of this provision is to prevent taxpayers from inserting a transaction without a *bona fide* non-tax purpose into a larger series of transactions that have a commercial purpose (Arnold, 2004:493). Despite the importance of this concept, section 245(2) and 245(3) of the Canadian Income Tax Act does not provide further guidance on the meaning of a series of transactions. However, a brief definition is included in the Canadian Income Tax Act in terms of section 248(10), where a series of transactions is defined as follows:

For the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or events completed in contemplation of the series.

This indicates that it should be possible to anticipate each step of the transaction in order to achieve the transaction as a whole. Further guidance was provided by the courts, including in *Craven (Inspector of Taxes) v White and Related Appeals* (1988) 3 All ER 495, *WT Ramsay Ltd v Inland Revenue Commissioners* (1981) 1 All ER 865 (HL), *OSFC Holdings Ltd. v The Queen* (2001) DTC 5471 and *Furniss v Dawson* (1984) 1 All ER 530 (HL). This guidance establishes that where a transaction is pre-ordained or pre-planned to comprise certain steps that will be put into place to complete a transaction, it is part of a series of transactions. Therefore, if a part of a transaction has been envisaged, planned or pre-ordained, it constitutes part of a series of transactions.

Nevertheless, there is evidence that the courts have in certain instances refused to isolate one step in a series of transactions for the purpose of applying the GAAR. In *Evans v R* (2005) TCC 684 Bowman CJ (at 22-24) held that the entire series of transactions had a commercial *bona fide* purpose and the manner in which the series was undertaken was one that resulted in the least amount of tax. He therefore did not apply the GAAR to an isolated transaction in the series as the commercial purpose of the entire series of transactions had previously been established. In a more recent case, *Copthorne Holdings Ltd v The Queen* (2011) SCC 63, this concept was also considered when Rothstein J (at 71) stated that:

while an avoidance transaction may operate alone to produce a tax benefit, it may also operate as part of a series of transactions that results in the tax benefit. While the focus must be on the transaction, where it is part of a series, it must be viewed in the context of the series to enable the court to determine whether abusive tax avoidance has occurred. In such a case, whether a transaction is abusive will only become apparent when it is considered in the context of the series of which it is a part and the overall result that is achieved.

Interpretation of this statement varies as Kujinga (2013) is of the opinion that it should be interpreted to mean that an individual transaction in a series of transactions must have its purpose determined with reference to the purpose of the series as a whole. However, it is submitted that Rothstein J was attempting to articulate that if the specific transaction did not help to achieve the non-tax purpose of the entire series of transactions, then its purpose could not be said to be the purpose of the entire series of transactions. Therefore, if the purpose of the transaction was clearly different from that of the entire series, then it could be attacked under the GAAR.

#### **6.3.4 TAX PURPOSE**

Once it has been determined that a tax benefit has been derived from a transaction or series of transactions, it must be established, in terms of section 245(3), whether it may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. Therefore if the primary purpose of the transaction is to obtain the tax benefit, then the transaction is an avoidance transaction. This test specifically includes the word “reasonably” and it is submitted that the inquiry is an objective one and the reasonable person’s interpretation of the facts in the case is essential to this inquiry (Hogg P.W., 2010:682). This was confirmed by the courts in *Canada Trustco Mortgage Company v*

*Canada* (2005) SCC 54, when McLachlin CJ and Major J (at 28) stated that the “words of the section simply contemplate an objective assessment of the relative importance of the driving forces of the transaction”. In addition to this McLachlin CJ and Major J (at 29) were of the opinion that the

taxpayer cannot avoid the application of the GAAR by merely stating that the transaction was undertaken or arranged primarily for a non-tax purpose. The Tax Court judge must weigh the evidence to determine whether it is reasonable to conclude that the transaction was not undertaken or arranged primarily for a non-tax purpose. The determination invokes reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

Therefore, the facts of the transaction must be considered in light of the evidence presented, as opposed to a mere representation by the taxpayer regarding the primary purpose of the transaction. It is important to note that in *Water's Edge Village Estates (Phase II) Ltd. v. Canada (C.A.)* (2002) FCA 291, Noël JA made a comparison between the size of the tax and non-tax benefits in order to determine the primary purpose of the transaction. In his judgment Noël JA (at 35) stated that

[t]he value of the tax loss in the hands of the appellants (all of whom were in a position to absorb it quickly) when contrasted with the income-earning prospects of the computer makes the predominant purpose of the transactions plain and obvious.

Therefore, one test that may be applied in the instance where a tax purpose and a commercial purpose for the transaction are identified is to compare the size of the tax benefit achieved to the non-tax benefits achieved. However, this test should be applied carefully as a taxpayer is entitled to choose a manner of effecting the transaction that attracts less tax. In *Evans v. R* (2005) TCC 684, the court confirmed this assertion when Bowman CJ (at 22) stated that “[t]he method chosen was one designed to enable him to do so at the least tax cost”. In coming to this conclusion, the court emphasised the Explanatory Notes adopted by the Supreme Court of Canada in the case of *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, when referring to the re-characterisation of a transaction for the purpose of determining if the transaction is an avoidance transaction. In this regard the Explanatory Notes (Canadian Government, 1988:464) read as follows:

Subsection 245(3) does not permit the "recharacterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a

transaction to be considered to be an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes.

Therefore, the use of the most tax-efficient method, when conducting a transaction, does not necessarily make the transaction an avoidance transaction for the purposes of the GAAR.

### **6.3.5 MISUSE OR ABUSE**

The misuse or abuse indicator is the final step to consider under the Canadian GAAR and it is important for the purposes of the present research because a similar indicator has been included in the South African legislation. Some commentators on the Canadian GAAR consider this to be the “single most significant” step that is “the most difficult issue” in applying the GAAR and is the key to distinguishing between permissible and impermissible tax avoidance in Canada (Krishna, 2002:870; Hogg P.W., 2010:685).

The misuse or abuse indicator is contained in section 245(4) of the Canadian Income Tax Act and provides that the GAAR will not apply to a transaction if:

it may reasonably be considered that the transaction would ... result directly or indirectly in a misuse of the provisions of ... this Act, ... would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

However, prior to its amendment in 2005 section 245(4) of the Canadian Income Tax Act provided that the GAAR would not apply to a transaction if:

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

From this extract it is evident that there could be many differing conclusions regarding its application to actual complex financial transactions. The courts commented on the difficulties presented in this provision when McLachlin C.J. and Major J (at 37) noted the following in *Canada Trustco Mortgage Company v Canada* (2005) SCC 54:

It is this requirement that has given rise to the most difficulty in the interpretation and application of the GAAR. A number of features have provoked judicial debate. The section is cast in terms of a

double negative, stating that the GAAR does “not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse . . . or an abuse”. It is tempered by the word “reasonably”, suggesting some ministerial and judicial leeway in determining abuse. It does not precisely define abuse or misuse. To further complicate matters, the English and French versions of s. 245(4) differ. Overarching these particular difficulties is the central issue of the relationship between the GAAR and more specific provisions of the Act.

The first problem noted by the court in this case was the use of the double negative. This issue was amended by the 2004 budget, applicable retroactively from September 1988. In interpreting the meaning of the words “misuse” and “abuse” the Supreme Court has also found that the use of these two different concepts is further complicated by the differences in the French and English versions of the legislation. As a result of the use of the two different words, the Federal Court, in *OSFC Holdings Ltd. v The Queen* (2001) DTC 5471, mandated two different inquiries:

- The first was to determine if there was a misuse of the particular provisions of the Act that was relied upon to achieve the tax benefit.
- The second was to determine if there was an abuse of any policy of the Act read as a whole.

However, in a subsequent case (*Canada Trustco Mortgage Company v Canada* (2005) SCC 54) the court disagreed with this interpretation of the provision when McLachlin CJ and Major J (at 39) stated that:

[w]ith respect, we cannot agree with this interpretation of s. 245(4). Parliament could not have intended this two-step approach, which on its face raises the impossible question of how one can abuse the Act as a whole without misusing any of its provisions.

The court in this case considered the use of the two terms to be inseparable and therefore superfluous. They also concluded that the provision required a single, unified approach to the textual, contextual and purposive interpretation of the specific provisions of the Canadian Income Tax Act that are relied on by the taxpayer in order to determine whether there was abusive tax avoidance. The correct approach was clarified by the court as a two-step process that was described by McLachlin CJ and Major J (at 44) as follows:

The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that



purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the Income Tax Act is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive.

The purposive approach adopted in this case means that if a transaction is abusive of the provisions of the Canadian Income Tax Act, it will be disregarded, even if it complies with the literal interpretation. Following this, the court confirmed certain principles that should be applied in order to manage the effect of the GAAR: the principles of fairness, consistency and predictability. In order to achieve these goals, McLachlin CJ and Major J (at 45) clarified the term “abusive”:

This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the Income Tax Act in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions. By contrast, abuse is not established where it is reasonable to conclude that an avoidance transaction under s. 245(3) was within the object, spirit or purpose of the provisions that confer the tax benefit.

However, despite this guidance on the determination of an abusive avoidance arrangement, the court also stated that the lack of economic substance in relation to the transaction does not necessarily mean that the transaction is abusive. In fact, economic substance has limited importance into this inquiry and McLachlin CJ and Major J (at 58) were of the opinion that

[w]hether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance

In conclusion, the guidance provided in *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, complies with the principle of purposeful interpretation of the legislation while trying to maintain the fairness, consistency and predictability of the Canadian Income Tax Act. However, many courts have highlighted that the GAAR should be applied with the utmost caution as a last resort. It seems that the

Minister has in fact applied the GAAR responsibly because in all instances that could have needed the application of the GAAR, it has first been considered at the GAAR Committee (Arnold, 2004:491). However, the GAAR still does not provide an absolute answer to the tax avoidance problems experienced in Canada. This view was stated by McLachlin CJ and Major J (at 16) in the Supreme Court case of *Canada Trustco Mortgage Company v Canada* (2005) SCC 54:

The GAAR draws a line between legitimate tax minimization and abusive tax avoidance. The line is far from bright. The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act. But precisely what constitutes abusive tax avoidance remains the subject of debate.

In addition to this, although guidance on the interpretation and application of the GAAR was provided in *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, there are also instances where the GAAR has been misapplied. One such case is *OSFC Holdings Ltd v The Queen* (2001) DTC 5471, where Rothstein J (at 70) was of the opinion that where the policy was not clear and unambiguous, Parliament would have to accept that the transaction was not abusive. This view has been criticised and Kujinga (2013:193) contends that the correct approach should have been to require the Minister to prove that a transaction used a provision in a manner not intended by the legislator. As a result of the error in interpretation in *OSFC Holdings Ltd v The Queen* (2001) DTC 5471, the Minister had an extremely onerous task to discharge to prove that there was a clear and unambiguous policy that had been contravened in undertaking the transaction (Kujinga, 2013:195). Some subsequent cases providing evidence of this conundrum include:

- *Canada v Jabin Investments Ltd* (2003) 2 CTC 25
- *Canada v Imperial Oil Ltd* (2004) FCA 36
- *Canada v Produits Forestiers Donohue Inc* (2002) FCA 422.

This error in interpretation of the misuse or abuse provision negatively impacted the efficacy of the GAAR in Canada. This stems from the opinion that “a GAAR will never be a complete solution to taxpayer behaviour characterized as avoidance so long as it requires the courts to apply a meaningful degree of scrutiny in order to form an opinion on questionable arrangements. In particular, the legislation must have a coherent policy rationale, because, where none exists, it will be very difficult for judges to devise one”

(Gammie, 2005:1052). However, the *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, case seems to have negated the clear and unambiguous approach taken in some preceding cases and has promoted the purposive approach to interpreting the legislation where the misuse or abuse principle is applied. In this case it should, however, be noted that the transaction was not abusive and the Supreme Court then upheld the decision taken in the lower courts, despite the difference in interpretation.

#### **6.4 CONCLUSION**

In this chapter the components of the Canadian GAAR were analysed, thus contributing to phase 1 of the study. The review was in the form of a critical analysis and provided an opportunity to investigate the components of the Canadian GAAR for purposes of the comparison to its South African counterpart that will be made in Chapter 7. From the analysis, it is clear that the Canadian GAAR requires a purposive interpretation to isolate and curb impermissible tax avoidance. This purposive interpretation has been problematic in the case of the misuse or abuse provision, as the *OSFC Holding* case required an inquiry into the inconsistency of the transaction in relation to a “clear and unambiguous policy”. This proved to be problematic to the Minister in subsequent cases until the Supreme Court postulated a purposive approach requiring a two-step approach (*Canada Trustco Mortgage Company v Canada* (2005) SCC 54).

This purposive approach was, however, qualified when the court specified that in instances where the legislation is detailed, a more literal approach should be adopted as the intent of the legislature is reflected in the literal interpretation of the provision. In addition to this, the courts stated that in applying the purposive approach, the principles of fairness, consistency and predictability should be maintained in order to manage the effect of the GAAR. However, the courts were also of the opinion that the use of the GAAR should be a last resort and where a transaction contravenes a specific provision of the Canadian Income Tax Act, it would be attacked by the Minister on the basis of that specific provision (*Cophorne Holdings Ltd v The Queen* (2011) SCC 63; *Canada Trustco Mortgage Company v Canada* (2005) SCC 54). Therefore, even if a transaction complies with the literal interpretation of the Canadian Income Tax Act it may be successfully attacked under the GAAR if it is abusive of the provision.

The introduction of this purposive approach in applying the misuse or abuse principle remains contentious. While some transactions may be clearly abusive and contrived, the legislative purpose is not always clear.

Similarly, where there is doubt that would introduce uncertainty regarding the applicability of the GAAR to a transaction, the courts will find in favour of the taxpayer in order to maintain certainty in tax.

In addition to the issues highlighted regarding the purposive approach and the misuse or abuse provision, the isolation of a step in a series of transactions is also an area of concern. Some courts have refused to isolate a step in a series of transactions for the purposes of the GAAR, whereas others have acknowledged its presence. Some commentators are of the opinion that an individual transaction in a series of transactions must have its purpose determined by reference to the purpose of the series as a whole. However, it is submitted that if the specific transaction does not help to achieve the non-tax purpose of the entire series of transactions, then its purpose could not be said to be that of the purpose of the entire series of transactions. Therefore, the isolation of a step in a series of transactions may be problematic in combating impermissible tax avoidance where the Minister wants to attack one part of a transaction in a series of transactions under the GAAR.

In conclusion, the components of the Canadian GAAR were analysed in this chapter, including any areas of concern and uncertainty. In the following chapter the South African, Canadian and Australian GAARs are critically compared in order to contrast their differences on a theoretical basis and identify the provisions of the Australian and Canadian GAARs that could be used to improve the effectiveness and efficiency of the South African GAAR.

## CHAPTER 7: COUNTRY COMPARATIVE ANALYSIS

### 7.1 INTRODUCTION

This study analyses and compares the GAARs in South Africa, Canada and Australia in order to identify how the deficiencies in the South African GAAR could be addressed. While Chapters 4, 5 and 6 presented an analysis of literature in order to explore and describe the components of the South African, Australian and Canadian GAARs, this chapter includes a critical analysis of these GAARs in order to draw comparisons between these rules in all three jurisdictions. The chapter is therefore presented in the form of a conceptual study and comparative analysis and is consistent with the purpose of the study. The relationship between Chapters 4, 5, 6 and 7 is represented in Figure 14 below:

FIGURE 14 PHASE 1 CHAPTER RELATIONSHIPS



Source: Own design

In this context the further aim of this chapter was to identify amendments that could be made to the South African GAAR that could result in more robust anti-avoidance legislation. The comparative analysis of the three jurisdictions is presented below and the differences between the three GAARs are identified in order to determine what relative strengths of the Australian and Canadian GAARs could be incorporated into the South African legislation in order to address its weaknesses. This chapter thus completes Phase 1 of the study (doctrinal research) and will be compared with the results from the reform-oriented research conducted in Chapter 8 and 9. The use of both the doctrinal research and reform-oriented research has the advantage of allowing knowledge gained in Phase 1 to be compared with the knowledge gained in Phase 2. More significantly, if the results of the two phases converge, this will provide a strong validation of the findings on the GAAR in Phase 3 of the study.

It remains important, however, to understand that there is lack of consensus on how an effective GAAR should be designed and still allow a taxpayer the freedom to arrange his or her affairs in such a way as to avoid tax legitimately. Given this context, and the uncertainties regarding impermissible tax avoidance, any GAAR will inherently involve an element of uncertainty. The critical analysis presented in this chapter will thus aid in identifying on a theoretical basis:

- which aspects of the Australian and Canadian GAARs could be included in the South African GAAR in order to improve its effectiveness; and
- which aspects of the South African GAAR could be amended or repealed, when compared to the Australian and Canadian GAARs in order to improve its effectiveness.

How the data from Chapters 4, 5 and 6 will be analysed and compared is described below.

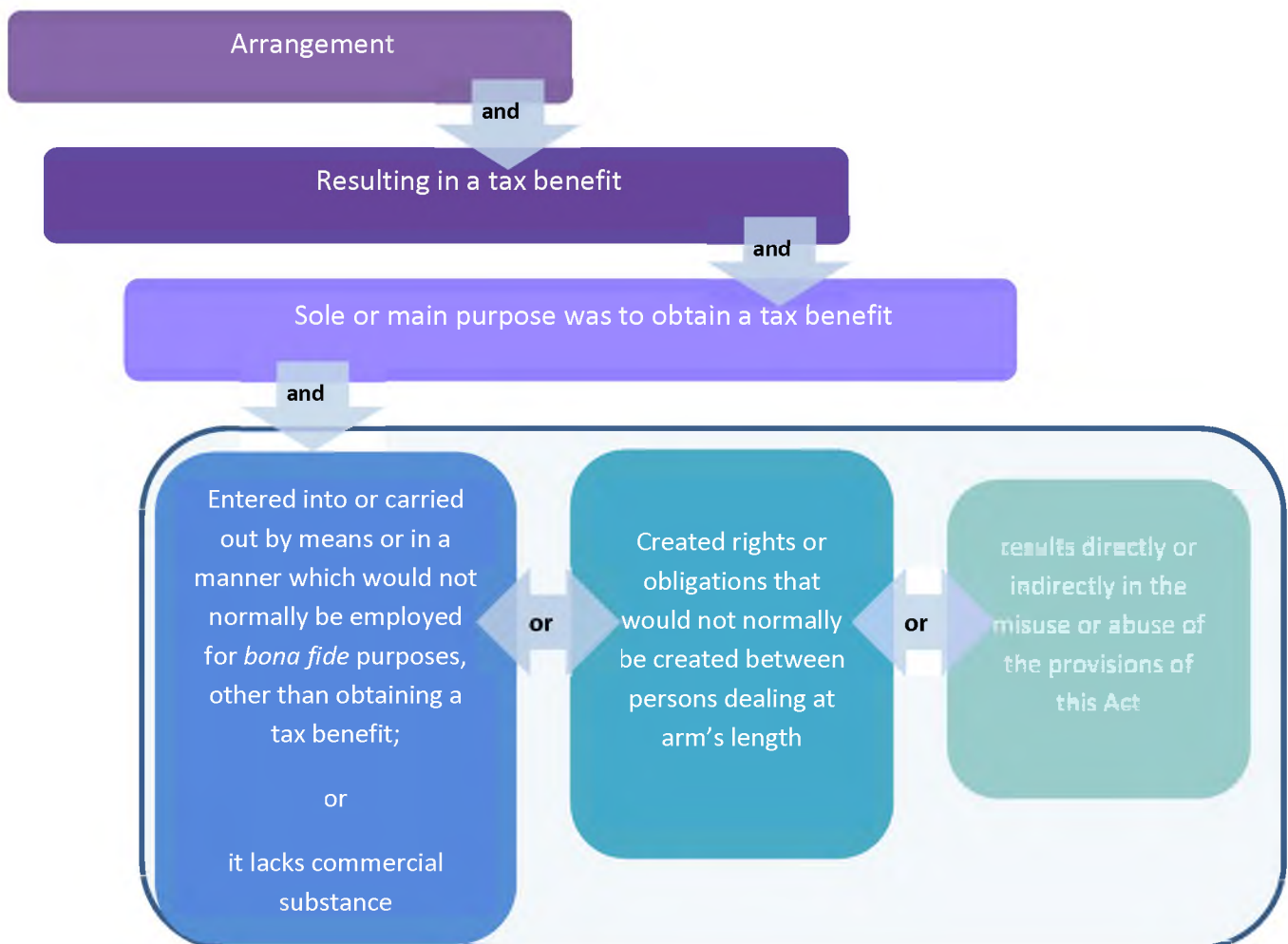
## **7.2 DATA-PROCESSING METHOD**

In order to effectively compare and contrast the GAARs from all three jurisdictions, the basic structure and outline of each of the three GAARs is compared and contrasted. This was carried out at a high level in order to identify key concepts and themes within the GAARs. Each of these themes is then analysed on a more detailed basis in order to obtain an accurate understanding of the different aspects of the GAARs. The high-level comparison of the three GAARs is presented below and the themes for detailed discussion are identified.

### 7.3 OVERVIEW OF THE DIFFERENCES BETWEEN THE GAARS

As demonstrated in Chapters 4, 5 and 6, each of the jurisdictions analysed in this study includes a GAAR in its tax legislation in order to curb impermissible tax avoidance. While the South African GAAR is contained in sections 80A to 80L of the Income Tax Act, the most pivotal provision within these sections is section 80A that defines the term “impermissible avoidance arrangement”. The remaining provisions expand on this provision, provide for the remedies of the Commissioner and deal with related procedural and administrative aspects. Section 80A is represented in Figure 15 below:

FIGURE 15 THE SOUTH AFRICAN GAAR (SECTION 80A OF THE INCOME TAX ACT)



Source: Own design

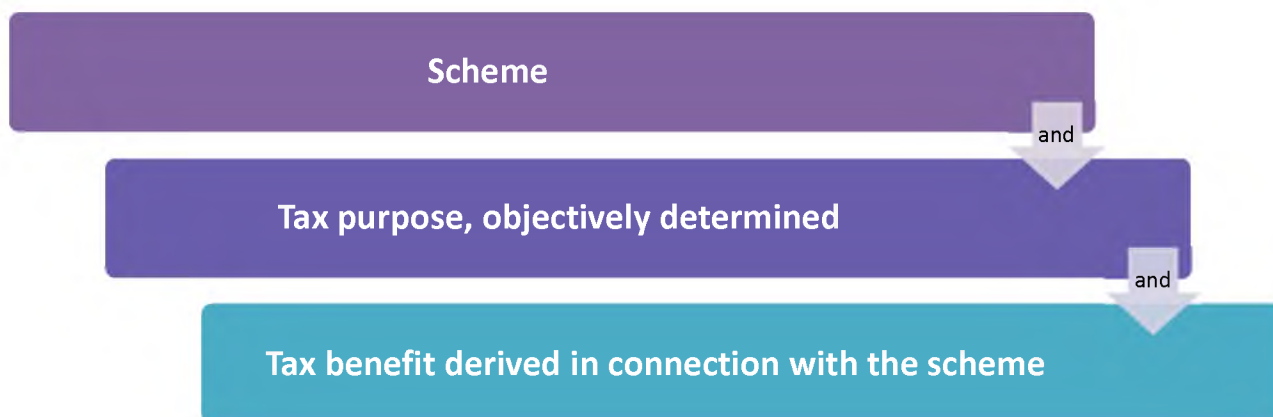
As seen in the lowest block in the above diagram, the South African GAAR consists of four main requirements. However, when comparing the requirements of the Australian and Canadian GAARs to the

South African GAAR, it appears that the most obvious difference is that they only have three main requirements. For purposes of the summary of the South African GAAR presented in Figure 15 above it is argued that the splitting of the tainted elements into different contexts (section 80A(a) – (c)) is unnecessary because they all apply both in a business and a non-business context, with the exception of the commercial substance element, which is not required in a context other than business. Therefore, understanding the remaining differences between the requirements of these GAARs is essential and a critical comparative discussion of the individual differences is set out below. The representations of the Australian and Canadian GAARs are set out below.

### ***The Australian GAAR***

Part IVA of the Income Tax Assessment Act can be represented in Figure 16 below:

**FIGURE 16 THE AUSTRALIAN GAAR (PART IVA OF THE INCOME TAX ASSESSMENT ACT)**



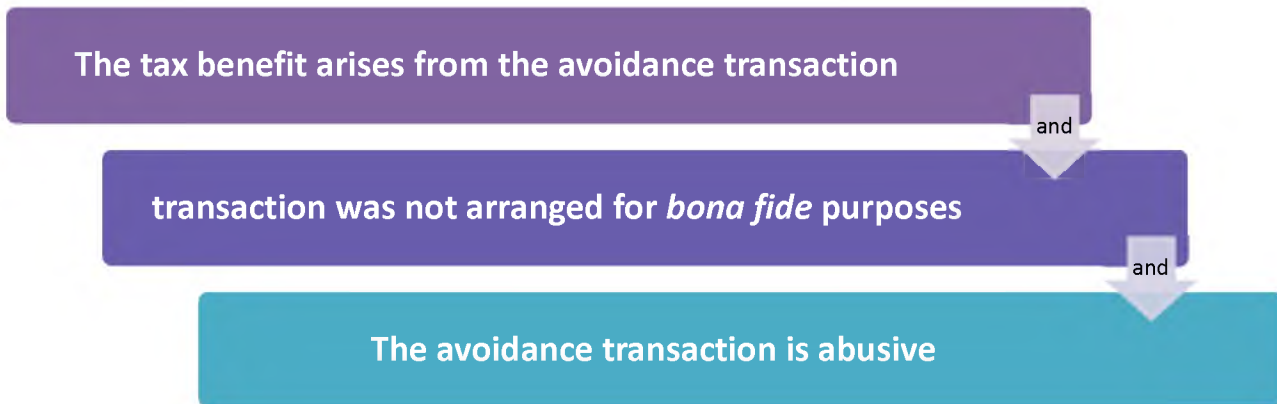
Source: Own design

### ***The Canadian GAAR***

Section 245 of the Canadian Income Tax Act is represented in Figure 17 below:



FIGURE 17 THE CANADIAN GAAR (SECTION 245 OF THE CANADIAN INCOME TAX ACT)



Source: Own design

If the three GAARs are compared in more detail, it appears that they are similar in the following ways:

- Each of the three GAARs requires an arrangement (South Africa), scheme (Australia) or transaction (Canada) to be present. The manner in which these individual terms are defined in their legislative frameworks does not differ significantly and the terms are thus comparable.
- Each of the three GAARs requires the presence of a tax benefit. This is expected as impermissible tax avoidance by its very nature requires that a taxpayer obtain a more favourable tax assessment than he or she would have had without the arrangement, scheme or transaction. These terms are thus comparable.
- Each of the three GAARs requires the tax benefit to result from the arrangement, transaction or scheme in question. This requirement is also to be anticipated, as a revenue authority would not attack a transaction, scheme or arrangement that did not result in a tax benefit for the taxpayer.
- Each of the three GAARs requires an element of purpose to be present. These terms are thus comparable at a high level.

Therefore, it would seem that the most recognisable differences relate to the remaining requirements of the GAARs. The most obvious difference is that conceptually the South African GAAR requires a four-step approach before it can be applied, whereas the Australian and Canadian GAARs require a three-step approach. The fact that the South African GAAR incorporates an additional element compared to Australia and Canada may make it more difficult to successfully attack a transaction when it is contested in the South African courts.

South Africa requires one step for purpose and another for any one of the tainted elements, depending on the context in which the challenged transaction exists. In Australia the inquiry consists of a step for purpose, which includes the application of eight objective factors that will aid in objectively determining such purpose. In Canada a purpose and abusive element is required, but as previously explained (Chapter 6), this step requires a purposive interpretation of the specific provisions of the Canadian Income Tax Act that are relied upon by the taxpayer, in order to determine whether there was an abusive tax avoidance transaction. Therefore, while some of the elements seem to be similar, the practical application of these requirements is inherently different.

In light of the above, the difference between using a three- versus four-step approach is one which requires further examination. This means that the use of both a purpose requirement and a tainted element requirement remains the most obvious difference between the three GAARs. This issue is not novel in the South African context and the use of both of these requirements was recognised as a weakness of the South African GAAR, even before the 2006 amendments (Chapter 4). In this regard it has been noted that the GAAR faces additional challenges in South Africa as a taxpayer could enter into a scheme with the sole purpose of obtaining a tax benefit, but the means or manner in which it is carried out is not considered to be abnormal and thus the requirements of GAAR will not be met. Similarly, a taxpayer could with impunity enter into a scheme that is abnormal, provided that he did not have the sole or main purpose of tax avoidance (SARS, 2005:44).

The impact of this is significant because the GAAR requires both the purpose and tainted elements provisions to be present before a transaction could fall foul of the legislation and places the taxpayer in the powerful position of being able to avoid the application of GAAR by justifying either the tainted elements or purpose requirements with relative ease, when planned with sufficient foresight.

In light of the above, it is suggested that the South African GAAR be amended in such a way that it does not require a separate two-part inquiry into the purpose and tainting of the scheme. A possible solution to this problem would be to formulate a single-part inquiry that replaces the two-part inquiry, where the abnormality of the scheme could inform the test of purpose. This concept is similar to the manner in which the Australian GAAR is structured, where the dominant purpose requirement is informed by the eight objective factors set out in section 177D. In order to compare the GAARs in further detail, each of the themes is discussed in the remainder of the chapter.

The themes for discussion and comparison have been identified as follows:

- arrangement, scheme or transaction;
- tax benefit resultant from the arrangement, scheme or transaction;
- the element of purpose; and
- the element of abnormality, abuse or tainting.

## **7.4 SUMMARY OF THE DIFFERENCES**

The high-level overview of the differences between the three jurisdictions has contributed to understanding what structural differences between the GAARs may impact on the effectiveness of the South African GAAR. A comparative analysis of each of the component themes of the GAARs identified above is now presented.

### **7.4.1 ARRANGEMENT, SCHEME OR TRANSACTION**

The need for the presence of an arrangement, scheme or transaction in each of the three GAARs has already been identified. The definitions of these terms in each of the three GAARs refer to various terms including transaction, operation, scheme, agreement, understanding, arrangement, promise, undertaking, plan, proposal, action, course of action, course of conduct and event. In each of the GAARs it is evident that these terms are widely defined and there are consistencies in the three GAARs in this respect. However, a more detailed analysis reveals that both South Africa and Australia allow the revenue authority to identify steps within a wider transaction to which to apply the GAAR. In the South African context this has been criticised, as it may result in the arrangement identified losing its commercial substance when considered separately from the larger scheme (Broomberg, 2007c:1).

In Australia this is also an area of uncertainty due to various conflicting court judgments. The South African legislature appears to have anticipated these problems and included section 80G(2), which provides that “[t]he purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole”. This does not seem to address the problems that may occur when the courts are required to interpret the arrangement for the purpose of applying the GAAR. It therefore seems that this provision may be inherently uncertain, and it may be left to the courts

to decide on a case-by-case basis how and when this may be applied. Therefore, it is submitted that additional guidance should be provided.

In addition, the Australian GAAR broadens the definition of a scheme by including a reference to unilateral undertakings. It is uncertain if an inclusion of a similar provision in the South African counterpart would add value as it appears that this will already be included in the definition of an arrangement.

#### **7.4.2 TAX BENEFIT RESULTING FROM THE ARRANGEMENT, SCHEME OR TRANSACTION**

The need for a tax benefit to be present is included in all three jurisdictions, as discussed above. In South Africa this concept is introduced with the use of the term “avoidance arrangement”, while in Canada it arises as a result of the term “avoidance transaction”. Each jurisdiction deals with this concept slightly differently. In South Africa this is a widely defined term that has been interpreted by the courts. This has resulted in the possible application of the “but for” test or the question of a taxpayer having “stepped out of the way of the anticipated tax liability”.

In Australia a list of tax benefits obtained by the taxpayer is included in the GAAR, which has resulted in a less widely interpreted provision. This will ultimately reduce the discretion in interpreting this concept as it would not be considered to be a subjective term. However, it is submitted that the incorporation of this list may allow taxpayers to obtain tax benefits that are not included in the list, so that all impermissible transactions undertaken cannot be attacked under the GAAR. However, it could be of value for the South African legislature to include a similar list in the definition of a tax benefit in order to prevent a narrower interpretation in future that will reduce the impact of the GAAR.

The Australian GAAR has also anticipated the situation where a taxpayer has created the conditions necessary to take advantage of a provision in the legislation that provides a tax benefit. In this regard the Australian legislature has prevented this by specifically providing that if this is done, it will be considered a tax benefit. This may be a more effective approach than the South African GAAR and could also be included in the South African GAAR. This will ensure that taxpayers do not evade the application of the GAAR by creating the circumstances necessary to use a tax-advantageous provision in the Income Tax

Act. It is uncertain if the inclusion of the misuse or abuse element will prevent this, due to the lack of guidance provided with regard to its application, as well as the many unanswered questions that may be raised with regard to the misuse or abuse element (De Koker and Williams, 2015:par.19.39). Further, the current interpretation of the misuse or abuse element refers to the frustration, exploitation or manipulation of the purpose of any of the provisions of the Act or the achievement of results not intended by the Act. Where a taxpayer has created the circumstances necessary to use a tax-advantageous provision, which will comply with the Income Tax Act, it will not be considered an abuse of the Income Tax Act as these circumstances are specifically compliant with the Income Tax Act. Should further guidance be provided with regard to the interpretation or application of the misuse or abuse element it is submitted that it may be possible for the misuse or abuse element to address this issue.

In addition to providing a list of the benefits, Australia requires a determination of whether the tax benefit would have arisen in the absence of the scheme. This allows a quantification of the tax benefit resulting from the scheme in question and any tax benefit would then be calculated as the difference between the tax effect of the scheme and the identified alternative. In the South African context, De Koker and Williams (2015:par.19.37) are of the opinion that the Commissioner would need to show what arrangement would otherwise have been entered into to produce the same commercial result and the tax consequences in order to prove what tax benefit results from the arrangement entered into. Therefore the Commissioner would be required to provide a reasonable alternative transaction that could have been entered into by the taxpayer in order to achieve the same end result. De Koker and Williams (2015:par.19.37) further note that it is not sufficient that the Commissioner simply contends that there is a tax benefit, but the tax benefit must be quantified when compared to the alternative arrangement.

In light of the above, although the South African judiciary has not previously had problems in determining the tax benefit of schemes attacked under the GAAR, it may be useful to provide additional guidance in order to prevent problems in future. However, in doing so, the problems experienced in Australia with regard to identifying a most likely alternative must be considered before providing such guidance so that more uncertainty for the GAAR is not created (i.e. determining if it is reasonable to assume that no scheme would have been entered into or what alternatives can be considered with regard to achieving the same commercial objectives).

In Canada, while the terms “tax benefit” and “tax consequences” are defined, no alternative arrangement concept is included in the GAAR. However, the courts have identified that there may, in certain circumstances, be a need to quantify a tax benefit with reference to an alternative arrangement. This supports the suggestion made above regarding the inclusion of such a provision in the South African GAAR.

### **7.4.3 THE ELEMENT OF PURPOSE**

As highlighted above, each of the three jurisdictions includes an element of purpose in the GAARs. Therefore, in each of the three jurisdictions, before a transaction can be attacked successfully by the GAAR, the scheme or arrangement must have an element of purpose.

In South Africa this is referred to as the sole or main purpose requirement and the taxpayer must provide evidence to prove that the sole or main purpose of the arrangement was not to obtain the tax benefit. In Australia the test is in the form of a sole or dominant purpose test and it is submitted that there is arguably no difference between these two tests in the light of the meaning of the words used. In Canada this provision is slightly different because an avoidance transaction is one where the transaction results in a tax benefit, unless it is arranged primarily for *bona fide* purposes other than to obtain the tax benefit. This test is thus formulated in the negative. However, the differences in structure are arguably negligible as the test is essentially similar to both the South African and Australian counterparts.

In all three jurisdictions this test should effectively exclude those transactions that were undertaken for genuine commercial purposes and will allow the revenue authorities to attack transactions that were entered into for purposes of obtaining the tax benefits. This test has been highlighted as the pivotal provision of the Australian GAAR and now appears in the legislation before the tax benefit requirement. It is submitted that the order in which the requirements are tested does not serve to improve the efficacy of the GAAR and no recommendations for the South African GAAR are made in this regard.

One difference noted in the Australian GAAR is that section 177D(1) provides that at least one of the persons who entered into or carried out the scheme, or any part of the scheme, did so for the purpose of obtaining the tax benefit for the taxpayer. Therefore, the dominant purpose requirement can be met if any party (other than the taxpayer) has the dominant purpose of obtaining the tax benefit for the taxpayer. This

provision is not present in the South African GAAR and may strengthen the GAAR as it will prevent one party to the transaction from providing evidence on the commercial purpose of the transaction, which is essentially not related to the taxpayer's purpose for entering into the transaction.

In addition, both the Australian and Canadian GAARs require the purpose test to be determined objectively. Australia uses eight statutory factors to aid in this inquiry, while in Canada the test specifically includes the word "reasonably". This leads to the conclusion that the test is based on a reasonable person's interpretation of the facts of the case and this view has been confirmed by the judiciary (*Canada Trustco Mortgage Company v Canada* (2005) SCC 54).

The Canadian GAAR thus requires the facts of the transaction to be considered in light of the evidence presented, as opposed to a mere representation by the taxpayer regarding the primary purpose of the transaction. In South Africa it is not certain if this test should be applied objectively or subjectively, but section 80G of the Income Tax Act creates a presumption that the sole or main purpose of the arrangement is to obtain a tax benefit. The slight differences in the structure of the Canadian GAAR, when compared to the South African GAAR (as noted above), leads to the conclusion that this is also required in the Canadian context. In light of the fact that the South African GAAR is untested legislation and uses similar words to those of the previous provision (which used a subjective test in this regard), it is uncertain how this test should be applied. Therefore, it is submitted that guidance should be provided to address the uncertainty regarding the subjective or objective interpretation of this test.

Perhaps the most notable difference between the three jurisdictions is that the Australian GAAR uses eight factors (listed in section 177D(2)) to guide the objective determination of a particular scheme's sole or dominant purpose. These factors broadly deal with three categories related to the transaction: the manner in which the scheme operated, the consequences resulting from the scheme and the nature of the connection between the taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer. It is submitted that the inclusion of similar guidance may be of value in the South African context as it is untested in its current form and there is already evidence of uncertainty regarding its subjective or objective application (*Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A); *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A); *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A)) *Commissioner for Inland*

*Revenue v Middelman* (1989) 52 SATC 323 and *Income Tax Case No 1607* (1995) 58 SATC 340; De Koker and Williams, 2015:par.19.38; Meyerowitz, 2008:par29-12).

Where only a part of a larger transaction is identified for attack under the GAAR in Australia, the dominant purpose of the scheme must be determined with reference to the whole transaction and not just the narrower scheme identified by the Commissioner. In using the eight factors it is important to weigh the scheme's commercial and tax features as the courts have in cases denied the application of the Australian GAAR, even where the scheme contained some elements of tax reduction (*Federal Commissioner of Taxation v Hart* (2004) 55 ATR 712). However, no guidance has been provided on how to weigh these factors in determining the dominant purpose of a scheme. Inevitably this is left to the courts to decide and introduces the possibility of differing interpretations.

Lastly, all three jurisdictions have recognised that the GAAR should still allow a taxpayer to choose a manner of effecting the transaction that attracts less tax, without falling foul of the provisions of the GAAR. It is then the responsibility of the judiciary to determine where the line between permissible and impermissible avoidance transactions lies in this context.

#### **7.4.4 THE ELEMENT OF ABNORMALITY, ABUSE OR TAINING**

The last step of the South African GAAR is the presence of tainted elements in an avoidance arrangement (previously referred to as the abnormality requirement). While the onus of proving that one of these tainted elements is present in an avoidance arrangement lies with the Commissioner, the Income Tax Act contains guidelines and definitions that the Commissioner may rely on to discharge this onus.

The Australian GAAR has no such tainting requirement, but the use of the eight factors that guide the objective determination of the purpose test may arguably achieve the same objectives as the tainting elements in the South African GAAR. As noted, the eight factors in the Australian GAAR broadly deal with three categories related to the transaction:

- the manner in which the scheme operated (the manner, the form and substance, the timing and duration);
- the consequences resulting from the scheme (the result, the change in financial position and other consequences); and



- the nature of the connection between the taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer.

The requirements of the South African GAAR in relation to the tainting elements broadly include the following categories:

- an element of abnormality;
- a lack of commercial substance (consideration of the substance over form, the presence of round-trip financing, accommodating or tax-indifferent parties and offsetting or cancelling effects);
- creation of rights or obligations not at arm's length; and
- misuse or abuse of the Act.

When analysing the two GAARs in more detail, the differences between the two seem to be more apparent than real. For example, in Australia typical features of failed schemes are that there is “considerable doubt as to whether the taxpayer will generate a pre-tax return, the arrangement, or part of it, is effected by book entries or a round robin of funds, and there are non-arm's length entities or transactions”(Calvert and Dabner, 2012:73). In many ways this is comparable to the lack of commercial substance element in the South African GAAR. In fact, it is evident that the form and substance of the arrangements are expressly required by both GAARs. Similarly, an inquiry into the consequences resulting from the scheme would include round-robin financing (round-trip financing) and offsetting or cancelling elements, as required in the South African GAAR.

In addition, the nature of the connection between the taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer, included in the Australian GAAR would require the creation of rights and obligations that are not at arm's length. However, one significant difference between the Australian GAAR and the South African GAAR is the detailed reference to accommodating or tax-indifferent parties in South Africa, which has not been a consideration that has been necessarily focused on by the Australian courts (Calvert and Dabner, 2012:74). Arguably, the more prescriptive approach taken in the South African GAAR with regard to accommodating or tax-indifferent parties attempts to focus the attention on the possible application of the GAAR in circumstances where a party to the arrangement is tax indifferent, for example where they may be resident in a tax haven.

The Australian GAAR also includes two aspects that have not been expressly included in the South African GAAR:

- the manner in which the scheme was entered into or carried out (which includes a consideration of the method or procedure used to carry out the scheme, including a consideration of how the scheme in question was established (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183)); and
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out, which includes a possible “flurry of activity” undertaken at the year-end of the taxpayer, indicating a possible tax motive (*Federal Commissioner of Taxation v Sleight* (2004) 55 ATR 555).

These two factors, while structured more broadly than any of the tainted elements in the South African GAAR, allow the courts to consider additional features of the arrangements, rather than the explicitly defined South African elements. Arguably, they could add strength to the South African GAAR as the courts would be able to consider other characteristics of the scheme, which would lead to a more accurate conclusion on the sole or main purpose of the arrangement, as indicated in the examples above.

Based on the above discussions regarding the tainted elements, it is evident that the only remaining tainted elements not found in the Australian GAAR are those of abnormality and of misuse or abuse. However, when considering the element of abnormality, and its weaknesses discussed in Chapter 4, it is submitted that this element does not add strength to the South African GAAR and may in fact reduce its effectiveness by introducing an element of uncertainty.

Notwithstanding the fact that no element of abnormality is present in the Australian GAAR, the aspects should be considered that are inherent to the Australian GAAR, without being specifically prescribed in the legislation. In this regard it is important that the Australian GAAR requires a calculation of the difference between the tax effect of the scheme and the identified alternative. In doing so, the court has the obligation to decide which alternative transaction (alternative postulate as referred to for purposes of the Australian GAAR) is the most likely, from the alternative postulates presented by the Commissioner, the taxpayer or the court itself.

Therefore, the alternative postulate requires a consideration of how the taxpayer might reasonably have been expected to have structured the transaction and limits the ability of a taxpayer to suggest an alternative that is not reasonable (i.e. not normal). Therefore, it is suggested that a less prescriptive stance could be taken in the South African GAAR, which could require a similar comparison (between the tax effect of the scheme and an identified alternative) in order to change the broad abnormality element into a more concrete form, with a view to removing the current tainted element of abnormality. This means that in suggesting a reasonable alternative any abnormal options should be excluded from the analysis and effectively converts the abnormality requirement from a prescriptive provision, to one that determines a reasonable alternative. This suggestion is not without its own problems though, as this alternative is also inherently subjective, and it may be difficult to identify possible alternatives that achieve the same commercial outcomes. However, the problems of the current abnormality element should be compared with those of the Australian alternative postulate, which seems to be more effective (though not without its own problems). It is interesting to note that the Canadian GAAR has a similar alternative provision, which adds strength to the suggestion that a similar provision could be added to the South African GAAR.

The last tainted element that is included in the South African GAAR and that is not present in the Australian GAAR is the misuse or abuse element. This is the only element that can be compared to the Canadian GAAR (presumably because it was drawn from the Canadian GAAR, as discussed in Chapter 4). Differences in the use of this test in South Africa and Canada stem primarily from the positive versus the negative application of the test, as explained in Chapter 4. Effectively, the Canadian GAAR applies the concept as a limitation on the operation of the GAAR, which arguably has the effect of precluding the GAAR from being too broad and therefore the test could be applied similarly in both countries (Louw, 2007:40; Calvert and Dabner, 2012:75). Currently, as a positive test in the South African GAAR, in conjunction with its possible wide interpretation, this could place the current GAAR in a predicament similar to that faced by its predecessor, where its ambit was considered to be too wide (Calvert and Dabner, 2012:65).

Commentators on the Canadian provision question whether this element adds anything beyond requiring a purposive approach to legislative interpretative principles (Arnold, 1995:550-551). It is submitted that such a provision is not required in the South African GAAR, as a purposive approach has long received judicial support in South Africa.

In addition, the Canadian GAAR provides that the transaction will not be subjected to GAAR if it could reasonably have been considered to have been undertaken for *bona fide* purposes other than obtaining the tax benefit. The South African GAAR does not use the word “reasonably” in this misuse or abuse element and the implication of the absence of this word is that the Canadian GAAR directs the revenue authority and the judiciary to adopt a fair and reasonable application of the GAAR. The absence of a requirement of reasonability may result in a more stringent application of the South African GAAR by the judiciary (Calvert and Dabner, 2012:65).

It is therefore submitted that the uncertainty and lack of guidance regarding this element of the South African GAAR will ultimately reduce the efficacy of the GAAR and two options are available to remedy the problem:

- If the provision is intended to reinforce a purposive approach to the GAAR, it should be removed and could add greater value if it is used as guidance in respect of the interpretation of the GAAR as a whole, as opposed to a separate test.
- If the provision is intended to achieve some other purpose, then guidance should be provided on its application.

This concludes the comparison of the abnormality, abusive or tainting elements present in the three jurisdictions. The recommendations for improvements to the South African GAAR are summarised in the following section.

## **7.5 RECOMMENDATIONS FOR IMPROVEMENT OF THE SOUTH AFRICAN GAAR**

The analysis of both the high-level structural differences and the more detailed requirement-specific analysis have resulted in recommendations for possible improvements to the South African GAAR. These recommendations are briefly summarised below.

### ***a) The abnormality and purpose requirements as two separate tests***

It is suggested that the South African GAAR be amended in a way that does not require a separate two-part inquiry into the purpose and abnormality of the scheme. A possible solution to this problem would be to formulate a single-part inquiry that replaces the two-part inquiry, where the abnormality of the

scheme could inform the test of purpose. This concept is similar to the manner in which the Australian GAAR is structured, where the dominant purpose requirement is informed by the eight objective factors in section 177D.

***b) Steps within a wider transaction***

Though the South African GAAR allows the Commissioner to identify steps within a wider transaction to which to apply the GAAR, this has been criticised as it may result in the arrangement losing its commercial substance when considered in isolation, in the absence of the context provided by the wider scheme. In Australia this is also an area of uncertainty due to various conflicting court judgments. It is suggested that additional guidance be provided on this matter to enhance the understanding of the purpose of this provision when applying the GAAR purposively, in order to avoid the problems experienced in Australia.

***c) Defined list of tax benefits***

It is submitted that it could be of value for the South African legislature to include a list, similar to that used in Australia, with regard to defining a tax benefit. This should aim to maintain the strength of the current definition, but to add a defined, but not exclusive, list of items specifically identified as a tax benefit. This will prevent the narrow interpretation of the GAAR in future.

***d) Creating circumstances necessary to obtain a tax benefit***

It may be valuable for the South African legislature to specifically include a provision in the GAAR that prevents a taxpayer from artificially creating the conditions necessary to take advantage of a specific provision that will provide a tax benefit. This will ensure that taxpayers do not evade the application of the GAAR by creating the artificial circumstances necessary to use a tax-advantageous provision in the Income Tax Act.

***e) Calculating the amount of the tax benefit using the most likely alternative***

It is submitted that it may be useful to provide additional guidance on quantifying a tax benefit by calculating the difference between the tax effect of the scheme and the identified alternative. This suggestion is not without its own problems, as this alternative is also inherently subjective and it may be difficult to identify possible alternatives that achieve the same commercial outcomes.

***f) Dominant purpose for other parties to the transaction***

One difference noted in the Australian GAAR is that section 177D(1) provides that at least one of the persons who entered into or carried out the scheme or any part of the scheme did so for the purpose of obtaining the tax benefit for the taxpayer. Therefore, the dominant purpose requirement can be met if any party (other than the taxpayer) has the dominant purpose of obtaining the tax benefit for the taxpayer. This concept is not present in the South African GAAR and may add strength to the GAAR as it will prevent one party to the transaction from providing evidence of the commercial purpose of the transaction, which is essentially not related to the taxpayer's own purpose for entering into the transaction.

***g) The objectivity or subjectivity of the sole or main purpose requirement***

In South Africa it is not certain whether the sole or main purpose requirement should be applied objectively or subjectively. It is recommended that guidance be provided to reduce the uncertainty regarding the subjective or objective interpretation of this test. Australia has provided eight factors (listed in section 177D(2)) to guide the objective determination of a particular scheme's sole or dominant purpose. These factors broadly deal with three categories related to the transaction: the manner in which the scheme operated, the consequences resulting from the scheme and the nature of the connection between the taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer. It is submitted that the inclusion of similar guidance may be of value in the South African context as the sole or main purpose aspect is as yet untested in its current form and there is already evidence of uncertainty regarding its subjective or objective application (*Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A); *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A); *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A)) *Commissioner for Inland Revenue v Middelman* (1989) 52 SATC 323 and *Income Tax Case No 1607* (1995) 58 SATC 340; De Koker and Williams, 2015:par.19.38; Meyerowitz, 2008:par29-12).

***h) The tainted element of abnormality***

The Australian GAAR introduces an alternative postulate to determine the tax benefit of a scheme. This requires a calculation of the difference between the tax effect of the scheme and the identified alternative. In doing so, the obligation is created to decide which alternative transaction is the most likely and how

the taxpayer might reasonably have been expected to have structured the transaction, thereby preventing a taxpayer from suggesting an alternative that is not reasonable (i.e. not normal). Therefore, it is recommended that the South African GAAR should require a similar comparison (between the tax effect of the scheme and the identified alternative) in order to enforce the abnormality element in a more coherent form (within the tax benefit requirement) with a view to removing the current tainted element of abnormality. This suggestion is not without its own problems, as this alternative postulate is also inherently subjective and may in fact introduce additional problems. However, the problems of the current abnormality element should be weighed up against those of the Australian alternative postulate, which appears to be more effective (though not without its own problems).

***i) The manner and timing of the arrangement***

The Australian GAAR includes two aspects that have not been expressly included in the South African GAAR:

- the manner in which the scheme was entered into or carried out (which includes a consideration of the method or procedure used to carry out the scheme, including a consideration of how the scheme in question was established (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183)); and
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out, including a consideration of a possible “flurry of activity” undertaken at the year-end of the taxpayer, indicating a possible tax motive (*Federal Commissioner of Taxation v Sleight* (2004) 55 ATR 555).

These two factors, while structured more broadly than any of the tainted elements in the South African GAAR, allow more factors surrounding the arrangements to be considered, than the present South African elements. Arguably, they could add strength to the South African GAAR as the characteristics of the scheme under attack could be taken into consideration, which would lead to a more accurate conclusion on the sole or main purpose of the arrangement.

*j) The misuse or abuse element*

Concerning the misuse or abuse element used in the South African GAAR, it is submitted that the uncertainty and lack of guidance provided regarding this element will ultimately damage the efficacy of the GAAR and two options are available to remedy the problem:

- If the provision is intended to reinforce a purposive approach to the GAAR, it should be removed and could add greater value if it is used as guidance for interpreting the GAAR as a whole, as opposed to a separate test.
- If the provision is intended to achieve some other purpose, then guidance should be provided on its application.

This section of the study has resulted in proposals to improve the efficacy of the South African GAAR on a theoretical basis. In this context it is also important to remember that many of the weaknesses identified in the current South African GAAR were already present in its predecessor. It is therefore relevant to determine if any of the suggestions made to improve the efficiency of the South African GAAR would address the weaknesses experienced by its predecessor. It is impossible, however, to conclude with complete certainty whether these untested proposals will have the intended effect in addressing the weaknesses identified in the predecessor to the current GAAR that were not addressed by the 2006 amendments, as discussed in Chapter 4.

## **7.6 RECOMMENDATIONS ADDRESSING THE WEAKNESSES OF THE PRECEDING SOUTH AFRICAN GAAR**

Chapter 4 introduced a discussion on the weaknesses of the predecessor to the South African GAAR (section 103(1)). The 2006 amendments to the GAAR were intended to address these weaknesses in order to create a more effective and robust GAAR. In light of the comparisons made in this chapter (between the South African, Australian and Canadian GAARs), it is important to consider if any of the previously identified weaknesses could be addressed by the recommendations made above (the numbers (a) – (j) as used in section 7.5 above are referred to again in this section). The weaknesses of the previous GAAR were noted as follows:



### *Not an effective deterrent to tax avoidance*

The GAAR frequently failed to stand up to the rigours of court and the significant amount of time and resources committed to detecting and combating these schemes was costly and had a negative impact on the relationship between SARS and taxpayers (Olivier, 1996:378; SARS, 2005:42). The abnormality and purpose requirements were identified as the most crucial areas of weakness and, in addition to the individual problems noted in each of these cases, the effectiveness of the GAAR was further reduced by the fact that the transaction would need to satisfy both criteria before the GAAR would apply. Therefore, by the taxpayer disproving only one of the requirements, the GAAR would fail to stand up to the rigours of the courts (SARS, 2005:43).

Recommendation (a) “The abnormality and purpose requirements as two separate tests” is intended to aid in alleviating the problem of the GAAR being an ineffective deterrent to tax avoidance. This is due to the fact that the two tests (abnormality and purpose tests) will be combined in a manner similar to the Australian GAAR.

### *The “abnormality” requirement*

The Margo Commission (1988) criticised the abnormality requirement due to the fact that if a particular transaction was widely used, it became normal through the extensive use of such transactions (Williams, 1997; SARS, 2005; Werksmans, 2006). More recently, these criticisms have again been noted (despite amendments since 1986) because the commercial acceptability of a transaction could result in the abnormality test not being satisfied, regardless of the fact that the transaction may have been entered into solely for the avoidance of tax (Olivier, 1997:742). This, in essence, rendered the GAAR an ineffective deterrent for tax avoidance (Williams, 1997; SARS, 2005).

Recommendation (h) “The abnormality tainted element vs the alternative postulate” is intended to aid in alleviating the problems noted in the abnormality requirement, as an obligation arises to decide which alternative transaction is the most likely. A deliberation is required of how the taxpayer might reasonably have been expected to have structured the transaction and this eliminates the ability of a taxpayer to suggest an alternative that is not reasonable (i.e. not normal).

### ***The purpose requirement***

The purpose requirement was similarly criticised since obtaining a tax benefit would need to be the sole or main purpose of the transaction (Brincker, 2001:163). The relative ease with which taxpayers were able to justify the commercial purpose of transactions left SARS in the difficult position of having to prove that the dominant purpose of the transaction was to obtain a tax benefit (SARS, 2005:43).

Recommendations (f) and (g) “Dominant purpose for other parties to the transaction” and “The objectivity or subjectivity of the sole or main purpose requirement and the eight factors” are intended to aid in addressing this problem.

Firstly, introducing an element similar to that of the Australian GAAR where one party to the transaction is prevented from providing evidence of the commercial purpose of the transaction that is essentially not related to the taxpayer’s purpose for entering into the transaction will add strength to the GAAR. Secondly, providing guidance regarding the subjective or objective interpretation of this test will reduce uncertainty. Thirdly, the use of factors to aid in this inquiry will provide guidance in considering certain relevant factors objectively.

### ***The abnormality and purpose requirements together***

The two weaknesses discussed above with regard to the abnormality and purpose requirements are compounded when it is considered that they both needed to be present for an arrangement to fall foul of the GAAR. Therefore a taxpayer could with impunity enter into a transaction with the (subjective) sole purpose of avoiding tax, provided that there was no (objective) abnormality in the means or manner or in the rights and obligations that it created and vice versa (SARS, 2005:44). Therefore, the structure of the GAAR, requiring both the purpose and abnormality provisions to be present before a transaction could fall foul of the legislation, placed the taxpayer in a powerful position of being able to avoid the application of the GAAR by justifying either the abnormality or purpose requirements with relative ease when planned with sufficient foresight.

Recommendation (a) “The abnormality and purpose requirements as two separate tests” is intended to aid in solving this problem. The South African GAAR could be amended in a way that does not require a

separate two-part inquiry into the purpose and abnormality of the scheme. A single-part inquiry could replace the two-part inquiry, where the tainted elements could be used in a manner that informs the test of purpose as opposed to becoming its own test. This concept is similar to the manner in which the Australian GAAR is structured, where the dominant purpose requirement is informed by the eight objective factors of section 177D.

### ***Procedural and administrative issues***

Additional concerns raised relate to the uncertainties with regard to the scope of the GAAR. Firstly, there was uncertainty about the extent to which the GAAR could be applied to individual steps in a larger transaction. Secondly, there was uncertainty as to whether the Commissioner had authority to apply the GAAR in the alternative where another provision in the Income Tax Act applied (SARS, 2005:44).

Though the 2006 amendments to the GAAR now allow the Commissioner to identify parts of an arrangement, recommendation (b) “Steps within a wider transaction” could add value. This provision has been criticised as it may result in the arrangement identified losing its commercial substance when considered in isolation. It is submitted that the Australian GAAR may help provide guidance in understanding the purpose of this provision in greater depth when applying the GAAR purposively, in order to avoid the problems experienced in Australia.

Despite the recommendations made to address the weaknesses in the predecessor to the South African GAAR, it is impossible to be unequivocal regarding the impact these recommendations will have if implemented. This is due to the inherent uncertainty inherent in any GAAR that is designed to combat structures that aim to circumvent the GAAR.

## **7.7 CONCLUSION**

This chapter presented a critical analysis of the Australian, Canadian and South African GAARs in order to draw comparisons between the rules in all three jurisdictions, with a view to making recommendations for improvements to the South African GAAR. This chapter completes phase 1 of the study and its outcomes (in the form of recommendations in relation to amendments of the South African GAAR) can be compared with the outcomes from phase 2 of the study, in Chapter 8 and 9. The use of the doctrinal research and reform-oriented research has the advantage of allowing the outcome of the research in phase

1 to be compared with phase 2. This is due to the fact that, while the doctrinal research enables comparisons to be drawn between the three GAARs in order to make suggestions regarding the effectiveness of the South African GAAR, the reform oriented research proposes changes to the South African GAAR and complements this phase on a practical basis by applying the South African GAAR to cases in Australia and Canada in order to determine:

- which aspects of the South African GAAR are effective and should remain intact;
- which aspects of the South African GAAR are ineffective and should be amended;
- which aspects of the Australian GAAR are effective and should be included in its South African counterpart; and
- which aspects of the Canadian GAAR are effective and should be included in its South African counterpart.

More significantly, if the results of the two phases converge, there will be strong validation of the findings on the GAAR in phase 3 of the study. In this context the outcomes from the comparative analysis presented in this chapter include recommendations for the strengthening of the South African GAAR that could result in a more robust South African GAAR. In the comparative analysis, both structural and requirement-specific aspects of the three GAARs were compared. The recommendations made for improvement included the following:

- A single-part inquiry should be formulated that will replace the separate purpose and abnormality (tainted element) requirements. This single-part inquiry could be informed by factors similar to those of the tainted elements (South African GAAR) or factors similar to the eight factors (Australian GAAR).
- Additional guidance should be provided on the application of the GAAR to steps within a wider transaction. This guidance should aim to determine the impact this will have upon the commercial substance of the whole arrangement.
- It is suggested that a list, similar to that used in Australia when defining a tax benefit, could also be included in the South African GAAR. This should aim to maintain the strength of the current definition, but add a defined list of items specifically included as a tax benefit to prevent a narrow interpretation in future.

- The South African GAAR should include a provision that will prevent taxpayers from artificially creating the circumstances necessary to take advantage of a specific provision of the Income Tax Act. This will attempt to ensure that taxpayers who use provisions in the legislation to obtain a tax benefit are doing so legitimately without artificially creating the circumstances necessary to do so.
- It is suggested that guidance be provided on quantifying a tax benefit. This could be done by calculating the difference between the tax effect of the scheme and the identified alternative.
- Introducing a dominant purpose for all parties to the arrangement may prevent one party from providing evidence on the commercial purpose of the transaction that is essentially not related to the specific taxpayer's own purpose for entering into the transaction.
- It is suggested that guidance be provided on the objective or subjective inquiry into the sole or main purpose requirement.
- Introducing an alternative postulate to be applied in calculating the tax benefit will result in a consideration of how the taxpayer might reasonably have been expected to have structured the transaction and thereby eliminate the ability of a taxpayer to suggest an alternative that is not reasonable (i.e. not normal). This may resolve further issues with the abnormality requirement.
- Including factors such as the manner and timing of the arrangement into the GAAR will allow more factors relating to the arrangements to be considered, rather than the present defined South African elements. As a result, characteristics of the scheme under attack could be considered, which would lead to a more accurate conclusion on the sole or main purpose of the arrangement.
- The misuse or abuse element should be clarified to reduce uncertainty and aid in the application of this test.

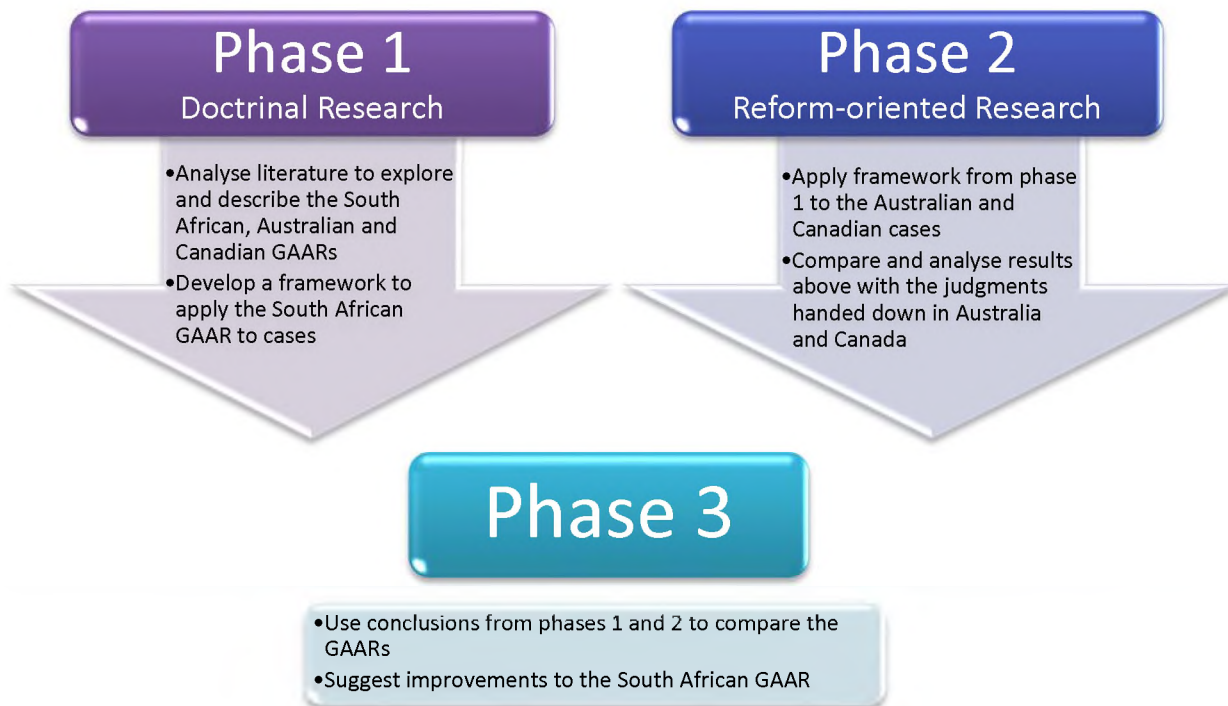
Nevertheless, it remains important to understand that there is lack of consensus on how an effective GAAR should be designed that will still allow a taxpayer the freedom to arrange his affairs so as to legitimately avoid tax. Given this and the uncertainties regarding impermissible tax avoidance, any GAAR will inherently involve an element of uncertainty. The following chapters form the first part of phase 2 of the study and the framework developed in phase 1 is used to apply the South African GAAR to the facts of cases heard in both Australia and Canada.

## CHAPTER 8: AUSTRALIAN CASE LAW IN RELATION TO GAAR

### 8.1 INTRODUCTION

This chapter forms the first part of phase 2 of the study, which aims to analyse and compare the GAAR applying in South Africa, Canada and Australia in order to identify how the deficiencies in the South African GAAR could be addressed. In this chapter the focus will be on applying the framework of the South African GAAR to the facts from Australian case law. The relationship between the phases of the research methodology is represented in Figure 18 below:

FIGURE 18 RESEARCH METHODOLOGY



Source: Own design

In this chapter the framework of the South African GAAR developed in chapter 4 is applied to selected cases from Australia to analyse the effectiveness of the South African GAAR in combatting arrangements that were suspected of impermissible avoidance. The goal/purpose of the research is thus directly addressed, that was defined in Chapter 1 as:

To analyse and compare the GAAR in South Africa, Canada and Australia from a case law perspective in order to identify how the existing deficiencies in the South African GAAR could be overcome. This investigation results in determining the amendments to the South African GAAR that would result in more robust anti-avoidance legislation. This research culminates with recommendations for the formulation and drafting of a new, more robust GAAR.

This chapter will also directly achieve research objective 2 as defined in Chapter 1:

To apply the GAAR in South Africa to the facts of the cases selected from Australia and Canada and therefore determine which provisions require amendment when comparing the results to the judgments in these jurisdictions.

In achieving the second research objective referred to above, the framework developed in phase 1 (Chapter 4) is used to apply the South African GAAR to the facts of cases in both Australia and Canada. The use of this framework ensures consistency in the application of the South African GAAR to the facts of each of the cases and will result in identifying the following:

- those aspects of the South African GAAR that are effective and should remain intact;
- those aspects of the South African GAAR that are ineffective and should be amended;
- those aspects of the Australian GAAR that are effective and should be included in the South African counterpart; and
- those aspects of the Canadian GAAR that are effective and should be included in the South African counterpart.

Upon completion of this phase the outcomes from phases 1 and 2 of the research can be compared and contrasted with a view to proposing amendments to the South African GAAR, thereby achieving the final research objective.

In conducting this research, records were obtained of selected case law from Australia to describe the transactions undertaken by the various taxpayers. This allows conclusions to be drawn on the efficacy of the South African GAAR when compared to its Australian counterpart. The use of multiple cases with differing facts allows:

- patterns and conditions across cases to be identified based on the application of the framework of the South African GAAR (McKerchar, 2004:10);
- more areas to be identified for improvement of the South African GAAR; and
- amendments to the South African GAAR to be proposed by considering the impact of these amendments on all the cases selected, thus adding strength to the proposed amendments.

## 8.2 SELECTION OF CASES

Before discussing the cases used in the study it is relevant to obtain a basic understanding of the court system in Australia. As in other countries, the Australian courts are organised in hierarchies where different courts or bodies are ranked or ordered, depending on their importance. A brief description of these hierarchies and the court system is set out below.

The High Court of Australia is the highest court in Australia's court system and the final court of appeal, which includes tax litigation. The High Court of Australia's functions include interpreting and applying the law of Australia and deciding cases of special federal significance, including constitutional challenges (Commonwealth of Australia, 2016). Decisions of the High Court of Australia on appeals are final and binding on all other courts throughout Australia (Commonwealth of Australia, 2016). Therefore, cases heard in the High Court of Australia create judicial precedent. All judgments by the High Court of Australia are contained in the Westlaw AU database (Thomson Reuters, 2017). A search of judgments under Part IVA (legislation cited search field) in this database yielded a total of 294 cases that were listed for the Commonwealth of Australia, classified as taxation or tax and duties cases (Thomson Reuters, 2017). In selecting cases for this study only those cases that came before the High Court of Australia are selected, as judgments in these cases are binding on lower courts.

A search conducted for all Part IVA cases in the Westlaw AU database heard in the High Court of Australia identified the following:

1. *Commissioner of Taxation v Hart* (2004) HCA 26
2. *Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) HCA 32
3. *Commissioner of Taxation v Spotless Services Ltd* (1996) HCA 34
4. *Deputy Commissioner of Taxation v Richard Walter Pty Ltd* (1995) HCA 23



5. *Commissioner of Taxation v Peabody* (1994) HCA 43
6. *John v Commissioner of Taxation* (1989) HCA 5
7. *Federal Commissioner of Taxation v Gulland* (1985) HCA 83

Further analysis of these cases revealed the following:

- The issue in the case of *Deputy Commissioner of Taxation v Richard Walter Pty Ltd* (1995) HCA 23 related to the taxpayer's right to dispute an assessment on the basis that two taxpayers were assessed to tax in respect of the same income. Therefore, the case was not presented before the courts on the basis of the Australian GAAR and was not analysed for the purposes of this study as it was outside the scope of the study.
- The facts of the *John v Commissioner of Taxation* (1989) HCA 5, and *Federal Commissioner of Taxation v Gulland* (1985) HCA 83, cases reveal that, while the cases were only decided after the introduction of Part IVA of the Income Tax Assessment Act (the Australian GAAR), the transactions undertaken occurred before 27 May 1981. Therefore, the cases were not presented before the courts on the basis of Part IVA of the Income Tax Assessment Act and were not analysed for the purposes of this study as it was considered outside the scope of the study.

The four High Court of Australia cases used for the purposes of this chapter are therefore:

1. *Commissioner of Taxation v Peabody* (1994) HCA 43
2. *Commissioner of Taxation v Spotless Services Ltd* (1996) HCA 34
3. *Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) HCA 32
4. *Commissioner of Taxation v Hart* (2004) HCA 26.

The facts of these four cases and the application of the framework of the South African GAAR developed in phase 1 (Chapter 4) to the facts of these cases are set out in sections 8.3 - 8.6 below.

### **8.3 COMMISSIONER OF TAXATION v PEABODY**

#### **8.3.1 FACTS OF THE CASE**

This case was taken on appeal from the Full Court of the Federal Court of Australia. A business that comprised four companies (Pozzolanic Enterprises Pty Ltd, Pozzolanic (Queensland) Pty Ltd, Pozzolanic Bulk Carriers (Queensland) Pty Ltd and Coastal Bulk Haulage Pty Ltd) was owned to the extent of 62% by Peabody interests and 38% by Mr Ray Kleinschmidt or interests associated with him. There were other companies that were all subsidiaries of the four companies identified and are collectively referred to as the Pozzolanic Group.

The Peabody interests in the Pozzolanic Group were held in the name of TEP Holdings Pty Ltd as a trustee for a discretionary trust (Peabody Family Trust). Mrs Peabody and her two children were the beneficiaries of the trust. Mrs Peabody and her husband, T Peabody, were the only directors of TEP Holdings Pty Ltd.

The scheme in question was initiated by Mr Peabody, who formulated a plan to acquire Mr Ray Kleinschmidt's interest in the Pozzolanic Group. To this end Mr Peabody and Mr Kleinschmidt reached an agreement that Mr Kleinschmidt would sell his interest to the Peabody interests for \$8.6 million. However, Mr Kleinschmidt did not want this price disclosed publicly. It was anticipated that difficulties would be experienced in not disclosing the amount paid to Mr Kleinschmidt if a prospectus needed to be issued for the floatation of shares that were acquired by the Peabody interests. Therefore, after discussions with advisors, the possibility was identified of converting the shares acquired to a different class (with restricted rights) in order to render them almost worthless. In consequence, the shares held by TEP Holdings Pty Ltd would increase in value by the amount of Mr Kleinschmidt's shares.

The solicitor pointed out that this would allow TEP Holdings Pty Ltd to sell its shares to a public company formed for the purpose of the floatation, for a price that represented the increased value, and therefore prevent the application of section 26AAA of the Income Tax Assessment Act. In terms of this section, the profit from the sale of property (Mr Kleinschmidt's shares) that was acquired within 12 months of the sale would have been included in assessable income.

In addition, it became apparent that there were benefits related to using a financier rather than borrowing the money for the purchase of Mr Kleinschmidt's shares. A financier could subscribe for redeemable preference shares in the company so that the costs of finance could be reduced:

- The financier could receive dividends (equal to the interest it would have received under a conventional loan, but less the tax that it would have paid on that interest). This would occur because a rebate of 100% of the tax would be available in respect of dividends. Therefore, the financier could receive a tax-free dividend equal to the after-tax interest.
- Subsequently the preference shares could be redeemed so that the financier could receive an amount equal to the principal of the loan.

In terms of this option, the following steps were taken:

1. TEP Holdings Pty Ltd acquired a shelf company, Loftway Pty Ltd.
2. Westpac Banking Corporation subscribed for redeemable preference shares in Loftway Pty Ltd.
3. The funds from the preference share issue were used by Loftway Pty Ltd to purchase Mr Kleinschmidt's shares in the Pozzolan Group.
4. The four companies in the Pozzolan Group declared dividends to Loftway Pty Ltd that were used to pay Westpac Banking Corporation its dividends.
5. The four companies in the Pozzolan Group converted Mr Kleinschmidt's shares (now held by Loftway Pty Ltd) to Z class shares with restricted rights. This reduced their value from \$8.6 million to less than \$500. The shares in the Pozzolan Group held by TEP Holdings Pty Ltd came to represent virtually 100% of the shares in the Pozzolan Group.
6. TEP Holdings Pty Ltd sold all the ordinary shares in the Pozzolan Group to Pozzolan Industries for \$30 million. The purchase price was paid partly in shares and partly in cash. This resulted in TEP Holdings Pty Ltd owning 50% of the shares in Pozzolan Industries.
7. The remaining 50% of the Pozzolan Industries shares were floated to the public.
8. Using the money raised from the sale of the ordinary shares in the Pozzolan Group, TEP Holdings Pty Ltd lent money to Loftway Pty Ltd to enable it to redeem the preference shares from Westpac Banking Corporation.
9. Loftway Pty Ltd then transferred the Z class shares in the Pozzolan Group to TEP Holdings Pty Ltd which then transferred them to Pozzolan Industries.

10. TEP Holdings Pty Ltd forgave the debt for the loan it had made to Loftway Pty Ltd.

The Commissioner contended that \$888,005 should be included in the assessable income of Mrs Peabody on the basis that Mrs Peabody was a beneficiary of the trust and entitled to the income of the trust estate. This amount was calculated as one-third of the profit for purposes of section 26AAA, which TEP Holdings Pty Ltd would have realised if it had bought Mr Kleinschmidt’s shares and sold them within 12 months of their acquisition.

A diagrammatical representation of the transactions undertaken in terms of the Peabody case is provided in Appendix A. The progress of this case is presented in Table 4 below:

**TABLE 4 PROGRESS OF THE *COMMISSIONER OF TAXATION V PEABODY* CASE**

<b>Court</b>	<b>Federal Court</b>	<b>Full Court</b>	<b>High Court</b>
<b>Decision</b>	Held in favour of the Commissioner	Held in favour of the taxpayer	Held in favour of the taxpayer

**8.3.2 ARRANGEMENT**

To determine if the facts in the *Peabody* case constitute an impermissible avoidance arrangement, the first requirement that must be met is the presence of an arrangement in terms of the South African GAAR. In the case presented to the courts in Australia, the Commissioner particularised the scheme as including the following steps (at 380):

- (1) The purchase of all the shares of [the Pozzolanic Group] that were owned by R T Kleinschmidt by [Loftway];
- (2) The issue of preference shares by [Loftway] to [Westpac];
- (3) The conversion of shares in the [Pozzolanic Group] to “Z” class preference shares;
- (4) The reduction in the considered value of the [Pozzolanic Group] shares by [Loftway];

- (5) The special resolution by the [Pozzolanic Group] to remove the right of “Z” class preference shareholders to receive preferential dividends;
- (6) The loan made by [TEP Holdings] that was the trustee of the Peabody Family Trust to [Loftway] and the terms and conditions of that loan;
- (7) The public float of Pozzolanic Industries Ltd. which float excluded the “Z” class shares;
- (8) The redemption of its preference shares in the target entities by [Loftway] from [Westpac];
- (9) The sale of the [Pozzolanic Group] “Z” class shares by Loftway to [TEP Holdings] for a consideration of \$476.00;
- (10) The transfer of the shares by [TEP Holdings] as a gift or at par value to Pozzolanic Industries Ltd.

In applying the framework for the South African GAAR developed in Chapter 4 of this study, the steps taken by the taxpayers in the *Peabody* case constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. If presented before the South African courts, the transactions considered in the *Peabody* case would be considered to constitute an arrangement for purposes of the South African GAAR.

### **8.3.3 TAX BENEFIT**

In applying the second requirement of the framework for the South African GAAR, the tax benefit must be a consequence of the scheme identified. Therefore, the presence of a tax benefit derived from the arrangement is a critical requirement, regardless of the amount of the tax benefit. From the facts of the case, the Commissioner contended that \$888,005 should be included in the assessable income of Mrs Peabody on the basis that she was a beneficiary of the trust and entitled to the income of the trust estate. This amount was calculated as one-third of the profit for purposes of section 26AAA, that TEP Holdings Pty Ltd would have realised had it bought Mr Kleinschmidt’s shares and sold them within 12 months of their acquisition.

In applying the framework for the South African GAAR to the *Peabody* case, the tax benefit must have arisen because the taxpayer effectively stepped out of the way of, escaped or prevented an anticipated

liability, or the “but for” test must be applied (*Smith* case; *King* case; *Income Tax Case No 1625* (1996) 59 SATC 383 and *Louw* case).

- In determining if the taxpayer (Mrs Peabody) effectively stepped out of the way of an anticipated liability for tax, it is submitted that the scheme identified by the Commissioner (the ten steps) did not result in preventing an anticipated liability for tax.
  - The first reason for this is because the trust was unable to purchase the shares because the purchaser was required to be a company.
  - Secondly it was recognised by the court and the Commissioner (at 385) that there was no reasonable expectation that TEP Holdings Pty Ltd would have acquired the shares as part of the floatation as the most rational expectation was that Loftway Pty Ltd should purchase the shares.
  - Lastly it was also recognised (at 385) that even if TEP Holdings Pty Ltd had acquired the Kleinschmidt shares in its own right there would have been no present entitlement on Mrs Peabody to any part of the profit arising from the sale of those shares.

Therefore, there was no profit that was anticipated to be included in the taxpayers’ income that had been escaped for purposes of applying the GAAR and any profits would have reasonably been attributed to Loftway Pty Ltd had the devaluation not taken place

- In applying the “but for” test, it is submitted that if the scheme identified by the Commissioner (the ten steps) had not occurred, there would have been no profit (for purposes of section 26AAA) that would have been realised if Mr Kleinschmidt’s shares had been bought and sold within 12 months of their acquisition.

This leads to the conclusion that the identification of the ten steps by the Commissioner for purposes of identifying the arrangement for the application of the GAAR may have been flawed because neither test was satisfied. The reason for this is because the Commissioner incorrectly identified Mrs Peabody as the taxpayer in question for purposes of applying the GAAR and thereby rendered the identification of the ten steps inapplicable.

Notwithstanding this, it is still relevant to consider the opinion of De Koker and Williams (2015:par.19.37) that the Commissioner would need to show what arrangement would otherwise have been entered into to

produce the same commercial result and the tax consequences thereof in order to prove what tax benefit resulted from the arrangement entered into. In the facts of the *Peabody* case, the possible alternative arrangements that could have yielded the same commercial outcomes (in the absence of the tax considerations) were rejected by the courts, as they were not reasonable or viable options available (or they would have resulted in possible tax benefits being obtained by other parties to the arrangement rather than Mrs Peabody).

The fact that no tax benefit would have accrued to Mrs Peabody when applying the framework of the South African GAAR to the facts of the *Peabody* case means that the arrangement does not constitute an avoidance arrangement as defined in section 80L of the Income Tax Act. Therefore, it is not necessary to continue applying the remaining requirements of the framework of the South African GAAR to the facts of the case. However, to draw a full conclusion regarding the application of the framework of the South African GAAR, the remaining requirements have been discussed below.

#### **8.3.4 SOLE OR MAIN PURPOSE**

In applying the sole or main purpose requirement to the facts presented in the *Peabody* case, it must be determined if the sole or main purpose of the arrangement was to obtain the tax benefit, in the context of the arrangement identified by the Commissioner and presented before the courts. Therefore, the sole or main purpose of the ten steps identified by the Commissioner in the *Peabody* case must be shown to be the achievement of the tax benefit. Two tests are used to determine if the sole or main purpose of the arrangement is to obtain the tax benefit. The subjective test uses the stated intention of the taxpayers to indicate if the sole or main purpose of the arrangement was to obtain the tax benefit. The objective test is used in conjunction with the subjective test to determine if the objective effect of the transactions supports the intention provided by the taxpayer.

In the *Peabody* case the stated intention (subjective test) of the arrangement identified by the Commissioner (i.e. the ten steps) was to enable the acquisition of Mr Kleinschmidt's shares and the floatation of the public company, while avoiding the difficulties that would be experienced in not disclosing the amount paid to Mr Kleinschmidt if a prospectus needed to be issued for the floatation of shares. The objective effect of the arrangement supported this non-tax-motivated intent, as the results

anticipated were achieved (acquisition of Mr Kleinschmidt's shares and the floatation of the public company).

However, section 80G of the Income Tax Act creates a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit and the taxpayer would be required to provide affirmative or conclusive evidence to discharge this onus. For purposes of this study a detailed description of the affirmative or conclusive evidence was not included in the thesis but in analysing the evidence provided to the courts, it was clear that the taxpayer was able to justify why the specific arrangement was undertaken and was also able to provide grounds to reject the alternatives presented by the Commissioner. In this regard the following factors were considered:

- Alternative arrangements were considered and put forward by the Commissioner that could arguably have achieved the same commercial results. However, all possible alternative arrangements presented by the Commissioner that could have yielded the same commercial outcomes in the absence of the tax considerations were rejected by the courts, as they were not reasonable or viable options (or they would have resulted in possible tax benefits being obtained by other parties to the arrangement, as opposed to Mrs Peabody).
- The dominant subjective purpose of the avoidance arrangement was to achieve a non-tax business purpose (acquisition of Mr Kleinschmidt's shares and the floatation of the public company) that indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement.

In light of the above, the sole or main purpose of the arrangement in the *Peabody* case was not to obtain the tax benefit. It is important to note that the High Court in Australia did not conclude on the dominant purpose requirement under Part IVA of the Income Tax Assessment Act, due to the fact that the tax benefit requirement was not met. Similarly, it is relevant to consider the importance of the alternative transactions presented by the Commissioner before the courts because the reasonability or viability of these transactions may impact upon the conclusions reached when applying the sole or main purpose requirement objectively. Therefore, the alternative arrangements may not only play a role in determining and quantifying the tax benefit requirement, but may also be considered for purposes of the sole or main purpose requirement.



The Australian GAAR was amended after this case was presented before the courts. One significant change is that the dominant purpose requirement now appears before the tax benefit requirement. If the current Part IVA of the Income Tax Assessment Act is applied to the *Peabody* case, it is still doubtful whether the courts would have held in the Commissioner's favour because of the deficiencies related to the identification of the scheme that resulted in the inability to connect the tax benefit to the scheme. This further highlights the importance of identifying the correct scheme (and the correct taxpayer) for purposes of applying a GAAR, as recent amendments to improve the efficiency of the Australian GAAR would not have yielded a different conclusion. Therefore, it is submitted that a well-drafted GAAR will succeed only where the correct scheme and taxpayer is identified by the revenue authority.

It is submitted that if the Commissioner had identified a specific part of the scheme (i.e. the conversion of Mr Kleinschmidt's shares to Z class shares and subsequent transfer of these shares to TEP Holdings Pty Ltd, that were then sold to Pozzolanic Industries), the conclusion regarding the sole or main purpose requirement may have been different. Nevertheless, the submissions made by the taxpayer in this regard lead to the conclusion that the sole or main purpose of this part of the arrangement was to avoid the disclosure in the prospectus that might have been necessary if Loftway Pty Ltd had sold the shares to the public company at a profit. Therefore, it is doubtful that the identification of that part of the scheme would satisfy the sole or main purpose requirement of the South African GAAR. All the different schemes that the Commissioner could have attacked for purposes of GAAR have not been examined in greater depth in this study, as it is not in the scope of the study to speculate on alternative arrangements and tax benefits that were not brought before the courts.

### **8.3.5 TAINTED ELEMENTS**

In applying the framework for the South African GAAR to the facts of the *Peabody* case, at least one of the tainted elements should be present before the tainted requirement is met. It is necessary to determine if the arrangement entered into in the *Peabody* case would constitute a transaction entered into in the context of business or any other context. It is submitted that the transactions were undertaken in the context of business, as this was a venture undertaken by a group of companies. Similarly, the scheme was intended to achieve a commercial purpose (acquisition of Mr Kleinschmidt's shares and the floatation of the public company).

## ***ABNORMALITY***

The first tainted element is to determine in terms of section 80A of the Income Tax Act if the arrangement was entered into or carried out by means or in a manner that would not normally be employed. In determining normality, it is necessary to determine if there is a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration. In this regard it is submitted that the alternative arrangements identified by the Commissioner that could have yielded the same commercial outcomes in the absence of the tax considerations were rejected by the courts because they were not commercially reasonable or viable options (or they would have resulted in possible tax benefits being attained by other parties within the arrangement as opposed to Mrs Peabody).

It is likely that the scheme (the ten steps identified by the Commissioner) would have been entered into without consideration of the tax benefit. Therefore, the arrangement is not considered abnormal for purposes of applying the framework for the South African GAAR. The alternative transactions presented by the Commissioner may become relevant for purposes of the abnormality element. This is because the alternative transactions can be considered to be examples of “normal” transactions in the absence of a tax consideration. Therefore, the identification of reasonable alternative transactions by the Commissioner may play an important role for more than just the tax benefit requirement.

## ***LACK OF COMMERCIAL SUBSTANCE***

The next tainted element to be considered is lack of commercial substance. In applying the framework for the South African GAAR, each of the individual tests is dealt with separately as follows:

### ***General lack of commercial substance test***

The scheme identified by the Commissioner did result in a significant effect upon the net cash flows and business risks because the purchase of Mr Kleinschmidt’s shares and subsequent floatation of the Pozzolan Industries Ltd shares resulted in a significant effect upon the cash flows and business risks for different parties to the transaction (section 80C definition and Broomberg, 2007:9) including but not limited to the following:

- *Mr Kleinschmidt* received \$8.6million for his shares in the Pozzolan Group and this has a significant effect upon his cash flows and risks associated with this part of the arrangement.
- *Loftway Pty Ltd* purchased Mr Kleinschmidt's shares in the Pozzolan Group for \$8.6 million which similarly had an impact upon its risk and cash flows. Loftway Pty Ltd also issued redeemable preference shares (for \$8.6million) and paid dividends to the financier. Both the issue of shares and payment of dividends impacted upon risk and cash flows for Loftway Pty Ltd.
- *TEP Holdings Pty Ltd* obtained 100% ownership of Loftway Pty Ltd which increased the risks associated with this ownership. Further, TEP Holdings sold all the ordinary shares in the Pozzolan Group to Pozzolan Industries for \$30 million. While this purchase price was paid partly in shares and partly in cash it resulted in a 50% ownership of the shares in Pozzolan Industries. Therefore, there was a significant difference in business risk and cash flows from the arrangement for TEP Holdings Pty Ltd.
- *The Pozzolan Group* declared dividends to Loftway Pty Ltd and converted Mr Kleinschmidt's shares to Z class shares with restricted rights and therefore there was also a significant difference in business risk and cash flows for the Pozzolan Group from the arrangement. Pozzolan Industries Ltd floated 50% of its shares to the public and there was therefore also a significant difference in the business risk and cash flows from the arrangement.

### ***Substance over form test***

It is submitted that the true intention of the parties was reflected in the agreements entered into as a whole, as the end result of the scheme was reflected in the cumulative agreements (the ten steps). However, it is arguable that the loan to Loftway Pty Ltd and subsequent forgiving of the loan by TEP Holdings Pty Ltd indicate that these parties never intended the loan to be repaid. This could indicate that at inception the loan was not a loan and was in fact intended to be a gift or donation. However, without access to the loan agreement, it is impossible to conclude on this matter.

### ***Round trip financing test***

There are aspects of the scheme that have the presence of round trip financing, including the loan to Loftway Pty Ltd and subsequent forgiveness of this loan by TEP Holdings Pty Ltd. In this regard it is

relevant to note that the timing, sequence, means or manner in which this was done does not affect the presence of round trip financing in terms of section 80D of the Income Tax Act. Further, section 80D specifically includes an obligation to receive or pay cash (such as the loan and subsequent forgiveness of this loan from TEP Holdings Pty Ltd to Loftway Pty Ltd) in its definition of round trip financing. Therefore, the loan and subsequent forgiveness of this loan by TEP Holdings Pty Ltd would constitute round trip financing as defined in the South African GAAR. However, the reciprocal actions did not result in a tax benefit (contemplated in section 80D(1)(b)(i) of the Income Tax Act), but for the provisions of the GAAR. Nevertheless, if the tax benefit requirement had been met, it is submitted that round trip financing would be present as contemplated in section 80D of the Income Tax Act.

### ***Tax-indifferent party test***

It is submitted that there are no parties to the arrangement identified in the *Peabody* case that effectively sold their tax advantage to others.

### ***Offsetting or cancelling test***

There are elements within the transaction that may be considered to have the effect of offsetting or cancelling each other, including the loan to Loftway Pty Ltd and subsequent forgiving of the loan by TEP Holdings Pty Ltd. Similarly, the issue and redemption of preference shares between Westpac Banking Corporation and Loftway Pty Ltd may arguably be considered to include an element of offsetting or cancelling but it is impossible to be certain if the legislature will consider such a transaction as offsetting or cancelling.

While in certain instances this may indicate that there are parts of the transaction that were contrived for the purpose of obtaining a tax benefit, it is submitted that in this case these aspects were introduced due to other commercial considerations and restrictions (prevention of the disclosure of the selling price of Mr Kleinschmidt's shares and the financing requirements of the group). This element of the South Africa GAAR was introduced because its presence indicates that the arrangement (or part thereof) has no fiscal consequence and becomes of consequence only if the arrangement in question had a sole or main purpose of obtaining a tax benefit (De Koker and Williams, 2015:par. 19.39). If this is applied to the *Peabody* case, it is submitted that, because the tax benefit requirement was not satisfied, then the presence of offsetting

or cancelling aspects was not for the achievement of the tax benefit. Therefore, this test would arguably not be satisfied in terms of the South African GAAR.

In conclusion the arrangement identified in the *Peabody* case does not lack commercial substance in terms of the South African GAAR as on the balance of probabilities none of the individual tests were satisfied. However, if the tax benefit requirement had been met, it is possible that the round-trip financing and offsetting or cancelling tests may have been met. Similarly, if there was more conclusive information regarding the terms of the loan agreements between Loftway Pty Ltd and TEP Holdings Pty Ltd that would allow an assessment of the intention of the parties, the substance over form test may also have been satisfied.

Notwithstanding, there is an area arising from this part of the analysis that needs clarification in the interests of applying the South African GAAR as there are often instances where the parties to an arrangement or transaction are connected to each other. The relationships between parties often yield benefits that are not connected to one specific party but may in fact benefit the group as a whole. This leads to the conclusion that where a group prospers each individual party may benefit in some way from this. If this is applied in the *Peabody* case it is noted that by obtaining public funding it increases the funding available in the group (among other possible benefits resulting from a public floatation). This additional funding could arguably be of benefit to the entire group of companies even if this is not immediately evident. It does not seem reasonable to exclude considerations such as these when assessing the commercial substance of the arrangement.

Further, in applying the substance over form test in a situation where the parties are connected to each other, it is arguable that the intentions shared by senior management in the group may inherently be shared by the other entities within the group due to a shared vision for the group. Therefore, in a situation where a loan is provided by one connected party to another (loan by TEP Holdings Pty Ltd to Loftway Pty Ltd), that is later forgiven, can it be reasonably concluded that the parties misrepresented the transaction if the parties all knew of this eventuality? It is submitted that the relationship between the parties should be taken into account in applying the GAAR, but this should be carefully considered, so that any artificiality in using connected party relationships can be prevented. Therefore, it is submitted that for purposes of this requirement the commercial reasons for the group, in the absence of a tax consideration, should be considered relevant.

## ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

In determining if the rights and obligations created in the arrangement were at arm's length, it is important to note that the entities were connected to each other as they were part of a group of companies. For purposes of applying the framework for the South African GAAR it is recognised that there is no guidance on determining arm's length rights and obligations where the parties are connected to each other. As stated in Chapter 4 when applying the arm's length element to the facts of cases the test of whether unconnected persons would have done the same in this situation is applied. However, where a special relationship between the parties does exist, the context of this relationship must be considered in order to interpret the GAAR widely and to suppress the mischief, without leading to absurdities or anomalies (De Koker and Williams, 2015:par.19.39).

The following are examples of the creation of rights or obligations that may be considered not to be at arm's length in the absence of connected party relationships:

- It does not seem reasonable that any company would willingly purchase shares (Loftway Pty Ltd purchased Mr Kleinschmidt's shares) and allow them to be converted to a different class of shares with restricted rights that reduced their value from \$8.6 million to less than \$500.
- While TEP Holdings Pty Ltd was arguably obtaining the utmost possible advantage out of the transaction in its capacity as trustee when the shares in the Pozzolan Group came to represent virtually 100% of the shares in the Pozzolan Group, this was done at the expense of Loftway Pty Ltd (as described above). Therefore, Loftway Pty Ltd lost significant value in its interest in the Pozzolan Group. It is debatable if the forgiveness of the loan by TEP Holding Pty Ltd may be regarded as compensation for Loftway Pty Ltd in exchange for the devaluation of its shares when applying the GAAR to the arrangement, as this was directly related to the connected nature of the relationship between the two parties.
- It does not seem reasonable that any company (TEP Holdings Pty Ltd) would willingly forgive a debt for a loan (to Loftway Pty Ltd) in circumstances where the parties were unconnected to each other.

Therefore, it does not seem reasonable that any party to a transaction similar to that presented in the *Peabody* case would have entered into such a transaction (without reward or incentive) in the absence of

the relationships it had with the other companies in the group. Therefore, the arrangement did have the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length. However, due to the uncertainty regarding the rights and obligations to be considered where a special relationship exists, it is impossible to conclude on this matter with absolute certainty.

### ***MISUSE OR ABUSE OF THE ACT***

The misuse or abuse of the Act is the last tainted element to consider for purposes of applying the framework for the South African GAAR to the *Peabody* case. It is evident that section 26AAA was not applicable to Mrs Peabody because TEP Holdings Pty Ltd (acting in the capacity as trustee) did not acquire Mr Kleinschmidt's shares and sell them within 12 months of their acquisition. It is submitted that this provision was not avoided in a manner that was not intended by the legislator, as the circumstances necessary for the application of the provision were not present. Similarly, alternative transactions that would have resulted in the same commercial results were not viable in view of other commercial considerations. Therefore, the arrangement is not considered abusive of the Act.

### **8.3.6 PEABODY CASE CONCLUSION**

In analysing the results from applying the South African GAAR to the facts of the *Peabody* case, it is evident that the transactions entered into by the taxpayers fall within the definition of an arrangement but not an avoidance arrangement as it did not result in a tax benefit to the taxpayer because the Commissioner may have identified the wrong taxpayer for purposes of applying the GAAR. It is submitted that if the Commissioner had identified a specific part of the scheme and/or possibly a different taxpayer, the tax benefit requirement may have been applied successfully.

In addition to the above the sole or main purpose requirement was not met as both the subjective and objective tests supported the contention that the sole or main purpose for the arrangement was to enable the acquisition of Mr Kleinschmidt's shares and the floatation of the public company. However, in this analysis the importance of the alternative transactions presented by the Commissioner was highlighted, as the reasonability or viability of these alternatives may impact upon the conclusions reached when applying the sole or main purpose requirement objectively.

In analysing the tainted elements requirement, the arrangement was not considered to be abnormal, lacking in commercial substance or abusive but the relationships between the parties did raise doubt over the application of the GAAR. In this regard it was noted that there are often instances where the parties to an arrangement are connected to each other and these relationships often yield benefits that are not connected to one specific party, but may in fact benefit the group as a whole. Therefore, it does not seem reasonable to exclude considerations such as these when assessing the tainted elements. It is uncertain how this should be done so that any artificiality in using connected party relationships can be prevented. Further, the relationships between the parties impact upon the substance over form and rights and obligations tests as the rights, obligations and intention of senior management in the group may inherently be shared by the other entities within the group.

In conclusion, the arrangement in the *Peabody* case was not an impermissible avoidance arrangement for purposes of the South African GAAR. This is consistent with the conclusion reached by the Australian High Court when it was brought before the High Court. However, the following aspects may impact upon the successful application of the South African GAAR:

- The identification of the correct scheme by the Commissioner is critical to linking the tax benefit to the scheme. Incorrect identification of the scheme for attack under the GAAR could result in the GAAR not being applied successfully to the arrangement.
- Complications may arise in instances where the parties to an arrangement are connected to each other as the intention, risks, benefits and alternatives (related to the abnormality, lack of commercial substance, rights or obligations and misuse elements) for the arrangement may have been impacted by the commercial benefits related to the group as a whole. It is questionable whether these group commercial benefits should be disregarded in such arrangements as this does not seem to be consistent with the intention of the GAAR.
- The identification of the incorrect tax benefit related to an incorrect taxpayer may prevent the application of the round-trip financing test because, while there may be aspects of an arrangement that include round trip financing, the reciprocal actions may not result in the tax benefit contemplated in section 80D(1)(b)(i). Therefore, if the tax benefit requirement had been met, it is submitted that there may have been a presence of round trip financing as contemplated in section 80D of the Income Tax Act.



## **8.4 COMMISSIONER OF TAXATION v SPOTLESS SERVICES**

### **8.4.1 FACTS OF THE CASE**

This case was taken on appeal from the Full Court of the Federal Court of Australia. Two taxpayers, Spotless Services Ltd and Spotless Finance Pty Ltd, were companies resident in Australia. Both companies were part of the same group of companies whose substantial business activities were essentially conducted in Australia. After a successful public floatation of shares in Spotless Services Ltd, the taxpayers held approximately \$40 million of surplus funds that they wanted to invest over the short term.

Spotless Services Ltd and Spotless Finance Pty Ltd agreed via a joint venture agreement to invest the surplus funds in the Cook Islands (with European Pacific Banking Co Ltd) in the name of Spotless Services Ltd. In terms of the scheme, the interest earned was subject to a 5% withholding tax in the Cook Islands. This resulted in the interest income not being taxed in Australia. It was exempted in terms of section 23(q) of the Income Tax Assessment Act since it had already been subject to a withholding tax in the Cook Islands. In addition to this, there was no double tax agreement between Australia and the Cook Islands. From the facts of the case, the interest rate that the taxpayers received was 4% below that of the Australian bank bill buying rate. Additional factors that were noted included the following:

- a. There was a concerted and protracted effort by the parties to ensure that the source of the return on the investment was the Cook Islands as set out in the information in the memorandum and appendices.
- b. The interest rate offered in the Cook Islands was lower than that of an Australian investment.
- c. There was an increased security risk of investing offshore in the Cook Islands with a small new bank and therefore there was a need to introduce security otherwise not necessary for an investment in Australia.
- d. The taxpayers refused to go ahead with the investment unless the letter of credit establishing the security for the transaction was made payable in Australia.
- e. The taxpayers committed the funds to the scheme by handing over a bank cheque in Australia.
- f. There was confusion over the facts related to the corporate solicitors' visit to the Cook Islands, specifically regarding the taxpayer's bank account there.
- g. The role of the Midland Bank in the scheme was unclear.

- h. There were costs incurred in relation to each of i), iii) and iv) above and the taking of legal advice that would not have been incurred for an Australian investment.

A diagrammatical representation of the transactions undertaken in terms of this joint venture investment is provided in Appendix B. The progress of this case is presented in Table 5 below:

**TABLE 5 PROGRESS OF THE *COMMISSIONER OF TAXATION V SPOTLESS SERVICES LTD* CASE**

<b>Court</b>	<b>Federal Court</b>	<b>Full Court</b>	<b>High Court</b>
<b>Decision</b>	Held in favour of the taxpayer	Held in favour of the taxpayer	Held in favour of the Commissioner

#### **8.4.2 ARRANGEMENT**

The first requirement for applying the framework for the South African GAAR is to consider if there is an arrangement. The investment of surplus funds in the Cook Islands by Spotless Services Ltd and Spotless Finance Pty Ltd clearly constitutes a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act.

#### **8.4.3 TAX BENEFIT**

The second requirement of the framework for the South African GAAR is the presence of a tax benefit resulting from the arrangement. By entering into the arrangement Spotless Services Ltd and Spotless Finance Pty Ltd were not liable to pay tax in Australia on the interest income received because it was exempted in terms of section 23(q) of the Income Tax Assessment Act. This exemption applied because the interest had already been subject to a 5% withholding tax in the Cook Islands. This is consistent with the “but for” test set out in *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and the *Louw* case. The taxpayers were able to step out of the way of, escape or prevent an anticipated liability for tax as contemplated in the *Smith* case.

The transactions entered into by the taxpayers in the *Spotless Services Ltd* case constituted an arrangement that had the effect of obtaining a tax benefit. Therefore, the arrangement constitutes an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### **8.4.4 SOLE OR MAIN PURPOSE**

The third requirement of the framework for the South African GAAR is to determine if the sole or main purpose of the arrangement was to obtain the tax benefit. In terms of the subjective test referred to in the *Gallagher* case, the Executive Director of Spotless Services Ltd noted that the taxpayers sought a short-term investment that would yield the best return. The subjective test considers the stated intention of the taxpayers to indicate whether the sole or main purpose of the arrangement was to obtain the tax benefit. However, if the framework for applying the South African GAAR is used, the objective test should be used in conjunction with the subjective test in order to determine if the objective effect of the transactions supports the stated intention of the taxpayer. Further, section 80G of the Income Tax Act creates a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit and the taxpayer would be required to provide affirmative or conclusive evidence to discharge this onus.

In applying this test subjectively to the facts of this case, it is reasonable to conclude that the investment was chosen for its higher resultant returns. However, in calculating the return on the investment, it is evident that the tax consequences are a consideration. The question to be answered would be to determine if the tax consequences were the sole or main reason for entering into the arrangement. Therefore, if the sole or main purpose requirement is to be met for purposes of applying the South African GAAR, the test should be considered objectively in order to determine if the objective analysis supports the subjective intent of the taxpayers.

In this regard the following information was provided in the written judgments made by Brennan CJ, Dawson J, Toohey J, Gaudron J, Gummow J and Kirby JJ (at 418-419):

[I]n anticipation of the receipt of a significant amount upon the proposed flotation of shares of Spotless Services, Mr Williams invited proposals from a number of financial institutions for the short-term investment of those moneys. ...

A number of possible avenues of "off-shore" investment were considered, including the EPBCL proposal which was adopted.

Other alternatives which had been under consideration by Spotless Services included a similar kind of investment to be made in Hong Kong. That proposal, which appears to have been made by Rothschild Australia Ltd, was rejected. It would have required the issue of a tax clearance certificate under s 14c of the Taxation Administration Act 1953 (Cth) (the Administration Act). The Commissioner was empowered by s 14D to refuse to issue such a certificate if not satisfied by the applicant as to various matters. These were concerned, to put it broadly, with the avoidance or evasion of Australian tax. This system of the issue of certificates under the Administration Act operated in conjunction with s 39B of the Banking Act 1959 (Cth), and the Banking (Foreign Exchange) Regulations made under s 39 of the Banking Act and then in force. A tax clearance certificate was required for the placing of any currency in Australia to the credit, as a loan, of a resident of Hong Kong. This requirement did not extend to loans to residents of the Cook Islands.

Consequently, it can be concluded that the investment was made in the Cook Islands (with European Pacific Banking Co Ltd) after considering other alternatives. One of the factors considered was the tax consequences (including the obtaining of a tax clearance certificate that would consider the presence of tax avoidance) resulting from the investment. This may indicate that the taxpayers did not wish to apply for a tax clearance certificate, as they were concerned that such a certificate would not be issued in light of tax avoidance concerns. The concern that tax clearance certificates may not be issued due to tax avoidance concerns may be likely, but it is purely speculative as there may have been other operational, timing or administrative reasons why the taxpayers did not opt to obtain tax clearance certificates. Therefore, it is impossible to conclude on this from the facts provided in the case as this was not a consideration of the courts.

In addition, the holding company for European Pacific Banking Co Ltd provided a pamphlet that included the following relevant information (Brennan CJ, Dawson J, Toohey J, Gaudron J, Gummow J and Kirby JJ at 419):

The interest on this investment is subject to withholding tax at its source in the Cook Islands and as no international tax treaty exists between the Cook Islands and Australia, the interest derived from the

deposit should be exempt income for tax purposes in accordance with Section 23(q) of the Income Tax Assessment Act.

Attached as Appendix A, is a legal opinion from Stephen Jaques Stone James confirming that investment in the Certificates of Deposit by Australian residents produces exempt income. However, the advice in this opinion has been provided for the benefit of [EPBC] only and intending investors should seek independent legal advice upon their own particular circumstances.

It is therefore submitted that the tax consequences were a considerable factor taken into account for purposes of determining the intention of the taxpayers in the case (specifically because legal opinions were provided regarding the tax consequences, which indicates the importance of the tax consequences in relation to the other non-tax goals). Similarly, the above extracts indicate that the subjective purpose (as provided by the Executive Director of Spotless Services Ltd) with no specific defined tax motive may have been planned by the taxpayer before entering into the arrangement in order to anticipate an assessment of the dominant purpose for the possible application of the Australian GAAR. Therefore, in anticipation of the possible application of the Australian GAAR, a subjective purpose was defined in order to attempt to prevent the possible application of the dominant purpose requirement.

Additional objective factors that are relevant to the determination of the sole or main purpose include the fact that the interest rate offered in the Cook Islands was lower than on an Australian investment. The only significant difference in the returns resulted from the tax consequences. This indicates that the tax consequences were the dominant reason for entering into the transaction in the Cook Islands. Further, considerable effort was expended to ensure that the source of the income would be from the Cook Islands in order to take advantage of the exemption that would apply. Such considerable efforts similarly lead to the conclusion that the tax exemption was the sole or main purpose of the arrangement.

An argument can be made that supports the principle in the *Conhage* case. In this regard, if the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or that attracted less tax, it indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement. However, no other offshore investments were available to the taxpayers that were considered viable by the taxpayers, because the same after-tax return could not have been reasonably achieved (without tax clearance certificates, which would only be issued after tax avoidance considerations were addressed). Therefore, the only option available to the taxpayers was to

invest the surplus funds in Australia (that would have resulted in a higher interest rate return and less administrative effort) that would have resulted in a lower after-tax return. In the absence of the tax benefits there was no other reason for entering into the arrangement. Therefore, it is submitted that the sole or main purpose for entering into this arrangement in the *Spotless Services Ltd* case was to take advantage of the tax benefits it would achieve.

In addition to this, no objective evidence was brought before the courts by the taxpayer that discharges the onus created in section 80G of the Income Tax Act. Therefore, in the absence of the tax considerations, there are no other reasonable objective factors that would indicate that there was any other purpose for the arrangement. Consequently, it is submitted that the onus created in section 80G of the Income Tax Act adds significant strength to the South African GAAR.

#### **8.4.5 TAINTED ELEMENTS**

The investment made by the taxpayers in the *Spotless Services Ltd* case would constitute an avoidance arrangement that had the sole or main purpose of achieving tax benefits. However, before the arrangement would be considered impermissible in terms of the South Africa GAAR, one of the tainted elements must be present. For purposes of this analysis the tainted elements requirement has been considered in the context of business. The tainted elements in this case are considered below.

##### ***ABNORMALITY***

The first tainted element requires a determination regarding the normality of the arrangement. As explained previously, this normality provision has been applied in the context of business and it must be determined if there a difference between the transaction entered into by the taxpayer and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration (Louw, 2007:27). In this regard it is submitted that the investment in the Cook Islands resulted in a return (in the absence of the tax considerations) that was 4% lower than a similar return that could have been earned in Australia. In addition to this, there are no other commercial reasons for the additional complexity of the scheme. The factors considered in making this assessment include the following:

- The parties made a concerted and protracted effort to ensure that the source of the return on the investment was the Cook Islands as described in the information memorandum and appendices.
- There was an increased security risk in investing offshore in the Cook Islands with a small new bank and therefore there was a need to introduce security otherwise not necessary for an investment in Australia.
- The taxpayers refused to go ahead with the investment unless the letter of credit establishing the security for the transaction was made payable in Australia.
- The funds were committed to the scheme by handing over a bank cheque in Australia.
- There was confusion over the taxpayer's bank account in the Cook Islands that required a representative of the group to go to the Cook Islands.
- The role of the Midland Bank in the scheme was unclear.
- Additional costs incurred in relation to the scheme (including the taking of legal advice) were costs that would not have been incurred for an Australian investment.

It is submitted that in the normal course of business a less costly, time-consuming and onerous transaction could have been made in Australia in the absence of tax considerations (Louw, 2007:27). In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is likely that the investment of funds in the Cook Islands would not have been made had it not been for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is likely that such a transaction would not be entered into by another taxpayer without a tax consideration.

### ***LACK OF COMMERCIAL SUBSTANCE***

The lack of commercial substance is the next tainted element to be considered in applying the framework of the South African GAAR to the facts of the *Spotless Services Ltd* case. Considerations related to the individual tests of the framework for the South African GAAR are dealt with separately below.

#### ***General lack of commercial substance test:***

The transaction in the *Spotless Services Ltd* case did have a significant effect upon the net cash flows and business risks because a large sum of surplus cash was transferred to European Pacific Banking Co Ltd. Similarly increased risk resulting from this investment was identified that required additional measures to be undertaken in order to attempt to reduce this risk (including the provision of additional security).

***Substance over form test:***

It is submitted that the true intention of the parties was reflected in the agreement as the end result of the scheme was reflected in the cumulative agreements. Further, no information from the case suggests otherwise.

***Round trip financing test:***

Funding was transferred between the parties (i.e. payment of \$40 million that would have resulted in an eventual return of this capital with additional interest, less the withholding tax), that resulted in the tax benefit. The timing, sequence, means or manner in which this was done does not affect the presence of round trip financing in terms of the framework for the South African GAAR. Further, section 80D Income Tax Act specifically includes an obligation to receive or pay cash in its definition of round trip financing. Therefore, the obligation to repay the investment and capital in the facts of the case would constitute round trip financing as defined in the South African GAAR.

***Tax-indifferent party test:***

In accordance with section 80E of the Income Tax Act, the European Pacific Banking Co Ltd was a tax indifferent party as it was not subjected to normal tax in Australia and its participation in the arrangement gave rise to exempted income in the hands of the taxpayer. Therefore, European Pacific Banking Co Ltd effectively sold its tax advantage to the taxpayers in order to ensure that the interest earned by the taxpayers was only subject to a 5% withholding tax in the Cook Islands. The circumstances surrounding European Pacific Banking Co Ltd are, in fact, specifically provided for in section 80E(1)(b)(dd) of the Income Tax Act that states that the income would either not be included in gross income or be exempt from normal tax. Further, there was no double-tax agreement between Australia and the Cook Islands and this tax advantage was specifically pointed out to the taxpayers in a pamphlet published by the European Pacific Banking Co Ltd that marketed investments of this type through their company. Therefore, European Pacific Banking Co Ltd was in fact a tax-indifferent party as contemplated in the South African GAAR.



***Offsetting or cancelling test:***

There are no elements that have the effect of offsetting or cancelling each other in terms of the arrangement in the *Spotless Services Ltd* case.

In conclusion if the arrangement is compared the arrangement made to similar ones available in Australia, it is evident that the lower interest rate earned in the Cook Islands was offset by the tax benefits. This indicates that such parts of the transaction were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance. The avoidance arrangement identified in the *Spotless Services Ltd* case therefore lacks commercial substance in terms of the South African GAAR.

***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

In determining if the rights and obligations were at arm's length, it is important to consider that the taxpayers were not connected to European Pacific Banking Co Ltd and no elements of the transaction indicate that they were not acting in their own best interests. The taxpayers were attempting to achieve the best returns on their investment, while European Pacific Banking Co Ltd provided interest to them on their own terms. Therefore, the arrangement created rights or obligations that would normally be created between persons dealing at arm's length.

***MISUSE OR ABUSE OF THE ACT***

The misuse or abuse of the Act is the last tainted element to consider in the *Spotless Services Ltd* case. It is evident that the exemption of the interest income received by the taxpayers was in accordance with the Australian legislation. It is also submitted that the intention of the legislator was not violated in this instance as the applicable legislation was complied with. Therefore, it is submitted that the arrangement did not abuse, frustrate, exploit or manipulate the purpose of any of the provisions of the Act and did not use provisions of the Act to achieve a result not intended by the legislator. The issue in this case was the absence of a double-tax agreement with the Cook Islands that resulted in a tax-indifferent party being able to sell its tax advantage to others.

#### **8.4.6 SPOTLESS SERVICES CASE CONCLUSION**

In analysing the results from applying the South African GAAR to the facts of the *Spotless Services Ltd* case, it is evident that the transactions entered into by the taxpayers fall within the definition of an avoidance arrangement for purposes of the framework for the South African GAAR. While the taxpayers were attempting to make a short-term investment that would yield the best return, this required an evaluation of the best after-tax returns and considerable effort was expended to ensure that the source of the income would be from the Cook Islands in order to take advantage of the exemption that would apply. This leads to the conclusion that the sole or main purpose of the arrangement was to take advantage of the tax benefits resulting from the transaction.

In addition to the above the arrangement included tainted elements as it is considered abnormal due to the fact that it is unlikely that the transactions between the parties would have been entered into had it not been for the resultant tax benefits. Further, there is lack of commercial substance regarding the scheme entered into in the *Spotless Services Ltd* case due to the fact that both round trip financing and a tax-indifferent party are present.

In conclusion, it is evident that the avoidance arrangement entered into by the taxpayers in the *Spotless Services Ltd* case constitutes an impermissible avoidance arrangement in terms of the framework for the South African GAAR. The Australian High Court similarly applied the Australian GAAR, which indicates that both of the GAARs are equally effective. It is, however, submitted that the analysis of the sole or main purpose requirement (applying the subjective and objective tests) is integrally related to the manner in that the arrangement was carried out, as well as the effect of the arrangement. This relationship between these factors indicates that there is a close link between the evidence of the sole or main purpose requirement and the tainted elements requirement. The sole or main purpose requirement and the tainted elements should not, it is submitted, be separate tests. In combining the two requirements, the strengths of both tests could be maintained. This single test could be informed by additional factors, similar to the structure of the Australian GAAR and the eight objective factors. However, if these two tests are combined as suggested, this must be done with caution in order to prevent the GAAR from applying to legitimate *bona fide* transactions. For example, the analysis of the presence of the round-trip financing may present a problem, as it is submitted that many short-term investment will have the presence of a reciprocal action and transfer of funds between the parties.

## **8.5**     ***COMMISSIONER OF TAXATION v CONSOLIDATED PRESS HOLDINGS LTD***

### **8.5.1**   **FACTS OF THE CASE**

This case was taken on appeal from the Federal Court of Australia. There are two principal elements to this appeal, the first involving the operation of section 79D of the Income Tax Assessment Act together with the GAAR. Section 79D of the Income Tax Assessment Act provided that certain deductions otherwise allowable should be reduced by the amount that certain classes of income from a foreign source exceeded:

- a) any deductions allowable from that assessable income for that year that related exclusively to income of that class derived from that source; and
- b) so much of any other deductions allowable from that assessable income as, in the opinion of the Commissioner, might appropriately be related to income of that class derived from that source.

The second element concerns the specific provisions of section 177E of the Income Tax Assessment Act in relation to dividend stripping. For purposes of this study, the analysis of the case is restricted to the first element of the appeal.

A group of companies in Australia intended to participate in a takeover of a public company in the United Kingdom (BAT Industries Plc). The business activities of the group of companies were conducted in various countries, but central control and management of the holding company was in Australia. The taxpayer companies were the Australian Consolidated Press Ltd (that later changed its name to CPH Property Pty Ltd), Consolidated Press Holdings Ltd and Murray Leisure Group Pty Ltd. Australian Consolidated Press Ltd was a publisher of journals and had substantial cash flows, while Murray Leisure Group Pty Ltd did not carry on any business other than holding shares in its subsidiaries. Consolidated Press Finance Pty Ltd, a separate company in the group, acted as financier for the group. Typically, the financing for the group occurred as follows: Consolidated Press Finance Pty Ltd would borrow funds and lend them to Australian Consolidated Press Ltd. Australian Consolidated Press Ltd was then able to lend money to overseas companies within the group.

Holylake Investments Ltd (that was incorporated in Bermuda by the directors of the United Kingdom companies) whose shares were subsequently partially purchased by a newly incorporated group company

(CP Investment (Singapore) Pte Ltd), announced a takeover bid for BAT Industries Plc. The takeover was expected to yield substantial profits if it had been successful. However, Holylake Investments Ltd withdrew the offer due to the fact that a condition of the offer could not be satisfied and subsequently went into voluntary liquidation. The dispute concerned the tax consequences for the group in relation to the financing arrangements that were made in gearing up for the takeover bid and particularly the deductibility of interest in this regard.

The financing for this takeover bid was done pursuant to advice obtained from the group's external accountant, who took into account various considerations of commercial significance, including tax considerations in both Australian and overseas tax regimes. Among other things, the advisor took into account that the Australian government had made an announcement in relation to fiscal legislation that provided that dividends received by an Australian resident corporation from a non-Australian source would be treated as exempt income. Further, dividends received from such non-Australian sources by such companies with carried forward losses would be treated as reducing those losses. This would have applied to Australian Consolidated Press Ltd that had such carried forward losses so that they would not be able to claim deductions against assessable income.

In light of all the commercial and fiscal considerations a mixed debt-equity arrangement was proposed:

1. The result was that Australian Consolidated Press Ltd subscribed for and was allotted 600 000 redeemable preference shares for \$300.6 million in Murray Leisure Group Pty Ltd.
2. Australian Consolidated Press Ltd borrowed \$300.6 million (interest bearing) from Consolidated Press Finance Pty Ltd to pay for these shares.
3. Consolidated Press Investments (UK) Ltd (incorporated in the United Kingdom but resident in Bermuda and considered to be non-resident for taxation purposes) allotted 2.4 million fully paid ordinary shares to Murray Leisure Group Pty Ltd.
4. Murray Leisure Group Pty Ltd then lent US\$100 million (non-interest bearing) to Consolidated Press Investments (UK) Ltd.
5. This US\$100 million was immediately lent to CP Investment (Singapore) Pte Ltd, a new company incorporated by the group in Singapore that borrowed the US\$100 million (interest bearing) from Consolidated Press Investments (UK) Ltd to purchase a partial interest in Holylake Investments Ltd, incorporated in Bermuda.

6. Holylake Investments Ltd made the takeover offer that was later withdrawn due to the fact that a condition of the offer could not be satisfied.
7. The loan of US\$100 million from Murray Leisure Group Pty Ltd to Consolidated Press Investments (UK) Ltd was applied by the company to the allotment to Murray Leisure Group Pty Ltd of 1 million fully paid redeemable preference shares of US\$100 each.

A diagrammatical representation of the transactions undertaken in the *Consolidated Press Holdings* Case is provided in [Appendix C](#).

Australian Consolidated Press Ltd claimed allowable deductions under section 51(1) of the Income Tax Assessment Act for the interest incurred on the funds borrowed to take up the Murray Leisure Group Pty Ltd shares. However, the Commissioner disallowed the deduction on the basis that the GAAR applied, as it contended that the loan could have been expected to occur between Consolidated Press Finance Pty Ltd and Australian Consolidated Press Ltd, with an acquisition of shares directly by Australian Consolidated Press Ltd in Consolidated Press Investments (UK) Ltd. Further, the Commissioner contended that Consolidated Press Investments (UK) Ltd could fund CP Investment (Singapore) Pte Ltd to finance Holylake Investments' bid. Therefore, the Commissioner argued that the interposition of Murray Leisure Group Pty Ltd was critical to the deductibility of the interest. This was because, if the anticipated income from the transaction were to have resulted in dividends from Consolidated Press Investments (UK) Ltd to Australian Consolidated Press Ltd, section 79D of the Income Tax Assessment Act would have operated to deny Australian Consolidated Press Ltd deductibility of interest. In this regard it was contended that section 79D of the Income Tax Assessment Act would have operated to quarantine the deductions for interest allowable to Australian Consolidated Press Ltd had it not been for the interposition of Murray Leisure Group Pty Ltd.

CPH Property Ltd (formerly Australian Consolidated Press Ltd) appealed to the Federal Court where the appeal was allowed. The Commissioner appealed to the Full Court where the appeal was allowed. CPH Property Ltd then appealed to the High Court where the court found in favour of the Commissioner. The progress of this case is presented in Table 6 below:

**TABLE 6 PROGRESS OF THE *COMMISSIONER OF TAXATION V CONSOLIDATED PRESS HOLDINGS* CASE**

<b>Court</b>	<b>Federal Court</b>	<b>Full Court</b>	<b>High Court</b>
<b>Decision</b>	Held in favour of the taxpayer	Held in favour of the Commissioner	Held in favour of the Commissioner

### 8.5.2 ARRANGEMENT

In applying the framework for the South African GAAR developed in Chapter 4 of this study, the transactions entered into by the taxpayers in the *Consolidated Press Holdings Ltd* case (i.e. the course of action taken within the group for purposes of the BAT Industries Plc takeover bid) would constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act.

In the case presented to the courts in Australia, the Commissioner identified a part of the total scheme, the interposition of Murray Leisure Group Pty Ltd between Australian Consolidated Press Ltd and Consolidated Press Investments (UK) Ltd, as the relevant scheme for the application of GAAR. In defining this scheme, the following key steps were identified:

- the acquisition by subscription by Australian Consolidated Press Ltd of redeemable preference shares in Murray Leisure Group Pty Ltd;
- the acquisition by subscription by Murray Leisure Group Pty Ltd of redeemable preference shares in Consolidated Press Investments (UK) Ltd; and
- in each case the payment and allotment of moneys.

The South African GAAR similarly recognises the principle of a transaction involving individual steps. In accordance with the South African GAAR, the Commissioner may apply the GAAR to individual steps within arrangements, as is specifically provided for in section 80H of the Income Tax Act. Therefore, the wider scheme identified in the *Consolidated Press Holdings Ltd* case may represent the whole arrangement, while the narrower scheme may represent interposition of Murray Leisure Group Pty Ltd for purposes of the South African GAAR. The specific part of the scheme that had the effect of interposing Murray Leisure Group Pty Ltd into the larger scheme is an important aspect to consider, as the schemes

identified at trial by the Commissioner for attack are the only ones that can be used for attack under appeal for purposes of applying the framework for the South African GAAR.

### **8.5.3 TAX BENEFIT**

By entering into the identified arrangement, Australian Consolidated Press Ltd would have been granted a deduction for the interest on the money borrowed from Consolidated Press Finance Pty Ltd (in terms of section 51(1) of the Income Tax Assessment Act). This deduction would not have been allowed if the scheme identified (interposing Murray Leisure Group Pty Ltd into the larger scheme) had not been entered into, as section 79D of the Income Tax Assessment Act would have prevented this. While the detail of the application of section 79D of the Income Tax Assessment Act falls outside of the scope of this study, it is relevant to note that both the Full Court and High Court agreed that the application of section 79D would have prevented the deduction of the interest by Australian Consolidated Press Ltd. This is consistent with the “but for” test laid out in *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and the *Louw* case. Australian Consolidated Press Ltd was therefore able to step out of the way of, escape or prevent an anticipated liability for tax as contemplated in the *Smith* case when applying the South African GAAR.

Based on the application of the framework for the South African GAAR, the transactions entered into by the taxpayers in the *Consolidated Press Holdings Ltd* case constituted an arrangement that had the effect of obtaining a tax benefit. Therefore, the arrangement would constitute an avoidance arrangement as defined in section 80L of the Income Tax Act.

Notwithstanding, in this case the Commissioner was able to identify a reasonable alternative transaction with relative ease that did not include the interposition of Murray Leisure Group Pty Ltd (the loan could have been made directly between Consolidated Press Finance Pty Ltd and Australian Consolidated Press Ltd, with an acquisition of shares directly by Australian Consolidated Press Ltd in Consolidated Press Investments (UK) Ltd). In identifying this alternative arrangement, the same commercial outcomes would have been achieved for Australian Consolidated Press Ltd in the absence of the tax considerations. The relative ease with which the Commissioner was able to identify the reasonable alternative may not be possible in all cases that the Commissioner would like to attack under the GAAR.

#### 8.5.4 SOLE OR MAIN PURPOSE

The sole or main purpose requirement is the third requirement of the framework for the South African GAAR. In this regard the sole or main purpose of the arrangement (the interposing of Murray Leisure Group Pty Ltd into the larger scheme) entered into by Australian Consolidated Press Ltd must be demonstrated to be for purposes of obtaining the tax benefit (the interest deduction).

With regard to the wider scheme, it is evident that the subjective intent was to allow the group to make a takeover bid for BAT Industries Plc. However, because a specific part of the scheme was identified by the Commissioner for the application of GAAR (i.e. interposing Murray Leisure Group Pty Ltd into the larger scheme), the framework for the South African GAAR should be applied to the part of the scheme that was identified. In this regard, the insertion of Murray Leisure Group Pty Ltd into the larger scheme should be viewed separately with its own distinct purpose. The insertion of Murray Leisure Group Pty Ltd into the larger scheme had two purposes:

1. avoiding the application of section 79D of the Income Tax Assessment Act in order to allow the deduction of interest in terms of section 51(1) of the Income Tax Assessment Act; and
2. the need to adopt a structure that would not forego the tax credit relief (which would occur due to the proposal by the United Kingdom Government that non-resident United Kingdom companies should be taxed as residents, as opposed to taxation based on source rules). This could have resulted in the group being taxed twice, thus losing the benefit of losses and franking credits<sup>1</sup> arising from tax already paid.

Therefore, if the tax benefit identified (the deductibility of interest) was dominant, it would support the sole or main purpose requirement for purposes of applying the framework of the South African GAAR (*Conhage* case). However, section 80G of the Income Tax Act creates a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit. There is no affirmative or conclusive evidence in the facts of the case to rebut this presumption as an inquiry into the subjective purpose is not required in

---

<sup>1</sup> “Franking credits arise for shareholders when certain Australian-resident companies pay income tax on their taxable income and distribute their after-tax profits by way of franked dividends. These franked dividends have franking credits attached.” (Australian Government: Australian Tax Office, 2017:1)



terms of the Australian GAAR. The sole or main purpose of the scheme in this case is therefore to achieve the tax benefit (the deduction of interest) (De Koker and Williams, 2015:par.19.38).

Despite the presumption that the sole or main purpose of the arrangement was to obtain the tax benefit, an evaluation of the objective purpose could be considered. In determining the objective purpose of the arrangement, the timing of the tax benefits becomes relevant because the first purpose (the deduction of interest) resulted in an immediate tax benefit for the 1989 and 1990 years of assessment. However, the second purpose (the possible double taxation resulting from the loss of losses and franking credits arising from tax already paid) would only arise on a much longer term should the proposals of the United Kingdom Government become effective. In light of the lack of evidence provided in the facts of the case, it is impossible to determine what the sole or main purpose for the arrangement was, as the objective factors (if considered over both the short and longer term) would have been achieved. However, due to the fact that the takeover bid was later withdrawn, the longer-term objective (tax credit relief) was not achieved and cannot be considered to objectively support a view that the sole or main purpose was not to achieve the deduction of interest.

In light of the above subjective and objective analysis for the sole or main purpose requirement it is evident that, section 80G of the Income Tax Act (creating the presumption of purpose) allows a conclusion that the sole or main purpose of the scheme was to obtain the tax benefit. In this context it is relevant to consider that the taxpayers in this case relied on the assertion that they adopted the advice provided by their professional advisors in structuring the scheme in its entirety. Therefore, the taxpayers asserted that they could not be considered to have had a tax motive in structuring the wider arrangement. In the South African context, no guidance is provided regarding the ability to attribute the purpose of a tax advisor to the taxpayer. Should guidance be provided in this regard, it is important to consider the possibility that the tax knowledge of the taxpayer would then become a relevant consideration. Therefore, if the taxpayer contends that he or she was not aware of the tax benefits, it could result in a decision in favour of the taxpayer. This would be an obstacle to the application of the GAAR as many taxpayers who intend to enter into complex transactions often seek the advice of professional advisors and could use this as a means to avoid the application of the GAAR.

Consequently, it is submitted that the sole or main purpose requirement should be considered an objective test without consideration of a subjective purpose. However, this should be managed carefully because

the possible introduction of subjective considerations by the judiciary could impact upon which factors they consider in their objective inquiry. Therefore, it is suggested that guidance be provided that will aid in identifying which factors could be considered, these factors being similar to the eight objective factors included in the Australian GAAR. For purposes of this case the following principles included in the South African GAAR have been considered:

- If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or that attracted less tax, it indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (*Conhage* case).
  - In this regard it is not reasonable to answer this question based on the facts of this case as the taxpayers followed the advice provided by their professional advisors and no indication is given of a choice between the alternatives.
- If the dominant subjective purpose of the avoidance arrangement (i.e. what was in the mind of the taxpayer who entered into the transaction) was to achieve some non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement.
  - It is not possible to answer this question based on the facts of this case as the taxpayers followed the advice provided by their professional advisors and no subjective purpose was raised by the taxpayer.

### **8.5.5 TAINTED ELEMENTS**

For the avoidance arrangement in the *Consolidated Press Holdings Ltd* case to be considered impermissible in terms of the South African GAAR, at least one of the tainted elements must be present. For purposes of this analysis it is necessary to determine if the avoidance arrangement entered into by the taxpayers in the *Consolidated Press Holdings Ltd* case would constitute a transaction entered into in the context of business or any other context. It is submitted that the transactions were undertaken in the context of business as this was a venture undertaken by a group of companies. Similarly, the wider scheme was intended to achieve a commercial purpose (to allow the group to make a takeover bid for BAT Industries Plc).

## ***ABNORMALITY***

In terms of section 80A of the Income Tax Act the first tainted element is whether arrangement was entered into or carried out by means or in a manner that would not normally be employed. In answering this question, it is necessary to determine if the insertion of Murray Leisure Group Pty Ltd between Australian Consolidated Press Ltd and Consolidated Press Investments (UK) Ltd was normal. It is submitted that the insertion of Murray Leisure Group Pty Ltd introduced additional complexity without a requisite commercial reason (in the absence of the tax considerations). There are no other commercial reasons for this complexity. It is submitted that in the normal course of business, the transaction could have been entered into by means of one of two *bona fide* alternatives (Louw, 2007:27):

- Australian Consolidated Press Ltd could have subscribed directly for shares in Consolidated Press Investments (UK) Ltd for the value required in terms of the BAT Industries Plc takeover bid; or
- Australian Consolidated Press Ltd could have made a loan to Consolidated Press Investments (UK) Ltd for the value required in terms of the BAT Industries Plc takeover bid.

In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is likely that the scheme (insertion of Murray Leisure Group Pty Ltd) would not have been entered into had it not been for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is unlikely that such a transaction would be entered into by another taxpayer without a tax consideration.

## ***LACK OF COMMERCIAL SUBSTANCE***

The next tainted element to be considered is the lack of commercial substance. The facts of the case indicate that the arrangement (insertion of Murray Leisure Group Pty Ltd between Australian Consolidated Press Ltd and Consolidated Press Investments (UK) Ltd) as a whole lacked commercial substance. This is due to the fact that in the absence of the tax considerations, the arrangement served no purpose other than to include additional complexity and unnecessary steps into a wider transaction. The effect of the transaction is that Consolidated Press Finance Pty Ltd lent money to Murray Leisure Group Pty Ltd to fund CP Investment (Singapore) Pte Ltd.

In applying the framework for the South African GAAR, each of the individual tests are dealt with separately below.

***General lack of commercial substance test***

The loans and share subscriptions between Australian Consolidated Press Ltd, Murray Leisure Group Pty and Consolidated Press Investments (UK) Ltd did not result in a significant effect on the net cash flows or business risks, as the insertion of the Murray Leisure Group Pty would still have required similar transactions to occur between Australian Consolidated Press Ltd and Consolidated Press Investments (UK) Ltd (section 80C definition and Broomberg, 2007:9).

***Substance over form test***

It is submitted that the true intention of the parties is not reflected in the agreement, as Murray Leisure Group Pty merely served as a conduit for the financing required for the group's takeover bid of BAT Industries Plc.

***Round trip financing test***

The insertion of Murray Leisure Group Pty into the scheme resulted in funding being transferred between parties, through reciprocal actions via loans and share subscriptions, resulting directly in the tax beneficial interest deduction.

***Tax-indifferent party test***

In accordance with section 80E of the Income Tax Act, Murray Leisure Group Pty and Consolidated Press Investments (UK) Ltd were tax-indifferent parties as they were either not subjected to normal tax in Australia and/or their participation in the arrangement gave rise to deductible interest in the hands of the taxpayer. Therefore, they effectively sold their tax advantage to other companies in the group in order to create the circumstances necessary for Australian Consolidated Press Ltd to obtain the interest deduction.

***Offsetting or cancelling test***

There are elements within the transaction that have the effect of offsetting or cancelling each other, including the conversion of the US\$100 million loan from Murray Leisure Group Pty Ltd being applied

to the allotment of 1 million fully paid redeemable preference shares of US\$100 each in Consolidated Press Investments (UK) Ltd. This indicates that there are parts of the transaction that were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance.

In conclusion the avoidance arrangement identified in the *Consolidated Press Holdings Ltd* case therefore lacks commercial substance in terms of applying the framework for the South African GAAR.

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

In determining if the rights and obligations were not at arm's length, it is important to consider that the entities were connected to each other as they were part of a larger group of companies. In this regard it does not seem reasonable that any company would be willing to provide a US\$100 million loan to another company without some reward (usually in the form of interest). In the facts of this case Murray Leisure Group Pty Ltd lent US\$100 million to Consolidated Press Investments (UK) Ltd without an arm's length interest rate being negotiated. Therefore, Murray Leisure Group Pty Ltd did not strive to get the utmost possible advantage out of the transaction (*Hicklin* case).

Similarly, it does not seem reasonable that any party to a transaction would have entered into such a transaction (without reward or incentive) in the absence of the relationships it had with Australian Consolidated Press Ltd and Consolidated Press Investments (UK) Ltd. Therefore, the arrangement did have the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length.

### ***MISUSE OR ABUSE OF THE ACT***

The last tainted element to consider is misuse or abuse of the Act. It is clear that the provisions allowing for the deduction of interest resulting from the financing, required for purposes of the BAT Industries Plc takeover bid, were applied correctly in terms of the strict interpretation of section 51(1) of the Income Tax Assessment Act. However, the interest deduction was only permitted as a result of the insertion of Murray Leisure Group Pty Ltd, as section 79D of the Income Tax Assessment Act would have operated to prevent the deduction otherwise. Therefore, the additional complexity and unnecessary steps inserted into the wider arrangement can be considered to have intentionally frustrated, exploited or manipulated the purpose of section 79D of the Income Tax Assessment Act. In light of this it is submitted that, for purposes

of strengthening the South African GAAR, a provision should be included in the South African GAAR that prevents taxpayers from artificially creating complex circumstances necessary to use a tax-advantageous provision in the Income Tax Act.

#### **8.5.6 CONSOLIDATED PRESS HOLDINGS CASE CONCLUSION**

In analysing the results from applying the framework for the South African GAAR to the facts of the *Consolidated Press Holdings Ltd* case, it is evident that the transactions entered into by the taxpayers fall within the definition of an avoidance arrangement. The sole or main purpose of the narrower arrangement as identified by the Commissioner (interposing Murray Leisure Group Pty Ltd into the larger scheme) was to take advantage of the tax benefits to be derived from the deduction of interest for the loans provided. This conclusion can be made despite the fact that the sole or main purpose of the wider arrangement was to allow the group to make a takeover bid for BAT Industries Plc. The presumption of purpose created by section 80G of the Income Tax Act formed a significant part of this analysis as there was no evidence to refute the presumption of purpose in the facts of the case. This indicates that the creation of a presumption of purpose does add strength to the South African GAAR.

In analysing the tainted elements requirement, the transaction is considered to be abnormal when comparing the transaction to a transaction entered into for *bona fide* business purposes in the absence of a tax consideration, as it is unlikely that the scheme (insertion of Murray Leisure Group Pty Ltd) would have been entered into had it not been for the resultant tax benefits. Further, the arrangement did not result in a significant effect upon the net cash flows or business risks and all the indicators for lack of commercial substance were present (substance over form, round trip financing, tax-indifferent parties and offsetting or cancelling features). Lastly, the arrangement had the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length as well as the introduction of elements of artificiality for purposes of creating the circumstances necessary to obtain the interest deduction (misuse or abuse of the Act).

In conclusion, it is evident that the avoidance arrangement entered into by the taxpayers in the *Consolidated Press Holdings Ltd* case does constitute an impermissible avoidance arrangement in terms of the framework for the South African GAAR. If one considers that the Australian High Court

successfully applied the Australian GAAR, this indicates that both of the GAARs are equally effective. However, the following aspects may impact upon the successful application of the South African GAAR:

- It is submitted that guidance should be provided to clarify whether the purpose of a tax advisor can be attributed to the subjective intention of taxpayers in cases such as these and under what circumstances the subjective purpose of a tax advisor can be attributed to the taxpayers. If this issue is not addressed it may be possible for taxpayers to contend that they did not have a tax motive because they adopted the advice provided by their professional advisors in structuring the scheme. However, in providing this guidance the legislature should consider the possibility that the tax expertise of the taxpayer would become a relevant consideration and in the instance where a taxpayer contends that he or she was unaware of the tax consequences (therefore cannot have had the subjective intention of obtaining the tax benefit) this could result in the GAAR not being applied to the scheme. It is therefore submitted that the sole or main purpose requirement should be considered an objective test without the consideration of a subjective purpose. Because subjectivity could impact upon which factors are considered in the objective inquiry, these factors could operate in a manner similar to the eight objective factors included in the Australian GAAR.
- There was ample evidence, easily available to the Commissioner, that allowed a comparison of the outcomes and tax consequences for:
  - the arrangement entered into; and
  - its reasonable alternative in the absence of the tax benefits.

This may not be possible in all cases that the Commissioner would like to attack under the GAAR.

## **8.6 *COMMISSIONER OF TAXATION v HART***

### **8.6.1 FACTS OF THE CASE**

This case was taken on appeal from the Federal Court of Australia. The facts of the case are that a married couple, Mr and Mrs Hart, owned property in Australia that was mortgaged. They wanted to purchase a new residence and use their former home to earn rental income. In terms of tax legislation, the couple would be allowed to deduct the costs incurred in producing assessable income from the rental-producing investment property, but were not entitled to deduct costs incurred for purposes of their new residence. Shortly after paying a holding deposit on their new property, the couple received a brochure from a

mortgage company promoting a “Wealth Optimiser” scheme. In terms of this brochure a loan could be structured to finance both an investment property and a residence by paying the same monthly instalment, but additional benefits could be derived:

- (i) The home loan for the residence could be paid off 20 times faster; and
- (ii) The deductible interest incurred on the investment property would be increased.

The couple took advantage of the Wealth Optimiser scheme and applied to borrow \$298,000 from the mortgage company. In terms of this split loan facility agreement:

- (i) interest accrued daily but was payable monthly;
- (ii) the lender could vary the interest rate;
- (iii) the loan was repayable in monthly instalments, each calculated according to the prevailing interest rate to enable the interest and principal to be repaid in 300 months; and
- (iv) the borrower could direct the lender to split the loan account to represent two different purposes for which the borrower intended to use the fund and could direct the application of the whole of any monthly payment to any portion of a loan account so split.

The couple split the loan by directing that \$95,112 of the borrowings should be applied towards the refinancing of an existing loan on the investment property, while the balance of \$202,888 be applied to a home loan and certain other expenses. Further, they directed that the whole of each monthly repayment be applied in satisfaction of that part of the loan used for purposes of refinancing of the new residential home. In terms of the above agreement the interest incurred on the split loan was higher than that on their former mortgage loan. Interest on the investment property portion of the loan was capitalised and compounded. Consequently, there was no reduction of the principal outstanding on the part of the loan allocated to the investment property for the 1997 year of assessment. In completing their 1997 tax return the couple decided not to deduct this interest due to the release of a draft statement from the Commissioner in terms of which the Commissioner expressed the view that any capitalised and compounded interest on loans similar to that of the Wealth Optimiser was not allowable as a deduction.

However, the couple later decided to participate as a test case to be funded by the Commissioner in relation to this issue and amended their tax returns for the 1997 year of assessment. Therefore, the couple claimed allowable deductions for the interest incurred and capitalised for the investment property portion to the



value of \$67 for the 1997 year of assessment and \$336 for the 1998 year of assessment. Shortly thereafter the Commissioner made determinations under section 177F of the Income Tax Assessment Act that the interest was not an allowable deduction for the tax returns completed for the 1997 and 1998 years of assessment. Mr and Mrs Hart objected to these assessments.

A diagrammatical representation of the transactions undertaken in terms of this split loan is provided in Appendix D. The progress of this case is presented in Table 7 below:

**TABLE 7 PROGRESS OF THE *COMMISSIONER OF TAXATION V HART* CASE**

<b>Court</b>	<b>Federal Court</b>	<b>Full Court</b>	<b>High Court</b>
<b>Decision</b>	Held in favour of the Commissioner	Held in favour of the taxpayers	Held in favour of the Commissioner

### **8.6.2 ARRANGEMENT**

In applying the framework of the South African GAAR, the transactions entered into by the taxpayers in the *Hart* case (i.e. the use of a split loan facility for financing both a residential home and an investment property, including specifications relating the payment allocations) constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. Therefore, if presented before the South African courts, the transactions considered in the *Hart* case would similarly be considered to constitute an arrangement for purposes of the South African GAAR.

It is relevant to note that in the judgment delivered by Gummow J and Hayne J (at 238) the Commissioner identified both a wider scheme and a narrower scheme. The wider scheme was said to be “all the steps leading to, and the entering into, and the implementation of the loan arrangements” between the lender’s agent and the respondents, including five particular steps. The steps were defined as follows:

- a) the marketing of the loan to the respondents;
- b) splitting the loan;

- c) acceptance by the lender's agent of capitalisation of interest on that part of the loan used for investment purposes on the basis that it received another predetermined amount in reduction of the home loan portion;
- d) the respondents' election to allocate all repayments to the home loan portion until that portion of the loan was paid; and
- e) the consequential incurring of additional interest (including compound interest) on the investment loan portion.

The narrower scheme identified by the Commissioner was said to be “the provision in the loan for the division into two portions and the direction of the repayments to one or other portion and the direction by the [respondents] of the repayments to the home loan portion”.

As previously identified the South African GAAR similarly recognises the principle of a transaction involving individual steps. In accordance with section 80H of the Income Tax Act, the Commissioner may apply the GAAR to individual steps within arrangements. Therefore, the wider scheme identified in the *Hart* case may represent the whole arrangement, while the narrower scheme may represent the steps within the scheme, for purposes of the applying the framework of the South African GAAR.

This is an important aspect as the schemes identified at trial by the Commissioner for attack represent the only grounds that can be addressed by the court under a later appeal for the purposes of applying the South African GAAR (Department of Justice, 2009:par.49.3). In this analysis both the narrower and the wider schemes identified constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act.

### **8.6.3 TAX BENEFIT**

In applying the second requirement of the framework for the South African GAAR to both the wider and narrower schemes identified for attack, it is noted that by entering into either the wider or the narrower arrangement, the taxpayers incurred higher deductible interest costs than would have been incurred in the absence of the scheme (the “but for” test as contemplated in *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and the *Louw* case).

Therefore, the split loan financing arrangement increased the value of the interest deduction related to the investment property and consequently resulted in a reduced taxable income for the taxpayers. Therefore, the taxpayers effectively stepped out of the way of, escaped or prevented an anticipated liability for tax as contemplated in the *Smith* case. Further, the fact that the investment property was already financed by a mortgage bond at a lower interest rate indicated that the amount of the tax benefit would easily be established by the Commissioner by calculating the difference between the interest deduction claimed under both financing options available to the taxpayers (De Koker and Williams, 2015:par.19.37).

In light of the above application of the framework for the South African GAAR, the transactions entered into by the taxpayers in the *Hart* case constituted an arrangement that had the effect of obtaining a tax benefit. Therefore, both the wider and narrower schemes identified for attack by the Commissioner, in the *Hart* case constitute an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### **8.6.4 SOLE OR MAIN PURPOSE**

In applying the third requirement of the framework for the South African GAAR, the sole or main purpose of the arrangement must be the obtaining of the tax benefit. In reviewing the facts of the case, it appears that the stated intention (subjective test) of the wider arrangement (i.e. the use of a split loan facility for financing both a residential home and investment property including payment allocations) was to enable the taxpayers to obtain the finance to buy a new house and to finance the retention of their former home as an income-producing investment property. Further, from a review of the facts of the case it is evident that the objective effect of the wider arrangement supports the stated intention as the arrangement did in fact achieve the results anticipated (to finance a residential home and investment property, while achieving a tax saving due to the entitlement to split the loan and allocate the payments).

The manner in which the financing was arranged indicates that, objectively, there was more than one purpose for entering into the arrangement. The question to be answered would be whether the tax motive was the dominant reason. In this regard it is relevant to note that the agent went to great lengths to give the taxpayers material that identified the advantages of the scheme as opposed to other forms of financing. This material included examples illustrating how quickly the residential home could be paid off and how large the tax benefits would be. This indicates that, while it may be problematic to determine which purpose was dominant (as required by the *Conhage* case), the same commercial result could have been

achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax. Obtaining a tax benefit, in itself, does not imply that the sole or main purpose of an arrangement was to obtain a tax benefit. However, the manner in which the payments on the loan were allocated indicates that the only purpose was to obtain a tax benefit. Nevertheless, there is uncertainty regarding the extent to which the judgement made in the *Conhage case* will be applied. Where a greater weighting is attached to the ability of a taxpayer to achieve the same commercial result in a different manner and to choose the manner that attracts less tax, it is possible that the sole or main purpose requirement of the wider scheme would not be satisfied and the GAAR would not apply to the avoidance arrangement.

If the steps identified by the Commissioner in the “wider scheme” are referred to for the purpose of applying the framework for the South African GAAR, all of the steps support a conclusion that the sole purpose of the scheme in both its wide and narrow sense was to obtain a tax benefit. In this regard, it would seem that both the subjective test and objective test would lead to the conclusion that the sole or main purpose of either of the arrangements (the wider and narrower schemes) was to take advantage of the considerable tax benefits to be derived.

In considering the principles developed in the framework, the following were considered:

- The taxpayers were entitled to deduct the full interest expenditure attributed to the investment property at a higher amount than that expected if the investment property had been financed by a loan in isolation.
- The interest rate agreed to was higher than the original mortgage financing over the property or standard loan options available from the same lender for both properties.
- The same commercial result could have been obtained in a different manner using different financing methods, with the advantage of incurring a marginally lower interest rate over the investment property.

When brought before the courts in Australia, the transactions contemplated in the *Hart* case were determined to have the dominant purpose of obtaining a tax benefit under Part IVA of the Income Tax Assessment Act. Thus the application of the provisions of the South African GAAR (effective at the date of the scheme) would not have a different result regarding the dominant purpose requirement of the Australian GAAR (effective at the date of the scheme). However, in light of the possibility that a different

conclusion may be drawn regarding the sole or main purpose of the wider scheme, due to the principles applied from the *Conhage case*, it is submitted that identification of the correct scheme for purposes of applying the South African GAAR is critical to the success or failure of the GAAR when presented before the courts.

#### **8.6.5 TAINTED ELEMENTS**

The last requirement to be met before the arrangement is considered to be an impermissible avoidance arrangement is for the arrangement to have one or more of the tainted elements. For purposes of this analysis it is important to determine if the avoidance arrangement entered into by the taxpayers in the *Hart* case would constitute a transaction entered into in the context of business or any other context. The “context of business” and any other context have not been defined for purposes of applying the GAAR. In order to determine if the transactions could be considered to be in the context of business it is submitted that it is appropriate to consider if the transaction was undertaken for purposes of trade, family, personal or charitable motives. Business transactions that are undertaken for the purposes of trade may not always be conducted through a business entity. In terms of section 11(a) of the South African Income Tax Act, deductions are only allowed to be made against income of a person if a trade is carried on. In this context the term “trade” is defined in section 1 of the Income Tax Act as

every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act [57 of 1978], or any design as defined in the Designs Act [195 of 1993], or any trade mark as defined in the Trade Marks Act [194 of 1993], or any copyright as defined in the Copyright Act [98 of 1978], or any other property which is of a similar nature

In light of this definition it is evident that the definition of trade is wide and includes active pursuits, whilst specifically including certain passive income generating activities. These passive income streams may not traditionally be considered to represent the carrying on of a trade and therefore justify the specific inclusion in the definition of trade. While the letting of property is specifically included in the definition of trade it should be distinguished from the mere intention to let property. In this regard the judgments from *Income Tax Case No 777* (1953) 19 SATC 320 (at 322) and *Income Tax Case No 1476* (1989) 52 SATC 141 (at 147-149) are relevant, where it was held that a mere intention to let property would not

amount to the carrying on of a trade. Therefore, it is submitted that for purposes of applying the framework for the South African GAAR, the intention to let property as intended in the *Hart* case is a passive activity that is not be considered to be trading in the context of business.

### ***ABNORMALITY***

As the scheme in the *Hart* case has been identified as one that was not entered into in the context of business, one of the final tests used to determine if an arrangement would be considered an impermissible avoidance arrangement in terms of section 80A of the Income Tax Act would be to establish whether the arrangement was entered into or carried out by means or in a manner that would not normally be employed. In this regard the following factors were taken into account:

- The decision to enter into a loan agreement that would result in a higher interest rate than that already agreed to in terms of the existing mortgage over the investment property indicates that there was a difference between the transaction as entered into by the taxpayer and a transaction entered into for *bona fide* purposes in the absence of a tax consideration (Louw, 2007:27). Further, standard loans were available to the taxpayers at interest rates lower than those of the Wealth Optimiser scheme, which indicates that the means or manner in which the financing was undertaken was not *bona fide*. Under normal circumstances, the costs to be incurred would have been a consideration in entering into the financing arrangement. Therefore, the decision to enter into the Wealth Optimiser scheme cannot be said to have been entered into for *bona fide* purposes in the absence of the tax consideration.
- There was no indication that financiers, in the absence of the Wealth Optimiser scheme, would have allowed the borrower to enter into a fixed-term loan with no capital repayments and in terms of which the only payments would be interest repayments. This also indicates that the arrangement was not entered into for *bona fide* purposes, in the absence of a tax consideration.
- The fact that the interest would continue to be compounded and would ultimately result in the outstanding amount of the loan on the investment property being more than the value of the property also indicates that the financing arrangement was not entered into for *bona fide* purposes.

In comparing the arrangement to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is likely that such financing would typically not be taken up were it not for the resultant

tax benefits. Therefore, the arrangement can be considered abnormal as it is unlikely that such a transaction would be entered into by another taxpayer without a tax consideration. In accordance with the application of the framework for the South African GAAR to the *Hart* case, the transaction undertaken would be considered to be an impermissible avoidance transaction. However, the remaining tainted elements that may be applied to the *Hart* case, are analysed below (creation of right or obligations not at arm's length or misuse or abuse of the Act).

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

The next tainted element is the creation of rights and obligations not at arm's length. In applying the framework to the facts of the *Hart* case, the following factors were considered for the narrow and wider schemes identified:

- For purposes of the wider scheme, the financier can be considered to have been striving to get the utmost advantage out of the transaction as it would be receiving a total monthly payment from the taxpayers that was higher than the rate they would be receiving under separate loan agreements over both properties. Therefore, the financier was able to achieve a better return from the financing arrangement than that of other options available to the financier (*Hicklin* case).
- For purposes of the narrower scheme, the manner in which the payments were allocated ultimately resulted in the outstanding amount of the loan over the investment property being higher than the value of the property, thereby increasing the risk of recoverability should the taxpayers default on payment. However, this risk was mitigated to the extent that additional security was provided over the property. This indicates that the rights attributed to the investment property may not be at arm's length, as commercially the taxpayers would not have been able to achieve the results in the absence of the payment terms and security provided in terms of the Wealth Optimiser scheme.
- The Wealth Optimiser scheme and the manner in which the payments were allocated resulted in the taxpayers incurring more interest than on the standard loans available to them for both the wider and narrower schemes identified. This indicates that the monthly obligations resulting from the Wealth Optimiser scheme were not at arm's length, in the absence of a tax consideration.
- The fact that ultimately the loan over the investment property would be higher than the value of the property also indicates that the obligation relating to the investment property could not be considered to be at arm's length, as this was not to the taxpayers' advantage (*Hicklin* case).

However, it is arguable that when considering the wider scheme and its tax benefits, the Wealth Optimiser scheme did result in the best possible advantage for the taxpayers as they were beneficiaries of the tax benefits resulting from the scheme.

As the financier and the taxpayers were not connected persons (*Hicklin* case), it was not necessary to discuss the issue of connected parties to the transaction.

In light of the above the rights and obligations attached to the Wealth Optimiser scheme could not have been expected in any other similar transaction between parties dealing at arm's length. This is specifically evident in the *Hart* case when considering the narrower scheme because it cannot be expected that a financier would have entered into an agreement with the taxpayers which would result in the outstanding amount of the loan over the investment property being higher than the value of the property, disregarding security provided. Similarly, the taxpayers incurred additional interest which was not at arm's length for the financing of the wider and narrower scheme, in order to obtain the tax benefits. There were also aspects of the scheme that had the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length and that would not necessarily be achieved under other principal and interest-based loans available, without tax considerations. This is confirmed by the fact that the scheme in question was specifically marketed with reference to and examples of the tax benefits available to the borrowers.

### ***MISUSE OR ABUSE OF THE ACT***

Lastly, concerning the misuse element, it is clear that the provisions allowing for the deduction of interest in relation to the investment property were correctly applied, as the deduction was claimed within the strict letter of the law. However, in applying the framework for the South African GAAR to the *Hart* case it is evident that the interest attached to the investment property was manipulated in order to remain within the letter of the law. Therefore, the manner in which the interest was manipulated in the wider and narrower schemes did in fact exploit or manipulate the deduction allowed in terms of the legislation.

### **8.6.6 HART CASE CONCLUSION**

In analysing the results from applying the framework for the South African GAAR to the facts of the *Hart* case, it is evident that the transactions entered into by the taxpayers fall within the definition of an



avoidance arrangement. The sole or main purpose (on a subjective and objective basis) of the wider and narrower arrangement was arguably to enable the taxpayers to buy a new house and to finance the retention of their former home as an income-producing investment property. However, the manner in which the financing was arranged indicates that, objectively, there was more than one purpose for entering into the arrangement. While there is uncertainty regarding the extent to which the judgement made in the *Conhage case* will be applied for purposes of this analysis, the manner in which the payments on the loan were allocated indicates that the only purpose was to obtain a tax benefit. Therefore, both the wider and narrower arrangements satisfy the sole or main purpose requirement of the framework for the South African GAAR.

In analysing the tainted elements requirement, the transaction was considered abnormal when comparing the arrangement to one entered into for *bona fide* purposes in the absence of a tax consideration. Therefore, it is unlikely that the arrangement would have been entered into had it not been for the resultant tax benefits. In addition to this, the rights and obligations attached to the arrangement could not have been expected in any other similar transaction between parties dealing at arm's length without the tax considerations. Lastly, it is clear that the provisions allowing for the deduction of interest in relation to the investment property were correctly applied but the transaction was artificially manipulated in order to remain within the letter of the law and therefore the wider and narrower schemes misused or abused the deduction allowed in terms of the legislation.

In conclusion, it is evident that the avoidance arrangement entered into by the taxpayers in the *Hart case* constitutes an impermissible avoidance arrangement in terms of the South African GAAR. Similarly, the Australian GAAR was applied successfully when the case was brought before the Australian courts. This indicates that, in respect of the facts of the case, both of the GAARs are equally effective. However, the following aspects related to the successful application of the South African GAAR in this specific case have been noted:

- In light of the possible differing conclusions drawn between the sole or main purpose of the wider and narrower schemes identified (due to the uncertainty regarding the extent to which the principles of the *Conhage case* will be used in applying the GAAR), it is submitted that if the South African GAAR were to be applied to the arrangement on the same basis as that identified by the Commissioner in Australia for this case, it is possible that only the narrow arrangement

specified would satisfy the sole or main purpose requirement. Therefore, it is critical that the correct scheme is identified when an arrangement is attacked in South Africa (whether that is the wider or narrower scheme).

- In identifying an alternative arrangement that could have achieved the same commercial outcomes, there was ample evidence, easily available to the Commissioner, which allowed a comparison of the outcomes and tax consequences for:
  - the arrangement entered into; and
  - its reasonable alternative, in the absence of the tax benefit.

This may not be possible in all cases that the Commissioner would like to attack under the GAAR. This would be a considerably more onerous task where a more complex or tailored scheme is used by a taxpayer to avoid tax. In certain instances, a comparative alternative may be almost impossible to identify as very few alternatives may lead to identical outcomes. Similarly, the subjectivity regarding the feasibility of entering into any of the identified alternatives also introduces an opportunity for the taxpayer to refute any comparisons with alternative transactions and provides taxpayers with the opportunity to defend their choice of transaction with relative ease.

In this case it is submitted that the ability of the taxpayers to allocate their monthly repayments to the residential home so that the higher interest on the investment property could be compounded and deducted in calculating their tax liability was a blatant attempt to achieve the tax benefit. This leads to the view that the GAAR could be applied successfully to such a scheme, as the judiciary would be able to identify the artificial nature of the manner in which the financing was arranged with relative ease. More specifically, the arrangement was undertaken in a manner that allowed the taxpayer to artificially manipulate the interest attributed to the investment property in order to create the conditions necessary to take advantage of a specific provision providing a tax benefit. In the analysis of the *Hart* case this manipulation and exploitation to achieve a tax benefit was clear and facilitated the application of the framework for the South African GAAR. However, it may strengthen the South African GAAR if a provision is included that provides that taxpayers should be prevented from artificially creating the circumstances necessary to obtain a tax benefit by using a tax-advantageous provision in the Income Tax Act

Lastly, it is also relevant to consider that the manner in which the Wealth Optimiser scheme was marketed (including examples of its resultant tax benefits) indicates that the arrangement in this case is one that can

be considered ideally suited to the application of GAAR. This is evident because one of the main reasons for the 2006 amendments to the South African GAAR was that

the [GAAR] has proven to be an inconsistent and at times, ineffective deterrent to the increasingly complex and sophisticated tax ‘products’ that are being marketed by banks, ‘boutique’ structured finance firms, multinational accounting firms and law firms (SARS, 2005:1).

Therefore, the intention of the legislature in drafting the South African GAAR was to prevent transactions that have these characteristics and provides support for the successful application of the GAAR.

The results from the four Australian cases analysed in this chapter are summarised below in order to draw conclusions regarding the comparative effectiveness of the Australian and South African GAARs.

## **8.7 SUMMARY OF APPLIED CASES**

The first step in achieving the objectives of this chapter is to collate the individual findings from the four Australian cases analysed. In collating the findings, two tables have been prepared:

- Table 8 summarises results from applying the South African GAAR to the Australian cases at a high level so that trends can be identified within the cases analysed.
- A summary of the results from applying the South African GAAR to the Australian cases at a detailed level so that trends can be identified in the cases analysed is provided in Appendix E.

TABLE 8 FRAMEWORK FOR SOUTH AFRICAN GAAR – HIGH-LEVEL CASE SUMMARIES (AUSTRALIA)

Table 8: Framework for applying sections 80A – 80L to the facts of previous case law	Peabody Case	Spotless Services Case	Consolidated Press Holdings Case	Hart Case
1 - Is there an arrangement?	✓	✓	✓	✓
2 - Does the transaction/operation/scheme result in a tax benefit?	✗	✓	✓	✓
3 - Is the sole or main purpose to obtain such tax benefit?	✗	✓	✓	✓
4 - Tainted elements requirement	✓	✓	✓	✓
<p>One of the following with regard to business transactions:</p> <ul style="list-style-type: none"> <li>- <i>Entered into in a manner not normal for bona fide business purposes?</i></li> <li>- <i>Does the transaction lack commercial substance?</i></li> </ul> <p>The following with regard to transactions not in the context of business:</p> <ul style="list-style-type: none"> <li>- <i>Has the arrangement been entered into in a manner not normal for bona fide purposes?</i></li> </ul> <p>One of the following with regard to transactions in any context:</p> <ul style="list-style-type: none"> <li>- <i>Has the arrangement created rights and obligations that are not at arm's length?</i></li> <li>- <i>Is there misuse or abuse of provisions of the Act?</i></li> </ul>	<ul style="list-style-type: none"> <li>✗</li> <li>✗</li> </ul> <p>N/A</p> <ul style="list-style-type: none"> <li>✓</li> <li>✗</li> <li>✗</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> </ul> <p>N/A</p> <ul style="list-style-type: none"> <li>✗</li> <li>✗</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> </ul> <p>N/A</p> <ul style="list-style-type: none"> <li>✓</li> <li>✓</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> <li>N/A</li> </ul> <p>✓</p> <ul style="list-style-type: none"> <li>✓</li> <li>✓</li> </ul>

### 8.7.1 HIGHLEVEL FINDINGS

In summarising the findings of the Australian cases analysed in this chapter at a high level, it is evident (from Table 8) that if these cases had been presented before the courts for purposes of the South African GAAR, three of the four cases would have found in favour of the Commissioner. Therefore the South African GAAR would have been applied successfully to three of the four cases selected for purposes of this study. The three cases in which the South African GAAR would have been applied successfully are:

- *Commissioner of Taxation v Spotless Services Ltd* (1996) HCA 34
- *Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) HCA 32
- *Commissioner of Taxation v Hart* (2004) HCA 26

At this point it is relevant to note that in all three of these cases, the results from applying the Australian GAAR were similar to the framework for the South African GAAR. Therefore, in both jurisdictions it is submitted that on the balance of probabilities that the judgements of the Australian High Courts and South African counterparts would find in favour of the Commissioner. Therefore, it would seem that for these three cases both the South African and Australian GAARs are equally effective at combatting impermissible tax avoidance.

An initial high-level review of the information in Table 8 reveals the following:

- All four cases were found to have the presence of an arrangement.
- Three cases (the *Hart*, the *Consolidated Press Holdings* and the *Spotless Services* cases) resulted in finding that the tax benefit requirement was satisfied. Therefore, these three cases met the criteria for the presence of an avoidance arrangement.
- In three of the four cases (the *Hart*, the *Consolidated Press Holdings* and the *Spotless Services* cases) the sole or main purpose of the arrangement was to obtain a tax benefit.
- All four cases contained one or more tainted elements.

. The only case that did not satisfy the framework for the application of the South African GAAR is the *Peabody* case. The Australian GAAR was also not applied successfully to the case when it was presented in the Australian High Court. This indicates that there may be deficiencies in both GAARs that rendered

the GAARs an ineffective tool for combatting this type of impermissible tax avoidance. However, such deficiencies cannot be assumed in both GAARs, as there may have been other reasons for the failure to apply the GAAR of both jurisdictions.

In investigating the reason why the *Peabody* case had such a significantly different outcome from the three remaining cases, it is submitted that the primary reason for the failure to apply the South African GAAR relates to the lack of a tax benefit. This also results in the inability to satisfy the sole or main purpose requirement because, in the absence of a tax benefit, it is impossible to find that the sole or main purpose of the arrangement was to obtain the tax benefit. This issue was also evident in the judgement from the Australian High Court.

This indicates that the reason for the failure to apply the South African GAAR is the possibility that this case should not have been attacked by the revenue authority in the first place. Alternatively, as was suggested in the analysis of the case, the Commissioner identified the incorrect taxpayer and/or part of the arrangement for purposes of the GAAR. Therefore, the deficiency identified in the *Peabody* case is not necessarily related to a deficiency in the GAAR, but the incorrect decision to attack the arrangement in terms of the GAAR by the Commissioner in Australia. However, the progress of the case through the Australian legal system shows that while the ruling was initially in favour of the Commissioner in the Federal Court, both subsequent appeals were found in favour of the taxpayer. Therefore, this indicates that the Commissioner believed that there were sufficient grounds on which to apply the Australian GAAR to the case. A more detailed discussion of the findings from all four cases is presented below.

### **8.7.2 DETAILED ANALYSIS**

For purposes of ensuring a comprehensive detailed analysis, each requirement of the South African GAAR has been analysed separately below.

#### ***ARRANGEMENT***

As identified in the high-level findings, all four of the cases analysed in this chapter satisfied the definition of an arrangement for the purposes of the South African GAAR. This result was expected because the definition of an arrangement has been widely interpreted in a manner that is consistent with the purpose

of the GAAR. However, it is interesting to note that the arrangements attacked by the Commissioner differed from case to case:

- In the *Hart* case the Commissioner identified both a wider scheme and a narrower scheme for attack under the GAAR.
- In the *Consolidated Press Holdings* case a narrow scheme within a larger scheme was identified for attack under the GAAR.
- In both the *Spotless Services* and *Peabody* cases a wider scheme was identified for attack under the GAAR.

In this regard it is noted that in the *Spotless Services* case the entire scheme was attacked (and in both jurisdictions the GAAR was successfully applied). It is submitted that it might not have been necessary to identify a part of the scheme for attack in the *Spotless Services* case due to the fact that it was a much simpler arrangement with fewer components compared to the other three cases. However, in the *Hart*, the *Consolidated Press Holdings* and the *Peabody* cases, the arrangements entered into were particularly complex and consisted of many individual transactions. When the Commissioner identified a part of the scheme for attack under the GAAR, the Australian High Court found in favour of the Commissioner in both the *Hart* and the *Consolidated Press Holdings* cases. Similar results existed when applying the framework for the South African GAAR. This can be contrasted with the *Peabody* case, because the whole scheme was attacked as opposed to a smaller part of the scheme, while the transactions were arguably the most complex of the four cases. In addition, this is the only case where the GAARs in both jurisdictions could not be applied. This leads to the conclusion that the combination of these two factors may have played a role in the failure to apply the GAARs in both jurisdictions.

This leads to the conclusion that, while the individual requirements for the presence of an arrangement may easily be satisfied, the impact of identifying the correct scheme or part thereof is critical to the success of both the South African and Australian GAARs. Support for this is found when analysing the findings from the *Peabody* case in isolation, because the connection between the arrangement identified and the tax benefit resulting from the arrangement is critical. Therefore, if the incorrect arrangement is identified, it may lead to failure to apply the tax benefit requirement.

It is also submitted that there was a possibility that, in addition to the failure to identify the correct scheme, the Commissioner may have identified the incorrect taxpayer to which to apply the GAAR. Therefore, careful consideration of the arrangement (or part thereof) is necessary.

### ***TAX BENEFIT***

As identified in the high-level findings, three of the four cases (the *Hart*, the *Consolidated Press Holdings* and the *Spotless Services* cases) analysed in this chapter satisfied the tax benefit requirement for the purposes of the South African GAAR. However, the ability of the Commissioner to identify and quantify the tax benefit depended on the Commissioner's ability to identify reasonable alternative schemes that the taxpayer could have entered into. It was specifically noted in the *Consolidated Press Holdings* and *Hart* cases that the alternative transactions were identified with relative ease by the Commissioner. However, due to the complex nature of many schemes that may be considered impermissible avoidance arrangements, the identification of alternatives may not be possible (see, for example, the problems experienced in the *Peabody* case).

This problem is compounded because it is left to the Commissioner to determine the tax consequences related to impermissible tax avoidance in terms of section 80B of the Income Tax Act. If one considers that taxpayers and their consultants often spend a significant amount of time and resources designing an arrangement that results in a tax benefit, it may require a similar investment of time and resources for the Commissioner to identify alternative reasonable schemes. Further, if it is considered that taxpayers and their consultants spend a considerable amount of time eliminating options that are available to them to achieve the same outcome, it would be necessary for the Commissioner to do the same. This is specifically evident in the *Peabody* case where the alternative options were rejected by the courts because they were not reasonable or viable options. For example, in the *Peabody* case, the trust was unable to purchase the shares because the purchaser was required to be a company.

The time and resources necessary for the Commissioner to determine the tax consequences of the impermissible tax avoidance arrangement may make it more difficult for the Commissioner to apply the GAAR successfully in South Africa where time and resources are subject to constraints. As a result, the taxpayer is in a position of power because it may not be subject to the same constraints experienced by



the Commissioner and may result in the failure to apply the GAAR successfully in instances where the GAAR should in fact be applied successfully.

It is important not to underestimate the critical nature of both the arrangement and tax benefit, as an error made in identifying either of these two requirements may result in an impermissible tax avoidance arrangement being found to be permissible.

### ***SOLE OR MAIN PURPOSE***

The high-level findings discussed above reveal that three of the four cases (the *Hart*, the *Consolidated Press Holdings* and the *Spotless Services* cases) analysed in this chapter satisfied the sole or main purpose requirement for the purposes of the South African GAAR. The case that did not satisfy this requirement, the *Peabody* case, is of concern due to the failure to identify the correct arrangement (or part thereof), or attribute the tax benefit obtained to the correct party to the transaction. This could affect the success or failure of the sole or main purpose requirement. For example, the reason for the failure to satisfy the sole or main purpose requirement in the *Peabody* case was not because of deficiencies identified in the sole or main purpose requirement, but because of the deficiencies related to the tax benefit requirement, as discussed above. Therefore, a deficiency in the arrangement or tax benefit requirements may result in the inability to satisfy the sole or main purpose requirement, because in the absence of a tax benefit it is impossible to find that the sole or main purpose of the arrangement was to obtain the tax benefit.

In addition, the *Peabody* case also made a contribution to this study in view of the impact it had on understanding the onus created by the presumption of purpose in terms of section 80G of the Income Tax Act. In this case, the taxpayer was able to justify that the possible alternative arrangements presented by the Commissioner (that could have yielded the same commercial outcomes in the absence of the tax considerations) were not reasonable or viable options (or they would have resulted in possible tax benefits being attained by other parties within the arrangement, as opposed to Mrs Peabody). In discharging this onus, the taxpayer was required to provide affirmative or conclusive evidence of why the alternative transactions (presented by the Commissioner in relation to the tax benefit requirement) were not ones that could have been entered into. Therefore, the *Peabody* case highlights why the considerations related to the tax benefit requirement are important in relation to other aspects of the application of the GAAR. The alternative arrangements may not only play a role in determining and quantifying the tax benefit, but may

also be considered for purposes of the sole or main purpose requirement. This further highlights the importance of identifying the correct scheme for purposes of applying a GAAR as a well-drafted GAAR will only succeed where the correct scheme and tax benefit are identified by the revenue authority.

The analysis of the sole or main purpose requirement in the *Hart* case revealed that, while on the balance of probabilities the wider arrangement did not satisfy the sole or main purpose requirement, the narrower arrangement did. The factors that were taken into consideration were those related to the manner in which the arrangement was undertaken and indicated that there was more than one motive for entering into the arrangement. The identification of alternative arrangements that could have yielded similar outcomes also played a significant part in identifying that there was more than one purpose for the arrangement and that the dominant purpose was to achieve tax benefits. This again supports the view that the identification of alternative arrangements by the Commissioner is an important factor to be considered for purposes of the sole or main purpose requirement.

In the *Consolidated Press Holdings Ltd* case a specific part of the scheme was identified by the Commissioner for the application of the GAAR and was determined to have two purposes. The dominant purpose was determined to be the achievement of the tax benefit. However, limited information was provided in the case to determine the subjective purpose of the part of the scheme identified for attack under the GAAR. Therefore, the operation of section 80G of the Income Tax Act (creating a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit) allowed a determination that the achievement of a tax benefit was the dominant purpose for the arrangement for purposes of applying the framework for the South African GAAR. As a result, it can be concluded that the inclusion of section 80G of the Income Tax Act added strength to the GAAR in this instance. However, if such a case were brought before the South African courts, the need to rely on section 80G of the Income Tax Act would be reduced, as evidence would be provided regarding the subjective test for the sole or main purpose requirement as part of the judicial investigation. Therefore, there would be less reliance on section 80G of the Income Tax Act due to the fact that more evidence would be available than that provided in the cases used in this study. Nevertheless, section 80G of the Income Tax Act would still add value as it would still require a taxpayer to provide affirmative or conclusive evidence to discharge this onus (De Koker and Williams, 2015:par.19.38).

Nevertheless, in the *Consolidated Press Holdings Ltd* case the taxpayers asserted, in defence, that they adopted the advice provided by their professional advisors in structuring the scheme in its entirety and therefore they did not have a tax motive in structuring the arrangement. In the South African context, no guidance is provided on the ability to attribute a purpose of a tax advisor to the taxpayer. Should guidance be provided in this regard, it is important to consider the possibility that the tax knowledge of the taxpayer would then become a relevant consideration. Therefore, if the taxpayer contends that he or she was not aware of the tax benefits, it could result in the application of the GAAR in favour of the taxpayer. This would affect the application of the GAAR, as many taxpayers who intend to enter into complex transactions often seek the advice of professional advisors and could use this as a means to avoid the application of the GAAR.

It is submitted that the sole or main purpose requirement should be considered an objective test without consideration of a subjective purpose. Therefore, it is suggested that guidance be provided that will aid in identifying which factors could be considered, these factors being similar to the eight objective factors included in the Australian GAAR.

### ***TAINTED ELEMENTS***

The high-level findings above show that all four cases contained one or more of the tainted elements. In three of the cases (the *Consolidated Press Holdings*, the *Spotless Services* and the *Peabody* cases) the transactions were considered to have occurred in the context of business. The transactions in the *Hart* case were considered to be in a context other than business. Further analysis revealed the following:

- The tainted element of abnormality was satisfied in three of the four cases (the *Hart*, the *Consolidated Press Holdings* and the *Spotless Services* cases).
- The element of lack of commercial substance was satisfied in two of three cases when applying this indicator (the *Consolidated Press Holdings* and the *Spotless Services* cases).
- In three of the four cases (the *Hart*, the *Consolidated Press Holdings* and the *Peabody* cases) the rights and obligations were found not to be at arm's length.
- The misuse or abuse of the Act element was satisfied in two of the four cases (the *Hart* and the *Consolidated Press Holdings* cases).

With regard to the lack of commercial substance element, it must be considered that there are numerous indicators for the lack of commercial substance and if the Commissioner is able to identify the presence of one of these indicators, it would assist in proving a lack of commercial substance. Therefore, it is not unexpected that there are aspects of many of the cases analysed that satisfy the lack of commercial substance element. Notwithstanding, specific items related to the tainted elements requirement were noted in the individual cases analysed in this chapter:

- In the *Spotless Services* case, there was arguably a blatant use of a tax-indifferent party within the arrangement. This resulted in a withholding tax of only 5% (and there was no double-tax agreement between Australia and the Cook Islands). Similarly, the tax advantages resulting from the use of this tax-indifferent party was specifically marketed to taxpayers in a pamphlet distributed by its holding company.
- In both the *Hart* and the *Consolidated Press Holdings* cases, it is submitted that the taxpayers artificially created the conditions necessary to create the tax benefit that was not intended by the legislator. Therefore, this element of artificiality resulted in the satisfaction of the misuse or abuse of the Act element.
- In the *Peabody* case, while it is submitted that the true intention of the parties was reflected in the agreements entered into as a whole, it is arguable that the provision of a loan by one party and subsequent forgiving of that loan indicates that the parties never intended the loan to be repaid. This could indicate that the loan was not a loan and was in fact a gift or donation.
- In the *Peabody* case it was noted that there are often instances where the parties to an arrangement are connected to each other and the nature of their relationship often yields benefits that are not connected to one specific party, but may in fact benefit the group as a whole. This led to the conclusion that where a group prospers, each individual party may benefit in some way from this prosperity. In the *Peabody* case, it is noted that by obtaining public funding, the funding available in the group increased (among other possible benefits resulting from a public floatation). This additional funding could arguably be of benefit to the entire group of companies, even if this is not immediately evident. It does not seem reasonable to exclude considerations such as these when assessing the commercial substance of the arrangement.

## 8.8 CONCLUSION

In concluding on the analysis of the Australian cases for purposes of phase 2 of the study, it is noted that the South African GAAR would have been applied successfully to three of the four cases selected for this study (the *Spotless Services case*; the *Consolidated Press Holdings case* and the *Hart case*).

The only case that did not satisfy the requirements of the South African GAAR was the *Peabody case*. However, similar results were experienced in Australia when these cases were brought before the High Court. Therefore, it would seem that for these three cases both the South African and Australian GAARs are equally effective at combatting impermissible tax avoidance.

While this may indicate that there may be deficiencies in both GAARs that rendered the GAARs ineffective for combatting this type of impermissible tax avoidance in the *Peabody case*, this is not certain. The reason for this uncertainty results from the fact that the deficiency in the *Peabody case* was related to the failure to satisfy the tax benefit requirement. This failure subsequently also resulted in the inability to satisfy the sole or main purpose requirement, because in the absence of a tax benefit it is impossible to find that the sole or main purpose of the arrangement was to obtain the tax benefit.

Additional results from the analysis of the cases reveal that the importance of the arrangement and tax benefit requirements should not be overlooked when attacked by the revenue authority. If the incorrect arrangement (wider or narrower or part thereof) is identified, the ability to satisfy the remaining four requirements of the South African GAAR is impeded. Similarly, the incorrect identification of the tax benefit resulting from the scheme (or even the identification of the incorrect party for purposes of the tax benefit) will seriously impact the ability to satisfy the sole or main purpose requirement and certain aspects of the tainted elements requirement. In addition to this, the identification of the incorrect tax benefit may impact the ability to satisfy the round-trip financing test because while there may be aspects of an arrangement that include round trip financing, the reciprocal actions may not result in the tax benefit contemplated in section 80D(1)(b)(i) being satisfied.

Another observation reveals that while in certain cases it may be relatively easy for the Commissioner to identify an alternative arrangement that could have achieved the same commercial outcomes, this may not be possible in all cases where the arrangement was specifically designed for the taxpayer's needs. Similarly, the subjectivity regarding the viability of the identified alternative also introduces an

opportunity for taxpayers to defend their position with relative ease and places the taxpayers in a position of power in this regard. It is important to note that the alternative transactions presented by the Commissioner may also become relevant for purposes of the abnormality element because the alternative transactions can be considered to be examples of “normal” transactions in the absence of a tax consideration. Therefore, the identification of reasonable alternative transactions by the Commissioner may play an important role for more than just the tax benefit requirement and should not be underestimated.

With regard to the sole or main purpose requirement, it is relevant to note that taxpayers may use professional advisors when planning arrangements. In these instances, taxpayers may contend that they did not have a tax motive in structuring the arrangement that was presented to them by their advisor. It is submitted that this is a possible area of weakness to be addressed in the South African GAAR and that guidance should be provided to clarify whether the purpose of a tax advisor can be attributed to the taxpayers in cases such as these. Should guidance be provided in this regard, it is important to consider the possibility that the tax knowledge of the taxpayer would then become a relevant consideration. Should a taxpayer contend that he or she was unaware of the tax consequences and therefore cannot have had the subjective intention of obtaining the tax benefit, it could result in the application of the GAAR in favour of the taxpayer. This would be an impediment to the application of the GAAR, as many taxpayers who intend to enter into complex transactions often seek the advice of professional advisors and could use this as a means to avoid the application of the GAAR.

It is therefore submitted that the sole or main purpose requirement should be considered an objective test without consideration of a subjective purpose. However, this should be managed so that the possible subjectivity introduced could impact upon which factors are considered in the objective inquiry. Therefore, it is suggested that guidance should be provided that will aid in identifying which factors could be considered that are similar to the eight objective factors included in the Australian GAAR.

It is submitted that the analysis conducted of the sole or main purpose requirement (applying the subjective and objective tests) is integrally related to the manner in which the arrangement was carried out as well as the effect of the arrangement. This relationship between these factors indicates that there is a close link between the evidence used for purposes of the sole or main purpose requirement and the tainted elements requirement. It is therefore submitted that the sole or main purpose requirement and the tainted elements

should not be separate tests. In combining the two requirements the strengths of both tests could be maintained. A single test could be informed by additional factors, similar to the structure of the Australian GAAR and the eight objective factors. However, if these two tests are combined as suggested, this must be done with caution in order to prevent the GAAR from applying to legitimate *bona fide* transactions. For example, the analysis of the presence of the round-trip financing may present a problem, as any short-term investment will have the presence of a reciprocal action and transfer of funds between the parties.

In cases where the arrangement was highly artificial in nature, the misuse or abuse of the Act element is more likely to be met (see the analysis on the *Hart* and the *Consolidated Press Holdings* cases). In both of these cases the taxpayers inserted artificial components into the arrangement that created the conditions necessary to achieve a tax benefit that was not intended by the legislator. Therefore, while there is considerable debate regarding the misuse or abuse element, it is easily satisfied where elements of artificiality are present within the arrangement. However, clarity on the misuse or abuse element is required in order to strengthen the South African GAAR so that the taxpayer, the Commissioner and the judiciary are provided with the tools to understand this element effectively in more detail.

Where parties to an arrangement are connected to each other, additional concerns arise about the impact this has on the South African GAAR. The parties may share commonality in achieving benefits related to the group as a whole and not individually. Therefore, these shared benefits may impact the assessment of the intention, risks, benefits and alternatives (related to the lack of commercial substance element) of the arrangement. It is questionable whether these group commercial benefits should be disregarded in such arrangements, as this does not seem to be consistent with the intention of the GAAR. Further, in applying the substance over form test in a situation where the parties are connected to each other, it is arguable that the intentions shared by senior management in a group may inherently be shared by the other entities within the group. Therefore, in a situation where a loan is provided by one connected party to another and later forgiven, it can reasonably be concluded that the substance differed from the form (parties misrepresented the transaction) if the parties all knew of this eventuality. In this regard it is submitted that the relationship between the parties should be taken into account in applying the GAAR, but this should be carefully considered, so that any mischief by these parties can be prevented. For purposes of this requirement the commercial reasons, in the absence of a tax consideration, for the group as a whole should be considered relevant.

The following chapter forms the second part of phase 2 of the study and the framework developed in phase 1 is used to apply the South African GAAR to the facts of cases heard in Canada.

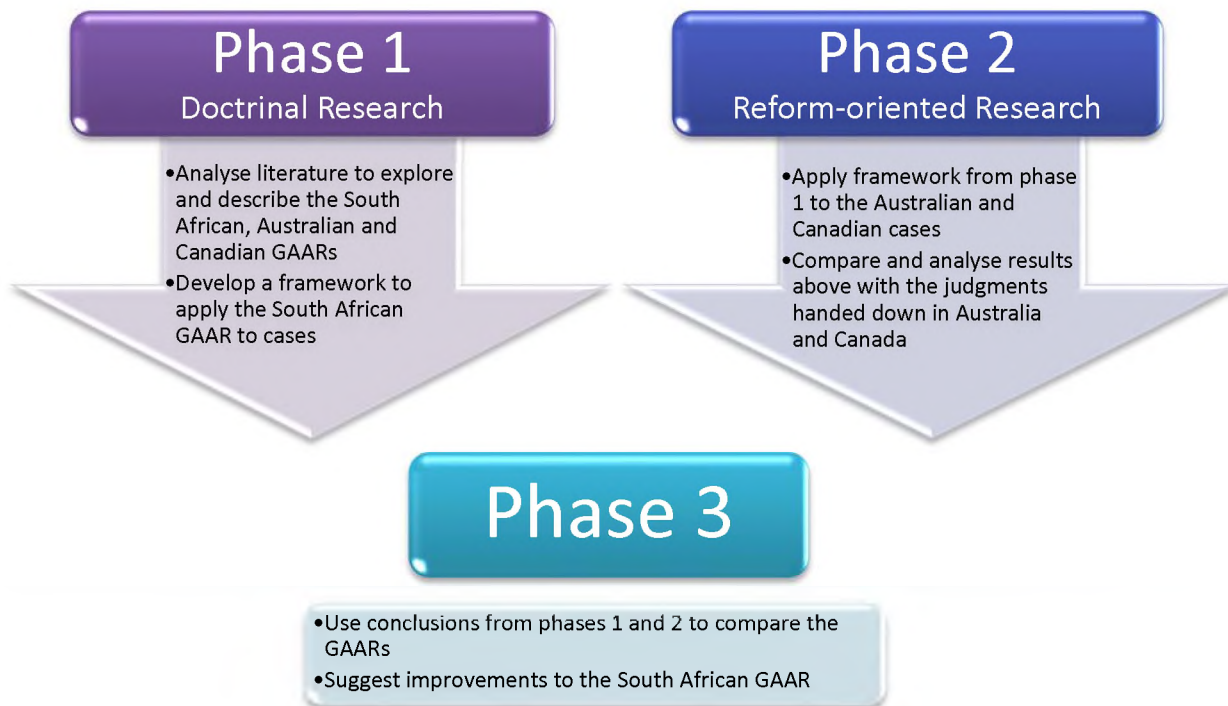


## CHAPTER 9: CANADIAN CASE LAW IN RELATION TO GAAR

### 9.1 INTRODUCTION

This chapter forms the second part of phase 2 of the study, which aims to analyse and compare the GAAR applying in South Africa, Canada and Australia in order to identify how the deficiencies in the South African GAAR could be addressed. In this chapter the focus will be on applying the framework of the South African GAAR to the facts from Canadian case law. The relationship between the phases of the research methodology is represented in Figure 19 below:

FIGURE 19 RESEARCH METHODOLOGY



Source: Own design

In this chapter the framework of the South African GAAR developed in chapter 4 is applied to selected cases from Canada to analyse the effectiveness of the South African GAAR in combatting arrangements that were suspected of impermissible avoidance. The goal/purpose of the research is thus directly addressed, that was defined in Chapter 1 as:

To analyse and compare the GAAR in South Africa, Canada and Australia from a case law perspective in order to identify how the existing deficiencies in the South African GAAR could be overcome. This investigation results in determining the amendments to the South African GAAR that would result in more robust anti-avoidance legislation. This research culminates with recommendations for the formulation and drafting of a new, more robust GAAR.

This chapter will also directly achieve research objective 2 as defined in Chapter 1:

To apply the GAAR in South Africa to the facts of the cases selected from Australia and Canada and therefore determine which provisions require amendment when comparing the results to the judgments in these jurisdictions

In achieving the second research objective referred to above, the framework developed in phase 1 (Chapter 4) is used to apply the South African GAAR to the facts of cases in both Australia and Canada. The use of this framework ensures consistency in the application of the South African GAAR to the facts of each of the cases and will result in identifying the following:

- those aspects of the South African GAAR that are effective and should remain intact;
- those aspects of the South African GAAR that are ineffective and should be amended;
- those aspects of the Australian GAAR that are effective and should be included in the South African counterpart; and
- those aspects of the Canadian GAAR that are effective and should be included in the South African counterpart.

Upon completion of this phase the outcomes from phases 1 and 2 of the research can be compared and contrasted with a view to proposing amendments to the South African GAAR, thereby achieving the final research objective.

In conducting this research, records were obtained from selected case law in Canada to describe the transactions undertaken by the various taxpayers. This allows the conclusions to be drawn on the efficacy of the South African GAAR when compared to its Canadian counterpart. The use of multiple cases with differing facts allows:

- patterns and conditions across cases to be identified based on the application of the framework of the South African GAAR (McKerchar, 2004:10);
- more areas to be identified for improvement of the South African GAAR; and
- amendments to the South African GAAR to be proposed by considering the impact of these amendments on all the cases selected, thus adding strength to the proposed amendments.

## **9.2 SELECTION OF CASES**

Before discussing the cases used in the study it is relevant to obtain a basic understanding of the court system in Canada. As in other countries, the Canadian courts are organised in hierarchies where different courts or bodies are ranked or ordered, depending on their importance. A brief description of these hierarchies and the court system is set out below.

The Supreme Court of Canada is Canada's final court of appeal and is positioned at the pinnacle of the judicial branch of Canada's government (Office of the Registrar of the Supreme Court of Canada, 2016). The Court assures uniformity, consistency and correctness in the articulation, development and interpretation of legal principles throughout the Canadian judicial system and has jurisdiction over disputes in all areas of the law, including tax law (Office of the Registrar of the Supreme Court of Canada, 2016). The decisions made in the Supreme Court of Canada are final and binding on Canadian federal courts and the courts from all provinces and territories in Canada. Therefore, cases heard in the Supreme Court of Canada constitute judicial precedent.

Case law in Canada can be accessed via the Canadian Legal Information Institute (CanLII) (Lexum, 2016a). This database provides access to primary sources of Canadian law, including legislative and judicial texts, as well as legal commentaries, from federal, provincial and territorial jurisdictions in Canada. A search of judgments under GAAR (document text search field) in this database yielded a total of 145 cases listed for Federal Canada. The number of cases brought before the courts is an indication of the experience the judiciary has had with regard to the GAAR. In selecting cases for this study only those cases that came before the Supreme Court of Canada were selected, as judgments in these cases are binding on lower courts.

All judgments for the Supreme Court of Canada are contained in the Lexum collection, that was created in 1875 and is updated within minutes of the public release of the judgments by the court (Lexum, 2016b).

A search conducted for all GAAR cases in the Lexum collection identified the following:

1. *Lipson v Canada* (2009) SCC
2. *Canada Trustco Mortgage Company v Canada* (2005) SCC 54
3. *Mathew v Canada* (2005) SCC
4. *Copthorne Holdings Ltd v The Queen* (2011) SCC 63
5. *Neuman v M.N.R.* (1998) 1 SCR 770
6. *Placer Dome Canada Ltd v Ontario* (2006) SCC 20
7. *Imperial Oil Ltd v Canada; Inco Ltd v Canada* (2006) SCC 46

Further analysis revealed that four of these cases were presented before the court on the basis of the GAAR. The remaining three cases (*Neuman*, *Placer Dome Canada Ltd* and *Imperial Oil Ltd*) were based on other tax legislation (mining tax) or other sections of the Canadian Income Tax Act. Therefore, these three cases have not been analysed for the purposes of this study and were outside the scope of the study.

The four Supreme Court of Canada cases used for the purposes of this chapter are therefore:

1. *Canada Trustco Mortgage Company v Canada* (2005) SCC 54
2. *Mathew v Canada* (2005) SCC
3. *Lipson v Canada* (2009) SCC
4. *Copthorne Holdings Ltd v The Queen* (2011) SCC 63

The facts of these four cases and the application of the framework of the South African GAAR to the facts of these cases are set out in sections 9.3 - 9.6 below.

### **9.3 CANADA TRUSTCO MORTGAGE COMPANY v CANADA**

#### **9.3.1 FACTS OF THE CASE**

This case was heard on appeal from the Federal Court of Appeal in Canada. From a review of the facts of the case Canada Trustco Mortgage Company was a mortgage lender. In addition to this mortgage lending business, Canada Trustco Mortgage Company received large revenues from leased assets.

In 1996 (the 1997 tax year) Canada Trustco Mortgage Company purchased trailers that it leased back to the vendor. The lease of the trailers allowed Canada Trustco Mortgage Company to offset the lease revenue by claiming a capital cost allowance. The lease revenue for the 1997 tax year amounted to \$51,787,114, while the capital cost allowance claimed against this revenue was \$31,196,700. Therefore, Canada Trustco Mortgage Company was able to defer the payment of taxes on the profits by reducing the taxable income by the allowable capital cost allowance. Upon disposal of the trailers, the excess of the amounts claimed in terms of the capital cost allowance would be recaptured into income. In brief the transactions occurred as follows:

1. On 17 December 1996 Canada Trustco Mortgage Company used its own funds and a loan of approximately \$100 million from the Royal Bank of Canada to purchase trailers from Transamerica Leasing Inc. These trailers were purchased at a fair market value of \$120 million. On this same date Canada Trustco Mortgage Company appointed Transamerica Leasing Inc as a trustee and agent to hold (in Transamerica Leasing Inc's name) the certificates of title, ownership, registration and the like for the trailers. The terms of the trust agreement provided that Transamerica Leasing Inc was appointed as trustee and agent solely for administrative convenience.
2. Canada Trustco Mortgage Company leased these trailers to Maple Assets Investments Limited, which in turn subleased them back to Transamerica Leasing Inc (the original owners). The terms of the sublease were similar to those in the original lease to Maple Assets Investments Limited.
3. Transamerica Leasing Inc prepaid all the amounts due under the sublease. As a result of this prepayment, Transamerica Leasing Inc maintained certain obligations regarding the indemnities and early termination, but did not have sublease payment obligations and Maple Assets Investments Limited had no credit risk.

4. Maple Assets Investments Limited placed an amount on deposit equal to the loan for purposes of making the lease payments (approximately \$100 million).
5. A bond was pledged as security to guarantee a purchase option payment to Canada Trustco Mortgage Company at the end of the lease (approximately \$20 million). Therefore, the risk of the inability of Maple Assets Investments Limited to pay the first option value to Canada Trustco Mortgage Company was removed.

As a result of these transactions Canada Trustco Mortgage Company was able to minimise its financial risk and Transamerica Leasing Inc had no ongoing sublease payment obligations. Further, the trailers remained in the possession of Transamerica Leasing Inc throughout the period. In addition to this, Canada Trustco Mortgage Company assigned the rental payments (owed by Maple Assets Investments Limited) to the Royal Bank of Canada and also provided that Maple Assets Investments Limited pay the assigned rentals directly to the Royal Bank of Canada, for the payments due by it. Further, the parent corporation of Transamerica Leasing Inc guaranteed, to Maple Assets Investments Limited and Canada Trustco Mortgage Company, the performance of Transamerica Leasing Inc’s obligations under the transactions. A diagrammatical representation of the transactions undertaken in terms of the Canada Trustco Mortgage case is provided in [Appendix F](#).

In October 2002 the Minister of National Revenue reassessed Canada Trustco Mortgage Company on its 1997 tax year and denied the capital cost allowance claimed on the basis that they had not acquired title to the trailers and, in the alternative, that the GAAR applied to the transactions. Subsequently the argument that Canada Trustco Mortgage Company had not acquired title to the trailers was abandoned and the appeal before the Tax Court proceeded on the issue of GAAR. The progress of this case is presented in Table 9 below:

**TABLE 9 PROGRESS OF THE *CANADA TRUSTCO MORTGAGE COMPANY V CANADA* CASE**

<b>Court</b>	<b>Tax Court of Canada</b>	<b>Federal Court of Appeal</b>	<b>Supreme Court</b>
<b>Decision</b>	Held in favour of the taxpayer	Held in favour of the taxpayer	Held in favour of the taxpayer

In order to understand how the tax benefit was derived, a brief description of the capital cost allowance as described in the Tax Court is necessary. In this regard a capital cost allowance recognises that the capital cost of assets is consumed in a taxpayer's business. These allowances are often larger in earlier years than the depreciation recorded in the financial statements. However, it was government's intention that these write-offs should be directed to taxpayers most directly carrying out the intended activity. In some instances, the allowances were effectively traded to another taxpayer in exchange for lower financing costs and therefore there was an increase in transactions that in substance were of a financial nature but were drawn up in the form of a lease. This allowed the financing corporation the benefit of deducting the allowance which the person utilising the assets could not (either because of a tax exemption or a lack of taxable income). The solution to this was to grant the allowance in lease financing to a limited degree only. In doing so, limitations were introduced that would reduce the allowance for certain types of property. If the type of asset was exempted, however, the more favourable allowance was granted (trailers were considered exempt property).

### **9.3.2 ARRANGEMENT**

In applying the framework for the South African GAAR, the transactions entered into by the taxpayers in the *Canada Trustco* case (listed in points 1 to 5 above) constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. Therefore, if presented before the South African courts, it is submitted that the transactions would be considered to constitute an arrangement for purposes of the South African GAAR.

### **9.3.3 TAX BENEFIT**

The tax benefit requirement is the second requirement of the framework for the South African GAAR. In this case it is noted that by entering into the arrangement, Canada Trustco Mortgage Company was able to deduct a capital cost allowance of \$31,196,700 in the 1997 tax year. Therefore, in terms of the decisions in the *Smith* case and *King* case, it was able to effectively step out of the way of, escape or prevent an anticipated liability for tax on the total revenue derived from the lease. Further, in terms of the decisions in *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and *Louw* case, a larger tax liability would have existed but for the arrangement. Therefore, the arrangement entered into in the *Canada*

*Trustco* case constituted an arrangement that had the effect of obtaining a tax benefit and constitutes an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### **9.3.4 SOLE OR MAIN PURPOSE**

The third requirement of the framework for the South African GAAR is the sole or main purpose requirement. In terms of this requirement, the sole or main purpose of the arrangement must be to obtain the tax benefit. In reviewing the facts of the case described in the Supreme Court, it is noted that Canada Trustco Mortgage Company purchased and leased the trailers for the purpose of generating the capital cost allowance deductions. This fact (resulting from the appeal from the Federal Court) was not disputed in the case brought before the Supreme Court and the issue was whether there was abusive tax avoidance. Therefore, an assessment of purpose was not undertaken in the case brought before the Supreme Court. However, upon a review of the judgement (at 11) of the Tax Court a Mr Lough (on behalf of the taxpayer) provided evidence regarding the purpose of the transaction:

“Q. Mr. Lough, why did Canada Trust, or why did the appellant do the transactions that are the subject matter of this litigation?

A. We did these transactions as an investment to earn income for the Canada Trust. It was, you know, we, as I had mentioned earlier, we had, you know, a number of alternatives that my department looked at. The lease portfolio had run off in recent years so we were looking to do a lease in order to, you know, to maintain the diversification between the various portfolios.

Q. Mr. Lough, how did - did tax considerations enter into the decision to do this transaction? And if they did, how?

A. You know, certainly we looked at the after tax returns on this transaction as we would on any sort of transaction.”

In light of the above it appears that the stated intention (subjective test) of the arrangement was to earn additional income from the investment. In addition to this Mr Lough’s report to the Credit Committee specifically referred to the tax benefits generated from the transaction and this was also summarised for the Board that referred to the sheltering of other taxable lease income. From a review of the facts of the case it is evident that the objective effect of the arrangement supports the stated intention as the



arrangement did in fact result in investment income for the taxpayer (an 8.5% rate of return was earned). However, an assessment of the objective purpose is required to satisfy the sole or main purpose requirement. In this regard it is submitted that the complexity and manner in which the transactions were arranged indicates that, objectively, there was more than one purpose for entering into the arrangement.

The question to be answered would be whether the tax motive was the dominant reason. In this regard it is relevant to note that the correspondence evidence considered by the Tax Court indicated that while the use of the non-recourse debt structuring did improve the regulatory capital requirements it was of no economic import to Canada Trustco Mortgage Company (and this advantage was only as a result of the capital cost allowance claimed). Further, in the arguments raised by the taxpayer related to purpose, Mr Meghij only contended that sale and leasebacks were not avoidance transactions and no other objective evidence was brought before the courts by the taxpayer that discharges the onus created in section 80G of the Income Tax Act (presumption of purpose). In this regard it is relevant to note that the arguments raised by the appellant were largely focused on the misuse or abuse element of the Canadian GAAR and therefore little objective evidence was provided for purposes of the sole or main purpose requirement. In light of this it is submitted that section 80G of the Income Tax Act does add strength to the South African GAAR where the taxpayer does not provide objective evidence to support the subjective intent. Therefore the sole or main purpose of the scheme in this case is determined to be the achieving of the tax benefit from the capital cost allowance deductions (De Koker and Williams, 2015:par.19.38).

### **9.3.5 TAIANTED ELEMENTS**

The last requirement to be met before the arrangement is considered to be an impermissible avoidance arrangement is for the arrangement to have one or more of the tainted elements. For purposes of this analysis it is important to determine if the avoidance arrangement entered into by the taxpayers in the *Canada Trustco* case would constitute a transaction entered into in the context of business or any other context. It is submitted that the transactions (listed in points 1 to 5 in the facts of the case above) will have been entered into in the context of business. Therefore, for the purposes of applying the South African GAAR to the *Canada Trustco* case, the analysis has been based on a business context.

## ***ABNORMALITY***

One of the final tests used to determine if an arrangement would be considered an impermissible avoidance arrangement would be to establish whether the arrangement was entered into or carried out by means or in a manner that would not normally be employed for *bona fide* business purposes in terms of section 80A of the Income Tax Act. In this regard the following factors were taken into account:

- On the same date that Canada Trustco Mortgage Company purchased the trailers from Transamerica Leasing Inc, it appointed Transamerica Leasing Inc as a trustee and agent to hold (in Transamerica Leasing Inc's name) the certificates of title, ownership, registration and the like for the trailers. This indicates that Canada Trustco Mortgage Company knew that the trailers would not be used by Maple Assets Investments Limited and also that the insertion of Maple Assets Investments Limited into the larger arrangement was not for *bona fide* purposes without a tax consideration.
- On the same date that Maple Assets Investments Limited leased the trailers from Canada Trustco Mortgage Company, these trailers were subleased back to Transamerica Leasing Inc (the original owners). This indicates that Maple Assets Investments Limited never intended to use the trailers for business purposes. Similarly, because the terms of the sublease were similar to those in the original lease, it indicates that Maple Assets Investments Limited was not to receive benefits from entering into the arrangement. This indicates that there was a difference between the transaction entered into by the taxpayer and the transaction entered into for *bona fide* business purposes.

In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is unlikely that such transactions would typically be entered into were it not for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is likely that such a transaction would not be entered into by another taxpayer without a tax consideration.

## ***LACK OF COMMERCIAL SUBSTANCE***

The lack of commercial substance element is the next tainted element to be considered. In applying the framework for the South African GAAR, each of the individual tests is dealt with separately below:

### *General lack of commercial substance test*

After a review of the arrangement it can be concluded that there are instances where there was a lack of commercial substance for the arrangement, as a whole and parts thereof, for the parties to the transactions:

- Canada Trustco Mortgage Company was largely insulated from both net cash flows and business risks under its loan and the lease, due to the prepayment and pledges made.
- Transamerica Leasing Inc did not experience a significant effect upon its cash flows as the amounts paid by Canada Trustco Mortgage Company were used to prepay the lease of the same trailers from Maple Assets Investments Limited. Similarly, its risks to make payments under the lease were extinguished by the prepayment.
- Maple Assets Investments Limited similarly did not experience a significant effect upon its cash flows due to the prepayments and pledges made under the lease and sublease. In addition to this, the business risks were not significant as a result of the reciprocal agreements.

### *Substance over form test*

It is submitted that the true intention of the parties is reflected in the agreements entered into as a whole, as the end result of the scheme was reflected in the cumulative agreements. However, the prepayment of the amounts due under the sublease between Transamerica Leasing Inc and Maple Assets Investments Limited may indicate that the liability was contrived, as the parties never intended the loan to be paid off in terms of the agreement. This is specifically highlighted because the prepayment occurred on the same day as the purchase of the trailers by Canada Trustco Mortgage Company and the subsequent lease of these trailers to Maple Assets Investments Limited. As a result of the arrangement, Transamerica Leasing Inc had no ongoing sublease payment obligations. Similarly, it can be argued that the lease and subsequent sublease of the trailers by Maple Assets Investments Limited indicate that the lease of trailers by Maple Assets Investments Limited was never intended to occur. Therefore, in effect, all the transactions reveal that the individual sale and leaseback agreements may not reflect the substance of the arrangement as a whole.

### ***Round trip financing test***

There are aspects of the arrangement that have the presence of round trip financing, however, it is relevant to note that the timing, sequence, means or manner in which this was done does not affect the presence of round trip financing in terms of the GAAR. Further, section 80D specifically includes an obligation to receive or pay cash in its definition of round trip financing. Therefore, the loan and eventual repayment of this loan by Canada Trustco Mortgage Company would constitute round trip financing as defined in the South African GAAR. The following aspects of the arrangements were considered:

- The loan of funds by Canada Trustco Mortgage Company from the Royal Bank of Canada and the assignment of rental payments (owed by Maple Assets Investments Limited) to the Royal Bank of Canada constitute round trip financing. In this regard it is recognised that without this loan the taxpayer may not have had sufficient capital to enter into the arrangement and is therefore related to the tax benefits resulting from the arrangement.
- The lease of the trailers by Canada Trustco Mortgage Company to Maple Assets Investments Limited and subsequent sublease (and prepayment thereof) by Transamerica Leasing Inc resulted in round trip financing that also resulted in the tax benefits.

These round tripped amounts did result in the tax benefit, as Canada Trustco Mortgage Company was able to claim the capital cost allowance as a result of the round-tripping arrangement but for the provisions of the GAAR.

### ***Tax-indifferent party test***

It is submitted that there is no evidence that any parties to the arrangement identified in the *Canada Trustco* case effectively sold their tax advantage to others.

### ***Offsetting or cancelling test***

There are elements of the transaction that have the effect of offsetting or cancelling each other, including all the loans between the parties. This is specifically highlighted in the prepayment of the amounts due under the sublease between Transamerica Leasing Inc. and Maple Assets Investments Limited and the bond pledge to Canada Trustco Mortgage Company at the end of the lease.

In conclusion, it is submitted that the arrangement identified in the *Canada Trustco* case lacks commercial substance in terms of the South African GAAR. However, many of the aspects identified are arguably present in any financing arrangement, as even *bona fide* sale and leaseback transactions that are entered into in the absence of a tax motivation would have the presence of one or more of the above indicators. While it is not the intention of the GAAR to apply to all the possible legitimate transactions that could have the presence of these indicators, in terms of the purposive approach to interpretation it would be up to the courts to define where the GAAR would apply. In the *Canada Trustco* case the timing and manner employed in relation to each of the aspects of the agreements indicate that the arrangement as a whole lacked commercial substance.

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

The creation of rights and obligations at arm's length element is the next tainted element to be considered in applying the South African GAAR to the facts of the *Canada Trustco* case. In applying the framework to the facts of the case the following factors were considered:

- From a review of the facts of the case there is no evidence that Canada Trustco Mortgage Company, Maple Assets Investments Limited or Transamerica Leasing Inc were connected to each other. However, there is other evidence of relationships between certain parties. For example, a wholly owned subsidiary of the Royal Bank of Canada (Royal Bank of Canada Trust Company Limited) was a trustee of the Maple Assets Charitable Trust, which owned 100% of Maple Assets Investments Limited.
- However, it is submitted that Maple Assets Investments Limited was not striving to obtain the utmost advantage for itself during the arrangement as there is no evidence that it was benefiting from the arrangement; the terms of the sublease to Transamerica Leasing Inc were similar to those of the lease to Maple Assets Investments Limited. Therefore, it is submitted that the rights and obligations were not at arm's length.

In light of the above, it does not seem reasonable to conclude that unconnected parties would have entered into this arrangement. Therefore, the rights and obligations attached to the arrangement were not those that could have been expected in any other similar transaction between parties dealing at arm's length.

### ***MISUSE OR ABUSE OF THE ACT***

The last tainted element is the misuse element. If this element is applied to the facts in the *Canada Trustco* case, it is clear that the provisions allowing for the deduction of interest were applied correctly in terms of the strict application of the legislation. In this regard it is relevant to consider that the Supreme Court of Canada found that the capital cost allowance provisions relied on by Canada Trustco Mortgage Company were not applied outside of the object, spirit or purpose of the relevant capital cost allowance provisions.

However, when analysing the intention of the legislature in allowing a deduction for a capital cost allowance, the results of the use of this provision were arguably not intended by the legislator. The argument for this is that, while the taxpayer did not explicitly misuse the capital cost allowance provision, they created the circumstances necessary to use this provision by exploiting the exempt property provisions without utilising the assets as intended by the legislature. It is therefore submitted that there was a misuse or abuse of the Act for purposes of the framework for the South African GAAR.

Due to the lack of guidance on the application of the misuse or abuse element, it is impossible to determine if the South African courts would assess this element in terms of the individual provision relied on by the taxpayer, or would apply this element with regard to the exploitation of the intention of the legislature in respect of the provision. It is therefore suggested that clarity be provided on the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard. This is specifically highlighted in this case because the introduction of this element was designed to bring the South African GAAR into line with international standards and practice, with specific reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Therefore, to what extent the South African courts would rely on the interpretation of this element by the Canadian courts is uncertain.

#### **9.3.6 CANADA TRUSTCO CASE CONCLUSION**

In analysing the results from applying the framework for the South African GAAR to the facts of the *Canada Trustco* case, it is evident that the transactions entered into by the taxpayers are considered to be an avoidance arrangement as Canada Trustco Mortgage Company was able to deduct a capital cost

allowance of \$31,196,700. The sole or main purpose of the arrangement was also determined to have been for the purpose of obtaining the tax benefit because, when considered objectively, the taxpayer purchased and leased the trailers for the purpose of generating the capital cost allowance deductions. This fact was not disputed in the case brought to the Supreme Court and no objective evidence was brought before the courts by the taxpayer that would discharge the onus created in section 80G of the Income Tax Act (presumption of purpose).

In applying the tainted elements requirement to the facts of the case, the arrangement was considered abnormal when comparing the arrangement to one entered into for *bona fide* purposes in the absence of a tax consideration. This is due to the fact that Canada Trustco Mortgage Company knew that the trailers would not be used by Maple Assets Investments Limited but would be used by Transamerica Leasing Inc. Similarly, four of the five indicators of lack of commercial substance are present in the arrangement: the general lack of commercial substance test, the substance over form test, the round-trip financing test and the offsetting or cancelling test. However, many of the indicators are arguably present in any financing arrangement, as even *bona fide* sale and leaseback transactions that are entered into in the absence of a tax motivation would have the presence of one or more of the above indicators. While it is not the intention of the GAAR to apply to all the possible legitimate transactions that could have the presence of these indicators, in terms of the purposive approach to interpretation it would be up to the courts to define where the GAAR would apply. In the *Canada Trustco* case the timing and manner employed in relation to each of the aspects of the agreements indicate that the arrangement as a whole lacked commercial substance.

In applying the misuse or abuse element to the *Canada Trustco* case, it is clear that the provisions allowing for the deduction of interest were applied correctly in terms of the legislation. When considered individually, the deduction was not applied outside the object, spirit or purpose of the relevant capital cost allowance provisions. However, when analysing the intention of the legislature in allowing a deduction for a capital cost allowance, the results of the use of this provision were arguably not the intended result of the legislator. The reason for this is because the intention was arguably to allow the person utilising the assets to claim the allowance and not Canada Trustco Mortgage Company. In light of the above, it is submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR. However, due to the lack of guidance on the application of the misuse or abuse element, it is impossible to determine if the South African courts would assess this element in terms of the individual provision relied on by the

taxpayer, or would apply this element with regard to artificially creating the circumstances necessary to use the provision. Therefore, clarity should be provided on the application of the misuse or abuse element. It is submitted that this guidance is of critical importance because this requirement was introduced into the South African GAAR with reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Therefore, the lack of clarity regarding to what extent the courts would rely on the interpretation of this element by the Canadian courts creates unnecessary uncertainty.

In conclusion it is evident that the avoidance arrangement entered into by the taxpayers in the *Canada Trustco* case does constitute an impermissible avoidance arrangement in terms of the South African GAAR. However, it is interesting to note that the Canadian GAAR was not applied successfully when brought before the Canadian courts. This indicates that the South African GAAR may be more effective at combatting this type of avoidance arrangement than the Canadian GAAR. In this regard it is important to recognise that even if the misuse or abuse element was not present all four requirements of the South African GAAR were met because the South African GAAR considered factors that were not necessarily required by the Canadian GAAR (abnormality, lack of commercial substance and non-arm's-length rights and obligations). Therefore, the inclusion of more explicit tainted elements to the GAAR in this case may have improved the efficacy of the South African GAAR.

#### **9.4 MATHEW v CANADA**

##### **9.4.1 FACTS OF THE CASE**

Standard Trust Company carried on a business that included the lending of money on the security of mortgages on real property. By May 1991 Standard Trust Company had become insolvent and Ernst & Young was appointed as the liquidator. At this time, Standard Trust Company owned a portfolio of 17 non-performing loans with underlying real estate properties having a fair market value of approximately \$33 million ("portfolio assets"). The cost to Standard Trust Company of these portfolio assets was approximately \$85 million. As a result of the liquidation, Standard Trust Company could not use the approximately \$52 million in unrealised losses from the portfolio assets. In order to realise maximum returns on the disposal of the portfolio assets, the liquidator (Ernst & Young) devised and



oversaw the execution of a series of transactions. The overall arrangement involved the following three stages:

**First stage:** On 21 October 1992 Standard Trust Company incorporated a wholly owned subsidiary and entered into a partnership agreement with this subsidiary (Partnership A). In terms of this partnership Standard Trust Company transferred the portfolio of mortgage assets (with unrealised losses) as its capital for a 99% interest in the partnership. The subsidiary borrowed \$417,318 from Standard Trust Company to make its capital contribution for a 1% interest in the partnership. At inception it was noted that the partnership did not deal at arm's length with Standard Trust Company.

- In terms of the legislation (section 18(13) of the Canadian Income Tax Act) a taxpayer whose ordinary business includes the lending of money is prohibited from deducting a loss on the disposition of a mortgage if, at the end of the period, the mortgage is owned by a partnership that does not deal at arm's length with the transferor (in such cases the loss is added to the cost of the mortgage to the partnership).

**Second stage:** Standard Trust Company relied on section 18(13) of the Canadian Income Tax Act to transfer the portfolio assets to Partnership A at a historical cost of \$85 million. This was done to preserve the \$52 million in unrealised losses. This was done so that Standard Trust Company could sell its 99% interest in Partnership A to an arm's length party. Between August 1992 and January 1993 Standard Trust Company contacted 38 prospective purchasers for its 99% interest in Partnership A. In January 1993 OSFC Holdings Ltd began negotiations to purchase the 99% interest and on 31 May 1993 the sale was concluded. One of the terms of this agreement provided that OSFC Holdings Ltd should pay Standard Trust Company an adjustable "additional payment" of up to \$5 million if Partnership A realised the losses from the disposal of the portfolio assets for income tax purposes.

- The partnership rules provided that the income or losses flowed through to the partners at the end of the tax year, who were entitled to claim a proportionate share of the losses, regardless of when they joined the partnership. As a result, when Standard Trust Company sold its 99% interest in the partnership to the arm's length party, any subsequent disposal of the portfolio assets would allow the arm's length party to claim 99% of the losses.

**Third stage:** On 5 July 1993 OSFC Holdings Ltd and TFTI Holdings Ltd (both OSFC Holdings Ltd and TFTI Holdings Ltd were controlled by Peter Thomas) formed the SRMP Realty & Mortgage Partnership (Partnership B) to acquire the 99% interest in Partnership A. The capital of Partnership B was divided into 35 class A units and 15 class B units that were allocated to individual partners. In terms of this allocation OSFC Holdings Ltd was issued 12 class B units as part of its consideration for transferring its 99% interest in Partnership A to Partnership B. In addition to this, OSFC Holdings Ltd also received cash and other considerations for the transfer of its Partnership A interest. Partnership B also assumed the \$5 million obligation to make the additional payment to Standard Trust Company. By 30 September 1993, Partnership A had sold some of the portfolio assets (and wrote down the remaining assets to fair market value) that allowed it to realise losses in excess of \$52 million and allocate them to its partners (99% were allocated to Partnership B, which then allocated them to its partners).

As a result of the transactions, the appellant taxpayers who joined Partnership B claimed their proportionate shares of the losses from the eventual sale or write-down of the mortgaged properties. They also relied on a combination of section 18(13) of the Canadian Income Tax Act and the partnership provisions to deduct over \$10 million of Standard Trust Company's losses against their own incomes. Therefore, the taxpayers were able to deduct losses from their incomes from the sale of mortgaged properties that originally belonged to Standard Trust Company. In doing so Standard Trust Company's losses were transferred through the partnership vehicles to arm's length taxpayers, who offset them against their own incomes, while Standard Trust Company was able to recover a portion of the losses associated with the defaulted mortgages. A diagrammatical representation of the transactions undertaken in the *Mathew* case is provided in Appendix G.

The Minister of National Revenue reassessed the taxpayers and applied the GAAR to disallow the \$10 million deduction. The Tax Court of Canada and the Federal Court of Appeal upheld the Minister's decision. The progress of this case is presented in Table 10 below:

TABLE 10 PROGRESS OF THE *MATHEW V CANADA* CASE

Court	Tax Court of Canada	Federal Court of Appeal	Supreme Court
Decision	Held in favour of the Minister	Held in favour of the Minister	Held in favour of the Minister

### 9.4.2 ARRANGEMENT

The first requirement for the framework for the South African GAAR is the presence of an arrangement. From a review of the facts of the case, the transactions entered into by the taxpayers in the *Mathew* case (described in the three stages above) constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. Therefore, if presented before the South African courts, it is submitted that the transactions would constitute an arrangement for purposes of the South African GAAR.

### 9.4.3 TAX BENEFIT

The next requirement for the framework for the South African GAAR is the presence of a tax benefit. In this case it is noted that by entering into the arrangement, the appellant taxpayers were able to deduct over \$10 million of Standard Trust Company's losses against their own incomes. Therefore, in terms of the principles of the *Smith* case and *King* case, the taxpayers were able to step out of the way of, escape or prevent an anticipated liability for tax in their personal returns.

In addition to this it is evident that, in terms of the *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and *Louw* case, a larger tax liability would have existed but for the arrangement. Therefore, the arrangement entered into in the *Mathew* case constituted an arrangement that had the effect of obtaining a tax benefit and constitutes an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### 9.4.4 SOLE OR MAIN PURPOSE

The sole or main purpose requirement is the third requirement of the framework for the South African GAAR. In this regard it must be determined if the sole or main purpose of the arrangement was to obtain the tax benefits. From a review of the facts of the case (in both the Federal Court and Supreme Court), the taxpayers conceded that the transaction was an avoidance transaction. Therefore, an assessment of purpose was not undertaken in the case brought before the Federal Court or Supreme Court. However, a review of the judgement (at 34) of the Tax Court revealed that the view of the appellant counsel was that the liquidator's duty was to maximize the assets of Standard Trust Company for the benefit of its creditors. However, due to difficulties in the real estate markets the liquidator decided to package for sale the mortgages with what they thought would be attractive characteristics. This was viewed as a way to:

- bring in partners with expertise in real estate in order to realize better net proceeds;
- create a marketing separation between Standard Trust Company and the assets to be sold; and
- generate an additional payment through the tax benefit attached to the portfolios.

This subjective motive (amongst others) indicates that there was more than one purpose for entering into the arrangement and the question would be whether the tax motive was the dominant reason. Some of the objective factors that are present (that support the view that the sole or main purpose of the arrangement was to obtain the tax benefit) are as follows:

- Neither of the partnerships (Partnership A or Partnership B) present in the arrangement ever acquired or sold any property other than the portfolio assets.
- Draft 3 of the Real Estate Portfolio Transaction Term Sheet set out the steps of the transaction that were to be followed in transferring the losses on the mortgages to outside investors by utilizing subsection 18(13) of the Canadian Income Tax Act. Further this document laid out that the selection of mortgages for the portfolio that was to be transferred was based in part on their sizable losses.
- The draft liquidator's report no. 13 clearly indicated that the tax losses were an object of the transactions.
- One of the terms of the agreement between Standard Trust Company and OSFC Holdings Ltd provided for an additional payment of up to \$5 million should Partnership A realise the losses from

the disposal of the portfolio assets for income tax purposes. This indicates that the realisation of the losses for income tax purposes was anticipated at the inception of the arrangement.

- Partnership B also assumed the \$5 million obligation to make the additional payment to Standard Trust Company, which again indicates that the realisation of the losses for income tax purposes was anticipated.

Insufficient objective evidence was brought before the courts by the taxpayers that could have discharged the onus created in section 80G of the Income Tax Act (presumption of purpose). Therefore the sole or main purpose of the scheme in this case is determined to be the achieving of the tax benefit from claiming their proportionate shares of the losses from the sale or write-down of the mortgaged properties (De Koker and Williams, 2015:par.19.38).

However, this case has brought to light the fact that the taxpayers attempted to argue that because they did not undertake or arrange the transaction (this was done by other parties and presented to them), the sole or main purpose requirement should not be met. However, in light of the fact that both subjective and objective factors are considered in the framework for the South African GAAR (including section 80G that created the presumption of purpose), this argument could not succeed. Further the section 80 A of the Income Tax Act provides that “An avoidance arrangement is an impermissible avoidance arrangement if *its* sole or main purpose was to obtain a tax benefit” [emphasis added]. Therefore, while the taxpayers are able to state their own subjective purpose it is the objective purpose of the arrangement itself that is important. Therefore, it is submitted that it is not necessary that the person who obtained the tax benefit must necessarily have been the person that arranged the transaction. However, in light of the conflicting views on an objective or subjective application of this test, which is as yet untested legislation, it is impossible to be certain about the manner in which the sole or main purpose requirement should be applied and guidance is required to address this issue.

#### **9.4.5 TAINTED ELEMENTS**

The final requirement to be met before the arrangement is considered to be an impermissible avoidance arrangement for purposes of the South African GAAR is for the arrangement to satisfy one or more of the tainted elements. For purposes of this analysis it is important to determine if the avoidance arrangement entered into by the taxpayers in the *Mathew* case would constitute a transaction entered into in the context

of business or any other context. It is submitted that the nature of the transactions (described in the three stages in the facts of the case) will be considered to be in the context of business. Therefore, for the purposes of applying the South African GAAR to the *Mathew* case, the analysis has been performed in the context of business.

### ***ABNORMALITY***

The first tainted element to consider for purposes of this case would be to establish whether the arrangement was entered into or carried out by means or in a manner that would not normally be employed for *bona fide* business purposes in terms of section 80A of the Income Tax Act. In this regard it is submitted that the transfer of the portfolio assets between Partnership A and Standard Trust Company at historical cost would not have been entered into had it not been for the tax considerations resulting from the arrangement.

In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is likely that such transactions would typically not be entered into were it not for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is unlikely that such a transaction would be entered into by another taxpayer without a tax consideration.

### ***LACK OF COMMERCIAL SUBSTANCE***

The lack of commercial substance element is the second tainted element to be considered in the *Mathew* case. In applying the framework for the South African GAAR, each of the individual tests is dealt with separately below:

#### ***General lack of commercial substance test***

After a review of the arrangement it can be concluded that there are instances where there was a lack of commercial substance for the arrangement, as a whole and parts thereof, for the parties to the transactions:

- Standard Trust Company remained insulated from all the business risk resulting from the arrangement, as it managed to transform unrealised losses into a realised additional payment with no risk of selling or writing off the portfolio assets individually.

- The appellant taxpayers similarly remained insulated from the business risk resulting from the arrangement, as they managed to realise the unrealised losses related to the portfolio assets with little or no risk attached.

### ***Substance over form test***

It is submitted that the true intention of the parties is reflected in the agreements entered into individually, as the end result of the scheme, was reflected in the cumulative agreements. However, the purpose of the arrangement as a whole only achieved the objective of allowing Standard Trust Company to realise a portion of its unrealised losses that would not have occurred otherwise. Consequently, the objective was the avoidance of the tax consequences that would have arisen if the arrangement had not occurred. Therefore, the effect of the arrangement reveals that the individual agreements may not reflect the substance of the arrangement as a whole.

### ***Round trip financing test***

There are aspects of the arrangement that have the presence of round trip financing including:

- the loan of funds between Standard Trust Company and its subsidiary, that was then paid to Partnership A; and
- the assumption by Partnership B of the \$5 million obligation to make the additional payment to Standard Trust Company.

These round tripped amounts did result in the tax benefit, as in the absence of these round tripped funds, the tax benefit would not have occurred. Similarly, the assumption of obligations for the additional payment also reduced the risks for OSFC Holdings Ltd.

### ***Tax-indifferent party test***

In accordance with section 80E of the Income Tax Act, Standard Trust Company is tax-indifferent party as its participation in the arrangement allowed the appellant taxpayers (who joined Partnership B) to claim their proportionate shares of the losses from the eventual sale or write-down of the mortgaged properties. They also deducted over \$10 million of Standard Trust Company's losses against their own incomes.

Therefore, Standard Trust Company effectively sold its tax benefit for the ultimate benefit of the appellant taxpayers.

### ***Offsetting or cancelling test***

There are elements in the transaction that have the effect of offsetting or cancelling each other, including all the loans between Standard Trust Company and its subsidiary, the exchange of portfolio assets for interests in partnerships, the exchange of partnership interests for other consideration and the assumption by Partnership B of the \$5 million obligation to make the additional payment to Standard Trust Company. However, it is argued that many of these offsetting or cancelling elements may be present in legitimate or *bona fide* transactions without a tax consideration.

In light of the above, it is submitted that the arrangement identified in the *Mathew* case lacks commercial substance in terms of the framework for the South African GAAR. However, many of the aspects identified are arguably present in any financing arrangement, as even *bona fide* financing transactions that are entered into in the absence of a tax motivation would have the presence of one or more of the above indicators. While it is not the intention of the GAAR to apply to all the possible legitimate transactions that could have the presence of these indicators, in terms of the purposive approach to interpretation it would be up to the courts to define where the GAAR would apply. In the *Mathew* case the timing and manner employed in relation to each of the aspects of the agreements indicate that the arrangement as a whole lacked commercial substance.

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

The creation of rights and obligations at arm's length element is the third tainted element to be considered in applying the South African GAAR to the facts of the *Mathew* case. In applying the framework to the facts of the case it is evident that Partnership A was not dealing at arm's length with Standard Trust Company. This is highlighted by the fact that the portfolio assets were transferred at a historical cost of \$85 million and not their market value. Therefore, this historical cost did not account for the \$52 million in unrealised losses that could not be used by the partnership if Standard Trust Company had not subsequently sold its interest in the partnership. Therefore, Partnership A was not striving to obtain the best possible advantage for itself and it is doubtful if an unconnected party would have done the same.



In light of the above, it does not seem reasonable to conclude that unconnected parties would have entered into this arrangement. Therefore, the rights and obligations attached to the arrangement were not those that could have been expected in any other similar transaction between parties dealing at arm's length.

### ***MISUSE OR ABUSE OF THE ACT***

The last tainted element is the misuse or abuse of the Act. If this element is applied to the facts in the *Mathew* case, it is clear that the provisions allowing for the deduction of the losses from the sale and write-downs of the portfolio assets were applied correctly in terms of the legislation (the taxpayers relied on a combination of section 18(13) of the Canadian Income Tax Act and the partnership provisions to deduct over \$10 million of Standard Trust Company's losses against their own incomes). It is also relevant to note that the Supreme Court of Canada found that the legislation applied by the taxpayers did not strictly prohibit the deduction of the losses. However, the Supreme Court of Canada also found that in considering the legislative context surrounding the provisions used, it is not likely that Parliament intended to have arm's length parties buy losses generated by section 18(13) transfers.

It is submitted that if this case had been presented before the South African courts, a similar conclusion would have been reached because the arrangement frustrated, exploited or manipulated the purpose of the two provisions relied on by the taxpayers in order to achieve a result not intended by the legislator. This is due to the fact that section 18(13) of the Canadian Income Tax Act does not allow taxpayers to preserve and transfer unrealised losses to arm's length parties. In fact, this section was designed to confine the losses to the transferor where the loss is a superficial disposition. In addition to this, it is also evident that the parties to the arrangement artificially created the circumstances necessary to use the relevant provisions of the legislation that did not explicitly or literally violate their operation. It is therefore submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR.

It is submitted that in this case the misuse or abuse element must be considered in the context of using both of the provisions of the legislation together. Therefore, if one considers each provision used by the taxpayers literally or in isolation, the misuse or abuse element may not be satisfied. Consequently, it is necessary to consider the context and effect of using all the provisions of the legislation (that are used by the taxpayers) in combination with each other when determining the misuse or abuse element. The problem that exists in the South African GAAR is that guidance for considering the context (of assessing

misuse or abuse of two or more provisions in conjunction with each other) and method of application is not provided. This lack of guidance may lead to conclusions being made that will result in the misuse or abuse element not being satisfied. This is specifically highlighted in this case because the findings of the lower courts in this regard included inconsistencies in the interpretation of the misuse of the Act element that could also introduce similar inconsistencies into the South African GAAR.

#### **9.4.6 MATHEW CASE CONCLUSION**

In analysing the results from applying the framework of the South African GAAR to the facts of the *Mathew* case, it is evident that the transactions entered into constitute an avoidance the appellant taxpayers were able to deduct over \$10 million of Standard Trust Company's losses against their own incomes.

The sole or main purpose of the arrangement was to obtain the tax benefit because the taxpayers could not have discharged the onus created in section 80G of the Income Tax Act (presumption of purpose). Further, when presented before the courts, it was conceded that the transaction could not be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit. It is recognised that a more detailed analysis of the subjective and objective purposes was not performed due to the fact that this was not an area for dispute when brought before the Supreme Court in Canada. Therefore, section 80G of the Income Tax Act was used to determine the sole or main purpose requirement in this case. It is submitted that the taxpayers may not concede the sole or main purpose requirement in other cases that are brought before the courts. Notwithstanding the above, there were objective factors evident in the facts of the case that supported the conclusion that the sole or main purpose of the arrangement was to achieve the tax benefit.

In applying the tainted elements requirement to the facts of the case, the arrangement was considered abnormal and not at arm's length when comparing the arrangement to one entered into for *bona fide* purposes in the absence of a tax consideration. This is highlighted by the fact that the transfer of the portfolio assets between Partnership A and Standard Trust Company occurred at historical cost, which would not have been done had it not been for the tax considerations resulting from the arrangement. Similarly, all five indicators of lack of commercial substance were present in the arrangement: the general lack of commercial substance test, the substance over form test, the round-trip financing test, presence of a tax-indifferent party and the offsetting or cancelling test. However, it is noted that many of the indicators

are arguably present in many *bona fide* financing arrangements and further guidance on this provision is required. Nevertheless, the manner employed in relation to each of the aspects of the agreements in this case indicate that the arrangement as a whole lacked commercial substance.

The misuse or abuse of the Act element was also confirmed in the case because, while the individual provisions of the legislation were applied correctly, the effect of the combination of the provisions in this instance was not as intended by the legislature. In addition to this, it is also evident that the parties to the arrangement artificially created the circumstances necessary to use the relevant provisions of the legislation that did not explicitly or literally violate their operation. It is submitted, however, that the misuse or abuse element must be considered in the context of using both of the provisions of the legislation together. Therefore, if one considers each provision used by the taxpayers literally or in isolation, the misuse or abuse element may not be satisfied. However, due to the lack of guidance on the misuse or abuse element, it is uncertain if the provisions relied on by the taxpayers will be considered individually or if the combined effect of the provisions will be considered. Therefore, this lack of guidance may lead to conclusions being made that will result in the misuse or abuse element not being satisfied.

In conclusion it is evident that the avoidance arrangement entered into by the taxpayers in the *Mathew* case constitutes an impermissible avoidance arrangement in terms of the South African GAAR. Similarly, the Canadian GAAR was applied successfully when brought before the Canadian courts and this indicates that the South African GAAR may be equally as effective at combatting this type of avoidance arrangement.

## **9.5 LIPSON v CANADA**

### **9.5.1 FACTS OF THE CASE**

This case was taken on appeal from the Federal Court of Appeal in Canada. The facts of the case are that Mr Earl Lipson and his wife, Jordanna Lipson, entered into transactions where the following occurred:

1. In April 1994 Mr Lipson and his wife entered into a purchase and sale agreement for the purchase of a family residence in Toronto for \$750,000.

2. On 31 August 1994 Mrs Lipson borrowed \$562,500 from the Bank of Montreal to finance the purchase at fair market value of 20 and 5/6 shares in a family corporation, Lipson Family Investments Limited.
3. Mrs Lipson then gave the funds for the shares directly to her husband, who transferred the shares to her.
4. Because Mrs Lipson did not earn enough income to pay the interest on the loan, Mr Lipson agreed to pay the loan in its entirety the following day. The loan would not have been granted to Mrs Lipson if this had not occurred. Mr and Mrs Lipson obtained a mortgage from the Bank of Montreal for \$562,500 (that was advanced on the closing date of 1 September 1994) and on the same day used the funds from the mortgage to repay the share loan in its entirety.

Mr Lipson claimed a deduction of the mortgage loan interest in terms of four provisions of the Canadian Income Tax Act:

- Section 73(1) allows a taxpayer to defer tax on interspousal transfers of property. Mr Lipson did not elect out of this provision as he was entitled to do, with the result that the share transfer was deemed to have occurred at his adjusted cost base rather than fair market value. Therefore, Mr Lipson did not sustain a gain or loss on the sale of the shares.
- Section 74.1 attributes any income or loss from property transferred from one spouse to another back to the transferring spouse for tax purposes. Therefore, although Mrs Lipson owned the shares, the dividend income and losses were attributed to Mr Lipson.
- Section 20(3) allows a deduction for interest on money borrowed to repay previously borrowed money if the interest on the original loan was deductible. Therefore, although the shares were paid for with the proceeds of the share loan rather than the mortgage loan, section 20(3) allowed a deduction for the interest and the mortgage loan was therefore treated as having funded the share purchase.
- Section 20(1)(c) was then used to deduct the interest on the mortgage loan for Mr Lipson because the money was borrowed for the purpose of earning income from a business or property. It was not in dispute that the shares in Lipson Family Investments Limited were income-producing assets for Mrs Lipson and that, were it not for the attribution rule of section 74.1, she would be entitled, under section 20(1)(c), to deduct the interest on the money borrowed to purchase the shares. Therefore, as a result of that attribution rule, the dividend income and the interest expense were attributed to Mr Lipson.

As a result of the transactions Mr Lipson deducted the interest on the mortgage loan and reported the taxable dividends on the shares as income where applicable for his 1994, 1995 and 1996 tax returns. The Minister of National Revenue disallowed the interest expenses of \$12,948.19, \$47,370.55 and \$44,572.95, respectively, for those years and reassessed Mr Lipson. A diagrammatical representation of the transactions undertaken in terms of the Lipson Case is provided in [Appendix H](#).

The Minister disallowed the deductions for the interest on the basis that the true economic purpose for the borrowed money was not to earn income and the interest was therefore not deductible under section 20(1)(c). However, by the time the case reached the Tax Court of Canada, this Court had rejected this “true economic purpose” in another case and the Minister argued the case on the basis of the GAAR and submitted that the series of transactions amounted to abusive tax avoidance. The progress of this case is represented in Table 11 below:

**TABLE 11 PROGRESS OF THE *LIPSON V CANADA* CASE**

<b>Court</b>	<b>Tax Court of Canada</b>	<b>Federal Court of Appeal</b>	<b>Supreme Court</b>
<b>Decision</b>	Held in favour of the Minister	Held in favour of the Minister	Held in favour of the Minister

### **9.5.2 ARRANGEMENT**

In applying the framework for the South African GAAR, the transactions entered into by the taxpayers in the *Lipson* case (where a purchase of shares by Mrs Lipson led to the deduction of mortgage interest for Mr Lipson) constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. Therefore, if presented before the South African courts, the transactions would be considered to constitute an arrangement for purposes of the South African GAAR.

### **9.5.3 TAX BENEFIT**

The second requirement of the framework for the South African GAAR is the presence of a tax benefit resulting from the arrangement. In this case it is noted that by entering into the arrangement, Mr Lipson

was able to deduct the interest incurred on the mortgage where this deduction would otherwise not have been permitted for personal expenses in terms of the Canadian Income Tax Act. Therefore, Mr Lipson was allowed to deduct interest on borrowed funds to fund personal expenditure to the benefit of himself and his wife. This is consistent with the “but for” test established in *Income Tax Case No 1625* (1996) 59 SATC 383, the *Smith* case and the *Louw* case. Consequently, Mr Lipson was able to step out of the way of, escape or prevent an anticipated liability for tax as contemplated in the *Smith* case when applying the South African GAAR. Therefore, the transactions entered into by the taxpayers in the *Lipson* case constituted an arrangement that had the effect of obtaining a tax benefit and constitutes an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### **9.5.4 SOLE OR MAIN PURPOSE**

The sole or main purpose requirement is the third requirement of the framework for the South African GAAR. In terms of this requirement, the sole or main purpose of the arrangement must be the obtaining of the tax benefit. A review of the facts of the case reveals that Mr Lipson agreed (in the Statement of Agreed Facts and Conclusion) that the transactions identified were undertaken for tax purposes. Therefore, in terms of the South African GAAR, the stated intention (subjective test) of the arrangement was to achieve the tax benefits derived from the arrangement. Further, the objective effect of the arrangement supports the stated intention as the arrangement did in fact achieve the results anticipated (a deduction for interest related to personal expenditure).

When brought before the courts in Canada, the concession by Mr Lipson, in the Statement of Agreed Facts and Conclusion regarding the transactions constituting avoidance transactions, satisfied the courts that the transactions were undertaken or arranged primarily to obtain the tax benefit. For purposes of the South African GAAR it is argued that this would similarly satisfy the sole or main purpose requirement. However, a concession such as was made by the taxpayer in this case is not likely in many cases and a more rigorous investigation regarding this requirement would normally be undertaken. Due to the fact that more evidence regarding this requirement was not necessary when brought before the courts in Canada, there is limited information available to allow for a rigorous determination for the purposes of this study.

#### **9.5.5 TAINTED ELEMENTS**

The last requirement to be met before the arrangement is considered an impermissible avoidance arrangement is for the arrangement to have one or more of the tainted elements. For purposes of this analysis it is important to determine if the avoidance arrangement entered into by the taxpayers in the *Lipson* case would constitute a transaction entered into in the context of business or any other context. It is submitted that the nature of the transactions (concerning the shares in a family corporation and the purchase of a private residence) will not be considered to be in the context of business. Similarly, the income earned by Mr Lipson in the form of dividends from the family corporation can be considered passive income as it does not involve active participation and arguably would not be considered in the context of business. Therefore, for the purposes of applying the South African GAAR to the *Lipson* case, the analysis has been performed in a context other than business.

### ***ABNORMALITY***

One of the final tests in terms of section 80A of the Income Tax Act used to determine if an arrangement would be considered an impermissible avoidance arrangement would be to establish whether the arrangement was entered into or carried out by means or in a manner that would not normally be employed. In this regard the following factors were taken into account:

- Mrs Lipson did not earn enough income to pay the interest on the share loan and still made the decision to enter into an agreement that she would not have been able to service had it not been for her husband's intervention. This indicates that the loan to acquire the shares was not entered into for *bona fide* purposes.
- Mr Lipson settled the share loan on behalf of his wife in its entirety without a direct benefit for himself. This indicates that the settlement of the share loan was not for *bona fide* purposes in the absence of Mr Lipson's relationship to Mrs Lipson.
- The share loan would not have been granted to Mrs Lipson by the Bank of Montreal had Mr Lipson not agreed to settle the loan on the following day. This supports the view that the share loan was not entered into for *bona fide* purposes as Mrs Lipson never intended to settle the loan herself.
- The advancement of the share loan and settlement thereof on the following day indicates that Mrs Lipson could have borrowed the money for the share purchase from her husband instead of entering into the share loan with the Bank of Montreal.

- The fact that the amount of the share loan (\$562,500) was identical to the mortgage loan indicates that the mortgage was never intended to service the residence (with a purchase price of \$750,000) but was intended to service the financing of the shares. This indicates that the financing was not entered into for *bona fide* purposes.

In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is likely that such financing would typically not be acquired were it not for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is likely that such a transaction would not be entered into by another taxpayer without a tax consideration.

Notwithstanding the above, there is an argument that determining the normality of the arrangement such as this is complex where the parties are connected to each other. In this case it could be argued that the benefits received by one spouse also benefit the other. Therefore, the settlement of a debt incurred by one spouse is also beneficial to the other. It is suggested that more guidance on determining the normality of arrangements in the context of connected persons be provided in order to prevent inconsistency and improve clarity for the South African GAAR.

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

The next tainted element to be considered is the creation of rights and obligations at arm's length. In applying the framework to the facts of the *Lipson* case, it is recognised that the Bank of Montreal was not connected to either Mr or Mrs Lipson. Further, when providing the share loan to Mrs Lipson (in circumstances where they were aware of her inability to afford the repayments), they granted the loan subject to the repayment of the loan by Mr Lipson the following day. Therefore, they would be considered to be striving to achieve the utmost possible advantage for themselves. However, it is submitted that Mr Lipson was not striving to obtain the utmost advantage for himself during the arrangement and that the rights and obligations were not at arm's length. For example, when Mr Lipson agreed to repay the share loan on behalf of his wife, he was not acting in his own best interests, as this action was beneficial to his wife.

While it is reasonable that a financier would have entered into the arrangement, it is not reasonable to conclude that unconnected persons (Mr and Mrs Lipson) would have entered into this arrangement



(*Hicklin* case). Therefore, the rights and obligations attached to the arrangement were not those that could have been expected in any other similar transaction between parties dealing at arm's length. Similarly, there were aspects of the scheme that had the effect of creating rights or obligations that would not normally be created between persons dealing at arm's length.

### ***MISUSE OR ABUSE OF THE ACT***

The last tainted element is the misuse element. If this element is applied to the facts in the *Lipson* case, it is clear that the provisions allowing for the deduction of interest were applied correctly in terms of the legislation. In this regard the following were considered:

- Section 20(1)(c) of the Canadian Income Tax Act allowed taxpayers to deduct interest on a loan used for a commercial purpose in order to incentivise taxpayers to accumulate capital to produce income.
- Section 20(3) of the Canadian Income Tax Act provided that the interest deductible under section 20(1)(c) of the Canadian Income Tax Act did not cease to be deductible if the original loan was refinanced.
- Section 73(1) of the Canadian Income Tax Act allowed taxpayers to perform interspousal transfers without triggering immediate tax consequences.
- Section 74.1 of the Canadian Income Tax Act is an anti-avoidance provision that is intended to prevent spouses from entering into interspousal transfers and using their relationship to take advantage of tax benefits.

However, when analysing the intention of the legislature in allowing a deduction for interest (that arguably related to a residential property), this was not the result that the legislature would have intended with the four sections relied on by the taxpayer. For example, Mrs Lipson was entitled to deduct the interest by virtue of sections 20(3) and 20(1)(c). Mr Lipson sold his shares to Mrs Lipson and bought the residence with the funds from the sale. Therefore, while Mrs Lipson financed the income-producing shares with debt, Mr Lipson financed the private residence with equity. The impact of sections 73(1) and 74.1(1) subsequently allowed Mr Lipson to deduct Mrs Lipson's interest from his own income and that cannot have been contemplated in the design of these four sections when applied in a series of transactions. Therefore, the manner in which the four sections were used in conjunction with each other resulted in an

outcome not intended by the legislator. In light of the above, it is submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR.

It is important to note that the misuse element was applied successfully, in this case, to the series of transactions undertaken by the taxpayer. Therefore, the impact of the use of all four sections of the legislation in terms of the entire series of the transactions was analysed. There is an alternative argument that the misuse element should be applied individually to each part of the legislation used separately in order to determine misuse. Due to the lack of guidance on the application of this element, it is impossible to determine which alternative would be applied by the South African courts. Similarly, the misuse element was applied objectively and therefore the arrangement was analysed with reference to the results achieved by the arrangement. No consideration of the subjective intent of the taxpayer was used in this analysis. In conjunction with the lack of guidance on the application of this element, it is similarly impossible to determine which alternative would be applied by the South African courts. Based on the above, it is suggested that clarity be provided regarding the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard.

#### **9.5.6 LIPSON CASE CONCLUSION**

In analysing the results from applying the framework for the South African GAAR to the facts of the *Lipson* case, it is evident that the transactions entered into by the taxpayers is considered an avoidance arrangement for purposes of the South African GAAR, as Mr Lipson was able to deduct interest resulting from the arrangement. The sole or main purpose (on a subjective and objective basis) of the arrangement was determined to be to take advantage of the tax benefits to be derived from the way the financing was structured. However, it is important to note that the taxpayer in this case agreed (in the Statement of Agreed Facts and Conclusion) that the transactions identified were undertaken for tax purposes. This may not occur in all cases and a more rigorous investigation would normally be undertaken when applying the South African GAAR.

In analysing the tainted elements requirement, the transaction was considered abnormal when comparing the arrangement to one entered into for *bona fide* purposes in the absence of a tax consideration. This is due to the fact that it is unlikely that such financing would typically be entered into had it not been for the resultant tax benefits. The rights and obligations attached to the arrangement also could not have been

expected in any other similar transaction between parties dealing at arm's length and the only reason why the parties achieved the results was by taking advantage of their non-arm's-length relationship.

Lastly, when applying the misuse or abuse element to the arrangement it is also submitted that the Act was misused as it achieved results that were not intended by the individual sections that the taxpayer applied to obtain the tax benefit. Therefore, the manner in which the four sections were used in conjunction with each other resulted in an outcome not intended by the legislator.

In conclusion it is evident that the avoidance arrangement entered into by the taxpayers in the *Lipson* case does constitute an impermissible avoidance arrangement in terms of the South African GAAR. Similarly, the Canadian GAAR was applied successfully when brought before the Canadian courts and this indicates that both of the GAARs may be equally effective. However, the following aspects related to the successful application of the South African GAAR in this specific case are noted:

- When applying the abnormality element, it could be argued that the benefits received by one spouse also benefit the other. Therefore, the settlement of a debt incurred by one spouse is also beneficial to the other. It is suggested that more guidance is provided on determining the normality of arrangements in the context of connected persons in order to prevent inconsistency and improve the clarity of the South African GAAR.
- While it is submitted that the misuse element would be applied successfully to this case, the following should be considered:
  - There is an alternative argument that the misuse element should be applied individually to each part of the legislation used separately in order to determine misuse. If the misuse element had been applied in this way to the facts of the *Lipson* case, it would have resulted in the failure to satisfy the criteria for this element. Therefore, additional guidance on the application of this element should be provided for clarity in this regard.
  - There is an argument to be made that requires a subjective analysis of the misuse or abuse element. No consideration of the subjective intent of the taxpayer was used in this analysis, but it is suggested that clarity be provided regarding the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard.

## **9.6 *COPTHORNE HOLDINGS v THE QUEEN***

### **9.6.1 FACTS OF THE CASE**

Two Canadian corporations, Copthorne Holdings Ltd (Copthorne I) and VHHC Holdings Ltd were parent and subsidiary companies in the same group. In 1993 the group decided to amalgamate Copthorne Holdings Ltd and VHHC Holdings Ltd and two other corporations. However, as a result of a series of transactions these two companies first became sister companies held by the same non-resident shareholder, Big City Project Corporation B.V.

Big City Project Corporation B.V. was the holding company of Copthorne Holdings Ltd. In 1994 Copthorne I, VHHC Holdings Ltd and the two other corporations were amalgamated under the name Copthorne Holdings Ltd (Copthorne II). All the issued shares of Copthorne II were held by Big City Project Corporation B.V. As a result of the amalgamation the paid-up share capital was aggregated to form the paid-up share capital of Copthorne II. However, the paid-up share capital of Copthorne II was essentially the paid-up share capital of VHHC Holdings Ltd, as the paid-up share capital in the other amalgamating companies was nominal.

Subsequent to this a company, L.F. Investments Ltd, was incorporated in Barbados and purchased the shares of Copthorne II. In January 1995 another amalgamation occurred under the name Copthorne Holdings Ltd (Copthorne Holdings III). Immediately following this amalgamation, a large portion of its shares were redeemed and Copthorne III paid out the aggregate of the paid-up share capital to L.F. Investments Ltd.

Though the various amalgamations may seem complex, it must be considered that for tax purposes if the two corporations had remained parent and subsidiary, the paid-up share capital of VHHC Holdings Ltd (\$67,401,279) would have been cancelled on amalgamation. Therefore, as a result of their classification as sister companies, there was more paid-up share capital than would have existed had they remained parent and subsidiary companies prior to amalgamation. The payment of the paid-up share capital was not treated as taxable income to L.F. Investments Ltd and was instead treated as a return of capital. A simplified diagrammatical representation of the transactions undertaken in terms of the facts of the case is provided in [Appendix I](#).

The Minister of National Revenue considered the transactions that transformed the corporations into sister corporations as abusive as they circumvented certain provisions of the legislation and contravened the GAAR. The Minister assessed the amalgamated company on the basis that the paid-up share capital of VHHC Holdings Ltd (\$67,401,279) would have been cancelled upon amalgamation and therefore the amount paid to the shareholder (in excess of the reduced paid-up share capital) would have constituted a deemed dividend. The Minister reassessed Copthorne III for unpaid withholding tax on the deemed dividend portion of the amount paid to L.F. Investments Ltd. The Tax Court of Canada and the Federal Court of Appeal upheld the Minister’s decision.

The progress of this case is presented in Table 12 below:

**TABLE 12 PROGRESS OF THE *COPTHORNE HOLDINGS V THE QUEEN* CASE**

<b>Court</b>	<b>Tax Court of Canada</b>	<b>Federal Court of Appeal</b>	<b>Supreme Court</b>
<b>Decision</b>	Held in favour of the Minister	Held in favour of the Minister	Held in favour of the Minister

**9.6.2 ARRANGEMENT**

The presence of an arrangement is the first requirement for the framework for the South African GAAR. From a review of the facts of the case it was identified that the sale of the companies, the amalgamation of the companies and the redemption of shares formed the series of transactions in question. It is submitted that this series of transactions entered into in the *Copthorne* case constitute a transaction, operation or scheme as envisaged in section 80L of the Income Tax Act. Therefore, if presented before the South African courts, it is submitted that the transactions would be considered to constitute an arrangement for purposes of the South African GAAR.

**9.6.3 TAX BENEFIT**

The presence of a tax benefit resulting from the arrangement is the next requirement for the framework for the South African GAAR. In this case it is noted that by entering into the arrangement, Copthorne III

was able to pay an amount to its shareholder (L.F. Investments Ltd) which was classified as a return of capital. However, if the two corporations (Cophorne I and VHHC Holdings Ltd) had retained their parent and subsidiary relationship, the application of section 87(3) of the Canadian Income Tax Act would have cancelled the paid-up share capital of VHHC Holdings Ltd upon amalgamation. The conversion of the companies to sister companies prevented the operation of the legislation and the paid-up share capital of both companies was aggregated to form the paid-up share capital of the amalgamated corporation.

Therefore, the amount of paid-up share capital was increased and resulted in the entire payment to L.F. Investments Ltd being classified as a capital return. None of the payment to the L.F. Investments Ltd was considered to be a deemed dividend and it was not subject to withholding tax. Therefore, in terms of the principles of the *Smith* case and *King* case, the amalgamated company was able to step out of the way of, escape or prevent an anticipated liability for tax.

As a result of the arrangement it is evident, in terms of the *Income Tax Case No 1625* (1996) 59 SATC 383, *Smith* case and *Louw* case, that a larger tax liability (in the form of withholding tax) would have existed but for the arrangement. Therefore, the arrangement entered into in the *Cophorne* case constitutes an arrangement that had the effect of obtaining a tax benefit and constitutes an avoidance arrangement as defined in section 80L of the Income Tax Act.

#### **9.6.4 SOLE OR MAIN PURPOSE**

The third requirement of the framework for the South African GAAR is the sole or main purpose requirement. For this requirement to be satisfied, the sole or main purpose of the arrangement must be to obtain the tax benefit. In terms of the subjective test, the taxpayer in the *Cophorne* case argued that the sale of VHHC Holdings Ltd to Big City Project Corporation B.V. was to simplify the larger group of companies as part of a reorganisation. However, if the framework for applying the South African GAAR is used, the objective test should be used in conjunction with the subjective test in order to determine if the objective effect of the transactions supports the intention provided by the taxpayer. In this regard it is noted that this part of the arrangement did not simplify the group and only achieved the ability to maintain the paid-up share capital of VHHC Holdings Ltd for purposes of amalgamation with Cophorne I.

In addition, there was no affirmative or conclusive evidence brought to the attention of the courts that supported the case presented by the taxpayer. Therefore, the presumption of purpose created in section 80G of the Income Tax Act was not discharged in terms of the South African GAAR.

Notwithstanding, it is also relevant to note that the simplification of the group could have been achieved without converting VHHC Holdings Ltd and Copthorne I into sister companies. While it is recognised that the taxpayer could argue the principle of the *Conhage* case (i.e. if the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, it indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement), it is also recognised that this may indicate that there was more than one purpose for entering into the transaction in the manner undertaken. It is submitted that while the conversion of VHHC Holdings Ltd and Copthorne I into sister companies and their subsequent amalgamation may have occurred for the larger purpose of simplifying the group, the manner in which the arrangement was undertaken indicates that the tax motive was the primary reason for converting the companies into sister corporations. If it is further considered that no affirmative or conclusive evidence was brought to the attention of the courts that supported the case presented by the taxpayer, it indicates that the tax motive was the sole or main purpose of the arrangement.

When brought before the Supreme Court in Canada, the transactions contemplated in the *Copthorne* case were determined not to have been entered into for a *bona fide* purpose other than to obtain the tax benefit in terms of the GAAR. Therefore, the application of the provisions of the Canadian GAAR would not have a different result with regard to the sole or main purpose requirement of the South African GAAR. However, it is important to note that the Minister identified that the part of the transaction that was specifically questioned in terms of the GAAR was the transformation of the corporations into sister corporations. Therefore, the identification of the correct arrangement, or part thereof, was critical to the successful application of the sole or main purpose requirement.

#### **9.6.5 TAINTED ELEMENTS**

The final requirement to be met before the arrangement is considered an impermissible avoidance arrangement for purposes of the South African GAAR is for the arrangement to satisfy one or more of the tainted elements. For purposes of this analysis it is important to determine if the avoidance arrangement

entered into by the taxpayers in the *Copthorne* case would constitute a transaction entered into in the context of business or any other context. It is submitted that the nature of the transactions will be considered in the context of business as they were conducted by legal entities and not in the personal capacity of any individual taxpayer. Therefore, for the purposes of applying the South African GAAR to the *Copthorne* case, the analysis has been performed in the context of business.

### ***ABNORMALITY***

The first tainted element to consider for purposes of this case would be to establish whether the arrangement was entered into or carried out by means or in a manner that would not normally be employed for *bona fide* business purposes in terms of section 80A of the Income Tax Act.

The sale of the VHHC Holdings Ltd shares to Big City Project Corporation B.V. (that created sister corporations as opposed to parent and subsidiary corporations) was abnormal. Big City Project Corporation B.V. already indirectly owned the shares in VHHC Holdings Ltd by virtue of its ownership of Copthorne I. Therefore, in the absence of the tax considerations, Big City Project Corporation B.V. would not have purchased these shares as this did not satisfy any other *bona fide* business purpose (Louw, 2007:27).

In comparing the transaction to a transaction entered into for *bona fide* purposes in the absence of a tax consideration, it is unlikely that such transactions would typically be entered into were it not for the resultant tax benefits. Therefore, the arrangement can be considered abnormal as it is likely that such a transaction would not be entered into by another taxpayer without a tax consideration.

### ***LACK OF COMMERCIAL SUBSTANCE***

The lack of commercial substance element is the second tainted element to be considered in the *Copthorne* case. In applying the framework for the South African GAAR, each of the individual tests is dealt with separately below:

#### ***General lack of commercial substance test***

After a review of the arrangement it can be concluded that there are instances where there was a lack of commercial substance for the arrangement, as a whole and parts thereof, for the parties to the transactions.



For example, the sale of the VHHC Holdings Ltd shares to Big City Project Corporation B.V. had no significant effect on the business risks for Big City Project Corporation B.V., as the latter already indirectly owned the shares in VHHC Holdings Ltd by virtue of its ownership of Copthorne I. Similarly, because this was done at a nominal cost of \$1,000, this may also be viewed as having no significant effect on the cash flows for Big City Project Corporation B.V. and Copthorne I.

### ***Substance over form test***

It is submitted that the true intention of the parties is reflected in the agreements entered into as a whole, as the end result of the arrangement was reflected in the cumulative transaction agreements. However, the purpose of the transaction that created sister corporations only resulted in the avoidance of tax. Therefore, the effect of the arrangement reveals that the individual agreements may not reflect the substance of the arrangement as a whole.

### ***Round trip financing test***

There are aspects of the arrangement that have the presence of round trip financing. For example, L.F. Investments Ltd paid Big City Project for shares of Copthorne II. Thereafter, the amalgamated companies (Copthorne II) returned funds to L.F. Investments in terms of the redemption of the shares. These round tripped amounts did result in the tax benefit, as in the absence of these round tripped funds, the tax benefit would not have occurred. Similarly, the risks related to the amalgamation of the companies (including losses, capital losses and gains attached to the individual amalgamating entities) were reduced as a result of the amalgamations. However, it is noted that any redemption of shares may have elements that are considered to be round tripped in terms of the GAAR. While it is not the intention for the GAAR to apply to all legitimate transactions in these instances, it is uncertain how the South African courts will apply this test. Therefore, further guidance is required in order to create certainty regarding the applicability of this test in legitimate transactions in the absence of a tax motive.

### ***Tax-indifferent party test***

It is submitted that Copthorne I can be considered a tax-indifferent party in terms of section 80E of the Income Tax Act due to the fact that as a result of its participation an amount was not included in gross income (of L.F. Investments Ltd) as it was classified as a return of capital. Therefore, Copthorne I

effectively sold its tax benefit (its interest in the paid-up capital of VHHC Holdings Ltd) for the ultimate benefit of distributing amounts as capital as opposed to a deemed dividend.

### ***Offsetting or cancelling test***

There are elements in the transaction that have the effect of offsetting or cancelling each other, including the ability of the various amalgamating companies to allow losses from the predecessor companies to shelter the profits of others. This is also evident from the ability to shelter capital profits with capital losses from predecessor companies. However, it is argued that many legitimate amalgamation transactions may have the presence of offsetting or cancelling elements without a tax consideration.

In conclusion, it is submitted that the arrangement identified in the *Copthorne* case lacks commercial substance in terms of the South African GAAR. However, many of the aspects identified are arguably present in many legitimate group reorganisations, as even *bona fide* reorganisations that are entered into in the absence of a tax motivation would have the presence of one or more of the above indicators. While it is not the intention of the GAAR to apply to all the possible legitimate transactions that could have the presence of these indicators, in terms of the purposive approach to interpretation it would be up to the courts to define where the GAAR would apply. In the *Copthorne* case the manner employed in relation to each of the aspects of the agreements indicates that the arrangement as a whole lacked commercial substance.

### ***CREATION OF RIGHTS OR OBLIGATIONS NOT AT ARM'S LENGTH***

The creation of rights and obligations at arm's length element is the third tainted element to be considered in applying the South African GAAR to the facts of the *Copthorne* case. In applying the framework to the facts of the case it is evident that there are elements in the arrangement that were not at arm's length. One such element that has been specifically identified is the sale of the VHHC Holdings Ltd shares to Big City Project Corporation B.V. This is identified because Big City Project Corporation B.V. already indirectly owned the shares in VHHC Holdings Ltd by virtue of its ownership of Copthorne I. Therefore, in the absence of the tax considerations Big City Project Corporation B.V. would not have purchased these shares as this did not result in any additional advantage for Big City Project Corporation B.V. Consequently, parties did not strive to get the utmost possible advantage out of the transaction for

themselves (*Hicklin* case) and therefore the rights and obligations attached to the arrangement were not those that could have been expected in any other similar transaction between parties dealing at arm's length.

### ***MISUSE OR ABUSE OF THE ACT***

The last tainted element is the misuse or abuse of the Act. If this element is applied to the facts in the *Copthorne* case, it is clear that the legislation was intended to operate to prevent the artificial increase of paid-up share capital in terms of amalgamations. However, while the arrangement did not contravene the provisions of the legislation, the arrangement was performed in a manner that artificially allowed the maintenance of VHHC Holdings Ltd's paid-up share capital. This was carried out in a manner that was not intended by the legislator and can be considered a frustration, exploitation or manipulation of the purpose of the legislation. Therefore, the parties to the arrangement artificially created the circumstances necessary to prevent the application of certain provisions of the legislation in order not to explicitly or literally violate their operation. It is submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR.

#### **9.6.6 *COPTHORNE* CASE CONCLUSION**

In analysing the results from applying the South African GAAR to the facts of the *Copthorne* case, it is evident that the transactions entered into constitute an avoidance arrangement. The tax benefit arose due to the fact that the payment to L.F. Investments Ltd was considered a return of capital and was not subject to withholding tax due to its deemed dividend status.

Since the taxpayer was unable to discharge the onus created in section 80G of the Income Tax Act (presumption of purpose), the sole or main purpose of the avoidance arrangement was to obtain the tax benefit. While the taxpayer argued that the sale of VHHC Holdings Ltd to Big City Project Corporation B.V. was to simplify the larger group of companies as part of a reorganisation, the objective facts do not support this view. In fact, this part of the arrangement did not simplify the group, but achieved the ability to maintain the paid-up share capital of VHHC Holdings Ltd for purposes of amalgamation with Copthorne I and made the reorganisation more complex by including an additional step. However, in this case it is important to consider that the Minister specifically identified the parts of the arrangement for

attack under the GAAR (the transformation of the corporations into sister corporations). Therefore, the identification of the correct arrangement, or part thereof, was critical to the successful application of the sole or main purpose requirement.

In applying the tainted elements requirement to the facts of the *Copthorne* case, the arrangement was considered abnormal and not at arm's length when comparing the arrangement to one entered into for *bona fide* purposes in the absence of a tax consideration. Similarly, all five indicators of lack of commercial substance were present in the arrangement: the general lack of commercial substance test, the substance over form test, the round-trip financing test, presence of a tax-indifferent party and the offsetting or cancelling test. However, many of the indicators are arguably present in many *bona fide* reorganisation and amalgamation arrangements without the tax considerations. In this regard it is not the intention to apply the GAAR to all these *bona fide* transactions that occur in the absence of a tax motive. However, in the *Copthorne* case the manner employed in relation to many of the aspects of the agreements indicates that the arrangement as a whole lacked commercial substance.

The misuse or abuse of the Act element was also confirmed in the *Copthorne* case because, while the individual provisions of the legislation were applied correctly, the manner in which certain parts of the arrangement were carried out (including the additional step used to transform two corporations into sister corporations) artificially prevented the application of the legislation. It is submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR.

In conclusion it is evident that the avoidance arrangement entered into by the taxpayers in the *Copthorne* case constitutes an impermissible avoidance arrangement in terms of the South African GAAR. Similarly, the Canadian GAAR was applied successfully when brought before the Canadian courts and this indicates that the South African GAAR may be equally as effective at combatting this type of avoidance arrangement. In this regard it is important to recognise that many aspects of the GAAR that were tested positively in this case may be present in many *bona fide* reorganisations and it is not intended for the GAAR to apply in all these circumstances.

The results from the four Canadian cases analysed in this chapter are summarised below in order to draw conclusions regarding the comparative effectiveness of the Canadian and South African GAARs.

## 9.7 SUMMARY OF APPLIED CASES

The first step in achieving the objectives of this chapter is to collate the individual findings from the four Canadian cases analysed. In collating the findings, two tables have been prepared:

- Table 13 summarises results from applying the South African GAAR to the cases at a high level so that trends can be identified in the cases analysed.
- A summary of the results from applying the South African GAAR to the Canadian cases at a detailed level so that trends can be identified in the cases analysed is provided in Appendix J.

TABLE 13 FRAMEWORK FOR SOUTH AFRICAN GAAR – HIGH-LEVEL CASE SUMMARIES (CANADA)

Table 13: Framework for applying sections 80A – 80L to the facts of previous case law	Canada Trustco case	Mathew case	Lipson Case	Copthorne Holdings Case
1 - Is there an arrangement?	✓	✓	✓	✓
2 - Does the transaction/operation/scheme result in a tax benefit?	✓	✓	✓	✓
3 - Is the sole or main purpose to obtain such tax benefit?	✓	✓	✓	✓
4 - Tainted elements requirement	✓	✓	✓	✓
One of the following with regard to business transactions:				
- <i>Entered into in a manner not normal for bona fide business purposes?</i>	✓	✓	N/A	✓
- <i>Does the transaction lack commercial substance?</i>	✓	✓	N/A	✓
The following with regard to transactions not in the context of business:				
- <i>Has the arrangement been entered into in a manner not normal for bona fide purposes?</i>	N/A	N/A	✓	N/A
One of the following with regard to transactions in any context:				
- <i>Has the arrangement created rights and obligations that are not at arm's length?</i>	✓	✓	✓	✓
- <i>Is there misuse or abuse of provisions of the Act?</i>	✓	✓	✓	✓

### 9.7.1 HIGH-LEVEL FINDINGS

In collating the findings of the Canadian cases analysed in this chapter at a high level, it is evident (from Table 13) that if these cases had been presented before the courts for purposes of the South African GAAR, all four cases would have found in favour of the Minister. An initial high-level review of the information in Table 13 reveals the following:

- All four cases were found to have the presence of an arrangement.
- All four cases satisfied the tax benefit requirement. Therefore, all four cases met the criteria for the presence of an avoidance arrangement.
- All four cases satisfied the criteria for the sole or main purpose of the arrangement.
- All four cases contained all of the tainted elements.

It is relevant to note that in three of the four cases, the results from applying the Canadian GAAR were similar to the application of the South African GAAR (*Lipson*, *Mathew* and *Copthorne* cases). Therefore, it would seem that for these three cases both the South African and Canadian GAARs may be equally effective at combatting impermissible tax avoidance.

The only case that did not satisfy Canadian GAAR is the *Canada Trustco* case, but it did satisfy the framework for the South African GAAR. In light of this it is submitted that the South African GAAR may be more effective at combatting impermissible tax avoidance than the Canadian GAAR for purposes of the *Canada Trustco* case. Further investigation reveals that the primary reason for the failure to apply the Canadian GAAR successfully in the *Canada Trustco* case relates to the misuse or abuse indicator. The difference between the applications of these similar provisions is discussed in the detailed analysis below.

### 9.7.2 DETAILED ANALYSIS

For purposes of ensuring a comprehensive detailed analysis, each requirement of the South African GAAR has been analysed separately below.

## ***ARRANGEMENT***

As identified in the high-level findings, all four of the cases analysed in this chapter satisfied the definition of an arrangement for the purposes of the South African GAAR. This result was expected because the definition of an arrangement has been widely interpreted in a manner that is consistent with the purpose of the GAAR.

## ***TAX BENEFIT***

All four cases analysed in this chapter satisfied the tax benefit requirement for the purposes of the South African GAAR. The ability of the Minister to identify and quantify the tax benefit depended on the Commissioner's ability to identify what the tax implications would have been, had the arrangement (or part thereof) not been entered into. Therefore, reasonable alternative schemes that the taxpayer could have entered into were presented on behalf of the Minister. However, it is submitted that it may not be possible in all cases to identify such alternatives in schemes of a more complex nature.

In South Africa the ability to identify reasonable alternatives may not be a simple task because it is left to the Commissioner to determine the tax consequences related to impermissible tax avoidance in terms of section 80B of the Income Tax Act. The time and resources necessary for the Commissioner to determine the tax consequences of arrangements may make it more difficult for the Commissioner to apply the GAAR successfully in South Africa where time and resources are subject to constraints. As a result, the taxpayers are in a position of power because they may not be subject to the same constraints experienced by the Commissioner and this may result in the failure to apply the GAAR successfully in instances where the GAAR should in fact be applied successfully.

De Koker and Williams (2015:par.19.37) are of the opinion that the Commissioner would need to show what arrangement would otherwise have been entered into to produce the same commercial result and the tax resulting consequences in order to prove what tax benefit results from the arrangement entered into. The authors further note that it is not sufficient that the Commissioner simply contends that there is a tax benefit, but the tax benefit must be quantified when compared to the alternative arrangement.



## ***SOLE OR MAIN PURPOSE***

The high-level findings discussed above reveal that all four cases analysed in this chapter satisfied the sole or main purpose requirement for the purposes of the South African GAAR. In this regard it is noted that in three of the four cases the taxpayers either conceded the purpose or agreed that the purpose was to obtain the tax benefit:

- In the *Canada Trustco* case the taxpayer did not dispute that the purpose of the transaction was to generate a capital cost allowance deduction and brought no objective evidence before the courts that discharge the onus created in section 80G of the Income Tax Act (presumption of purpose).
- In the *Mathew* case the taxpayer conceded that the transaction entered into could not be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit. Similarly, the taxpayer also did not provide sufficient objective evidence to discharge the onus of presumption of purpose.
- In the *Lipson* case the taxpayer agreed that the transactions identified were undertaken for tax purposes.

In light of the above it is noted that there was often limited information (subjective or objective factors) available for use in the application of the sole or main purpose requirement.

However, in the *Mathew* case the taxpayers attempted to argue that because they did not undertake or arrange the transaction (this was done by other parties), the sole or main purpose requirement should not be met. It is submitted that this argument could not succeed in the framework for the South African GAAR in light of the fact that both subjective and objective factors are considered (including the impact of section 80G that created the presumption of purpose). Therefore, while the taxpayers are able to state their own subjective purpose it is the objective purpose of the arrangement itself that played an important role. Therefore, it is submitted that it is not necessary that the person who obtained the tax benefit must necessarily have been the person that arranged the transaction. Nevertheless, in light of the conflicting views on an objective or subjective application of this test, which is as yet untested legislation, it is impossible to be certain about the manner in which the sole or main purpose requirement should be applied and guidance is required to address this issue.

It is noted that agreement as to the sole or main purpose requirement (as was made in the *Lipson* case) is not likely to be made in the South African context as this concession is to the benefit of the Commissioner. Further, it is also recognised that the time and resources required by the Commissioner to prepare more rigorous arguments in this regard would be increased when compared to these specific cases. However, section 80G of the Income Tax Act does add strength to the South African GAAR because it may reduce the amount of time and resources required for the Commissioner to invest in cases where the taxpayer fails to present a convincing argument to the judiciary.

The only case that deviated from the above observations is the *Copthorne* case. In this case the taxpayer argued that the specific part of the arrangement that was questioned by the Minister was to simplify the larger group of companies as part of a reorganisation. However, in assessing the objective facts of the case this specific part of the arrangement did not aid in simplifying the larger group of companies as it only achieved the ability to maintain the paid-up share capital of VHHC Holdings Ltd for purposes of amalgamation with Copthorne I. In addition, there was no affirmative or conclusive evidence brought to the attention of the courts that supported the subjective purpose provided by the taxpayer. The simplification of the group could have been achieved without this specific step of the larger arrangement. It is recognised that the taxpayer could have attempted to rely on the principle of the *Conhage* case (i.e. if the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, it indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement), but it is also accepted that this may indicate that there was more than one purpose for entering into the transaction in the manner undertaken in the case. In this regard it is uncertain how heavily this argument would have been weighed by the South African judiciary for purposes of applying the South African GAAR. Notwithstanding this, it is also relevant to note that this principle is only one of the factors that the judiciary would consider for purposes of this requirement and it is submitted that the manner in that the arrangement was undertaken would similarly have added weight to the submission that the purpose was to achieve the tax benefits.

It is important to note that the identification of the correct arrangement, or part thereof, was critical to the successful application of the sole or main purpose requirement in the *Copthorne* case. Further, the identification of alternative arrangements that could have yielded similar outcomes may also play a significant part in determining the purpose of the arrangement and again supports the view that the

identification of alternative arrangements by the Commissioner is an important factor to be considered for purposes of the sole or main purpose requirement. Therefore, it is submitted that the time and resources required by the Commissioner that would allow a strong case to be presented for purposes of the tax benefit requirement would also yield positive results in providing evidence for the sole or main purpose requirement.

### ***TAINTED ELEMENTS***

The high-level findings above show that all four cases contained all of the tainted elements. This suggests that where one tainted element is present, it is likely that many (if not all) of the tainted elements will be present. In three of the cases (the *Canada Trustco*, the *Mathew* and the *Cophorne* cases) the arrangements were considered to have occurred in the context of business. The transactions in the *Lipson* case were considered to be in a context other than business. Specific items related to the tainted elements requirement were noted in the individual cases analysed in this chapter. The notable items have been included below:

- In the *Lipson* case, it could be argued that where parties to the transactions are connected to each other, the benefits received by one party may also benefit another. In this regard it is submitted that more guidance must be provided in determining the normality of arrangements in the context of connected persons in order to prevent inconsistency and improve the clarity of the South African GAAR.
- In the *Lipson* case, it was noted that while each individual section of the legislation was not violated, the manner in which the four sections were used in conjunction with each other resulted in an outcome not intended by the legislator. However, there is an alternative argument that may be made where the misuse or abuse element should be applied individually to each part of the legislation used separately. Due to the lack of guidance on the application of this element, it is impossible to determine which alternative will be applied by the South African courts. In light of the above, it is suggested that clarity be provided regarding the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard.
- In the *Canada Trustco* case, the timing and similar terms for lease agreements in the arrangement indicated that the arrangement contained elements that were abnormal (i.e. that the insertion of Maple Assets Investments Limited into the larger arrangement was not for *bona fide* purposes and

that they never intended to use the trailers for business purposes). In this regard it is submitted that the inclusion of the abnormality requirement for purposes of the South African GAAR does add strength to the GAAR. However, these factors could have been used for the purposes of the sole or main purpose requirement instead and may indicate that the separation of this element from the sole or main purpose requirement is not necessary.

- In considering the lack of commercial substance element in the *Copthorne, Canada Trustco* and *Mathew* cases, it is submitted that many indicators of lack of commercial substance are arguably present in any financing or group reorganisation arrangements (for example even *bona fide* sale and leaseback or financing transactions that are entered into in the absence of a tax motivation would have the presence of one or more of the indicators). In this regard the timing and manner employed in relation to each of the aspects of the agreements were considered in order to prevent the application of GAAR in instances where the transactions were legitimate. Therefore, it is submitted that if it is necessary to differentiate between the lack of commercial substance indicators for *bona fide* and non-*bona fide* purposes by considering the manner and timing of the arrangement, the structure of the South African GAAR should be amended to reflect this appropriately.
- In the *Copthorne, Canada Trustco and Mathew* cases it was submitted that while the taxpayers did not explicitly misuse the specific provision of the legislation that resulted in the tax benefit, they artificially created the circumstances necessary to use this provision. However, due to the lack of guidance on the application of the misuse or abuse element, it is impossible to determine if the South African courts would assess the misuse or abuse element in terms of the individual provision relied on by the taxpayer, or would apply this element with regard to artificially creating the circumstances necessary to use the provision. In light of the above, it is suggested that clarity be provided regarding the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard. This is specifically highlighted in this case because the introduction of this element was designed to bring the South African GAAR into line with international standards and practice, with specific reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Therefore, to what extent the courts would rely on the interpretation of this element by the Canadian courts is uncertain.

## 9.8 CONCLUSION

In concluding on the analysis of the Canadian cases for purposes of phase 2 of the study, it is noted that the South African GAAR would have been applied successfully to all four cases selected for this study:

- *Canada Trustco Mortgage Company v Canada* (2005) SCC 54
- *Mathew v Canada* (2005) SCC
- *Lipson v Canada* (2009) SCC
- *Copthorne Holdings Ltd v The Queen* (2011) SCC 63

It would therefore seem that the South African GAAR is adequately designed to combat the types of impermissible avoidance arrangements that were undertaken in these cases. Notwithstanding this, there are still areas that have been identified as needing attention in order to improve the efficiency of the South African GAAR.

In three of the cases analysed the results were consistent with those of the Canadian GAAR (*Lipson*, *Mathew* and *Copthorne* cases). While this may indicate that the South African GAAR is more efficient than its Canadian counterpart at combatting impermissible avoidance arrangements, it is relevant to note that the primary reason for the failure to apply the Canadian GAAR successfully in the *Canada Trustco* case relates to the misuse or abuse indicator. In this regard the Supreme Court of Canada found that the capital cost allowance provision relied on by Canada Trustco Mortgage Company was not applied outside the object, spirit or purpose of the relevant capital cost allowance provisions. However, in analysing the intention of the legislature in allowing a deduction for a capital cost allowance, the results of the use of this provision were arguably not the intended result of the legislator as a whole for purposes of applying the South African GAAR. The argument for this is that, while the taxpayer did not explicitly misuse the capital cost allowance provision, they artificially created the circumstances necessary to use this provision. In light of the above it is submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR.

Due to the lack of guidance on the application of the misuse or abuse element, it is impossible to determine if the South African courts would assess the misuse or abuse element in terms of the individual provision relied on by the taxpayer, or would apply this element with regard to artificially creating the circumstances necessary to use the provision. It is therefore suggested that clarity be provided regarding the application

of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard. This is specifically highlighted because the introduction of this element was designed to bring the South African GAAR into line with international standards and practice, with specific reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Therefore, to what extent the courts would rely on the interpretation of this element by the Canadian courts is uncertain.

With regard to the sole or main purpose requirement, it is relevant to note that in the *Lipson* cases the taxpayer agreed that the purpose was to obtain the tax benefit. While it is accepted that if presented before the South African courts the time and resources required by the Commissioner to prepare arguments in this regard would be reduced, it is unlikely that taxpayers would concede in this manner as it would strengthen the case of the Commissioner. Nevertheless, section 80G of the Income Tax Act does add strength to the South African GAAR because it may reduce the amount of time and resources required for the Commissioner to invest in cases where the taxpayer fails to present a convincing argument to the judiciary. Further support for the view that section 80G of the Income Tax Act does add strength to the South African GAAR was identified in the remaining cases where no sufficient affirmative or conclusive evidence was brought to the attention of the courts that supported the subjective purpose provided by the taxpayer.

In considering the results of the tainted elements requirement, it is submitted that further guidance is required to improve the clarity of the following aspects:

- the normality of a transaction where parties are connected to each other;
- whether the misuse or abuse element should be applied individually to each part of the legislation separately or considered with reference to all the provisions relied upon by the taxpayer to achieve the tax benefit;
- whether the timing and manner employed in relation to each of the aspects of the agreements can be considered for purposes of the lack of commercial substance indicator in order to prevent the application of GAAR in instances where the transactions are legitimate; and
- whether the fact that the taxpayer artificially created the circumstances necessary to use a provision of the legislation in order to obtain a tax benefit would impact upon the misuse or abuse of the Act element.

In conclusion, many of the cases were highly artificial in nature and contrived the circumstances necessary to apply certain provisions of the legislation without strictly contravening them. The results of the cases were largely consistent with each other as many had similar characteristics. While it is recognised that this will not always be the case, it does indicate that the manner in which the South African GAAR has been applied for the purposes of this study results in a comparatively efficient GAAR. Nevertheless, there are areas where clarity is required in order to ensure that the South African GAAR can be understood and applied with consistency.

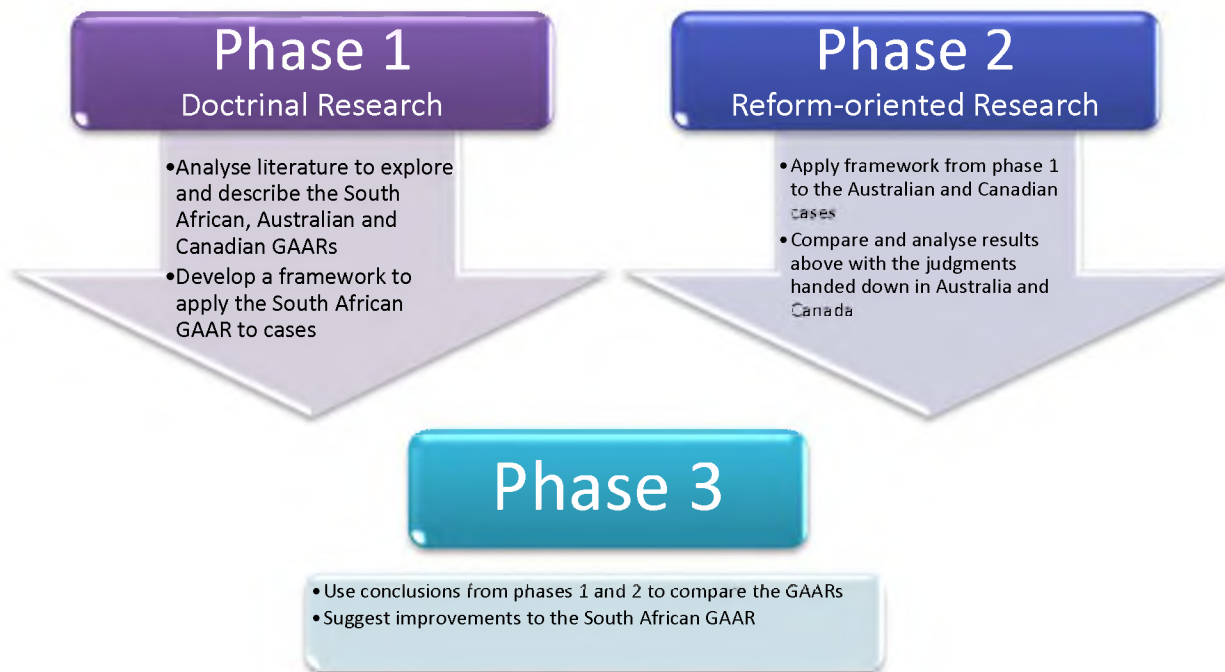
The following chapter represents phase 3 of the study, where the theoretical comparison of the three GAARs in phase 1 and the results from the practical case studies in phase 2 are analysed to suggest improvements to the South African GAAR.

## CHAPTER 10: FINDINGS AND PROPOSED CHANGES

### 10.1 INTRODUCTION

This chapter forms phase 3 of the study that combines the findings from the doctrinal research of the three GAARs performed in phase 1, and the results from the reform-oriented research performed in phase 2 of the study. This chapter will therefore form the basis of suggesting improvements to the South African GAAR from a theoretical and practical perspective. This chapter meets the key objective of the study in order to identify how deficiencies in the South African GAAR should be overcome in order to determine what amendments to the South African GAAR would result in more robust anti-avoidance legislation. This research culminates in recommendations for the formulation and design of a new, more robust South African GAAR. The three-phased research methodology is represented in Figure 20 below:

FIGURE 20 RESEARCH METHODOLOGY



Source: Own design

In this context the first part of the combining the research from the research performed in phases 1 and 2 is to analyse the results from Chapter 7 (Country comparative analysis), Chapter 8 (Australian case law application) and Chapter 9 (Canadian case law application) in combination. Thereafter, any suggestions



for improvement of the South African GAAR must be compared with the existing weaknesses identified in the South African GAAR from Chapter 4.

In facilitating the collation of findings from the theoretical analysis it is relevant to note that Chapters 4, 5 and 6 included an analysis of literature in order to explore and describe the components of the South African, Australian and Canadian GAARs. However, Chapter 7 included a critical analysis of these GAARs in order to draw comparisons between these rules in all three jurisdictions.

In order to exploit the advantage of using the doctrinal research and reform-oriented research to inform each other, the recommendations for improvements resulting from the doctrinal research performed in phase 1 of the study will be used as a basis for the analysis performed in this chapter. Thereafter, any additional recommendations for improvements from the reform-oriented research performed in phase 2 of the study will be discussed.

#### **10.1.1 DOCTRINAL RESEARCH RECOMMENDATIONS**

The recommendations for improvements to the South African GAAR from Chapter 7 are included below. Where these recommendations are supported or augmented by the results from the reform oriented research (phase 2 of the study) this has been specifically noted.

##### ***a) The abnormality and purpose requirements as two separate tests***

In Chapter 7 it was submitted that the South African GAAR be amended in a way that does not require a separate two-part inquiry into the purpose and abnormality of the scheme. A possible solution to this problem was suggested whereby this should be formulated as a single-part inquiry that replaces the two-part inquiry. This could be done in a manner where the abnormality of the arrangement could inform the test of purpose in a manner similar to that of the Australian GAAR, where the dominant purpose requirement is informed by the eight objective factors of section 177D.

This has been confirmed in the conclusions made in Chapter 8 (Australian case law application) where it was submitted that the analysis conducted on the sole or main purpose requirement (specifically with regard to the objective test) is integrally related to the manner in that the arrangement was carried out as

well as the effect of the arrangement. The relationship between these factors indicates that there is a close link between the evidence used for purposes of the sole or main purpose requirement and the tainted elements requirement. It is therefore submitted that the sole or main purpose requirement and the tainted elements should not be separate tests. In combining the two requirements the strengths of both tests could be maintained. A single test could be informed by additional factors, similar to the structure of the Australian GAAR and the eight objective factors. However, if these two tests are combined as suggested, this must be done with caution in order to prevent the GAAR from applying to legitimate *bona fide* transactions. For example, the analysis of the presence of the round-trip financing may present a problem, as any short-term investment will have the presence of a reciprocal action and transfer of funds between the parties.

***b) Steps within a wider transaction***

In Chapter 7 it was identified that though the South African GAAR allows the Commissioner to identify steps within a wider transaction in order to apply the GAAR, this has been criticised as it may result in the arrangement losing its commercial substance when considered in isolation, in the absence of the context provided by the wider scheme. In Australia this is also an area of uncertainty due to various conflicting court judgments. It was suggested that additional guidance be provided on this matter to enhance the understanding of the purpose of this provision when applying the GAAR purposively, in order to avoid the problems experienced in Australia.

In Chapter 8 (Australian case law in relation to GAAR) the importance was confirmed of the ability of the Commissioner to identify steps within a wider transaction in order to apply the GAAR. For example, in the *Hart* case the wider arrangement did not satisfy the sole or main purpose requirement, while the narrower arrangement did. Therefore, the additional guidance suggested for this area of the GAAR is necessary in order to prevent uncertainty regarding the impact of identifying part of a scheme so that it does not impact upon the relationship the arrangement has with the commercial substance indicator. The guidance provided should clearly identify that for purposes of applying the GAAR to a specific step in a larger transaction, it should be done so that it prevents a taxpayer from using the purpose of the larger scheme as a defence for a specific part of the scheme.

### ***c) Defined list of tax benefits***

In Chapter 7 it was submitted that it could be of value for the South African legislature to include a list of tax benefits, similar to that used in Australia, with regard to defining a tax benefit. No similar observations were made in the reform-oriented research in Chapter 8 or 9 and therefore no change to the tax benefit requirement has been made to the proposed structure of the South African GAAR. However, it is still argued that this may add value to the South African GAAR, but this should aim to maintain the strength of the current definition and to add a defined, but not exclusive, list of items specifically included as a tax benefit.

It has also been identified that in its current form the Commissioner may need to identify reasonable alternative schemes that the taxpayer could have entered into in order to prove the existence of the tax benefit (De Koker and Williams, 2015:par.19.37). However, it was also noted in both Chapters 8 and 9 that this may not always prove to be a simple task as the time and resources necessary for the Commissioner to determine the tax consequences of such arrangements may make it more difficult for the Commissioner to apply the GAAR successfully in South Africa where time and resources are subject to constraints. Therefore, if a list of tax benefits is included in the South African GAAR as suggested it may enhance the ability of the Commissioner to identify a tax benefit.

### ***d) Creating circumstances necessary to obtain a tax benefit***

In Chapter 7 it was submitted that it may be valuable for the South African legislature to specifically include a provision in the GAAR that prevents a taxpayer from artificially creating the conditions necessary to take advantage of a specific provision/s that will provide a tax benefit. This will ensure that taxpayers do not escape the application of the GAAR by creating the circumstances necessary to use a tax-advantageous provision in the Income Tax Act. Support for this submission is confirmed in both Chapters 8 and Chapter 9. For example:

- In the *Hart* and the *Consolidated Press Holdings* cases, the taxpayers artificially created the conditions necessary to create the tax benefit that was not intended by the legislator.
- In the *Copthorne*, *Canada Trustco* and *Mathew* cases it was submitted that while the taxpayers did not explicitly misuse the specific provisions of the legislation that resulted in the tax benefit, they artificially created the circumstances necessary to use the provisions.

However, this suggestion could be used in relation to the misuse or abuse element as any creation of such circumstances by a taxpayer could arguably result in the application of the misuse or abuse of the Act element. However, due to the lack of guidance with regard to the application of the misuse or abuse element it is impossible to determine if the South African courts would consider this in the application of the misuse or abuse element. In light of the above, it is suggested that clarity be provided with regard to the application of the misuse or abuse element in order to provide taxpayers, the Commissioner and the judiciary with certainty in this regard. This suggestion is specifically highlighted because the introduction of the misuse or abuse element was designed to bring the South African GAAR into line with international standards and practice, with specific reference to its Canadian counterpart (National Treasury, 2006:63; Louw, 2007:38). Therefore, to what extent the courts would rely on the interpretation of this element by the Canadian courts is uncertain.

***e) Calculating the amount of the tax benefit using the most likely alternative***

In Chapter 7 it was submitted that it may be useful to provide additional guidance on quantifying a tax benefit by calculating the difference between the tax effect of the arrangement and the identified alternative. However, as noted in point c) above this suggestion is not without its own problems as the complex nature of many arrangements that may be considered for attack under the GAAR make this task much more difficult (see, for example, the problems experienced in the *Peabody* case). This problem is further compounded by the fact that taxpayers and their consultants often spend a significant amount of time and resources designing an arrangement that results in a tax benefit, the same onerous resources may be required by the Commissioner in order to identify alternative reasonable arrangements. Further these complex arrangements may not have easily identifiable alternatives that can achieve the same commercial outcomes. In light of this, while it is submitted that an identification of the most likely alternative would be necessary for purposes of the South African GAAR it also places the taxpayer in a position of power because they may not be subject to the same constraints experienced by the Commissioner and may result in the failure to apply the GAAR successfully in instances where it should apply. Further, any alternative is also inherently subjective in nature and it may be problematic to identify possible alternatives that achieve the same commercial outcomes.

In addition, the analysis in Chapter 8 and 9 also revealed that the most likely alternatives presented by the Commissioner could be used for purposes of the sole or main purpose requirement. For example, in the

*Peabody* case the taxpayer was able to justify that the possible alternative arrangements presented by the Commissioner (that could have yielded the same commercial outcomes in the absence of the tax considerations) were not reasonable or viable options (or they would have resulted in possible tax benefits being attained by other parties in the arrangement, as opposed to Mrs Peabody). The results of the *Peabody* case highlight the fact that the alternative arrangements may not only play a role in determining and quantifying the tax benefit, but may also be considered for purposes of the sole or main purpose requirement. This further highlights the importance of identifying the correct arrangement and tax benefit for purposes of applying a GAAR as a well-drafted GAAR will only succeed where the correct arrangement and tax benefit are identified by the revenue authority.

***f) Dominant purpose for other parties to the transaction***

In Chapter 7 one difference was noted in the Australian GAAR when compared to the South African GAAR. It was identified that the Australian GAAR provides that at least one of the persons who entered into or carried out the scheme or any part of the scheme did so for the purpose of obtaining the tax benefit for the taxpayer. Therefore, the dominant purpose requirement can be met if any party (other than the taxpayer) has the dominant purpose of obtaining the tax benefit for the taxpayer. This concept is not explicitly present in the South African GAAR and may add strength to the GAAR as it will prevent one party to the transaction from providing evidence of the commercial purpose of the transaction that is essentially not related to the taxpayer's own purpose for entering into the transaction.

This suggestion is specifically relevant when considering the *Consolidated Press Holdings Ltd* case in Chapter 8 and the *Mathew* case in Chapter 9. In these cases, it was noted that the taxpayers attempted to assert that they either adopted the advice provided by their professional advisors or were not the arrangers of the scheme and as a result the sole or main purpose requirement could not succeed.

In the South African context, no guidance is provided on the ability to attribute the purpose of a tax advisor or other party to the taxpayer. However, if guidance is provided in this regard, it is important to consider the possibility that the tax knowledge of the taxpayer would then become a relevant consideration. Therefore, if the taxpayer contends that he or she was not aware of the tax benefits, it could result in the application of the GAAR to be in favour of the taxpayer. This would be destructive to the GAAR, as many

taxpayers who intend to enter into complex transactions often seek the advice of professional advisors and could use this as a means to avoid the application of the GAAR.

In light of this it was submitted that the sole or main purpose requirement should be considered to be an objective test, without consideration of a subjective purpose of any party. However, this should be managed as any subjective interpretations introduced by the judiciary could impact upon the factors that are considered in their objective inquiry. Therefore it is suggested that guidance be provided that will aid in identifying the factors that could be considered, these factors being similar to the eight objective factors included in the Australian GAAR.

***g) The objectivity or subjectivity of the sole or main purpose requirement***

Chapter 7 revealed that in South Africa it is not certain whether the sole or main purpose requirement should be applied objectively or subjectively. As highlighted in point f) above it was recommended that guidance be provided to reduce the uncertainty regarding the subjective or objective interpretation of this test. It was further suggested that lessons could be learnt from the Australian GAAR, where eight factors (listed in section 177D(2)) are used to guide the objective determination of a particular scheme's sole or dominant purpose. These factors broadly deal with three categories related to the transaction: the manner in which the scheme operated, the consequences resulting from the scheme and the nature of the connection between the taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer. It was submitted that the inclusion of similar guidance may be of value in the South African GAAR as the sole of main purpose aspect is as yet untested in its current form and there is already evidence of uncertainty regarding its subjective or objective application (*Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A); *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A); *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A); *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A)) *Commissioner for Inland Revenue v Middelman* (1989) 52 SATC 323 and *Income Tax Case No 1607* (1995) 58 SATC 340; De Koker and Williams, 2015:par.19.38; Meyerowitz, 2008:par29-12).

The analysis in Chapter 9 also adds weight to the argument that the sole or main purpose of an arrangement should be an objective test. In this regard the observations made with regard to *Cophorne* case are relevant

because the taxpayer argued that the specific part of the arrangement that was questioned by the Minister was for the purpose of simplifying the larger group of companies as part of a reorganisation. However in assessing the objective facts of the case this specific part of the arrangement did not aid in simplifying the larger group of companies as it only achieved the ability to maintain the paid up share capital of one entity for purposes of amalgamation with another. In addition to this there was no affirmative or conclusive evidence brought to the attention of the courts that supported the subjective purpose of the taxpayer. Similarly, the simplification of the group could have been achieved without this specific step of the larger arrangement.

The observation above may also add value to the submission made in point b) above because the context provided with regard to the larger arrangement was a factor that was considered in determining the sole or main purpose of the smaller step within the arrangement.

Notwithstanding, in the *Copthorne* case it was recognised that the taxpayer could have attempted to rely on the principle of the *Conhage* case (i.e. if the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracts less tax, it indicates that the obtaining of a tax benefit was not the sole or main purpose of the arrangement). However, this may have resulted in the conclusion that there was more than one purpose for entering into the transaction in the manner undertaken in the case. It is uncertain how heavily this argument would have been weighed by the South African judiciary for purposes of applying the South African GAAR. Similarly it was also argued that this principle is only one of the factors that the judiciary would consider for purposes of this requirement and it is submitted that the manner in which the arrangement was undertaken would similarly have added weight to the submission that the purpose was to achieve the tax benefits.

#### ***h) The tainted element of abnormality***

In Chapter 7 it was noted that the Australian GAAR introduces an alternative postulate to determine the tax benefit of a scheme. As explained in points c) and e) above this alternative postulate requires a calculation of the difference between the tax effect of the scheme and the identified alternative. In doing so, it is necessary to decide which alternative transaction is the most likely and how the taxpayer might reasonably have been expected to have structured the transaction, thereby preventing a taxpayer from suggesting an alternative that is not reasonable (i.e. not normal). In light of this, it was recommended that

the South African GAAR could require a similar comparison (between the tax effect of the scheme and the identified alternative) in order to enforce the abnormality element (within the tax benefit requirement) with a view to removing the current tainted element of abnormality.

While it is recognised that this suggestion was confirmed in the conclusions of Chapter 8, the alternative transactions presented in relation to the tax benefit requirement may also become relevant for purposes of the abnormality element. This occurs because alternatives can be considered to be examples of “normal” transactions in the absence of a tax consideration. Therefore the identification of reasonable alternative transactions by the Commissioner may play an important role for more than just the tax benefit requirement and should not be underestimated

This suggestion is not without its own problems, as this alternative postulate is also inherently subjective and may in fact introduce additional problems (see points c) and e) above). However, the problems of the current abnormality element should be weighed up against those of the Australian alternative postulate that appears to be more effective.

***i) The manner and timing of the arrangement***

In Chapter 7 it was noted that the Australian GAAR includes two aspects that have not been expressly included in the South African GAAR:

- the manner in which the scheme was entered into or carried out. This includes a consideration of the method or procedure used to carry out the scheme, including a consideration of how the scheme in question was established (*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183)); and
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out. This would include a consideration of a possible “flurry of activity” undertaken at the year-end of the taxpayer, indicating a possible tax motive (*Federal Commissioner of Taxation v Sleight* (2004) 55 ATR 555).

These two factors, while structured more broadly than any of the tainted elements in the South African GAAR, allow more factors relating to the arrangements to be considered, than the narrowly defined South African elements. Arguably, they could add strength to the South African GAAR as the characteristics of



the arrangement under attack could be taken into consideration, which would lead to a more accurate conclusion on the sole or main purpose of the arrangement.

In Chapter 9 this view was supported with reference to the analysis of the *Canada Trustco* case where the timing and similarly terms for lease agreements in the arrangement indicated that the arrangement contained elements that were abnormal (i.e. the insertion of an entity into the larger arrangement was not for *bona fide* purposes and this entity never intended to use the trailers for business purposes). In this regard it is submitted that while the inclusion of the abnormality requirement for purposes of the South African GAAR may have added strength to the GAAR in this instance, these factors could have been used for the purposes of the sole or main purpose requirement instead and may indicate that the separation of this element from the sole or main purpose requirement may not be necessary.

In addition, a consideration of the manner and timing of the arrangement was also suggested as a possible improvement for the lack of commercial substance element (see *Copthorne*, *Canada Trustco* and *Mathew* cases in Chapter 9). This suggestion was made because many indicators of lack of commercial substance are arguably present in any financing or group reorganisation arrangements (for example, even a *bona fide* sale and lease back, or a financing transaction that is entered into in the absence of a tax motivation, would have the presence of one or more of the indicators). In this regard the timing and manner employed in relation to each of the aspects of the agreements could be considered in order to prevent the application of GAAR in instances where the transactions are legitimate. Therefore it was submitted that if it is necessary to differentiate between the lack of commercial substance indicators for *bona fide* and non-*bona fide* arrangements, by considering the manner and timing of the arrangement the structure of the South African GAAR would be improved.

**j) *The misuse or abuse element***

When considering the misuse or abuse element used in the South African GAAR, it was submitted in Chapter 7 that the uncertainty and lack of guidance provided regarding this element will ultimately reduce the efficacy of the GAAR and two options are available to remedy the problem:

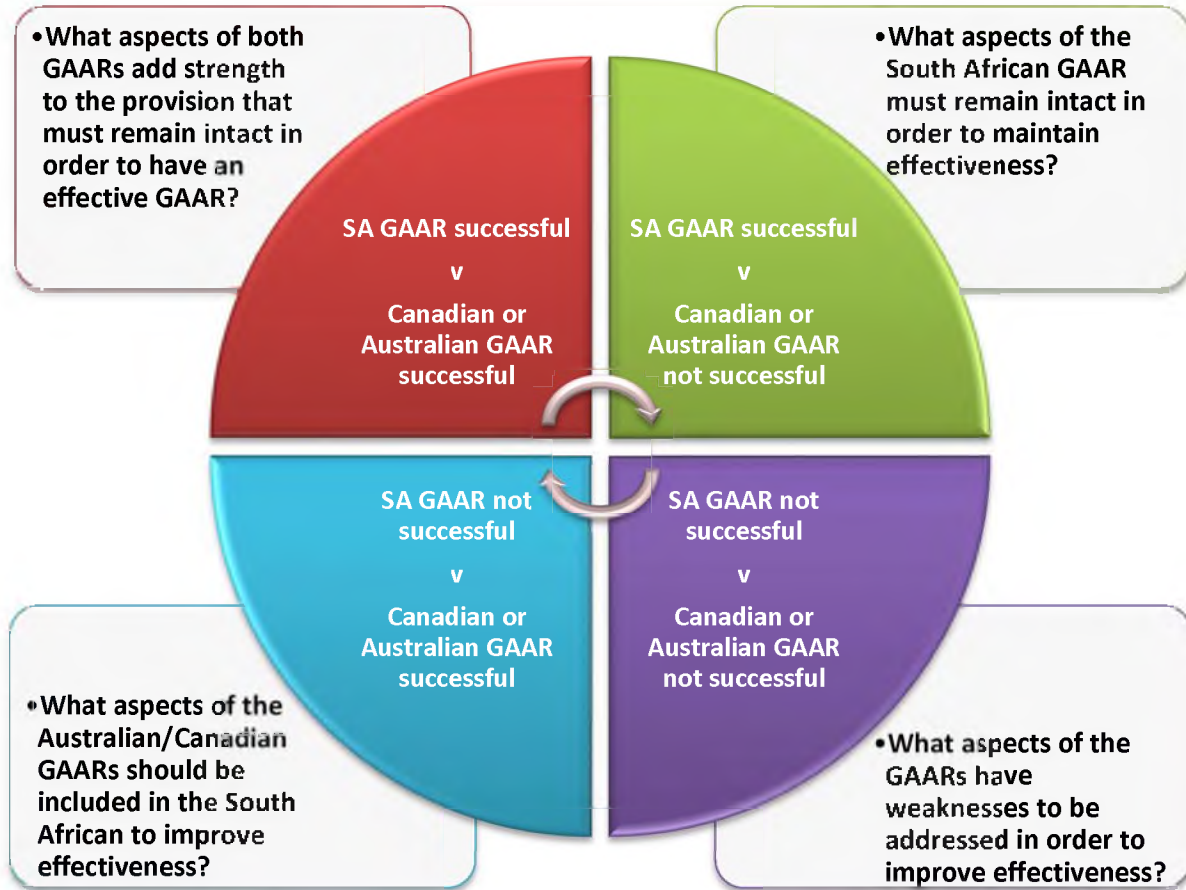
- If the provision is intended to reinforce a purposive approach to the GAAR, it should be removed and could add greater value if it is used as guidance for interpreting the GAAR as a whole, as opposed to a separate test in the GAAR.
- If the provision is intended to achieve some other purpose, then guidance should be provided on its application.

In Chapter 9 the need for clarity with regard to the misuse or abuse element was confirmed with reference to the *Lipson* case. In this case it was noted that, while each individual section of the legislation was not violated, the manner in which the four sections were used in conjunction with each other resulted in an outcome not intended by the legislator. However, an alternative argument was noted where the misuse or abuse element should be applied individually to each part of the legislation used separately. In light of this the lack of guidance with regard to the application of this element makes it impossible to determine which alternative will be applied by the South African courts.

### **10.1.2 REFORM ORIENTED RESEACH RECOMMENDATIONS**

The recommendations made for improvements to the South African GAAR in Chapters 8 and 9 (Phase 2 of the study) are included below. Only those recommendations that are not discussed in the doctrinal research reported (in section 10.1.1) above are noted below. The findings and recommendations that were identified in phase 2 of the study are as a result of one of four possible quadrants provided in Figure 21 below.

FIGURE 21 CASE ANALYSIS



Source: Own design

Each of the recommendations is discussed individually in order to gain an understanding of each of the recommendations as well as the impact they may have on each other.

***The impact of relationships between parties***

In both Chapter 8 and 9 (specifically the *Peabody* case and the *Lipson* case) it was noted that there are often instances where the parties to an arrangement have relationships with each other and these relationships often yield benefits that are not connected to one specific party, but may in fact benefit the group or family unit as a whole. This presents a problem when considering the commercial substance or the normality of the arrangement as it is possible in these instances to conclude that where one party benefits or prospers as a result of the arrangement the others may also benefit in some way. For example in the *Peabody* case, it was noted that by obtaining public funding, the funding available in the group of

companies is increased (among other possible benefits resulting from a public float). This additional funding could arguably be of benefit to the entire group of companies, even if this is not immediately evident in relation to one party in isolation. It does not seem reasonable to exclude considerations such as these when assessing the commercial substance of the arrangement. In light of this it is necessary for guidance to be provided for purposes of applying the South African GAAR in instances where special relationships are present between parties to an arrangement.

### ***Indicators of lack of commercial substance***

In Chapters 8 and 9 the findings related to the indicators of lack of commercial substance were not surprising. In this regard, where the lack of commercial substance test was applied, the cases each had the presence of two or more indicators of the lack of commercial substance. In this regard it is submitted that these indicators do provide strength to the GAAR by providing some guidance on which facts should be considered. However, guidance on the weight that should be attached to each of these individual indicators is lacking and it will therefore be left to the courts to decide how these individual factors contribute to the question of commercial substance. The concern in this regard is that many of these indicators could also occur in *bona fide* arrangements without a tax consideration. It is therefore suggested that guidance be provided to clarify the lack of commercial substance element in order to reduce uncertainty in this regard. This guidance should clearly indicate the intention of the legislature in this regard so that uncertainty is reduced, especially where arrangements are artificial or contrived.

## **10.2 WEAKNESSES OF THE PREVIOUS SOUTH AFRICAN GAAR ADDRESSED**

As highlighted in Chapters 1 and 4, sections 80A to 80L of the Income Tax Act replaced section 103(1) and were introduced to prevent a taxpayer from receiving a tax benefit when entering into an “impermissible avoidance arrangement” by addressing weaknesses in the predecessor provisions. However, in the context of this study it is important to consider if the suggestions for improvements to the South African GAAR in sections 80A to 80L of the Income Tax Act will address these weaknesses.

### ***NOT AN EFFECTIVE DETERRENT TO TAX AVOIDANCE***

The first weakness noted in the Discussion Document released by SARS before the 2006 amendments was that the GAAR was not an effective deterrent to abusive avoidance schemes and other impermissible

forms of tax avoidance. This resulted in the GAAR frequently failing to stand up to the rigours of court due to aggressive and increasingly sophisticated schemes entered into by taxpayers (Olivier, 1996:378). This had the effect that government was required to commit significant time and resources to detecting and combating these schemes. This investment of time and resources proved costly and the lengthy battles over the nature of transactions had a negative impact on the relationship between SARS and taxpayers (SARS, 2005:42). Further, while it was identified that the failure to disclose the required information or furnish information regarding the reporting rules (contained in Part B of Chapter 4 of the Tax Administration Act) may result in penalties of R1 million, some taxpayers raised technical points to avoid reporting or restructured their transactions to avoid the triggers for reporting. This indicates that it is possible that there may be uncertainties that taxpayers are able to use to their advantage, and that the penalty for not reporting may not be enough to deter taxpayers from entering onto these arrangements. Nevertheless, the abnormality and purpose requirements were identified as the most critical areas of weakness of the GAAR that resulted in the ineffectiveness of the previous GAAR. In this regard it is submitted that suggestions have been made in this study to both the purpose and abnormality requirements that will improve the efficiency of the present GAAR. Further, many suggestions for further guidance relating to individual aspects of the GAAR have been made for purposes of reducing uncertainty. The reduction of uncertainty regarding any of the provisions of the GAAR will arguably strengthen the present GAAR and lead to efficiencies for taxpayers, the judiciary and the Commissioner by reducing the time and resources necessary to resolve such disputes.

In addition to the weakness described above, it was also recognised that the South African GAAR may be an ineffective tool to deter tax avoidance because it does not impose penalties where the GAAR is successfully applied (Broomberg, 2007b:1). In this regard it is recognised that the Commissioner is only allowed to impose the tax that would have arisen in the absence of an impermissible avoidance arrangement. This may have the effect that taxpayers are in no worse a situation than if they had not attempted to avoid the tax in the first place, other than possible interest levied by the Commissioner, as the taxpayer is only expected to pay tax as if the scheme had not been entered into. Therefore, it is submitted that taxpayers could gain an advantage by attempting such schemes without a financial disadvantage (other than interest and a possible R1 million penalty for failure to report in terms of the reporting rules contained in Part B of Chapter 4 of the Tax Administration Act) if they are caught doing

so. In light of this, the possible impact of an introduction of penalties has been identified as an area of future research.

### ***ABNORMALITY REQUIREMENT***

The abnormality requirement received considerable commentary by critics both before and after the 1996 amendment. The most important criticisms were those noted by the Margo and Katz Commissions (before the 1996 amendments to GAAR) where amendments to the abnormality requirement were suggested in order to make it clear that if a particular form of transaction was commercially acceptable due to the fact that it was widely used, this did not mean that the abnormality test would not apply (Margo, 1988:par27:28; Katz, 1996:par11.2.2).

Despite the acceptance by the legislator prior to the 1996 amendments of the criticisms noted by the Margo and Katz Commissions, these criticisms remained valid after the 1996 amendments since it seemed that the “legislator did not grasp the problem” (Olivier, 1997:741). The suggestions made in the Katz Commission were that the abnormality test be amended to include a *bona fide* business purpose test, as opposed to a normality test, when the transaction, operation or scheme was undertaken in the context of business. The 1996 amendments did include the words “*bona fide* business purposes” but the word “normal” remained and that perpetuated the problems with the GAAR and aided in rendering the GAAR an ineffective deterrent for tax avoidance (Olivier, 1997:742; Williams, 1997:677; SARS, 2005:39; Werksmans, 2006:1). Similarly, these criticisms were noted in the Discussion Document released by SARS in 2005 almost a decade after the 1996 amendments were effected (SARS, 2005:41-44), indicating that SARS had, in fact, identified that the 1996 amendments had not addressed the problem which they were intended to address.

It was recognised that the 2006 amendments to the GAAR did expand this test with the inclusion of the lack of commercial substance test and the direct or indirect misuse or abuse of the Act test. However, research revealed that the abnormality was still identified as problematic due to the fact that the 2006 amendments to the GAAR did not necessarily address its weaknesses and the inclusion of the additional tests had created uncertainty regarding its application in the absence of appropriate guidance.

In this regard it is noted that some suggestions have been made in this study that are intended to improve the effectiveness of the GAAR. These suggestions include:

- The reasonable alternative transactions presented for purposes of the tax benefit requirement may also become relevant for purposes of the abnormality element because these alternatives may be considered to be examples of “normal” transactions in the absence of a tax consideration. Therefore the identification of reasonable alternative transactions by the Commissioner may play an important role for more than just the tax benefit requirement and would reinforce the abnormality element (within the framework of the tax benefit requirement) with a view to removing the current tainted element of abnormality.
- The manner and timing in which the arrangement is undertaken is also a suggestion that was made that is intended to improve this requirement. However, it is proposed that these factors should be considered for purposes of the sole or main purpose requirement that can then identify aspects of the arrangement that are not considered to be normal.
- Additional guidance and clarity for applying the misuse or abuse element was suggested to improve the tainted elements requirement.
- Additional guidance was suggested with regard to the impact of special relationships between parties to an arrangement that could impact upon the abnormality requirement.
- Additional guidance was suggested for the indicators of lack of commercial substance in order to provide clarity with regard to weighing up individual indicators and the impact of these on legitimate transactions without a tax motive.

### ***PURPOSE REQUIREMENT***

The purpose requirement also received extensive criticism as, even though there may have been a tax purpose for entering into a transaction, it would not have resulted in the transaction falling foul of GAAR if this tax purpose was not the sole or main purpose of the transaction (Brincker, 2001:163; SARS, 2005:41-44). Essentially a transaction, the main purpose of which was commercial or business related, would be sanctioned by the courts because the taxpayers were entitled to structure the transaction in the most beneficial manner, thus supporting the principles established in *IRC v Duke of Westminster* ((1936) 19 TC 490). More recently, the judgment in the *Conhage* case confirms this approach, where it was held that a transaction entered into with a dual purpose did not fall foul of the purpose requirement if the main reason for entering into such a transaction was business or commercially oriented.

It was further identified that the impact of this judgment was widespread as it led tax consultants to feel vindicated “on the basis that, for as long as a transaction has a business or commercial purpose, it does not matter in what manner the transaction is in fact structured” (Brincker, 2001:165). In fact, the Discussion Document recognised that taxpayers had argued with relative ease that the raising of capital was the purpose of an arrangement following the *Conhage* case (SARS, 2005:44). Brincker (2001:158) subsequently noted that the judgment in the *Conhage* case made it essential in tax planning to ensure that a business or commercial reason could be provided for a transaction as the first three requirements of the GAAR were often present. The impact of this is that taxpayers were able to justify a commercial purpose of a transaction with relative ease, while leaving SARS in the difficult position of having to prove that the dominant purpose of the transaction would be to obtain a tax benefit and thus rendering GAAR an ineffective deterrent to these types of transactions (SARS, 2005:43; Werksmans, 2006:1).

In this regard it is submitted that suggestions have been made to the purpose requirement that will improve the efficiency of the GAAR. Further, many suggestions for further guidance related to individual aspects of the GAAR have been made for purpose of reducing uncertainty. The suggestions made with regard to this requirement include:

- The use of reasonable alternative transactions for purposes of the tax benefit requirement that might indicate objective factors for consideration in relation to the sole or main purpose requirement.
- The use of the intention of other parties in connection with the transaction so that the sole or main purpose requirement can be met if any party (other than the taxpayer) has the dominant purpose of obtaining the tax benefit for the taxpayer.
- The sole or main purpose requirement should be considered to be an objective test, without consideration of a subjective purpose of any party, in a manner that provides guidance on which factors could be used to determine the purpose of the arrangement.
- The manner and timing in which the arrangement was entered into or carried out (that includes a consideration of the method or procedure used to carry out the scheme), including a consideration of how the scheme in question was established, should be used in determining the objective purpose of the arrangement.



### ***ABNORMALITY AND PURPOSE REQUIREMENTS TOGETHER***

In the Discussion Document SARS (2005:44) identified that the use of the abnormality and purpose requirements as two separate tests presented a problem as a taxpayer could with enter into a transaction with the sole purpose of avoiding tax, provided that there was no abnormality in the means or manner or in the rights and obligations that it created. The converse was also identified because a taxpayer could with enter into a transaction that was abnormal provided that the sole or main purpose was not for tax avoidance. Therefore the structure of the GAAR, requiring both the purpose and abnormality provisions to be present before a transaction could fall foul of the legislation, placed the taxpayer in a powerful position of being able to avoid the application of GAAR by justifying either the abnormality or purpose requirements with relative ease when planned with sufficient foresight.

In this regard it is submitted that suggestions have been made with regard to the structure of the South African GAAR, where a separate two-part inquiry into the purpose and abnormality of the arrangement should not be required. It was submitted that a single-part inquiry could be done in a manner where the abnormality of the arrangement could inform the test of purpose in a manner similar to the Australian GAAR, where the dominant purpose requirement is informed by the eight objective factors of section 177D.

### ***PROCEDURAL AND ADMINISTRATIVE ISSUES***

The final weakness of the GAAR as identified in the Discussion Document was described as procedural and administrative issues. In this regard it was noted that there was:

- uncertainty about the extent to which GAAR could be applied to individual steps within a larger transaction (SARS, 2005:44); and
- uncertainty as to whether the Commissioner had authority to apply GAAR in the alternative where another provision was also in dispute (SARS, 2005:44).

It submitted that the inclusion of section 80H of the Income Tax Act in respect of the current GAAR addressed the first weakness by providing that the Commissioner may apply the provisions of this Part to steps in or parts of an arrangement. Similarly the insertion of section 80I of the Income Tax Act addressed the second weakness by providing that the Commissioner may apply the provisions of the GAAR in the

alternative or in addition to any other basis for raising an assessment. In light of this no further recommendations for improvement have been made to the procedural and administrative weakness.

In light of the suggestions and recommendations made in the doctrinal and reform-oriented research a high-level structure for the South African GAAR is discussed below.

### **10.3 STRUCTURE OF AN IMPROVED GAAR**

Chapter 4 explored and described the components of the South African GAAR. The main components of South African GAAR were summarised in Chapter 4 and have been repeated briefly below:

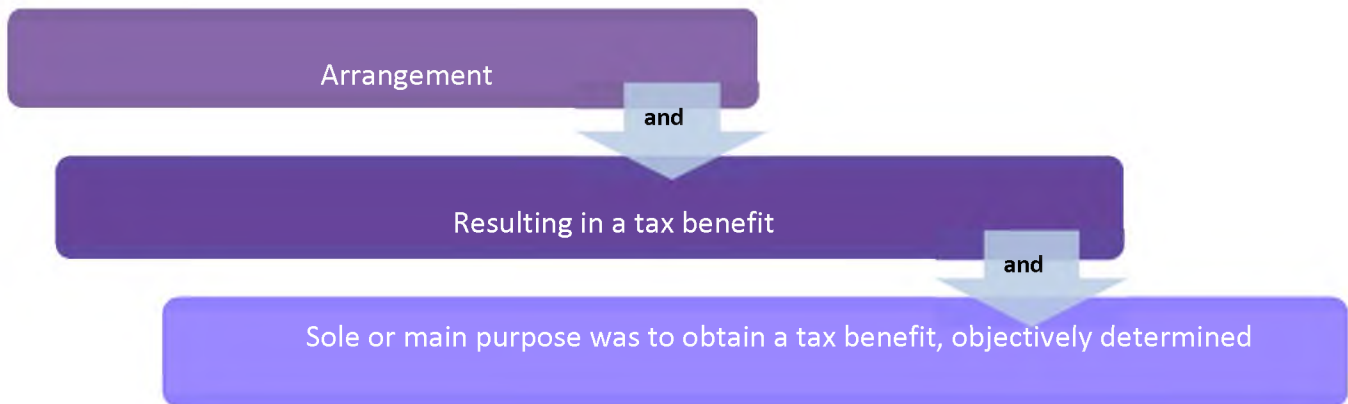
- A transaction, operation or scheme must be present.
- The transaction, operation or scheme must result in a “tax benefit”.
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit.
- The arrangement must be abnormal, lacking in commercial substance, carried out in a manner not normally employed for *bona fide* business purposes, create rights and obligations not normally arising between parties dealing at arm’s length or be abusive of the provisions of the Income Tax Act.

The recommendations and suggestions made to enhance the effectiveness of the South African GAAR as described in this Chapter result in the following proposed high level summary of an improved GAAR:

- A transaction, operation or scheme must be present (arrangement).
- The transaction, operation or scheme must result in a “tax benefit” (avoidance arrangement)
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit, objectively determined.

This proposed high-level structure of the proposed GAAR is represented diagrammatically in Figure 22 below:

FIGURE 22 HIGH-LEVEL PROPOSED GAAR STRUCTURE



Source: Own design

The above structure shows that only three requirements for the South African GAAR are proposed. However, the objective sole or main purpose requirement has been expanded to include aspects related to the tainted elements requirement (previous abnormality requirement), including those additional suggestions derived from the Canadian and Australian GAARs.

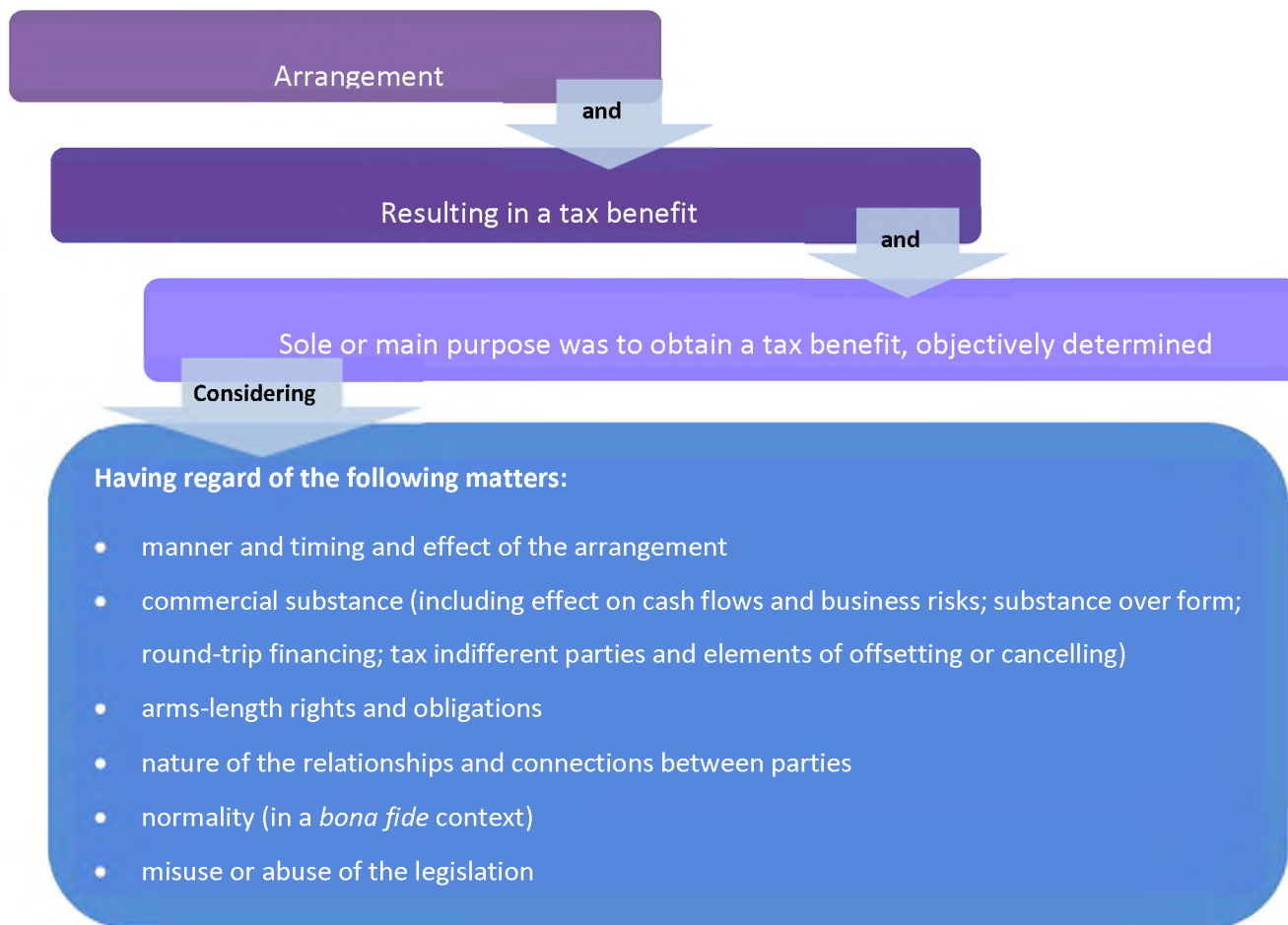
A summary of these more detailed proposals in respect of the GAAR are:

- A transaction, operation or scheme must be present (arrangement).
- The transaction, operation or scheme must result in a “tax benefit” (avoidance arrangement).
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit, objectively determined having regard of the following matters:
  - The manner in which the arrangement was entered into or carried out;
  - The time that the arrangement was entered into and the length of time during which the arrangement was carried out;
  - The effect of the arrangement on the financial position of the taxpayer or parties to the arrangement;
  - The commercial substance of the arrangement (including effect on cash flows and business risks; substance over form of the arrangement; round-trip financing; tax indifferent parties and elements of offsetting or cancelling);

- The arms-length nature of the rights and obligations arising between parties;
- The nature of the relationships and connections between parties to the arrangement;
- The normality of the arrangement in a *bona fide* context;
- Any misuse or abuse of the legislation; and
- Any other consequences or matters resulting from the arrangement.

The proposed structure of the GAAR is represented as follows in Figure 23 below:

**FIGURE 23 DETAILED PROPOSED GAAR STRUCTURE**



Source: Own design

While it is recognised that drafting the above proposals into legislation must be in the language and format required by the legislature, this is not included in the scope of the study. However, it is evident that the

inclusion of the matters to be considered in relation to the sole or main purpose of the arrangement constitutes the most extensive changes to the GAAR.

Notwithstanding, it is noted that the majority of suggestions made with regard to the South African GAAR constitute aspects where further guidance is required. Therefore, while it may not be necessary to amend the legislation for these areas, guidance is required in order to allow correct interpretation of the GAAR in terms of the purposive approach to interpretation of legislation. These areas of additional guidance have been specifically noted earlier in this chapter. There are many options available that may be used to provide guidance and clarity for purposes of interpreting the GAAR. This guidance could be provided in the form of explanatory memoranda (in the instance that the GAAR is amended), regulations, directives, interpretation notes or rulings. However, should guidance be provided it is important to consider to if this guidance may be relied on by the judiciary when presented before the courts. Therefore, it is suggested that regulations or binding general rulings may be the most appropriate tools to provide this guidance as they are considered binding.

Despite the recommendations made with regard to the GAAR in this chapter, additional observations have been made that may also have an impact on the efficiency of the South African GAAR. These additional observations are discussed below.

## **10.4 ADDITIONAL OBSERVATIONS FOR THE SUCCESS OF GAAR**

### **10.4.1 IDENTIFYING THE ARRANGEMENT**

In Chapter 8 the *Peabody* case provided valuable insight with regard to the arrangement requirement. In this regard it was noted that the whole scheme or arrangement was attacked for purposes of the GAAR as opposed to a specific part of the arrangement. The attack of the arrangement identified by Commissioner in Australia resulted in neither the tax benefit nor the sole or main purpose requirements being satisfied. This is significant because it was argued that because the Commissioner identified the incorrect arrangement and/or taxpayer, the GAAR in both jurisdictions (South Africa and Australia) failed to apply. This means that, while the individual requirements for the presence of an arrangement may easily be satisfied, the impact of identifying the correct arrangement or part thereof is critical to the success of both

the South African and Australian GAARs. Therefore, the importance of the first requirement of the South African GAAR should not be underestimated when the Commissioner is considering an attack under the GAAR. This is particularly important because this appears to be a straight-forward requirement that may suggest that more careful consideration is not necessary.

#### **10.4.2 ARRANGEMENT AND THE SOLE OR MAIN PURPOSE**

The analysis of the sole or main purpose requirement in the *Hart* case (Chapter 8) revealed that while the wider arrangement did not satisfy the sole or main purpose requirement, the narrower arrangement did. This again confirms the importance of identifying the correct arrangement in order to successfully apply the GAAR. In addition to this it is important to note that the objective factors that were taken into consideration in the *Hart* case indicated that there was more than one motive for entering into the arrangement. A similar observation was made in Chapter 9 with regard to the *Cophorne* case.

#### **10.4.3 SOLE OR MAIN PURPOSE AND ALTERNATIVE ARRANGEMENTS**

The analysis of the tax benefit requirement in the *Hart* case (Chapter 8) required an identification of alternative arrangements, which could have yielded similar outcomes. This played a significant part in identifying that there was more than one purpose for the arrangement and that the dominant purpose was to achieve tax benefits. This case highlighted that the time and resources required by the Commissioner to present a strong case for purposes of the tax benefit requirement would also yield positive results in providing evidence for the sole or main purpose requirement.

#### **10.4.4 PRESUMPTION OF PURPOSE AND SECTION 80G OF THE INCOME TAX ACT**

In Chapters 8 and 9 the importance and strength of section 80G of the Income Tax Act (creating a presumption that the sole or main purpose of the arrangement is to obtain the tax benefit) was highlighted for various reasons. Firstly, in instances where the taxpayer asserted that the purpose of the arrangement was not for tax considerations, the lack of affirmative or conclusive evidence to support this assertion was a key factor in the successful application of the South African GAAR. Secondly, where taxpayers made admissions with regard to the purpose of the arrangement (as in the *Lipson* case, the *Canada Trustco* case

and the *Matthew* case) the taxpayers would not satisfy the onus created by section 80G of the Income Tax Act and the Commissioner would not need to present opposing arguments.

#### **10.4.5 GAAR COMMITTEES AND PANELS**

In performing research on both the Australian and Canadian GAARs it was identified that Canada has a GAAR Committee and Australia has a GAAR panel. The functions of these are discussed individually below.

In Australia the GAAR Panel is a non-statutory, consultative body established to provide guidance on the application of the GAAR and other general anti-avoidance provisions (Travers, 2014:306). The Panel consists of business and professional experts and senior tax officers. While this Panel does not make decisions, its advice is taken into account by the Australian Tax Office. In providing this advice to tax officers and taxpayers, taxpayers may be invited to attend meetings but must provide a concise written submission prior to the meeting, or notify the Panel that they intend to rely on previous written submissions made to the Australian Tax Office. Prior to these meetings the taxpayer will be informed of the contentions of fact giving rise to the issue referred to the Panel, and of the substance of the Australian Tax Office's proposed approach to the application of the GAAR. During these meetings the taxpayer will be given an opportunity to address the Panel so that the Panel may ask questions to ensure that the taxpayer's submissions are understood. In this regard taxpayers should be prepared to respond to questions relating to the tax benefit and the eight objective factors in section 177D of the GAAR.

In Canada this GAAR Committee is similarly used to aid in only applying the GAAR with the utmost caution and as a last resort. This Committee is made up representatives from the Canadian Revenue Agency, the Department of Finance, and the Department of Justice (Office of the Auditor General of Canada, 2014: par. 3.23). In terms of the process to be followed, the Minister is informed by the considerations of the GAAR Committee in all instances that could need the application of the GAAR (Arnold, 2004:491). Once the GAAR Committee decides that the GAAR will apply to a case, the taxpayer is reassessed or, alternatively, if the taxpayer had requested an advance income tax ruling, a ruling is given that the GAAR will apply (Office of the Auditor General of Canada, 2014: par. 3.23).

While it is outside the scope of this research to determine the effectiveness of the GAAR Committee and GAAR Panel, it is submitted that the use of such a process in the South African context would be valuable in preventing cases from being brought before the courts where it is doubtful if the GAAR would be successfully applied. This would reduce the amount of time and resources spent on litigation and would improve the relationships between SARS and taxpayers by avoiding unnecessary lawsuits.

## **10.5 CONCLUSION**

In concluding on phase 3 of the research it is noted that many of the suggestions made in phase 1 (doctrinal research) were similar to those resulting from phase 2 (reform oriented research). This indicates that there was strong validation of the findings on the GAAR. The primary amendments that were proposed to improve the effectiveness of the South African GAAR included:

- The sole or main purpose requirement should be amended in order to ensure that this is an objective test without consideration of the subjective intention of the taxpayer. Therefore the objective facts should inform the decision regarding the sole or main purpose requirement.
- The sole or main purpose requirement and the tainted elements requirement (previously the abnormality requirement) were amended into a single inquiry for the sole or main purpose, but informed by a consideration of objective factors. This was done in a manner similar to the Australian GAAR, so that the tainted elements could inform the sole or main purpose requirement.
- A consideration of additional factors, such as the manner and timing of the arrangement, for purposes of informing the sole or main purpose requirement, allows additional objective factors to be considered, rather than the narrowly defined South African elements. As a result, characteristics of the scheme under attack could be considered, that would lead to a more accurate conclusion on the sole or main purpose of the arrangement.

In addition to changes to the GAAR itself there were instances where additional guidance was suggested in order to improve the effectiveness of the South African GAAR. These areas of guidance included:

- Guidance should be provided on the application of the GAAR to steps within a wider transaction. This guidance should aim to determine the impact this will have upon the commercial substance of the arrangement as a whole.



- It is suggested that a list of items for purposes of identifying a tax benefit could be included in guidance provided on the South African GAAR. This should aim to maintain the strength of the current definition, but add items specifically identified as a tax benefit to prevent a narrow interpretation in future.
- It is suggested that guidance be provided for purposes of quantifying a tax benefit by calculating the difference between the tax effect of the scheme and the identified alternative.
- Guidance should be provided in order to prevent taxpayers from artificially creating the circumstances necessary to take advantage of a specific provision of the Act. This could be provided as part of the guidance required for purposes of applying the misuse or abuse of the Act provision in order to provide clarity and to ensure that taxpayers who use provisions in the legislation to obtain a tax benefit are doing so legitimately without artificially creating the circumstances necessary to do so.
- Introducing guidance with regard to the use of the most reasonable alternative to be used in calculating the tax benefit will result in a consideration of how the taxpayer might reasonably have been expected to have structured the transaction and thereby eliminate the ability of a taxpayer to suggest an alternative that is not reasonable (i.e. not normal). This may resolve further issues with the abnormality requirement.
- Guidance on the misuse or abuse element should be provided in order to reduce uncertainty and aid in the application of this test.
- Guidance should be provided in order to clarify the impact of special relationships between parties for purposes of applying the individual requirements of the GAAR.
- Additional guidance is required for purposes of interpreting and applying each of the indicators of lack of commercial substance.

As a result of these proposed amendments and additional guidance it was submitted that all of the weaknesses of the GAAR (as identified in chapter 4) have been addressed in some manner. Therefore the research performed in phases 1 and 2 provide for an improved South African GAAR. Notwithstanding this, it remains important to understand that there is lack of consensus on how an effective GAAR should be designed that will still allow taxpayers the freedom to arrange their affairs so as to legitimately avoid tax. Given this and the uncertainties regarding impermissible tax avoidance, any GAAR will inherently involve an element of uncertainty.

Additional items for consideration were also noted as a result of this study. These additional items noted in the reform-oriented research included:

- The importance of identifying the correct arrangement in order to prevent the non-application of the remaining elements of the GAAR.
- Identifying alternative arrangements for purposes of the tax benefit requirement could also yield positive results in providing evidence for the sole or main purpose requirement.
- The importance of the presumption of purpose introduced by section 80G of the Income Tax Act.

In addition, it was also submitted that the success of the South African GAAR would also be improved if a GAAR Panel or GAAR Committee was used to make recommendations and provide advice to the Commissioner and taxpayers before embarking on litigation. This would reduce the number of cases that are brought before the courts and aid in reducing the costs of litigation. A further benefit would be the improvement of relationships between SARS and the taxpayers.

In conclusion, this chapter meets the key objective of the study by proposing amendments and guidance for the South African GAAR in order to overcome its weaknesses.

## **CHAPTER 11: CONCLUSION**

### **11.1 INTRODUCTION**

As discussed in Chapter 1 the desire to minimise one's tax has been a concern to taxpayers throughout the ages. The use of impermissible tax avoidance schemes to achieve this has been described as a threat to the integrity of tax systems and government revenues worldwide (Barker, 2009; OECD, 2010). In this context South Africa uses a GAAR as well as various specific anti-avoidance provisions to combat such avoidance schemes. However, the South African GAAR is untested in its current form as it has not yet been contested in the courts. This is problematic as the most recent amendments have been subjected to much criticism and it is contended that many of the weaknesses of the predecessors of the present GAAR may still be present. Similarly, the inclusion of provisions adopted from other jurisdictions has been criticised due to the fact that it has created uncertainty over the application of the GAAR. Therefore, research was necessary to address these issues.

Previous research conducted in South Africa centred on critical theoretical analyses of the GAAR after it failed to stand up to the interpretation of the courts (Calvert, 2011). In light of the fact that the present GAAR has not yet been contested before the courts this type of research cannot be performed. This study therefore fills a gap in the anti-avoidance research and aimed to determine amendments that could be made to the South African GAAR to address its weaknesses. Therefore, the goal of the research was to analyse and compare the GAAR in South Africa, Canada and Australia from a case law perspective in order to identify how the existing deficiencies in the South African GAAR should be overcome. This investigation resulted in determining what amendments to the South African GAAR would result in more robust anti-avoidance legislation.

This thesis aimed to identify two levels of improvements to the South African GAAR:

- provisions in the GAAR that should be removed due to weaknesses; and
- provisions that should be added to the GAAR, using principles from Australia and Canada.

The research objectives pursued in addressing the goal of the research were formulated in Chapter 1 as follows:

1. to identify the primary weaknesses of the GAAR in South Africa (Phase 1: Chapter 4);
2. to analyse the Australian and Canadian GAAR with the purpose of describing and comparing its elements with that of the South African GAAR (Phase 1: Chapters 5, 6 and 7);
3. to apply the GAAR in South Africa to the facts of the cases selected from Australia and Canada and therefore determine which provisions require amendment when comparing the results to the judgments in these jurisdictions (Phase 2: Chapters 8 and 9); and
4. to recommend amendments to improve the effectiveness of the GAAR (Phase 3: Chapters 7, 10 and 11).

The relationship between goal/purpose of the research and research objectives are represented in Figure 24 below:

FIGURE 24 RESEARCH PROBLEM AND OBJECTIVES



Source: Own design

In order to achieve these objectives both doctrinal and reform-oriented methodologies were employed in three separate phases. The first phase of the research employed a doctrinal methodology to compare the GAARs in Australia, Canada and South Africa, while the second phase employed reform-oriented research to apply the South African GAAR to the facts of cases from Australia and Canada in order to identify areas for possible improvement to the South African GAAR. The third phase combined the findings of phases 1 and 2 to make suggestions to improve the South African GAAR. This chapter will conclude on each of the research objectives in order to suggest improvements to the South African GAAR.

## 11.2 ACHIEVEMENT OF THE RESEARCH OBJECTIVES

As discussed in Chapters 1 and 4, the South African GAAR was amended in 2006 in order to address the weaknesses of its predecessor. However, a comparison of the provisions of the GAAR to its predecessor (in Chapter 4) revealed that many of the provisions are similar (despite the 2006 amendments thereto).

Therefore many of the primary weaknesses of the South African GAAR were those that were identified in its predecessor. These weaknesses are discussed briefly below. A comparison of the provisions of the GAAR to its predecessor reveals that although additional indicators have been incorporated, both the abnormality and the purpose requirements are still essentially present in the GAAR

### 11.2.1 THE PRIMARY WEAKNESSES OF THE GAAR

The Discussion Document listed the weaknesses as follows:

- **Not an effective deterrent to tax avoidance** – the GAAR frequently failed to stand up to the rigours of court and the significant amount of time and resources committed to detecting and combating these schemes was costly. Lengthy battles over the true nature of transactions had a negative impact on the relationship between SARS and taxpayers (Olivier, 1996:378; SARS, 2005:42). The abnormality and purpose requirements were identified as the most crucial areas of weakness and in addition to the individual problems noted in each of these cases, the effectiveness of the GAAR was further reduced by the fact that the transaction would need to satisfy both criteria before the GAAR would apply. Therefore, by the taxpayer disproving only one of the requirements, the GAAR would fail to stand up to the rigours of the courts (SARS, 2005:43).
- **The “abnormality” requirement** – the Margo Commission (1988) criticised the abnormality requirement due to the fact that if a particular transaction was widely used, it became normal through the extensive use of such transactions (Williams, 1997; SARS, 2005; Werksmans, 2006). More recently, these criticisms have again been noted (despite amendments since 1986) because the commercial acceptability of a transaction would result in the abnormality test not being satisfied, regardless of the fact that the transaction may have been entered into solely for the avoidance of tax (Olivier, 1997:742). This, in essence, rendered the GAAR an ineffective deterrent for tax avoidance (Williams, 1997; SARS, 2005).
- **The “purpose” requirement** - the purpose requirement was similarly criticised since obtaining a tax benefit would need to be the sole or main purpose of the transaction (Brincker, 2001:163). The relative ease with which taxpayers were able to justify the commercial purpose of transactions left SARS in the difficult position of having to prove that the dominant purpose of the transaction would be to obtain a tax benefit (SARS, 2005:43).

- **Procedural and administrative issues** - additional concerns raised relate to the uncertainties with regard to the scope of the GAAR. Firstly, there was uncertainty about the extent to which the GAAR could be applied to individual steps in a larger transaction. Secondly, there was uncertainty as to whether the Commissioner had the authority to apply the GAAR in the alternative where another provision in the Income Tax Act applied (SARS, 2005:44).

In addition to these weaknesses additional areas for improvement were noted from the results of the doctrinal and reform-oriented research performed in this study. The areas where these further weaknesses could be addressed were consolidated in Chapter 10 and are discussed briefly below.

### **11.2.2 AREAS REQUIRING AMENDMENT**

During the third and final phase of the research it was noted many of the suggestions made in phase 1 (doctrinal research) were also identified in phase 2 (reform oriented research) and indicates that there was strong validation of the findings on the GAAR. The primary amendments that were proposed to improve the effectiveness of the South African GAAR included:

- The sole or main purpose requirement should be amended in order to ensure that this is applied as an objective test, without consideration to the subjective intention of the taxpayer. Therefore the objective facts should inform the decision regarding the sole or main purpose requirement.
- The sole or main purpose requirement and the tainted elements requirement (previously the abnormality requirement) were proposed as a single inquiry for sole or main purpose, but informed by a consideration of objective factors. This was done in a similar manner as the Australian GAAR so that the tainted elements could inform the sole or main purpose requirement.
- A consideration of additional factors, such as the manner and timing of the arrangement, for purposes of informing the sole or main purpose requirement, was also proposed in order to allow more objective factors to be considered, rather than the narrowly defined South African elements. As a result, characteristics of the scheme under attack could be considered, that would lead to a more accurate conclusion on the sole or main purpose of the arrangement.

In addition to changes to the GAAR itself, Phase 3 of the research identified that there were instances where additional guidance was suggested in order to improve the effectiveness of the South African GAAR. These proposals included:

- Guidance should be provided on the application of the GAAR to steps within a wider transaction. This guidance should aim to determine the impact this will have upon the commercial substance of the arrangement as a whole.
- It is suggested that a list of items, for purposes of identifying a tax benefit, could be included in guidance provided on the South African GAAR. This should aim to maintain the strength of the current definition, but add items specifically included as a tax benefit to prevent a narrow interpretation in future.
- It is suggested that guidance be provided for purposes of quantifying a tax benefit by calculating the difference between the tax effect of the scheme and the identified alternative.
- Guidance should be provided in order to prevent taxpayers from artificially creating the circumstances necessary to take advantage of a specific provision of the Act. This could be provided as part of the guidance required for purposes of identifying the misuse or abuse of the Act in order to gain clarity and to ensure that taxpayers who use provisions in the legislation to attain a tax benefit are doing so legitimately without artificially creating the circumstances necessary to do so.
- Introducing guidance with regard to the use of the most reasonable alternative to be applied in calculating the tax benefit will result in a consideration of how the taxpayer might reasonably have been expected to have structured the transaction and thereby eliminate the ability of a taxpayer to suggest an alternative that is not reasonable (i.e. not normal). This may resolve further issues with the abnormality requirement.
- Guidance on the misuse or abuse element should be provided in order to reduce uncertainty and aid in the application of this test.
- Guidance should be provided in order to clarify the impact of special relationships between parties for purposes of applying the individual requirements of the GAAR.
- Additional guidance is required for purposes of interpreting and applying each of the indicators of the lack of commercial substance.

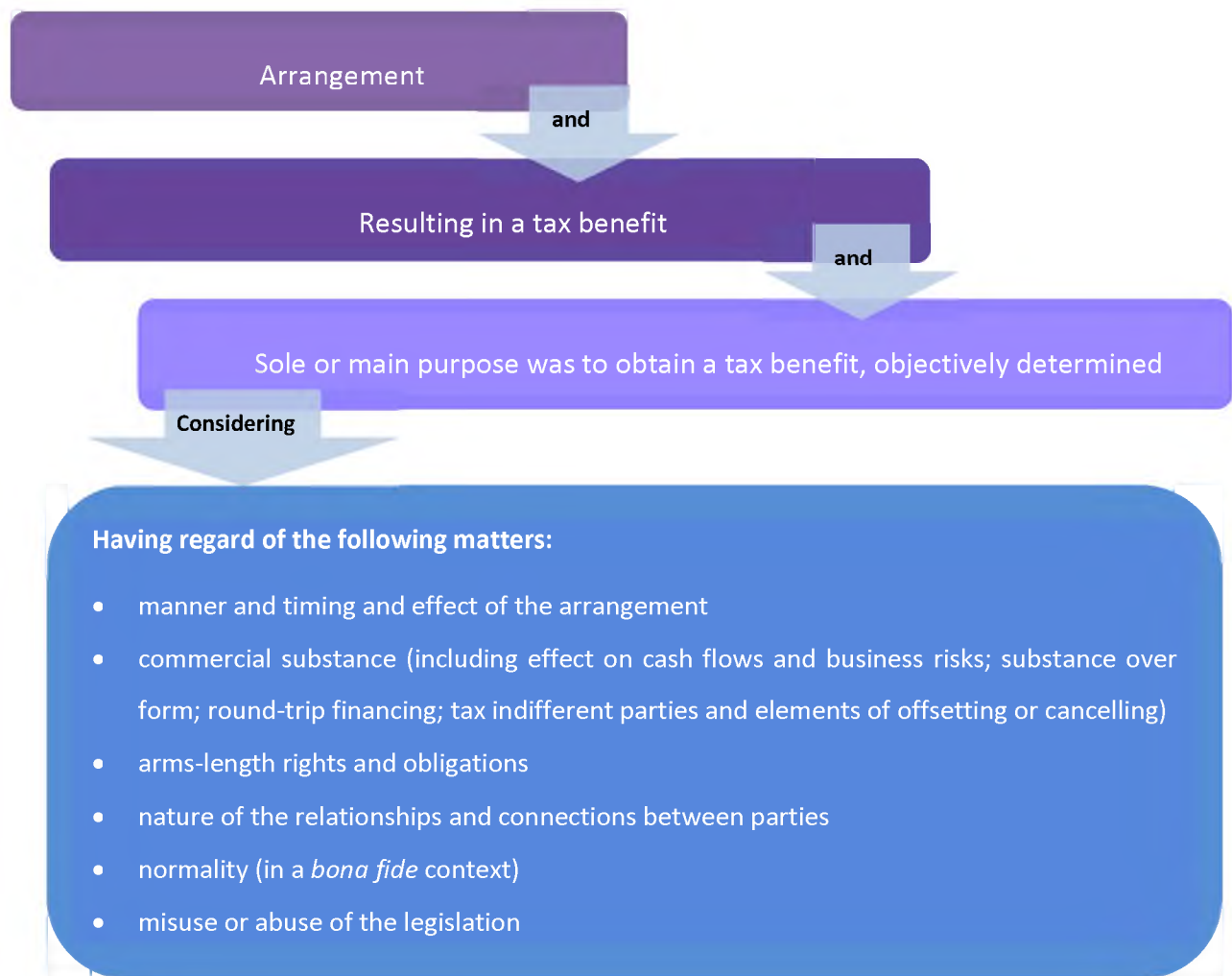


As a result of these proposals for improving the South African GAAR it is submitted that all of the weaknesses have been addressed in some manner. Therefore the results and proposals from the research performed in phases 1 and 2 of this study allow for an improved South African GAAR. The proposed structure of the South African GAAR resulting from this study is included below:

- A transaction, operation or scheme must be present (arrangement).
- The transaction, operation or scheme must result in a “tax benefit” (avoidance arrangement).
- The sole or main purpose of the transaction, operation or scheme must be to obtain the tax benefit, objectively determined having regard of the following matters:
  - The manner in which the arrangement was entered into or carried out;
  - The time that the arrangement was entered into and the length of time during which the arrangement was carried out;
  - The effect of the arrangement on the financial position of the taxpayer or parties to the arrangement;
  - The commercial substance of the arrangement (including effect on cash flows and business risks; substance over form of the arrangement; round-trip financing; tax indifferent parties and elements of offsetting or cancelling);
  - The arms-length nature of the rights and obligations arising between parties;
  - The nature of the relationships and connections between parties to the arrangement;
  - The normality of the arrangement in a *bona fide* context;
  - Any misuse or abuse of the legislation; and
  - Any other consequences or matters resulting from the arrangement.

The proposed structure of the GAAR is represented as follows in Figure 25 below:

FIGURE 25 DETAILED PROPOSED GAAR STRUCTURE



Source: Own design

It is, however, noted that the majority of suggestions and proposals made with regard to the South African GAAR constitute aspects where further guidance is required. Therefore, while it may not be necessary to amend the legislation for these areas, the additional guidance noted is required in order to allow correct interpretation of the GAAR in terms of the purposive approach to interpretation of legislation. Nevertheless additional items for consideration were also noted as a result of this study. These additional items noted in the reform-oriented research included:

- The importance of identifying the correct arrangement in order to prevent the non-application of the remaining elements of the GAAR.
- Identifying alternative arrangements for purposes of the tax benefit requirement could also yield positive results in providing evidence for the sole or main purpose requirement.
- The importance of the presumption of purpose introduced in section 80G of the Income Tax Act.

It remains important to understand that there is lack of consensus on how an effective GAAR should be designed that will still allow a taxpayer the freedom to arrange his affairs so as to legitimately avoid tax. Given this and the uncertainties regarding impermissible tax avoidance, any GAAR will inherently involve an element of uncertainty.

In conclusion, this chapter meets the key objective of the study by proposing amendments and guidance for the South African GAAR in order to overcome its weaknesses.

### **11.3 CASE OUTCOMES AND ADDITIONAL CONSIDERATIONS**

The individual results from the application of the South African GAAR to the facts of the cases in Australia and Canada were discussed in Chapters 8, 9 and 10. As a result of this research it was submitted that the South African GAAR would have been applied successfully to all four of the Canadian cases and three of the four Australian cases. The only case that did not satisfy the requirements of the South African GAAR was the *Commissioner of Taxation v Peabody* (1994) HCA 43. However, a similar result was experienced in Australia when this case was brought before the High Court of Australia. Therefore it would seem that the South African and Australian GAARs may be equally effective at combatting impermissible tax avoidance.

In Canada the Canadian GAAR was not successfully applied in the case of *Canada Trustco Mortgage Company v Canada* (2005) SCC 54, while it was argued that the framework for the South African GAAR would have applied successfully. Therefore, it would seem that the South African GAAR is better equipped to combat impermissible tax avoidance than the Canadian GAAR. However, the primary reason for the failure to apply the Canadian GAAR successfully in this case related to the misuse or abuse indicator. In this regard the Supreme Court of Canada found that the legislation relied on by the taxpayer was not applied outside the object, spirit or purpose of individual provisions. However, analysing the

intention of the legislature for purposes of the South African GAAR it was contended that while the taxpayer did not explicitly misuse the legislation they artificially created the circumstances necessary to use this provision. In light of this it was submitted that there was a misuse or abuse of the Act for purposes of the South African GAAR. However, due to the lack of guidance with regard to the application of the misuse or abuse element it is impossible to determine if the South African courts would assess misuse or abuse in terms of the individual provision relied on by the taxpayer, or apply this element with regard to artificially creating the circumstances necessary to use the provision.

While these high-level comparisons are useful, it is submitted that the true value of the research performed in Phase 2 of the study was that related to individual aspects of the GAAR. Individual aspects that were noted are as follows:

- The importance of the arrangement and tax benefit requirements should not be overlooked when attacked by the revenue authority as an attack of the incorrect arrangement (wider or narrower, or part thereof) will impede the ability of the revenue authority to apply the remaining four requirements of the South African GAAR. Similarly, the incorrect identification of the tax benefit resulting from the arrangement (or even the identification of the incorrect party for purposes of the tax benefit) will seriously impact the application of the sole or main purpose requirement and certain aspects of the tainted elements requirement.
- It may not always be easy for the Commissioner to identify an alternative arrangement that could have achieved the same commercial outcomes for purposes of the tax benefit requirement as an arrangement may be specifically designed for the taxpayer's needs using a substantial input of time and resources. The subjectivity regarding the viability of the identified alternative also introduces an opportunity for taxpayers to defend their position with relative ease and places the taxpayers in a position of power. In this context it is also necessary to consider that the alternative transactions may also become relevant for purposes of the abnormality element because the alternative transactions can be considered to be examples of "normal" transactions in the absence of a tax consideration. Therefore the identification of reasonable alternative transactions by the Commissioner may play an important role for more than just the tax benefit requirement and should not be underestimated.

- If the sole or main purpose requirement is not considered to be an objective test taxpayers may contend that they did not have a tax motive in structuring the arrangement as they followed the advice of their advisors. In this instance there is a possibility that the tax knowledge of the taxpayer would then become a relevant consideration that could result in the application of the GAAR in favour of the taxpayer. This would be destructive to the GAAR, as many taxpayers who intend to enter into complex transactions often seek the advice of professional advisors and could use this as a means to avoid the application of the GAAR.
- In cases where the arrangement was highly artificial in nature, the misuse or abuse of the Act element is more likely to be met. Therefore, while there is considerable debate regarding the misuse or abuse element, it is easily satisfied where elements of artificiality are present in the arrangement.
- In instances where parties to an arrangement are connected to each other, additional concerns arise as the parties may share in the benefits related to the group/family as a whole and not individually. Therefore, these shared benefits may impact upon the assessment of the intention, risks, benefits and alternatives (related to the lack of commercial substance element) for the arrangement. It is questionable whether these benefits should be disregarded in such arrangements, as this does not seem to be consistent with the intention of the GAAR. Further, in applying the substance over form test in a situation where the parties are connected to each other, it is arguable that the intentions shared by senior management in a group may inherently be shared by the other entities in the group.
- Section 80G of the Income Tax Act, which creates the presumption of purpose, does add strength to the South African GAAR because it may reduce the amount of time and resources required for the Commissioner to invest in cases where the taxpayer fails to demonstrate that the sole or main purpose of the arrangement was not to achieve the tax benefits. .

The above findings were valuable for purposes of proposing amendments to the South African GAAR and it was also noted that Canada employs a GAAR Committee, while Australia employs a GAAR panel in order to advise on any cases that are considered to be impermissible before being presented before the courts. In this regard it was submitted that the use of such a process in the South African context would be valuable in order to prevent certain cases from being brought before the courts where it is doubtful if the GAAR would be successfully applied. This would reduce the amount of time and resources spent on litigation and would improve the relationships between SARS and taxpayers by avoiding unnecessary lawsuits.

## **11.4 CONTRIBUTION OF THE RESEARCH**

The contribution made by the study lies in the outcomes of the critical comparisons between the South African, Australian and Canadian GAARs in the study. Further, the recommendations for improvement of the South African GAAR also contribute to the discourse on the topic. The study has also made a contribution to both the theoretical and practical application of the South African GAAR by virtue of the development and application of the framework for the South African GAAR.

A methodological contribution is also made in using both doctrinal and reform-oriented methodologies to triangulate results.

In addition to the above, an article was published during the course of the study in the Journal of the Australasian Tax Teachers Association entitled “GAARs in Australia and South Africa: Mutual Lessons” (Calvert and Dabner, 2012). This research was performed in conjunction with a peer researcher in Australia, where the authors examined the South African and Australian GAAR’s in order to identify if any lessons for their application and interpretation could be gathered. This provides evidence of the contribution of the present research.

## **11.5 LIMITATIONS**

As highlighted in Chapter 3 there are certain limitations to this study. The first of these limitations arises from the use of cases in Phase 2 of the research, since it is difficult to generalise the outcomes of the study when using cases. However, there is an argument that the findings of these cases may be indicative of characteristics included in the population of cases as a whole. This study therefore cannot be used to address all possible cases that may come before the courts, but provides insight into the practical workings of the South African GAAR. The following additional limitations of the study have been identified:

- The study is South African specific because it only addresses the current GAAR in a South African context and thus provides limited use for other jurisdictions/countries not used in this study.
- The use of interpretation of statutes in the context of this study introduces possible subjectivity.

The subjectivity with regard to the interpretation of statutes was limited as far as possible as described in Chapter 3 for purposes of applying the South African GAAR to the Australian and Canadian cases. Additional measures taken to limit bias and subjectivity included:

- The use of two different methodological approaches in the form of both doctrinal and reform-oriented research. The use of these two approaches had the advantage of allowing knowledge gained from the doctrinal research to be compared with the knowledge gained from the reform-oriented research. More significantly, since the results of the two methodologies converged, there was a validation of the findings on the South African GAAR.
- These two methodologies were conducted in three separate phases in order to allow for comparisons between the results.
- An objective methodology was applied in selecting the cases for the purposes of phase 2 of the study as described in Chapters 8 and 9.
- The population of cases for Australia and Canada, that provided the platform from which the cases were selected was obtained from impartial sources;
- The case law documentation obtained from objective sources contained the full facts and details of the cases as used in the Australia and Canada and a purposive approach was used when interpreting the legislation and applying it to the facts of the cases.

Notwithstanding, it is important to note that decisions in courts are derived from the views of judges where subjectivity may also be introduced. This subjectivity is thus inherent to the interpretation of statutes, but by using a detailed literature review in the form of doctrinal research the study provided insight into the workings of the South African GAAR on a consistent basis by the use of the framework described in Chapter 4.

## **11.6 FURTHER RESEARCH**

During the course of this study additional potential topics have been identified for future research:

- A study could be performed to compare the South African GAAR to the GAARs of other countries/jurisdictions where their GAARs are perceived to be working effectively. This may be

useful to aid in suggesting improvements that may be made to the South African GAAR by identifying additional areas for improvement.

- A study could be performed that will determine the impact of common law principles on the South African GAAR. This could empower the Commissioner to determine which cases should be attacked under these common law principles, as opposed to the use of the GAAR.
- A study could be performed to determine the impact and effectiveness of introducing penalties for arrangements that fall foul of the GAAR, as a tool for discouraging taxpayers from entering into these arrangements.

## **11.7 CONCLUSION**

In conclusion, it is submitted that there are many areas where the South African GAAR can be improved. Areas of improvement are not limited to legislative changes but also include guidance on the interpretation and application of the GAAR. Admittedly, the uncertainty that characterises the South African GAAR may act as a deterrent, due to the fact that some taxpayers may be apprehensive about entering into arrangements that test the boundary between permissible and impermissible avoidance. However this uncertainty may also lead to restrictive judicial interpretations seeking to protect the right of taxpayers to avoid tax. While it is recognised that extensive judicial interpretation is not necessarily harmful to the effectiveness of a GAAR, it can be argued that there is a relationship between this judicial interpretation and the introduction of inconsistent interpretation.

The results of this study suggest that the primary legislative amendments would include changing the sole or main purpose requirement to an objective test without a consideration to the subjective intent of the taxpayer. However, objective facts should inform the decision regarding the sole or main purpose requirement in a manner that combines the tainted elements requirement with the sole or main purpose requirement in a similar manner to the Australian GAAR. Additional objective factors should also be considered in this test, such as the manner and timing of the arrangement, which increases the scope of factors to be considered rather than the narrowly defined South African tainted elements. As a result, characteristics of the arrangement could be considered, that would lead to a more accurate conclusion on the sole or main purpose of the arrangement. In addition, the introduction of a GAAR Panel or Committee to advise on cases before litigation commences would also aid in improving the efficacy of the GAAR.



## REFERENCES

### *Cases*

- African Life Investment Corporation (Pty) Ltd v Secretary for Inland Revenue* (1969) (4) SA 259 (A).
- Ashwick (Qld) N 127 Ltd v Commissioner of Taxation* (2009) ATC 20.
- Ayrshire Pullman Motor Services and DM Ritchie v IRC* (1929) 14 TC 754.
- BC Plant Hire CC t/a BC Carriers v Greenco (SA) (Pty) Ltd* (2004) 1 All SA 612 (C).
- Canada v Imperial Oil Ltd* (2004) FCA 36.
- Canada v Jabin Investments Ltd* (2003) 2 CTC 25.
- Canada v ProduitsForestiers Donohue Inc* (2002) FCA 422
- Canada Trustco Mortgage Company v Canada* (2005) SCC 54.
- Commissioner for Inland Revenue v Bobat and Others* (2003) 67 SATC 47.
- Commissioner for Inland Revenue v Challenge Corporation* (1987) AC 155.
- Commissioner for Inland Revenue v Conhage (Formerly Tycon)* (1999) (4) SA 1149 (SCA).
- Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) 61 SATC 391.
- Commissioner for Inland Revenue v Delfos* (1933) 6 SATC 92 (A).
- Commissioner for Inland Revenue v Estate Kohler* (1953) 18 SATC 354.
- Commissioner for Inland Revenue v King* (1947) 2 SA 196 (A).
- Commissioner for Inland Revenue v Louw* (1983) 2 All SA 291 (A).
- Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A).

*Commissioner for Inland Revenue v Middelman* (1989) 52 SATC 323.

*Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* (1990) (2) SA 353 (A).

*Commissioner of Inland Revenue v BNZ Investments* (2002) 1 NZLR 450.

*Commissioner for South African Revenue Service v Airworld CC and another* (2008) 2 All SA 593 (SCA).

*Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd* (1999) 62 SATC 65.

*CSARS v NWK Ltd* (2011) 2 All SA 347 (SCA).

*Commissioner for South African Revenue Service v NWK Limited* (2010) ZASCA 168 (SCA).

*Commissioner of Customs and Excise v Randles Bros & Hudson Ltd* (1941) 33 SATC 48 (AD).

*Commissioner of Taxation v Ashwick (Qld) No 27 Pty Ltd* (2011) FCAFC 49.

*Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 47 ATR 229.

*Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) HCA 32.

*Commissioner of Taxation v Hart* (2004) HCA 26.

*Commissioner of Taxation v Mochkin* (2003) 52 ATR 198.

*Commissioner of Taxation v News Australia Holdings Pty Ltd* (2010) 79 ATR 461.

*Commissioner of Taxation v Peabody* (1994) HCA 43.

*Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183.

*Commissioner of Taxation v Spotless Services Ltd* (1996) HCA 34.

*Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA).

*Cophorne Holdings Ltd v The Queen* (2011) SCC 63.

*Craven (Inspector of Taxes) v White and Related Appeals* (1988) 3 All ER 495.

*Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330.

*Deputy Commissioner of Taxation v Richard Walter Pty Ltd* (1995) HCA 23.

*DFC of T v Purcell* (1921) 29 CLR 464.

*Eastern Nitrogen Ltd v Commissioner of Taxation* (2001) 108 FCR 27.

*Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996) (3) SA 942 (A).

*Evans v. R* (2005) TCC 684.

*Federal Commissioner of Taxation v Hancock* (1961) AITR 328.

*Federal Commissioner of Taxation v Hart* (2004) 55 ATR 712.

*Federal Commissioner of Taxation v Gulland* (1985) HCA 83.

*Federal Commissioner of Taxation v Metal Manufactures Ltd* (2001) 108 FCR 150.

*Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359.

*Federal Commissioner of Taxation v Sleight* (2004) 55 ATR 555.

*Furniss v Dawson* (1984) 1 All ER 530 (HL).

*Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A).

*Gregory v Helvering* (1935) 293 US 465.

*Hancock v Federal Commissioner of Taxation* (1959) 7 AITR 582.

*Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A).

*Hiddingh v Commissioner for Inland Revenue* (1941) AD 111.

*Husky Oil Ltd v Canada* (1998) 99 DTC 308 (TCC).

*IRC v Brebner* (1967) 1 All ER 779.

*IRC v Duke of Westminster* (1936) 19 TC 490.

*IRC v Wesleyan Assurance Society* (1948) 1 All ER 555 (HL).

*Imperial Oil Ltd v Canada; Inco Ltd v Canada* (2006) SCC 46.

*Income Tax Case No 777* (1953) 19 SATC 320.

*Income Tax Case No 1396* (1984) 47 SATC 141.

*Income Tax Case No 1476* (1989) 52 SATC 141.

*Income Tax Case No 1496* (1990) 53 SATC 229.

*Income Tax Case No 1582* (1994) 57 SATC 27.

*Income Tax Case No 1606* (1995) 58 SATC 328.

*Income Tax Case No 1607* (1995) 58 SATC 340).

*Income Tax Case No. 1625* (1996) 59 SATC 383.

*Income Tax Case No 1636* 60 SATC 267.

*John v Commissioner of Taxation* (1989) HCA 5

*Kilburn v Estate Kilburn* (1931) AD 501.

*Kommissaris van die Suid-Afrikaanse Inkomisdienste v Botha* (2000) 62 SATC 264 (O).

*Lategan v Commissioner for Inland Revenue* (1926) CPD.

*Maize Board v Hart* (2006) JOL 16857 (SCA).

*Maize Board v Jackson* (2005) JOL 15614 (SCA).

*Mathew v Canada* (2005) SCC.

*Matrix–Securities Ltd v Inland Revenue Commissioners* (1994) 1 All ER 769.

*Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A).

*Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290.

*Nedcor Bank Limited v ABSA Bank Limited* (1998) (2) SA 830 (W).

*Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1.

*OSFC Holdings Ltd. v. The Queen* (2001) DTC 5471.

*Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A).

*Peate v Federal Commissioner of Taxation* (1963) ALR 354.

*Placer Dome Canada Ltd. v Ontario* (2006) SCC 20.

*Pridecraft Pty Ltd v Commissioner of Taxation* (2004) 58 ATR 210.

*R Ltd and K Ltd v Commissioner of Taxes* (1983) 45 SATC 148 (ZH).

*RCI Pty Ltd v Federal Commissioner of Taxation* (2011) 84 ATR 785.

*Relier v Commissioner for Inland Revenue* (1997) 60 SATC 1 (A).

*Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 3 All SA 540 (A).

*Secretary for Inland Revenue v Gallagher* (1978) 40 SATC 39 (A).

*Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314.

*Smith v Commissioner for Inland Revenue* (1964) 26 SATC 1 (A).

*Stubart Investments Ltd v The Queen* (1984) CTC 294.

*Water's Edge Village Estates (Phase II) Ltd. v. Canada (C.A.)* (2002) FCA 291.

*WD & HO Wills (Aust) Pty Ltd v Commissioner of Taxation* (1996) 32 ATR 186.

*Weston's Settlements* (1968) 3 W.L.R. 786 (H.L.) (Eng.).

*WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66.

*WT Ramsay Ltd v Inland Revenue Commissioners* (1981) 1 All ER 865 (HL).

*Books, journals and other references*

- ALARIE, B. 2010. "Trebilock on tax avoidance", **The University of Toronto Law Journal**, 60: 623-642.
- ALLEY, C. and BENTLEY, D. 2008. The increasing imperative of cross-disciplinary research in tax administration. **eJournal of tax Research** [On line], Vol 6. No 2. Available: [https://www.business.unsw.edu.au/research-site/publications-site/ejournaloftaxresearch-site/Documents/paper3\\_v6n2.pdf](https://www.business.unsw.edu.au/research-site/publications-site/ejournaloftaxresearch-site/Documents/paper3_v6n2.pdf) [accessed 27/02/2015].
- ARENDSE, J. 2006. "Let's talk about tax avoidance", **Accountancy SA**, 521(1): 26-31.
- ARNOLD, B. 1995. "The Canadian general anti-avoidance rule", **British Tax Review**: 541.
- ARNOLD, B.J. 2004. "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule", **Canadian Tax Journal**, 52: 488.
- ASPREY, K.W. 1975. **Report of the Australian Taxation Review Committee**. Canberra.
- AUSTRALIA. 1999. **Final Report of the Review of Business Taxation, A Tax System Redesigned**. Canberra: Australian Government Printing Service.
- AUSTRALIAN GOVERNMENT: AUSTRALIAN TAX OFFICE. 2017. Franking Credits. [On line]. Available: <https://www.ato.gov.au/Non-profit/Your-organisation/Investments,-credits-and-refunds/Franking-credits/> [accessed 26/07/2017].
- AUSTRALIAN TAX OFFICE. 2008. **Identification of an aggressive tax planning arrangement**. Available: <http://law.ato.gov.au/atolaw/view.htm?locid=%27PSR/PS200815/NAT/ATO%27&PiT=20101112000001>.
- BABBIE, E. and MOUTON, J. 2009. **The Practice of Social Research**. Cape Town: Oxford University Press Southern Africa.
- BARKER, W.B. 2009. "The Ideology of Tax Avoidance", **Loyola University Chicago Law Journal**, 39 U. Loy. Chi. L. Rev. 229.
- BARCOCZY, S. 2010. **Australian tax casebook**. North Ryde, N.S.W.: North Ryde, N.S.W. : CCH Australia.

- BERUBE, M., JOST, D., et al. 1995. **Webster's II: New College Dictionary**. Second ed. New York: Houghton Mifflin Company.
- BRINCKER, E. 2001. "The purpose requirement of the general anti-avoidance provision in South African fiscal law", **Journal of South African Law**, 2001(1): 158-168.
- BROOMBERG, E.B. 2007a. **The new General Anti-Avoidance Rule**. SAFA Seminar, 6 March 2007a, Cape Town.
- BROOMBERG, E.B. 2007b. "Tax avoidance then and now", **Tax Planning Corporate and Personal**, 21.
- BROOMBERG, E.B. 2007c. "Then and now II", **Tax Planning Corporate and Personal**, 21.
- BROOMBERG, E.B. and KRUGER, D. 1998. **Tax Strategy**. Durban: Butterworths.
- BROWN, K.B. 2012. **A comparative look at regulation of corporate tax avoidance**. Dordrecht New York: Springer.
- BUTTERFIELD, J., SUMMERS, E., et al. 2003. **Collins English Dictionary: Complete and unabridged**. Sixth ed. Great Britain: HarperCollins Publishers.
- CALVERT, T. and DABNER, J.H. 2012. "GAARs in Australia and South Africa: mutual lessons", **Journal of the Australasian Tax Teachers Association**, 7.
- CALVERT, T.M. 2011. **An analysis of the 2006 amendments to the General Anti-Avoidance Rules: A case law approach**. Unpublished MCom Mini-dissertation. Potchefstroom: North-West University.
- CANADA REVENUE AGENCY. 2013. **Tax Avoidance**. Canada: Canada Revenue Agency. Available: <http://www.cra-arc.gc.ca/gncy/lrt/vvw-eng.html>.
- CANADA REVENUE AGENCY. 2014. **Canada Revenue Agency Annual Report to Parliament 2013-2014**. Canada: Canada Revenue Agency. Available: <http://www.cra-arc.gc.ca/gncy/nnnl/2013-2014/p4-cmplnc-eng.html>.



- CANADIAN GOVERNMENT. 1988. **Explanatory Notes to Legislation Relating to Income Tax**. Ottawa: Queen's Printer.
- CARTER, K. 1966. **Report of The Royal Commission on Taxation**. Ottawa: Queen's Printer.
- CASSIDY, J. 1995. "Peabody v. FCT and Part IVA. (anti-avoidance provisions) (Australia)", **Revenue Law Journal**, 5: 197-218.
- CHRISTIANS, A. 2014. "Avoidance, evasion, and taxpayer morality", **Washington University Journal of Law & Policy**, 44: 39+.
- CILLIERS, C. 2008. "Thou shalt not peep at thy neighbour's wife: section 80A(c)(ii) of the Income Tax Act and the abuse of rights.", **The Taxpayer**: 85-92.
- CLAASSEN, R.D. 2014. **Dictionary of Legal Words and Phrases**. South Africa: LexisNexis.
- CLEGG, D. and STRETCH, R. 2015. **Income Tax in South Africa**. South Africa: LexisNexis.
- COMMONWEALTH OF AUSTRALIA. 2016. High Court of Australia. [On line]. Available: <http://www.hcourt.gov.au/> [accessed 21/4/2016].
- COOPER, G.S. 1997. **Tax Avoidance and the Rule of Law**. Amsterdam, The Netherlands: IBFD Publications in association with the Australian Tax Research Foundation.
- COOPER, G.S. 2001. "International experience with general anti-avoidance rules.(Business Purpose, Economic Substance, and Corporate Tax Shelters)", **SMU Law Review**, 54: 83-130.
- COUNCIL OF AUSTRALIAN LAW DEANS. 2005. **Statement on the nature of legal research**. Australia. Available: <https://cald.asn.au/wp-content/uploads/2017/11/cald-statement-on-the-nature-of-legal-research-20051.pdf>.
- CRESWELL, J.W. 2007. **Qualitative Inquiry & Research Design: Choosing Among Five Approaches**. London: Sage.
- DABNER, J. 2000. "The spin of a coin - in search of a workable GAAR [General anti-avoidance rule]", **Journal of Australian Taxation**, 3: 232-252.

- DABNER, J. 2013. "Proposed amendments to Part IVA highlight its conceptual flaws ", **CCH Tax Week**: 4.
- DE KOKER, A.P. and WILLIAMS, R.C. 2015. **Silke on South African Income Tax**. Electronic ed. Cape Town: LexisNexis Butterworths.
- DE VOS, A.S. 2011. **Research at Grass Roots : for the Social Sciences and Human Services Professions**. Pretoria: Van Schaik, 2011.
- DELOACH, J.W. 2000. **Enterprise-wide Risk Management Strategies for linking risk and opportunity**. London: Financial Times/Prentice-Hall.
- DENSCOMBE, M. 2007. **The Good Research Guide for Small-Scale Social Research Projects**. England: McGraw-Hill.
- DEPARTMENT OF JUSTICE. 2009. **Uniform rules of court**. Cape Town: Juta and Company Limited. Available: [http://www.justice.gov.za/legislation/rules/UniformRulesCourt\[26jun2009\].pdf](http://www.justice.gov.za/legislation/rules/UniformRulesCourt[26jun2009].pdf).
- DUFF, D. 2006. "The Supreme Court of Canada and the General Anti-Avoidance Rule: Canada Trustco and Mathew", **Bulletin for International Taxation**, 60: 54-71.
- ELLIFFE, C. 2011. "The thickness of a prison wall-when does tax avoidance become a criminal offence?", **New Zealand Business Law Quarterly**, 17: 441-466.
- ERIKSSON, P. and KOVALAINEN, A. 2008. **Qualitative Methods in Business Research**. London: Sage, 2008.
- EUSTICE, J.S. 2002. "Abusive corporate shelters: old "brine" in new bottles", **Tax Law Review**, 55 (135).
- EVANS, C. 2008. "Containing tax avoidance: anti-avoidance strategies", **University of New South Wales Faculty of Law Research Series**.
- FEINSTEIN, K. 1998. Tax Planning: the Ten Commandments. **Integritax Newsletter** [On line], 546. Available: <http://www.saica.co.za/integritax/> [accessed 15/10/2010].

- FREEDMAN, J. 2004. "Defining taxpayer responsibility: in support of a general anti-avoidance principle", **Oxford Legal Studies Research Paper No. 14/2006**.
- FREEDMAN, J. 2011. "Responsive regulation, risk, and rules: applying the theory to tax practice", **University of British Columbia Law Review**, 44.
- GAMMIE, M. 2005. "Barclays and Canada Trustco: further comment from a UK perspective.(Policy Forum: Canada Trustco and Beyond)", **Canadian Tax Journal**, 53: 1047-1052.
- GOLDSWAIN, G.K. 2008. "The purposive approach to the interpretation of fiscal legislation - the winds of change", **Meditari Accountancy Research**, 16(2).
- GOMM, R., HAMMERSLEY, M., et al. 2000. **Case Study Method: Key Issues, Key Texts**. London: Sage.
- GOVERNMENT OF CANADA. **Income Tax Act RSC 1985, C. 1 (5th Supp)**. Canada.
- HAUPT, P. 2013. **Notes on South African Income Tax 2013**. Republic of South Africa: H & H Publications, Hedron Tax Consulting and Publishing CC.
- HOGG P.W., M.J.E.A.L.J. 2010. **Principles of Canadian income tax law**. Toronto: Carswell.
- HONORÉ, T. 1981. "Must we obey? necessity as a ground of obligation", **Virginia Law Review**, 67: 39-61.
- HONORÉ, T. 1993. "The dependence of morality on law", **Oxford Journal of Legal Studies**, 13: 1-17.
- HUTCHINSON, T. and DUNCAN, N. 2012. "Defining and describing what we do: Doctrinal legal research", **Deakin Law Review**, 17: [83]-119.
- KATZ, M. 1996. **Third Interim Report of the Commission of Inquiry into Taxation**. Pretoria: Government Printer.
- KNIGHT, A. and RUDDOCK, L. 2008. **Advanced Research Methodologies in the Built Environment**. United Kingdom: Blackwell.

- KOLITZ, M. 1999. "Tax avoidance: is paying less tax unjust?", **Tax Planning Corporate and Personal**, 13.
- KOLITZ, M. 2000. "Tax avoidance IV: the business purpose test", **Tax Planning Corporate and Personal**, 14.
- KREVER, R. 1997. "The ghost of the Duke of Westminster laid to rest in Australia?", **Canadian Tax Journal**, 45: 122-130.
- KRISHNA, V. 1990. **Tax Avoidance The General Anti Avoidance Rule**. Toronto: Carswell.
- KRISHNA, V. 2002. **The Fundamentals of Canadian Income Tax**. Toronto: Thomson-Carswell.
- KRUGER, D. and SCHOLTZ, W. 2003. **Broomberg on Tax Strategy**. Durban: LexisNexis Butterworths.
- KUHN, T.S. 1996. **The Structure of Scientific Revolutions**. Chicago, IL: University of Chicago Press.
- KUJINGA, B.T. 2013. **A comparative analysis of the efficacy of the General Anti-Avoidance Rule as a measure against impermissible income tax avoidance in South Africa**. Unpublished doctoral thesis. Pretoria: University of Pretoria.
- LEEDY, P.D. and ORMROD, J.E. 2005. **Practical Research: Planning and Design**. New Jersey: Prentice Hall.
- LEHMANN, G. 1983. "The income tax judgments of Sir Garfield Barwick: a study in the failure of the new legalism", **Monash University Law Review**, 9: 115-156.
- LEXUM. 2016a. **CanLII**. Lexum.
- LEXUM. 2016b. **Judgements of the Supreme Court of Canada**. Lexum.
- LIANG, B. 2013. **Comparative Analysis of the United Kingdom Judicial Anti-Avoidance Rule and GAAR of Canada-Lesson for the UK from Canada**. Unpublished doctoral thesis. Lund University.

- LIPTAK, E. 2008. "Battling with Boundaries: The South African GAAR Experience". In: Freedman, J. (ed.) **Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management**. Oxford: Oxford University Centre for Business Taxation.
- LOUW, I. 2007. **The New General Anti-Avoidance Rule: A comprehensive discourse on this statute**. Unpublished postgraduate diploma mini-dissertation. Cape Town: University of Cape Town.
- LYMER, A. and OATS, L. 2009-2010. **Taxation Policy and Practice**. Birmingham: Fiscal.
- MAIN, C.E. 2001. **A comparative analysis of the general anti-tax avoidance provisions of South Africa and selected countries**. Unpublished MCom dissertation. Johannesburg: University of the Witwatersrand.
- MARGO, C.S. 1988. **Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa**. Pretoria: Government Printer.
- MARTIN, E.A. and LAW, J. 2009. **A Dictionary of Law**. Seventh ed. New York: Oxford University Press.
- MCKERCHAR, M. 2004. The study of income tax complexity and unintentional non-compliance: research method and preliminary findings. **A tax Discussion Paper No. 6** [On line]. Available: <http://dx.doi.org/10.2139/ssrn.623627> [accessed 02/03/2015].
- MCKERCHAR, M. 2008. Philosophical paradigms, inquiry strategies and knowledge claims: applying the principles of research design and conduct to taxation. **eJournal of tax Research** [On line]. Available: <http://www.Austrlii.edu.au/au/journals/eJTR/2008/1.html> [accessed 29/07/2013].
- MCMECHAN, R. 2013. **Economic Substance and Tax Avoidance: An International Perspective**. Canada: Carswell.
- MEYEROWITZ, D. 2008. **Meyerowitz on Income Tax**. Cape Town: The Taxpayer.
- NATIONAL TREASURY. 2005. **The GAAR proposal: A National Treasury Perspective**. Pretoria: Government Printer.
- NATIONAL TREASURY. 2006. **Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006**. Pretoria: Government Printer.

NATIONAL TREASURY: REPUBLIC OF SOUTH AFRICA. **Income Tax Act No. 31 of 1941**.  
Pretoria: Government Printer.

NATIONAL TREASURY: REPUBLIC OF SOUTH AFRICA. **Income Tax Act No. 58 of 1962**.  
Pretoria: Government Printer.

NATIONAL TREASURY: REPUBLIC OF SOUTH AFRICA. **Tax Administration Act No. 28 of 2011**. Pretoria: Government Printer.

NATIONAL TREASURY: REPUBLIC OF SOUTH AFRICA. 1996. **Revenue Laws Amendment Act No. 36 of 1996**. Pretoria: Government Printer.

NATIONAL TREASURY: REPUBLIC OF SOUTH AFRICA. 2007. **Revenue Laws Amendment Act No. 20 of 2006**. Pretoria: Government Printer.

OECD. 2010. **Promoting Transparency and exchange of information for tax purposes: A Background information brief**. Paris: OECD Publishing.

OECD. 2015. **Centre for Tax Policy and Administration: Glossary of Tax Terms**. Paris.

OFFICE OF THE AUDITOR GENERAL OF CANADA. 2014. **2014 Spring Report of the Auditor General of Canada**. Canada: Office of the Auditor General of Canada,. Available:  
[http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201405\\_03\\_e\\_39334.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201405_03_e_39334.html).

OFFICE OF THE REGISTRAR OF THE SUPREME COURT OF CANADA. 2016. **Supreme Court of Canada**.

OLIVIER, L. 1996. "Tax avoidance and common law principles", **Journal of South African Law**, 1996(2): 378-383.

OLIVIER, L. 1997. "Tax avoidance: options available to the commissioner for inland revenue", **Journal of South African Law**, 1997(4): 725-745.

OLIVIER, L., DAVIS, D., et al. 2009. **Juta Income Tax**. South Africa: Juta.

- OLIVIER, L. and HONIBALL, M. 2008. **International Tax a South African Perspective**. Cape Town: Siber Ink.
- OROW, N.F. 1998. "Part IVA : seriously flawed in principle", **Journal of Australian Taxation**, 1: 57-78.
- PAYNE, K. 2013. Australia reforms its general anti-avoidance rules. **Australian Tax Brief** [On line]. Available:  
<http://www.minterellison.com/files/Uploads/Documents/Publications/Articles/Australian%20Tax%20Brief%2020130708.pdf> [accessed 29/2/2016].
- PEARCE, D., CAMPBELL, E., et al. 1987. **Australian Law Schools: A discipline Assessment for the Commonwealth Tertiary Education commission, A Summary**. Canberra: Australian Government Publishing Service.
- PICKUP, D. 2008. "In Relation to General Anti-Avoidance Provisions: A Comparative Study of the Legal Frameworks Used by Different Countries to Protect Their Tax Revenues". In: Freedman, J. (ed.) **Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management**. Oxford: Oxford University Centre for Business Taxation.
- PREBBLE, Z. and PREBBLE, J. 2010. "The morality of tax avoidance", **Creighton Law Review**, 43.
- RALPH, J. 1999. **The Review of Business Taxation, A System Redesigned**. Canberra: Australian Government Publishing Service.
- RALPH, O. 1998. "GAAR: Empty threat or deal stopper?", **International Tax Review**, 9(9): 13.
- RAZAK, A.A. 2009. Understanding legal research. **Integration and Dissemination Journal** [On line], 204. Available:  
<http://econ.upm.edu.my/researchbulletin/artikel/Vol%204%20March%202009/19-24%20Adilah.pdf> [accessed 25 August 2013].
- REGAN, J.M.C. 2013. "Tax advisors and conflicted citizens", **Legal Ethics**, 16: 322-349.
- REPUBLIC OF SOUTH AFRICA. **The Constitution of the Republic of South Africa**. Pretoria: Government Printer.

- ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME. 1955. **Royal Commission on the Taxation of Profits and Income: Final Report**. London: HMSO.
- SALTER, M. and MASON, J. 2007. **Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research**. Harlow: Pearson/Longman.
- SARS. 2005. **Discussion paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962**. Pretoria: Government Printer.
- SARS. 2008. **Media Release on New reportable arrangements legislation takes effect**. Johannesburg. Available: <http://www.sars.gov.za/AllDocs/Documents/MediaReleases/2008/SARS-MR-2008-012%20-%20Media%20Release%20on%20New%20reportable%20arrangements%20legislation%20takes%20effect%20-%209%20April%202008.pdf>.
- SARS. 2010. **Draft Comprehensive Guide to the General Anti-Avoidance Rule**. Pretoria: Government Printer.
- SMITH, A. 1776. **An Inquiry into the Nature and Causes of the Wealth of Nations**. London: Printed for W. Strahan and T. Cadell.
- STEPHENSON, J. 1997. **Tax-avoidance after Spotless**. Parliamentary Library: Parliamentary Library.
- STEWART, D.M. 1970. "The prohibition of tax avoidance: an evaluation of section 103 of the South African Income Tax Act (No 58 of 1962)", **The Comparative and International Law Journal of Southern Africa**: 168-196.
- STRETCH, R. and SILKE, J. 2006. "Tax avoidance – revised proposals", **Taxgram**, 4(November/December).
- THOMSON REUTERS. 2017. **Westlaw AU**. Thomson Reuters.
- THURONYI, V. 2003. **Comparative Tax Law**. Netherlands: Kluwer Law International.
- TRIVERS, G. 2014. **The Tax Adviser's Guide to Part IVA**. Australia: The Tax Institute.
- TREASURY: AUSTRALIAN GOVERNMENT. 1981a. **Explanatory Memorandum, Income Tax Laws Amendment Act No. 2 of 1981**. Australia: Government Printer. Available: [https://www.aph.gov.au/binaries/library/pubs/explanmem/docs/1981%20income%20tax%20laws%20amdt%20\(no%202\).pdf](https://www.aph.gov.au/binaries/library/pubs/explanmem/docs/1981%20income%20tax%20laws%20amdt%20(no%202).pdf).



TREASURY: AUSTRALIAN GOVERNMENT. 1981b. **Income Tax Laws Amendment Act No. 2 of 1981**. Australia: Government Printer. Available:  
<https://www.legislation.gov.au/Details/C2004A02487>.

TREASURY: AUSTRALIAN GOVERNMENT. 2013. **Explanatory Memorandum, Tax laws amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013**. Australia: Government Printer. Available:  
<https://www.legislation.gov.au/Details/C2013B00015/Explanatory%20Memorandum/Text>.

TRUMBLE, W.R. and STEVENSON, A. 2002. **Shorter Oxford English dictionary on historical principles**. Fifth ed. New York: Oxford University Press.

VAN SCHALKWYK, L. and GELDENHUYS, B. 2009. "The Income Tax Act. Section 80(c)(ii) of the Income Tax Act: Round-tripping between the draft version and the enacted version - part 1", **Accountancy SA**, 1074(1): 16-19.

WAITE, M. and HAWKER, S. 2009. **Oxford Dictionary & Thesaurus** New York: Oxford University Press.

WALTER, M. 2010. **Social Research Methods**. South Melbourne: Oxford University Press.

WANJIALIN, G. 2004. **An International Dictionary of Accounting and Taxation**. Lincoln: iUniverseInc.

WARDELL-JOHNSON, G. 2014. "The "new" Part IVA", **Tax Specialist**, 17: 118-129.

WEISBACH, D.A. 2002. "Ten truths about tax shelters. (Symposium on Corporate Tax Shelters)", **Tax Law Review**, 55: 215-253.

WERKSMANS, T. 2006. New general anti-avoidance rule in the works. **International Tax Review** [Online], Feb(1). Available:  
<http://ezproxy.lib.monash.edu.au/login?url=http://proquest.umi.com/pqdweb?did=997760081&Fmt=7&clientId=16397&ROT=309&VName=POD> [accessed 27/5/2010].

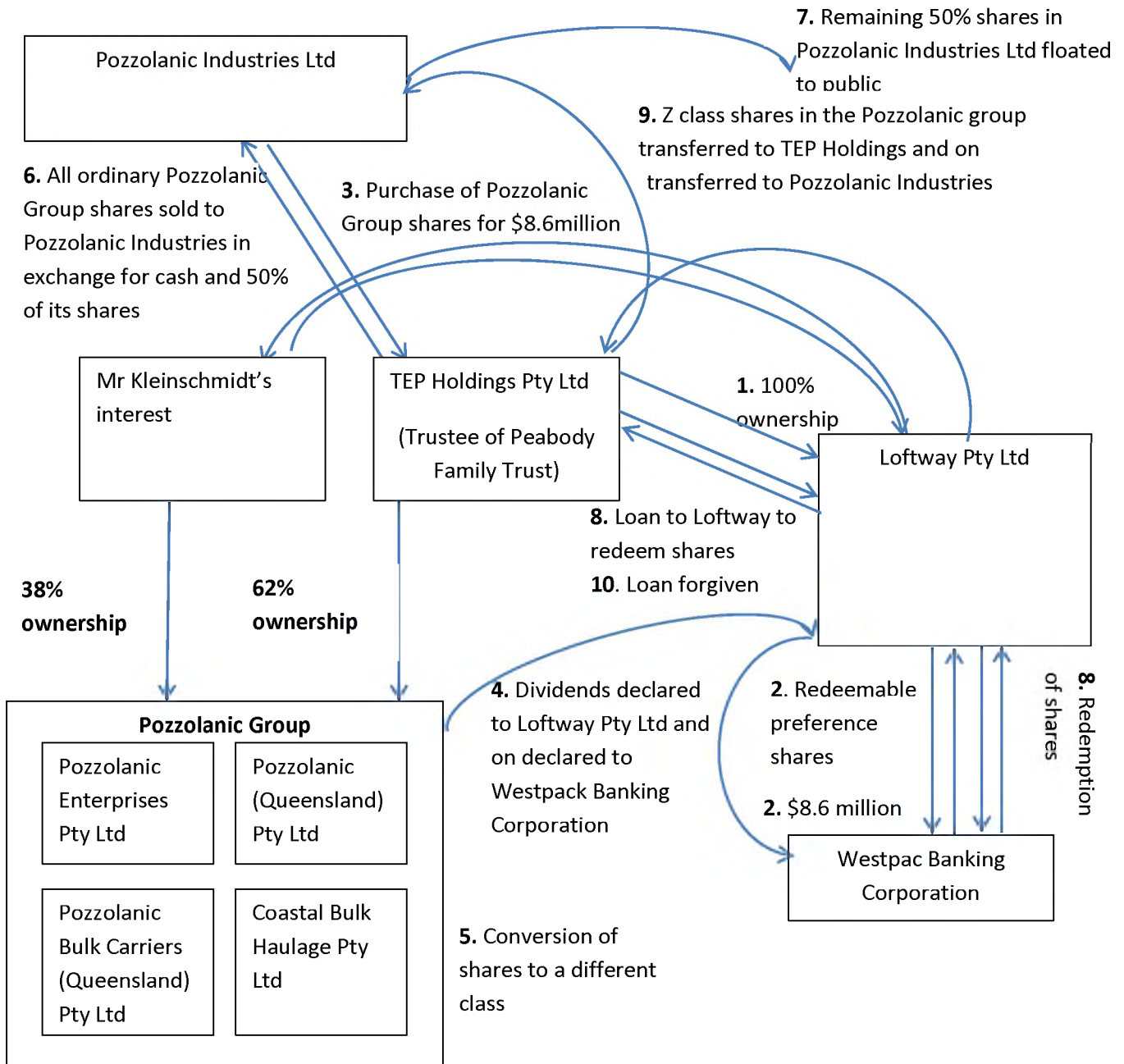
WHEATCROFT, G.S.A. 1955. "The attitude of the courts and the legislature to tax avoidance", **The Modern Law Review**, 18: 209-230.

WILLIAMS, R.C. 1997. "The 1996 amendments to the general anti-avoidance section of the Income Tax Act", **The South African Law Journal**, 114(4): 675-683.

WILLIAMS, R.C. 2005. **Income Tax in South Africa Cases and Materials**. Durban: LexisNexis.

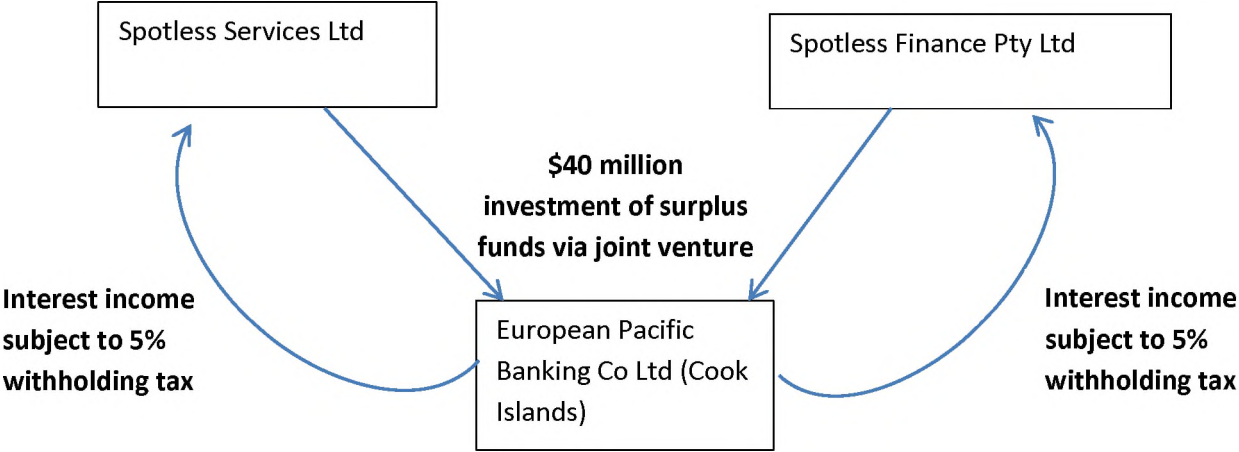
YIN, R.K. 2009. **Case Study Research: Design and Methods**. Los Angeles: Sage.

**APPENDIX A – PEABODY CASE**



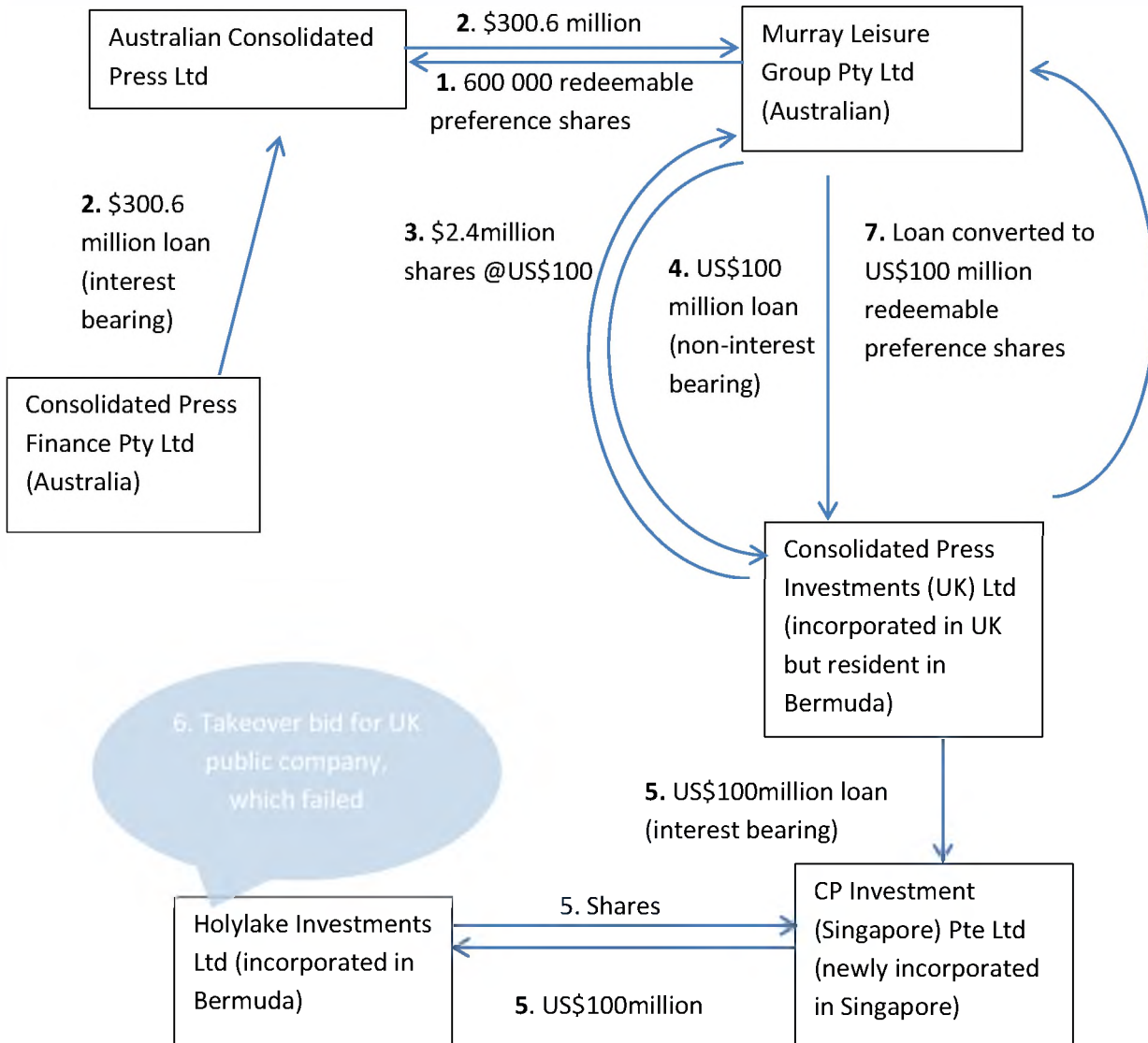
Source: Own design

**APPENDIX B – SPOTLESS SERVICES CASE**



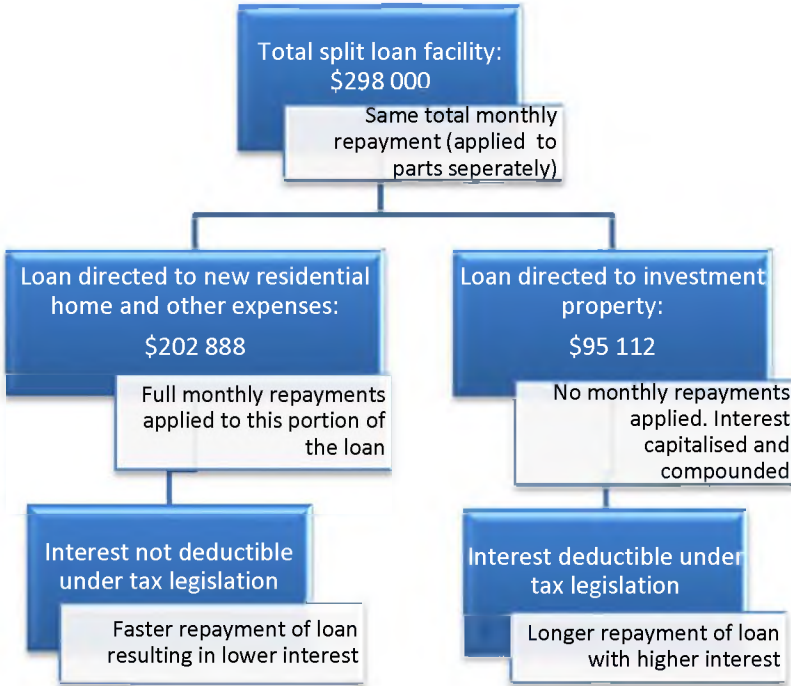
Source: Own design

**APPENDIX C – CONSOLIDATED PRESS HOLDINGS CASE**



Source: Own design

**APPENDIX D – HART CASE**



Source: Own design

**APPENDIX E – FRAMEWORK FOR THE SOUTH AFRICAN GAAR - CASE SUMMARIES (AUSTRALIA)**

<b>Framework for applying sections 80A – 80L to the facts of previous case law</b>	<b>Peabody Case</b>	<b>Spotless Services Case</b>	<b>Consolidated Press Holdings Case</b>	<b>Hart Case</b>
<p><b>1 - Is there an arrangement?</b></p> <ul style="list-style-type: none"> <li>• Is there a transaction, operation or scheme that has been entered into by the taxpayer? Widely interpreted in terms of section 80L of the Act and the <i>Meyerowitz</i> case.</li> </ul>	✓	✓	✓	✓
<p><b>2 - Does the transaction/operation/scheme result in a tax benefit?</b></p> <p>The definition of tax in section 80L is applied to the cases.</p> <ul style="list-style-type: none"> <li>• Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case)</li> <li>• Would a tax liability have existed but for this transaction (but for test)? (<i>Income Tax Case No 1625 (1996) 59 SATC 383</i>; <i>Smith</i> case and <i>Louw</i> case)</li> </ul>	✗	✓	✓	✓

**3 - Is the sole or main purpose to obtain such tax benefit?**

In applying the sole or main purpose requirement of the GAAR to the facts and circumstances of the case studies, the following factors are considered:

- Subjective test – Is it the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (*Gallagher case*)
- Objective test – Does the actual effect of the arrangement support the stated non-tax benefit intention of the arrangement? (Meyerowitz (2008:par.19-12); De Koker and Williams (2015:par.19.38) and *Ovenstone case*)

In applying the objective and subjective tests, the following principles may be considered:

- If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement to obtain the tax benefit? (*Conhage case*); or
- If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracts less tax, this

×	✓	✓	✓
×	×	N/A	✓
✓	×	N/A	✓



<p>does not indicate that obtaining a tax benefit was the sole or main purpose of the arrangement (<i>Conhage</i> case); or</p> <ul style="list-style-type: none"> <li>• If the dominant subjective purpose of the avoidance arrangement was to achieve some non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (i.e. determine what was in the mind of the taxpayer who entered into the transaction).</li> </ul>				
<b>4 - Tainted elements requirement</b>	✓	✓	✓	✓
<p><b>- One of the following with regard to business transactions:</b></p> <p>- <i>Entered into in a manner not normal for bona fide business purposes?</i></p> <ul style="list-style-type: none"> <li>• Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for <i>bona fide</i> business purposes in the absence of a tax consideration? (Louw, 2007:27)</li> </ul> <p>- <i>Does the transaction lack commercial substance?</i></p> <p>In order to determine whether an arrangement lacks commercial substance, the following are applied:</p> <ul style="list-style-type: none"> <li>• <i>General lack of commercial substance test:</i> Does the arrangement have no significant effect upon the net cash</li> </ul>	×	✓	✓	N/A
	×	✓	✓	N/A
	×	×	✓	N//A

flows or business risks? (Section 80C definition and Broomberg, 2007:9)	×	✓	✓	N/A
<ul style="list-style-type: none"> <li>• <i>Substance over form test</i>: Is the true intention of the parties reflected in the agreement (i.e. are the risks and rewards resulting from the transaction those that can be expected from such a transaction)? Has the taxpayer remained insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary? Or is the purpose of a transaction only to achieve an object that achieves the avoidance of tax? (Then it will be regarded as simulated and the mere fact that parties do perform in terms of the contract does not show that it is not simulated.)</li> </ul>				
<ul style="list-style-type: none"> <li>• <i>Round trip financing test</i>: Has funding been transferred between parties, through some type of reciprocal action, resulting directly or indirectly in a tax benefit?</li> </ul>	×	✓	✓	N/A
<ul style="list-style-type: none"> <li>• <i>Tax-indifferent party test</i>: Is there a party who effectively sold its tax advantage to others, irrespective of its relationship with any of the contracting parties?</li> </ul>	×	✓	✓	N/A
<ul style="list-style-type: none"> <li>• <i>Offsetting or cancelling test</i>: Are there elements within the transaction that have the effect of offsetting or cancelling each other? (This indicates that such parts of the transaction</li> </ul>	×	×	✓	N/A

<p>were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance.)</p>				
<p><b>- The following with regard to transactions not in the context of business:</b></p>	N/A	N/A	N/A	✓
<p>- <i>Has the arrangement been entered into in a manner not normal for bona fide purposes?</i></p> <ul style="list-style-type: none"> <li>• Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for <i>bona fide</i> business purposes in the absence of a tax consideration? (Louw, 2007:27)</li> </ul>	N/A	N/A	N/A	✓
<p><b>- One of the following with regard to transactions in any context:</b></p>				
<p>- <i>Has the arrangement created rights and obligations that are not at arm's length?</i></p> <p>The non-arm's-length rights or obligations element will not be met if one of the following factors is present:</p> <ul style="list-style-type: none"> <li>• Each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves? (<i>Hicklin</i> case)</li> <li>• Unconnected persons would not have done the same in this situation? (<i>Hicklin</i> case)</li> </ul>	✓	✗	✓	✓
	✓	✗	✓	✓
	✓	N/A	✓	N/A
<p>- <i>Is there misuse or abuse of provisions of the Act?</i></p>				

- Does the arrangement frustrate, exploit or manipulate the purpose of any of the provisions of the Act, or does the arrangement use provisions of the Act to achieve a result not intended by the legislator?

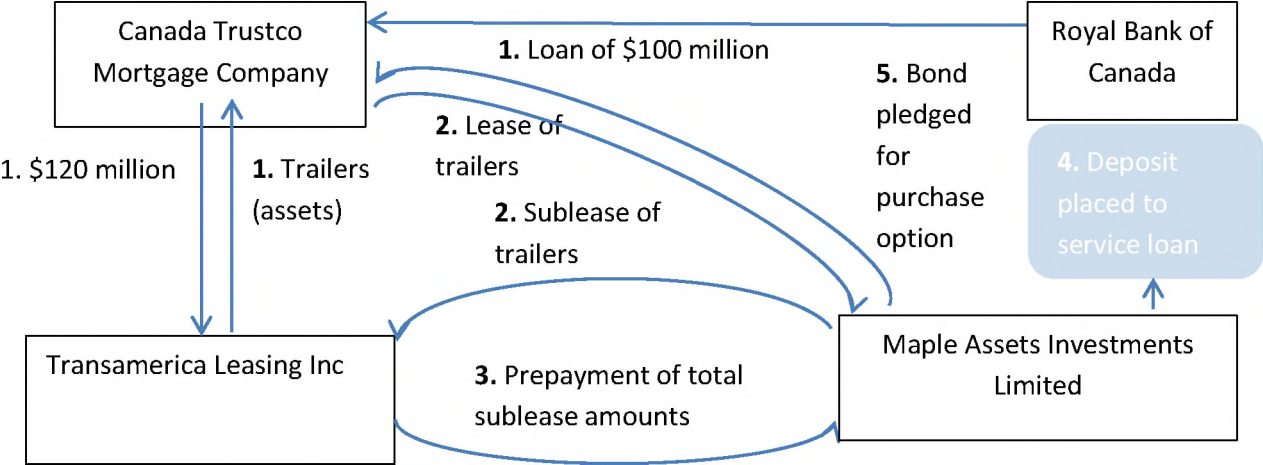
×

×

✓

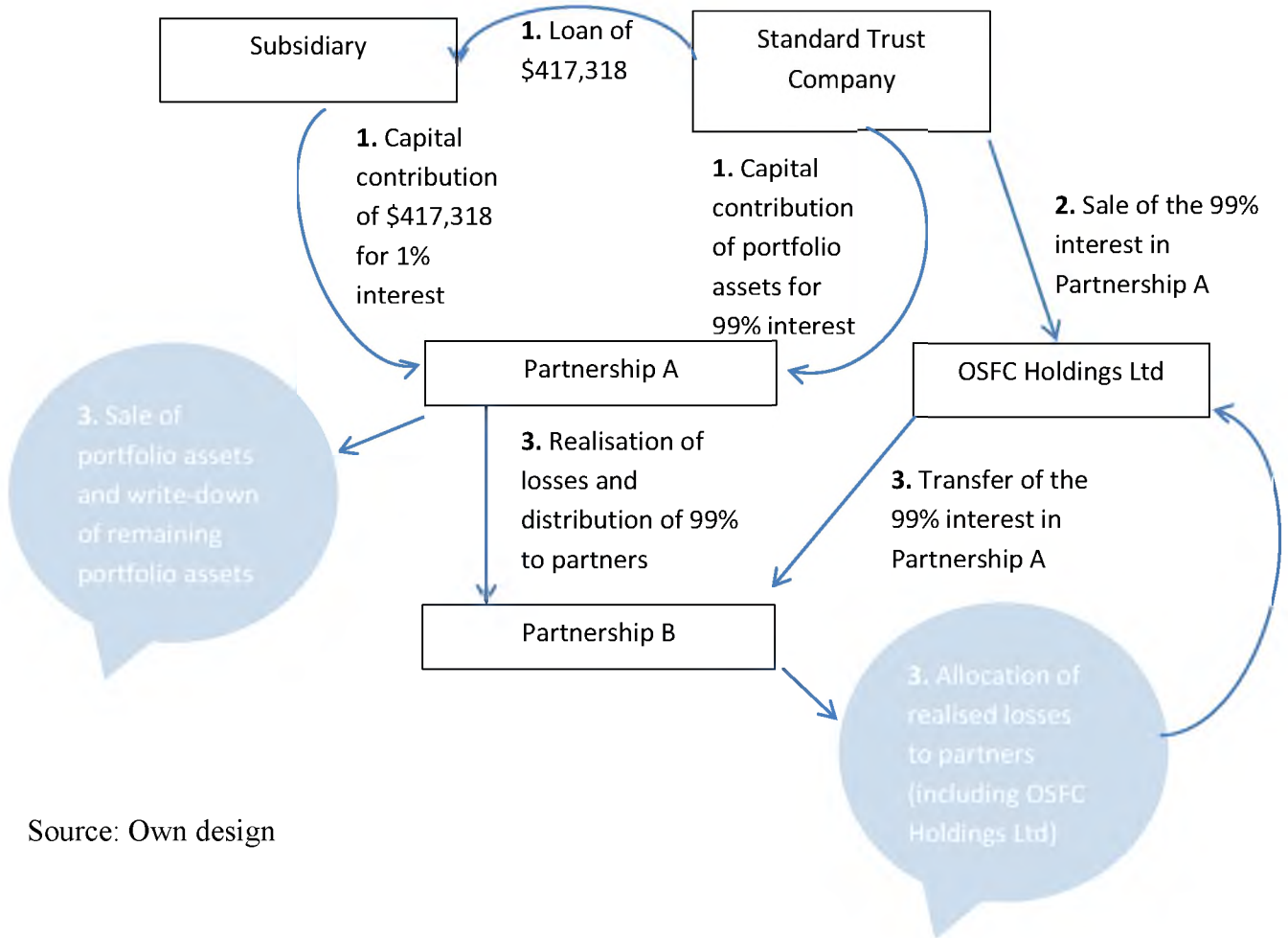
✓

**APPENDIX F - CANADA TRUSTCO MORTGAGE COMPANY CASE**



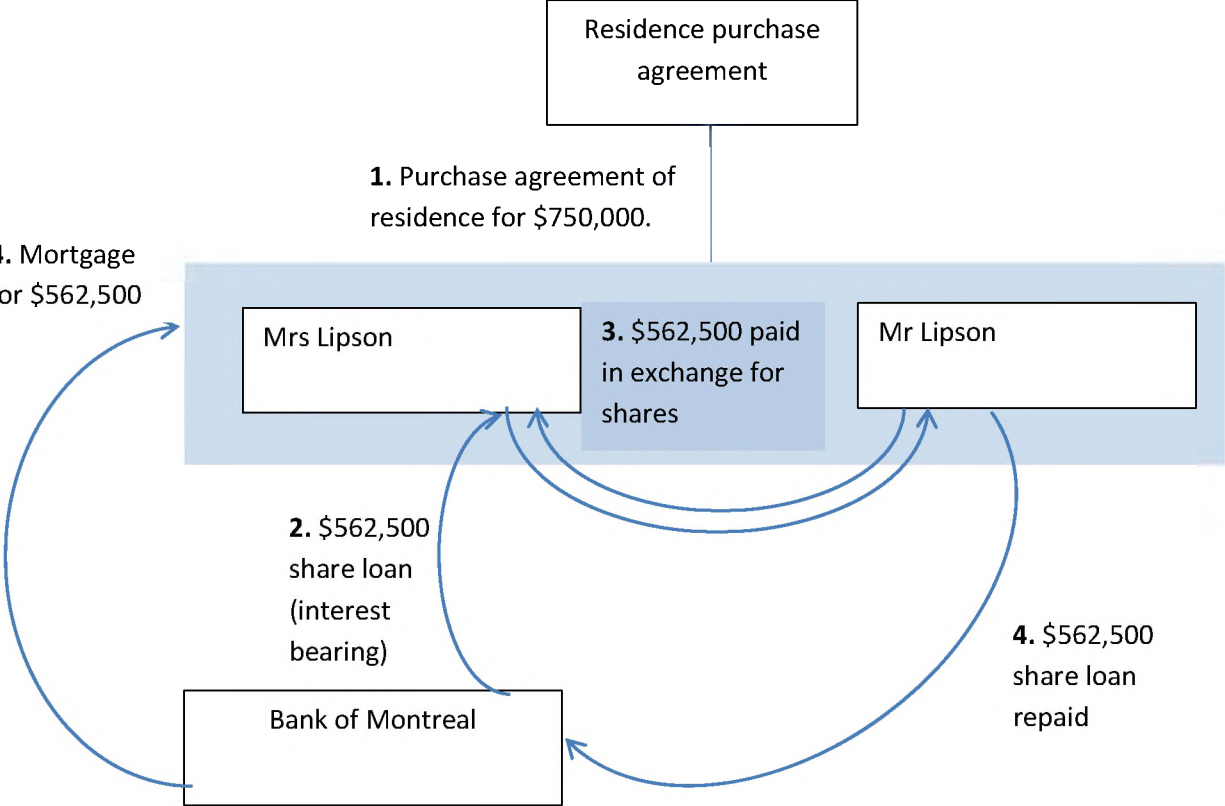
Source: Own design

**APPENDIX G - MATHEW CASE**



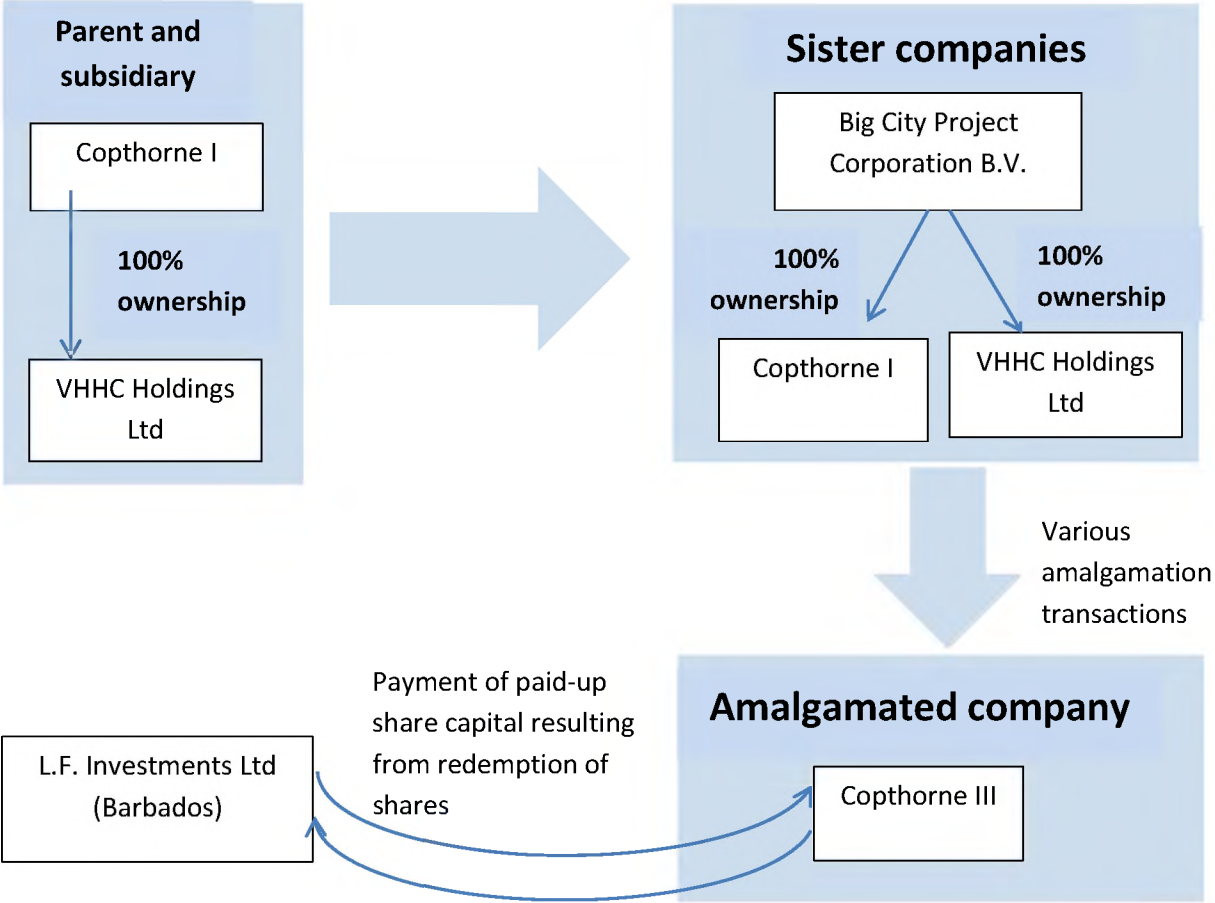
Source: Own design

**APPENDIX H – LIPSON CASE**



Source: Own design

**APPENDIX I – COPTHORNE HOLDINGS CASE**



Source: Own design



**APPENDIX J – FRAMEWORK FOR THE SOUTH AFRICAN GAAR – CASE SUMMARIES (CANADA)**

Framework for applying sections 80A – 80L to the facts of previous case law	Canada Trustco case	Matthew case	Lipson Case	Copthorne Holdings Case
<p><b>1 - Is there an arrangement?</b></p> <ul style="list-style-type: none"> <li>Is there a transaction, operation or scheme that has been entered into by the taxpayer? Widely interpreted in terms of section 80L of the Act and the <i>Meyerowitz</i> case.</li> </ul>	✓	✓	✓	✓
<p><b>2 - Does the transaction/operation/scheme result in a tax benefit?</b></p> <p>The definition of tax in section 80L is applied to the cases.</p> <ul style="list-style-type: none"> <li>Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escaped or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case)</li> <li>Would a tax liability have existed but for this transaction (but for test)? (<i>Income Tax Case No 1625</i> (1996) 59 SATC 383; <i>Smith</i> case and <i>Louw</i> case)</li> </ul>	✓	✓	✓	✓
<p><b>3 - Is the sole or main purpose to obtain such tax benefit?</b></p>	✓	✓	✓	✓

In applying the sole or main purpose requirement of the GAAR to the facts and circumstances of the case studies, the following factors are considered:

- Subjective test – Is it the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (*Gallagher case*)
- Objective test – Does the actual effect of the arrangement support the stated non-tax benefit intention of the arrangement? (Meyerowitz (2008:par.19-12); De Koker and Williams (2015:par.19.38) and *Ovenstone case*)

In applying the objective and subjective tests, the following principles may be considered:

- If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement to obtain the tax benefit? (*Conhage case*); or
- If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner that did not attract tax or attracted less tax, this does not indicate that obtaining a tax benefit was the sole or main purpose of the arrangement (*Conhage case*); or

N/A

N/A

✓

✗

N/A

N/A

✓

✗

<ul style="list-style-type: none"> <li>If the dominant subjective purpose of the avoidance arrangement was to achieve some non-tax business purpose, it would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose of the arrangement (i.e. determine what was in the mind of the taxpayer who entered into the transaction).</li> </ul>				
<b>4 - Tainted elements requirement</b>	✓	✓	✓	✓
<p><b>- One of the following with regard to business transactions:</b></p> <p><b>- Entered into in a manner not normal for bona fide business purposes?</b></p> <ul style="list-style-type: none"> <li>Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for <i>bona fide</i> business purposes in the absence of a tax consideration? (Louw, 2007:27)</li> </ul> <p><b>- Does the transaction lack commercial substance?</b></p> <p>In order to determine whether an arrangement lacks commercial substance, the following are applied:</p> <ul style="list-style-type: none"> <li><i>General lack of commercial substance test:</i> Does the arrangement have no significant effect upon the net cash flows or business risks? (Section 80C definition and Broomberg, 2007:9)</li> </ul>	✓	✓	N/A	✓
	✓	✓	N/A	✓
	✓	✓	N/A	✓

<ul style="list-style-type: none"> <li>• <i>Substance over form test</i>: Is the true intention of the parties reflected in the agreement (i.e. are the risks and rewards resulting from the transaction those that can be expected from such a transaction)? Has the taxpayer remained insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary? Or is the purpose of a transaction only to achieve an object that achieves the avoidance of tax? (Then it will be regarded as simulated and the mere fact that parties do perform in terms of the contract does not show that it is not simulated.)</li> </ul>	✓	✓	N/A	✓
<ul style="list-style-type: none"> <li>• <i>Round trip financing test</i>: Has funding been transferred between parties, through some type of reciprocal action, resulting directly or indirectly in a tax benefit?</li> </ul>	✓	✓	N/A	✓
<ul style="list-style-type: none"> <li>• <i>Tax-indifferent party test</i>: Is there a party who effectively sold its tax advantage to others, irrespective of its relationship with any of the contracting parties?</li> </ul>	✗	✓	N/A	✓
<ul style="list-style-type: none"> <li>• <i>Offsetting or cancelling test</i>: Are there elements within the transaction that have the effect of offsetting or cancelling each other? (This indicates that such parts of the transaction were contrived for the purpose of obtaining a tax benefit and indicate a lack of commercial substance.)</li> </ul>	✓	✓	N/A	✓

<p><b>- The following with regard to transactions not in the context of business:</b></p> <ul style="list-style-type: none"> <li>- <i>Has the arrangement been entered into in a manner not normal for bona fide purposes?</i> <ul style="list-style-type: none"> <li>• Is there a difference between the transaction entered into by the taxpayer and a transaction entered into for <i>bona fide</i> business purposes in the absence of a tax consideration? (Louw, 2007:27)</li> </ul> </li> </ul>	N/A	N/A	✓	N/A
<p><b>- One of the following with regard to transactions in any context:</b></p> <ul style="list-style-type: none"> <li>- <i>Has the arrangement created rights and obligations that are not at arm's length?</i> <p>The non-arm's-length rights or obligations element will not be met if one of the following factors is present:</p> <ul style="list-style-type: none"> <li>• Each of the parties is not striving to get the utmost possible advantage out of the transaction for themselves? (<i>Hicklin</i> case)</li> <li>• Unconnected persons would not have done the same in this situation? (<i>Hicklin</i> case)</li> </ul> </li> <li>- <i>Is there misuse or abuse of provisions of the Act?</i> <ul style="list-style-type: none"> <li>• Does the arrangement frustrate, exploit or manipulate the purpose of any of the provisions of the Act, or does the</li> </ul> </li> </ul>	✓	✓	✓	✓

arrangement use provisions of the Act to achieve a result not intended by the legislator?