

**An analysis of the 2006 amendments to the General Anti-Avoidance Rules:
A case law approach**

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KEYWORDS

- abnormality
- anti-avoidance
- avoidance case law
- avoidance rules
- avoidance schemes
- general anti-avoidance rules (GAAR)
- purpose
- tax avoidance

ABSTRACT

Tax avoidance has been a concern to revenue authorities throughout the ages, and revenue authorities worldwide are engaged in a constant struggle to ensure taxpayer compliance while combating tax avoidance. South Africa is no exception to this struggle and the increasingly innovative ways in which taxpayers seek to minimise their tax burdens necessitate amendments in order to remain at the forefront of taxpayer compliance. In view of the above, the general anti-avoidance rules (GAAR) have been amended numerous times to address weaknesses. The most recent of these amendments are those of 1996 and 2006.

The research on GAAR in South Africa has focused on critical analyses once the legislation fails to stand up to the rigours of court, and has thus used the principle of hindsight to criticise GAAR and recommend improvements. However, in their current form (post-2006 amendments) the GAAR have not been presented before the courts, and thus the use of hindsight is not an appropriate tool to determine if the current GAAR regime has improved upon the weaknesses identified in the past. This study applied a qualitative case study approach to determine if the 2006 amendments to GAAR have in fact addressed these weaknesses. The current GAAR regime was applied to previous cases to determine if the unfavourable judgments for the Commissioner would now be considered favourable.

In executing this process, an instrument was developed in phase 1 of the literature study to apply the new GAAR to the cases. In the second phase of the study this framework was applied to case law in which the previous GAAR regimes failed to stand up to the rigours of court, thus determining whether the 2006 amendments to GAAR addressed the weaknesses of the previous GAAR regime. The final phase of the study consisted of a literature control to determine if similar such conclusions have been made by other commentators to support the findings of the study.

The findings of the case studies revealed that, on a balance of probabilities, none of the cases selected for analysis would have been 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 and the courts used the instrument developed in phase 1 to apply the GAAR to these transactions. The study therefore indicates that the use of 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 amended abnormality test still result in a GAAR regime that may be an ineffective deterrent to tax avoidance.

UITTREKSEL

Belastingvermyding was deur die eeue heen 'n bekommernis vir inkomste-owerhede. Inkomste-owerhede is wêreldwyd betrokke in 'n konstante stryd om nakoming van belastingbetalers te verseker, terwyl hulle teen belastingvermyding stry. Suid-Afrika is nie 'n uitsondering in hierdie geval nie, en die toenemende innoverende maniere waarop belastingbetalers poog om hulle belasting te verminder noodsaak wysigings om aan die voorpunt van belastingbetaler nakoming te bly. In die lig van bogenoemde, is die algemene anti-vermyding reëls (AAVR) talle kere gewysig om swakhede aan te spreek. Die mees onlangse van hierdie wysigings is dié van 1996 en 2006.

Hierdie navorsing oor AAVR in Suid-Afrika gebruik 'n kritiese ontleding van die wetgewing, na dit gefaal het in die hoftoetsing, en die beginsel van nakennis om AAVR te kritiseer en verbeterings aan te beveel. In die huidige vorm (na-2006 wysigings) was die AAVR nog nie voor die hof aangebied vir toetsing nie, en is die gebruik van nakennis nie 'n geskikte metode om te bepaal of die huidige AAVR vereistes wel verbeter op die swakhede van die verlede nie. Hierdie studie gebruik 'n kwalitatiewe gevallestudie benadering om te bepaal of die 2006-wysigings aan AAVR in werklikheid die swakhede aangespreek het. Die huidige AAVR vereistes was toegepas op vorige gevalle om te bepaal of die ongunstige vonnisse teen die Kommissaris nou in 'n gunstige lig beskou sal word.

In die uitvoering van hierdie proses, is 'n instrument ontwikkel in fase 1 van die literatuurstudie wat die nuwe AAVR toepassing op die gevalle. In die tweede fase van die studie is die instrument toegepas op regspraak waarin die vorige AAVR vereistes die toetse van die hof gevaal het, en dus bepaal of die 2006-wysigings aan AAVR die swakhede van die vorige AAVR vereistes aangespreek. Die finale fase van die studie het bestaan uit 'n literatuur kontrole om te bepaal of soortgelyke gevolgtrekkings gemaak is deur ander kommentators om die bevindinge van die studie te ondersteun.

Die bevindinge van die gevallestudies het onthul dat, op 'n oorwig van waarskynlikhede, geeneen van die gevalle gekies vir analise ten gunste van die Kommissaris sou uitkom nie, indien hulle vandag op dieselfde gronde as

waarvoor hulle oorspronklik aangeval was voor die howe sou kom, en indien die howe die instrument wat ontwikkel is in fase 1gebruik in die ontleding van die AAVR vir die transaksies. Die studie dui dus aan dat die gebruik van 'n soortgelyke (dikwels identiese) bewoording van die doel toets soos in die vorige AAVR, sowel as die gebruik van die doel toets in samewerking met die gewysigde abnormaliteit toets nog steeds lei tot 'n AAVR vereiste wat dalk 'n oneffektiewe afskrikmiddel vir belasting ontduiking is.

CHAPTER 1 - THE PROBLEM, SIGNIFICANCE AND STRUCTURE OF THE STUDY

1.1 Introduction

1.1.1 Background to the General Anti-Avoidance Rule

A quotation from the Bible (Matthew 22:17-21) reads as follows:

“Tell us therefore, What thinkest thou? Is it lawful to give tribute unto Caesar, or not? But Jesus perceived their wickedness, and said, Why tempt ye me, ye hypocrites? Shew me the tribute money. And they brought unto him a penny. And he saith unto them, Whose is this image and superscription? They say unto him, Caesar's. Then saith he unto them, Render therefore unto Caesar the things which are Caesar's; and unto God the things that are God's.”

From the above quotation it can be noted that the aspiration to reduce tax burdens is evident, even from the time that the Pharisees asked Jesus if it was proper to pay tax. Since the time that the concept of taxation was introduced to humanity, people have constantly been seeking ways to minimise their tax burdens (Olivier, 1996:378).

In an information brief released by the Organisation for Economic and Co-operation and Development (OECD) in March 2010 it was identified that the concepts of tax avoidance and evasion remain a relevant issue in the current global context: “Tax avoidance and tax evasion threaten government revenues throughout the world. The US Senate estimates revenue losses amount to 100 billion dollars a year and in many European countries the sums run into billions of euros” (OECD, 2010:2). Revenue authorities worldwide are consequently engaged in a constant struggle to ensure taxpayer compliance while combating tax avoidance.

Though no statistics could be identified in quantifying the effect of tax avoidance and evasion in South Africa, the South African Revenue Service (SARS) is no exception to this struggle and taxpayers find the South African tax legislation scattered with various forms of specific anti-avoidance legislation. However,

specific anti-avoidance legislation can never deal with all the increasingly innovative methods in which taxpayers achieve tax avoidance. SARS too has recognised this and has noted that the flexibility of transactions makes it difficult to combat these products through specific anti-avoidance legislation. It has also been noted that even the most well-drafted tax laws will never encompass all the conceivable transactions that a taxpayer may enter into to avoid tax (SARS, 2005:1-6; National Treasury, 2006:62). In addition to these difficulties expressed by SARS, that in keeping with global trends, South African businesses are placing a greater emphasis on tax savings which has resulted in a tendency to view the tax department as a 'profit centre' (Stretch & Silke, 2006a:2).

The abovementioned challenges to the anti-avoidance legislation are compounded by the differences between the terms "tax evasion" and "tax avoidance". Huxham and Haupt (2010:456) describe tax avoidance as an attempt to minimise a tax liability using legal means while tax evasion is described as the use of illegal means to reduce one's tax liability (De Koker, 2010:19.1). Notwithstanding this, there is a fine line to tread between the legality of transactions within tax legislation. The dilemma arising from the difference between the terms "tax avoidance" and "tax evasion" is derived from the principle founded 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 affirmed in South African courts by Centrives in his minority judgment in *Commissioner for Inland Revenue v Estate Kohler* (1953) 18 SATC 354 as well as the judgment of *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A) (*Hicklin case*).

This rubicon between permissible and impermissible tax avoidance has been discussed by SARS and has resulted in the definition of impermissible 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).

In order to address this problem, South Africa, like many other countries, has included what is commonly referred to as the General Anti-Avoidance Rules (GAAR) in its tax legislation. In the South African tax landscape GAAR, unlike specific anti-avoidance legislation (such as transfer pricing and thin capitalisation legislation), are based on conceptual principles to address the impermissible avoidance of tax, as opposed to addressing specifically defined transactions that may provide taxpayers with the “loopholes” for impermissible tax avoidance (SARS, 2005:38). Following this, it is important to understand that GAAR, unlike specific anti-avoidance legislation, are not charging provisions and are intended to aid in protecting the tax base in South Africa (Ralph, 1998:1; *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975) (4) SA 715 (A) (*Glen Anil* case)).

Because of the necessity for and complexities surrounding tax avoidance and evasion, GAAR have been present within the South African context since 1941 in order to provide principles or boundaries to distinguish between permissible and impermissible tax avoidance. These rules have been amended several times, the most recent of which are the amendments of 1996 and 2006. The GAAR, after the promulgation of the 1996 amendments (hereafter referred to as the “previous GAAR regime” or derivatives thereof), are discussed briefly below.

1.1.2 Overview of the previous GAAR regime

The previous GAAR regime 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; and
- 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) (Income Tax Act 58 of 1962).

Despite the inclusion of these anti-avoidance rules in the tax legislation, the ever-changing economic environment necessitated the amendment of these rules in order to enable the intention of the legislator to remain intact. The need to make changes to the South African GAAR was most recently recognised by the Minister of Finance on 3 November 2005 where he stated: “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” in which it was 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 within the previous GAAR regime, SARS (2005:41-44) has made reference to literature, including case law, in which the anti-avoidance legislation failed to stand up to the rigours of court. The weaknesses referred to are discussed in detail in paragraph 2.4 (page 16).

As a result of these weaknesses amendments to the GAAR were effected in 2006 in order to “ensure that the new GAAR is broad enough to reach as many forms of impermissible tax avoidance as possible and strong enough to be an effective deterrent against them” (Stretch & Silke, 2006b:1). A brief overview of the GAAR regime resulting from these 2006 amendments is discussed below.

1.1.3 Brief overview of the current GAAR regime

The 2006 amendments to the GAAR were inserted by section 34(1) of the Revenue Laws Amendment Act 20 of 2006, and apply to any arrangements entered into on or after 2 November 2006. These amendments have resulted in the GAAR legislation found in South Africa today. The main requirements for applying the current GAAR, after the promulgation of the 2006 amendments (hereafter referred to as the “current GAAR regime” or derivatives thereof), are summarised briefly below.

- There must be a transaction, operation or scheme;
- that results in a 'tax benefit';
- the sole or main purpose of the transaction, operation or scheme of which is to obtain the tax benefit; and
- the arrangement is abnormal, lacking in commercial substance, carried out in a manner not normally employed for bona fide business purposes, creates rights and obligations not normally arising between parties dealing at arm's length or is abusive of the provisions of the Act (Income Tax Act 58 of 1962).

It is therefore evident that the fundamental principles of the previous GAAR regime have remained intact whilst additional indicators have been included in the legislation. It is thus necessary to determine if the 2006 amendments to the GAAR have changed the legislation sufficiently in order to address the weaknesses identified.

1.1.4 Rationale for the study

Despite the constant debate surrounding anti-avoidance legislation, the primary research conducted in South Africa has been centred on critical theoretical analyses of GAAR, after the GAAR failed to stand up to the rigours of court. These studies focused on analysing and interpreting the legislation and related literature in order to identify weaknesses and/or areas for improvement. No study has been conducted to consider the impact of changes to the legislation on previous court cases. Therefore hindsight was primarily used to evaluate effectiveness of the legislation. In most of the studies performed, limited (if any) emphasis has been placed on applying GAAR to practical cases before the legislation was presented before the courts.

Due to the fact that the current GAAR regime has not been tested extensively in South African courts, hindsight cannot be used as a tool for determining if the current GAAR regime adequately addresses impermissible tax avoidance in the current South African context. The impetus of this study thus originates from the observation that the 2006 amendments to GAAR have not been applied on a practical basis to existing case law. By applying the current anti-avoidance legislation to the facts from actual case law (where the previous GAAR proved to

be ineffective), this study aims to fill a gap in the tax avoidance research by determining whether the 2006 amendments addressed the weaknesses identified on a practical basis in relation to these cases.

1.2 Problem statement

The research problem investigated in the study can be expressed as follows:
Have the 2006 amendments resolved the weaknesses of the previous GAAR?

1.3 Research objectives

The research objectives pursued in answering this research problem were formulated as follows:

- i) to identify the primary weaknesses of the previous GAAR regime which will be addressed in paragraph 2.4 on page 16.
- ii) to identify what amendments were intended to address the primary weaknesses (refer to paragraphs 2.4.5, 2.4.6, 2.5, 2.5.3, 2.5.4 on pages 19 to 29).
- iii) to apply the current GAAR to the practical reality of facts of selected cases and thus determine if the 2006 amendments have resolved the weaknesses of the previous GAAR in these cases (refer to chapters 4 and 5).
- iv) to recommend aspects that have to be addressed to improve the effectiveness of the current GAAR regime (refer to chapter 6).

1.4 Research design and methodology

1.4.1 Research approach

This study follows a qualitative research approach in order to evaluate the practical effect of the 2006 amendments to GAAR. In conjunction with this the study aims to gain a detailed understanding of the different dimensions and layers of the current GAAR regime in a practical context (Creswell, 2007:40; Leedy & Ormrod, 2005:133).

A qualitative research approach was selected because the data was in the form of words, sentences and paragraphs which are all conducive to a qualitative research approach. In addition to this, the application of legislation to fact patterns of selected case law provides a greater depth of understanding and interpretation than a quantitative research approach (Leedy & Ormrod, 2005:133).

1.4.2 Research design

This study uses a literature review to identify the primary weaknesses of the previous GAAR regime as well as what recommended amendments were intended to address these weaknesses, thereby meeting the first two research objectives (refer to chapter 2). The study then uses relevant case law to explore whether the 2006 amendments to GAAR have effectively addressed the weaknesses identified in the literature review (refer to chapters 4 and 5), thereby meeting the third objective of the study (Yin, 2009:10). The case study design that was selected is not simply to describe the case for description's sake but to try to see patterns, relationships and the dynamics of the 2006 amendments to GAAR (Henning, Van Rensburg, Smit 2004:32).

The type of case study design that best achieved the purpose of the study was a collective/multiple case study design that focused on one issue (i.e. GAAR) but multiple cases were selected to further illustrate the issue and provide different perspectives of the issue (Creswell, 2007:74). The interest in the individual cases was secondary to the purpose of the study and cases were chosen so that the comparison could be made between cases and concepts within the GAAR legislation in order to determine if the 2006 amendments have addressed the weaknesses of GAAR (De Vos, Strydom, Fouche, Delport 2005:272). This document review is considered suitable due to the fact that the case law is of a comprehensive nature and of a high quality (i.e. complete; rigorously compiled; accurate and reliable). In using a multiple case study design the study uses cases to make comparisons, build theory, or propose generalisations regarding the 2006 amendments to GAAR (Leedy & Ormrod, 2005:135). The results achieved in using this collective/multiple case study design further the understanding about the social issue or population concerned (De Vos *et al.*, 2005:272).

The application of legislation (current GAAR) to facts from previous court cases raises concerns regarding the limitations and bias of the research. One such limitation, as noted by Yin (2009:38), is that it is often difficult to generalise the outcomes of research conducted using a collective case study approach. The limitations and bias of the study, as well as the methods used to limit the impact of these upon the results are discussed below.

1.4.3 Limitations and bias

Because it is difficult to generalise the outcomes of the study (Yin, 2009:38) 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). This study does therefore not aim to address all possible cases that may come before the courts, but may provide some insight into the practical workings of the 2006 amendments to the anti-avoidance legislation. In addition, the study explores principles of GAAR within specific fact patterns. Any findings must therefore be 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 have been identified:

- a) The study is South African specific in that it only addresses the 2006 amendments of the GAAR in a South African context and thus provides limited use to other jurisdictions/countries.
- b) The use of interpretation of legislation in the context of this study may inherently include subjectivity and though the measures, described in paragraph 1.4.4 below, have been implemented to limit this subjectivity/bias, it is important to note that many decisions in court are derived from the views of judges. Subjectivity is inherent in the field of interpreting GAAR legislation, but by using a detailed literature review the study will provide insight into the workings of the current GAAR regime.

In view of the limitations identified it is important to note that the limitation listed in (a) above does not affect the validity, reliability and objectivity of the study. The area that may impact on these factors of the study is that explained in point (b)

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 below (Denscombe, 2007:296-302).

1.4.4 Measures to ensure validity, reliability and objectivity

The following measures were included within the study to maintain the highest level of validity, reliability and objectivity in applying current GAAR to previous court cases:

- The development of subjectivity/bias in the literature review has been identified as a cause for concern, as the interpretation of the current GAAR regime included within the literature review impacts the application of these interpretations to the fact patterns of the case studies. A phased literature study was thus employed to address this concern. This phased literature study consists of the following phases:
 - *Phase 1: Literature review* - A literature review was used to explore and describe the weaknesses of the previous GAAR regime as well as aid in interpreting each of the requirements of the current GAAR regime. This was performed by using authoritative bodies of work from case law, books, journals and legislative interpretation guidance as explained in paragraph 1.4.5 below. No critical analysis of the current GAAR regime was included in this literature review to prevent the development of bias in applying the current GAAR to the selected cases. The literature review is thus in the form of a conceptual study and comparative analysis of the previous GAAR regime including its weaknesses and the current GAAR regime, and is consistent with the purpose of the study.
 - *Phase 2: Application of current GAAR to previous case law* - Records were obtained from selected case law to set the context of the transactions. The current GAAR were then applied to the fact patterns contained within these cases. A framework to apply the new GAAR to the fact patterns of the selected case law was developed based on the interpretive approach discussed in paragraph 1.4.5 below (page 11). The application of this framework

to the fact patterns of the cases ensured a consistent method and criteria of application for all cases selected and as well as improved objectivity for the study.

- *Phase 3: Literature control* - Once the current GAAR regime had been applied to the facts from selected court cases, a literature control was used to support or reject the findings of each case. The use of a literature control is imperative in maintaining objectivity with which to compare the case study findings.
- The selection of case law used in phase 2 of the study was identified as an area where subjectivity and bias may be introduced, in that the mere selection of a case on a subjective basis may negatively impact on the findings of the study. In order to address this concern, predefined objective selection criteria (refer to chapter 3) were used to eliminate bias in the selection of cases that could impact upon the findings of the study.
- In addition to this, the population of case law, which provides the platform from where the case law was selected, was from an impartial source (i.e. the South African Tax Cases Reports). This source is an independent database containing objectively written information that includes all the most relevant case law on GAAR in South Africa and eliminates bias in determining which cases should be available for selection.
- The final area identified that could be impacted by subjectivity/bias was the case law documentation, in that the full facts and details of the case needed to be studied so that an informed analysis could be performed. The case law documentation was thus obtained from the South African Tax Cases Reports (which is considered to be a neutral source).

As mentioned in paragraph 1.4.3 (page 8), differing interpretations of GAAR could impact upon the findings of the case studies. In order to prevent bias from developing in the manner in which the GAAR were interpreted when applied to the case studies and to ensure that the findings and interpretation maintained a high level of objectivity, a standardised methodology was developed. This methodology is explained below.

1.4.5 Interpretation

“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). Since words and language are what make up our legislation, it is evident that interpretation would be required when applying the current GAAR regime to the case law selected for detailed analysis. The method that was employed to address the concern regarding the development of bias within this interpretation therefore had to be determined in advance, so that a uniform structure could be applied consistently. Therefore, it was important to determine how the courts interpret the legislation so that this methodology could be applied to the case studies.

In order to interpret the fiscal (tax) legislation, the courts have explained that the golden rule of interpretation is to arrive at the intention of the legislature. This approach is referred to as the purposive approach (*Glen Anil case*; *Income Tax Case No 1396* (1984) 47 SATC 141; Goldswain, 2008:109). This must be done by having regard to the words used and giving them, unless specifically defined, their ordinary grammatical meaning. When 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 (Goldswain, 2008:109; *Glen Anil case*).

However, there is a view that where the law is ambiguous, the fiscal legislation must be interpreted using the *contra fiscum* rule, which favours the taxpayer. This principle has been adopted by judges when faced with uncertainty in the meaning of the words used in the tax legislation (Huxham & Haupt, 2010:11). Goldswain (2008:116) notes that the *contra fiscum* rule still remains a part of our common law and is not in conflict with the Constitution. He also notes that the *contra fiscum* rule complements the principles underpinning the Constitution by ensuring that inequitable decisions are not made by inadequate interpretation of fiscal legislation. The *contra fiscum* rule has traditionally been viewed as applicable in instances where there is ambiguity in the wording of the fiscal legislation (Goldswain, 2008:116). However, ambiguity may apply not only in the context of

the wording of the legislation, but similarly in the intention of the legislature arising from the wording used. To resolve areas where ambiguity may be present in interpreting the intention of the legislature, the purposive approach is more adequately designed to address this area so that the underlying intention of the section is considered, instead of just the wording of the legislation. This view is consistent with a recent case decided in the Supreme Court of Appeal, where the methodology 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 use of the *contra fiscum* rule was not applied and the use of the purposive approach was held to be the appropriate tool to be used to interpret fiscal legislation. This view has similarly been held in *inter alia* *Commissioner for Inland Revenue v Delfos* (1933) 6 SATC 92 (A), *Kommissaris van die Suid-Afrikaanse Inkomisdienste v Botha* (2000) 62 SATC 264 (O) and the *Glen Anil* case 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 the 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. This wide interpretation must be managed so that the meaning of the sections is not stretched beyond what the language permits (*Commissioner of Taxes v Ferera* (1976) 38 SATC 66; Huxham & Haupt, 2010:12).

In order to reduce the impact of bias in the interpretation of the GAAR and applying the aforementioned principles the following process was undertaken:

- Where a word, sentence or piece of legislation has already come before the courts (within a similar context and with a similar intention) this interpretation was used. Applying such interpretation in a similar context aids in reducing bias. This method was 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 such word, sentence or piece of legislation has not previously been interpreted by the courts the ordinary grammatical meaning of the word was 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 methodology above was applied in paragraph 2.5 (pages 21 to 44) to create a framework that was used to analyse the case studies in Chapter 4.

1.5 Chapter outline

Chapter 2 provides an analysis of the previous GAAR regime including a discussion of its weaknesses and the amended GAAR legislation. Based on this discussion the purposive approach (refer to paragraph 1.4.5 above) is applied to develop a framework for the application of the new GAAR to the fact patterns of the case law selected in chapter 3. Chapter 3 describes the basis for the selection of case law used when applying current GAAR to case law and concludes by selecting the cases for analysis. Chapter 4 provides the application of the current GAAR regime to the factual scenarios presented within the case law, using the framework developed in this study. The results of these analyses are then compared to literature on the current GAAR regime in chapter 5. Chapter 6 contains a summation of the research findings and highlights areas for future research in order to improve the GAAR within South Africa.

CHAPTER 2 - ANALYSIS OF THE PREVIOUS AND AMENDED GAAR

2.1 Introduction

“Oh what a tangled web we weave, when first we practice to deceive” is a quote by Walter Scott which 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 to the current GAAR regime in South Africa, the research question and objectives as well as the methodological overview of the study. This chapter forms phase 1 of the literature study and provides an opportunity to untangle the components of the previous (including its weaknesses) and current GAAR regimes (identifying areas where changes have been made to address the weaknesses). This chapter will thus achieve objectives i) and ii) in paragraph 1.3 (page 6), refer to paragraph 2.4 on page 16 and 2.5 on page 21. Based on the discussion of the amended GAAR, a framework is developed for application of the amended GAAR to the fact patterns of the case law selected in chapter 3.

2.2 GAAR in South Africa

Section 80A to 80L of the Income Tax Act 58 of 1962 (from now on referred to as the Act) replaced the provisions of section 103(1) of the Act (the previous GAAR regime) and apply to any arrangement entered into after 2 November 2006. The current GAAR legislation was introduced to prevent a taxpayer from receiving a tax benefit from entering into what the Act refers to as an “impermissible avoidance arrangement”.

Before commencing an investigation of the current GAAR regime a more detailed study of the previous GAAR regime is necessary in order to identify its weaknesses and the reasons why an amendment was necessary.

2.3 Previous GAAR regime

Post 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”

In order to apply section 103(1) the initial onus was on Commissioner for Inland Revenue to satisfy himself that the transaction, operation or scheme was one where these provisions would apply. It would be presumed, until proved to the contrary, that such transaction was entered into or carried out solely or mainly for the purpose of avoiding, postponing or reducing the amount of any tax payable. In applying section 103(1) all four of the requirements were required 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. In addition, it was left to the courts to formulate the norms and standards by which to determine if the transaction was normal, as no such standards were defined within the legislation. In applying the previous GAAR regime, it was determined that section 103(1) could only be applied to a transaction as a whole and not to individual steps within such transaction. In *Commissioner for Inland Revenue v Louw* (1983) 45 SATC 113 (A) (*Louw case*) this view was supported 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).

2.4 Weaknesses of the previous GAAR regime

The weaknesses of the previous GAAR regime referred to in paragraph 1.1.2 (page 4) are discussed in more detail below in achieving objective i) in paragraph 1.3 on page 6.

2.4.1 Not an effective deterrent to tax avoidance

As a result of the aggressive and increasingly sophisticated schemes entered into by taxpayers, the GAAR have frequently failed to stand up to the rigours of court (Olivier, 1996:378). The significant commitment of time and resources to detecting and combating these schemes has proved to be costly, and lengthy battles over the nature of transactions have had a negative impact on the relationships between SARS and taxpayers (SARS, 2005:42). The combination of the abnormality and purpose requirements were identified as the most critical areas of weakness that resulted in the ineffectiveness of the previous GAAR. The dominant criticisms of the abnormality and purpose requirements are discussed in paragraphs 2.4.2 and 2.4.3 below.

2.4.2 Abnormality requirement

The abnormality requirement has been the subject of much criticism both before and after the 1996 amendment. The most prominent of this criticism is that noted in the last two commissions of inquiry conducted in South Africa, namely the Margo Commission and the Katz Commission. Both these commissions (undertaken before the 1996 amendments to GAAR) suggested that the abnormality requirement required amendments 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; *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) 61 SATC 391 (*Conhage case*); *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* 33 SATC 113 (*Geustyn case*); *Income Tax Case No. 1636* (1997) 60 SATC 267).

The criticisms made in the Margo and Katz Commissions, though accepted by the legislator prior to the 1996 amendments, remained valid after the 1996 amendments since it seemed that the “legislator did not grasp the problem” (Olivier, 1997:741). This can be explained with reference to the Katz Commission, where it was suggested that the abnormality test, in the context of business, should be amended to include a *bona fide* business purpose test, as opposed to a normality test. The amendments did include the words “*bona fide* business purposes” but the word “normal” was still left intact which again aided in rendering the GAAR an ineffective deterrent for tax avoidance (Olivier, 1997:742; SARS, 2005:39; Werksmans Tax, 2006:1; Williams, 1997:677).

The above view is confirmed by the fact that the criticisms of the abnormality requirement before the 1996 amendments were noted in the Discussion Document released by SARS in 2005 (SARS, 2005:41-44).

2.4.3 Purpose requirement

The purpose requirement has similarly been the subject of extensive criticism (SARS, 2005:41-44). One of the key features of the purpose requirement is that even though there may be a tax purpose for entering into a transaction, it would not result in the transaction falling foul of GAAR if this tax purpose were not the

sole or main purpose of the transaction (Brincker, 2001:163). Essentially this means that an arrangement, which has a commercial or business purpose as its main purpose, will be sanctioned by the courts because the parties are entitled to structure the transaction in the most beneficial manner (*IRC v Duke of Westminster* (1936) 19 TC 490). This fundamental criticism of the purpose requirement was supported in the judgment in the *Conhage* case, where it was held that a transaction entered into with a dual purpose would not satisfy the purpose requirement if the main reason for entering into such a transaction was business and commercially orientated. This judgment has 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). Furthermore, it has been recognised by SARS that taxpayers have successfully argued that the raising of capital was the purpose of an arrangement with relative ease following the *Conhage* case (SARS, 2005:44). As a result, it has become an essential aspect during tax planning to ensure that a business or commercial reason can be provided for a transaction as the first three requirements of the GAAR are often present (Brincker, 2001:158). This results in taxpayers being able to justify a commercial purpose of a transaction with relative ease, leaving 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). This has rendered the GAAR an ineffective deterrent for tax avoidance (Werksmans Tax, 2006:1).

2.4.4 Abnormality and purpose requirements together

The concerns raised above with regard to the abnormality and purpose requirements are compounded by the fact that these requirements have to be read in conjunction with each other as explained below. This has been identified as a weakness of the GAAR by SARS (2005:44), which 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 of the GAAR was

similarly identified by Main (2001:34), Leach, J (*Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd* (1999) 62 SATC 65 – *Knuth case*) and Broomberg and Kruger (1998:252): “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.” This weakness 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.

2.4.5 Procedural and administrative issues

The final weaknesses of GAAR were identified under the procedural and administrative issue umbrella, where SARS (2005:44) identified two concerns as follows:

- Uncertainty about the extent to which GAAR could be applied to individual steps within a larger transaction (*Louw case*).
- Uncertainty as to whether the Commissioner had authority to apply GAAR in the alternative where another provision was also in dispute.

The first of these concerns stemmed from the realisation that though a transaction in its entirety may not fall foul of GAAR, individual steps in such complex transactions may have been entered into solely or mainly for the purpose of avoiding tax and may have been entered into in a manner that was abnormal. Therefore, if the entire transaction did not comply with these requirements, the opportunity for the Commissioner to question an individual part of the transaction may have been lost when considered from the much broader perspective of the transaction in its entirety (Olivier, 1997:736). This concern has been specifically addressed within the current GAAR regime by the insertion of section 80H of the Act which states that “the Commissioner may apply the provisions of the Part to steps in or parts of an arrangement”.

The second concern arose from the findings 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 essence, 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 specifically addressed within the current GAAR regime by the insertion of section 80I of the Act which states that “the Commissioner may apply the provisions of the Part in the alternative for or in addition to any other basis for raising an assessment”. For the purposes of this study only those cases that came before the courts based on GAAR were selected and thus this provision need not be specifically addressed (refer to paragraph 3.2 on page 45).

2.4.6 Primary weaknesses within the previous GAAR regime

The weaknesses of the previous GAAR regime that were intended to be addressed by the 2006 amendments have been discussed and analysed above. The concern raised about the application of GAAR to individual steps within the arrangement has been specifically addressed by section 80L of the current GAAR regime. The application of this change to the case studies is applied to individual steps or parts of the transaction of the cases where the Commissioner specifically identified such steps within the arrangement and where sufficient information was provided within the case law documentation. The concern raised with regard to the use of GAAR in the alternative has similarly been addressed by the current GAAR regime, and the use of predefined selection criteria in chapter 3 will address this weakness (refer to paragraph 3.2 on page 45). The main weaknesses investigated in this study are thus those weaknesses where the most extensive criticism has been noted and are those mentioned in the context of the purpose and abnormality requirements. Though the procedural and

administrative concerns have been addressed by specific sections within the current GAAR regime, the remaining weaknesses were intended to be addressed by the extensions to the purpose and abnormality requirements. Therefore, for purposes of answering the research question, this study focuses on the weaknesses discussed in 2.4.2, 2.4.3 and 2.4.4 (pages 17-19) above.

2.5 Current GAAR regime

The weaknesses of the previous GAAR regime, as discussed in 2.4 above, resulted in the amendment of the GAAR in 2006. The general anti-avoidance rules of the current regime are encapsulated in sections 80A to 80L of the Act. The most pivotal provision within these sections is section 80A of the Act. This provision defines the term “impermissible avoidance arrangement”. All other provisions of the current GAAR regime expand on this provision, provide for the remedies of the Commissioner and deal with related procedural and administrative aspects. Section 80A of the 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)”

Comparing these requirements to those of the previous GAAR regime reveals that although additional indicators have been included, both the abnormality and the purpose requirements are still fundamentally present within the current anti-avoidance regime (De Koker, 2010:19.2). Similar to the previous GAAR, both the purpose and abnormality tests have to be satisfied before the transaction, operation or scheme is determined to fall foul of the GAAR provisions. Each of the requirements of the current GAAR regime will be discussed below in order to create an interpretation framework that can be applied when analysing the case law selected in chapter 4. This chapter concludes with the proposed framework in paragraph 2.5.5 (page 41-44).

2.5.1 Arrangement and avoidance arrangement

The provisions of GAAR will only apply where there is an impermissible avoidance arrangement as defined in section 80A of the Act. The first element that has to be present is an arrangement. An arrangement is defined in section 80L of the 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 interpreted widely by the courts as is evident from the judgment held in *Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A) (*Meyerowitz case*) where it was held 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”. In more recent cases, the courts have tended to omit any express reference to a “transaction, operation or scheme” (e.g. *Commissioner for Inland Revenue v Bobat and Others* (2003) 67 SATC 47 – *Bobat case*).

This wide interpretation of the words “transaction, operation or scheme” is aligned with the purpose of GAAR, in that they must be interpreted widely so that they can be applied to any possible transaction or scheme to avoid tax in order to advance a remedy to the Commissioner. This wide interpretation that was suggested in the *Meyerowitz* case of an arrangement will be used in the framework for analysis in paragraph 2.5.5 (page 41-44). In applying the GAAR to individual steps within the arrangement of the cases in chapter 4 in terms of section 80H of the Act, it is noted that the current GAAR regime will only be

applied to individual steps or parts of the transaction of the cases where the Commissioner specifically identified such steps within the arrangement and where sufficient information was provided within the case law documentation.

2.5.2 Tax benefit

An impermissible avoidance arrangement can only be present if the arrangement is an “avoidance arrangement” as defined in section 80L of the Act. An avoidance arrangement is defined in section 80L of the Act as “any arrangement that ... results in a tax benefit”. For an arrangement to fall within the category of an avoidance arrangement, it must result in a tax benefit. The terms “tax” and “tax benefit” are defined in section 80L and section 1 of the Act, respectively. Tax is defined to include “any tax, levy or duty imposed by this Act or any other law administered by the Commissioner”. It therefore includes all taxes (e.g. income tax), levies or duties (e.g. estate duty) administered by SARS. Tax benefit is defined to include “any avoidance, postponement or reduction of any liability for tax”. This definition is very wide and could be interpreted to include any transaction undertaken by a taxpayer as part of its normal day-to-day business operations that has the effect of reducing its tax liability. However, such a wide interpretation of this definition could not have been the intention of the legislature. This view is supported by the words of Watermeyer CJ in *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) (*King case*), which remain valid even though specifically relating to section 90 of the Income Tax Act 31 of 1941 (De Koker, 2010:19.5): “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.”

Notwithstanding the above it is clear that the remaining requirements of GAAR do have the impact of reducing the wide application of the definition of a tax benefit so that not all such transactions that may be included in the definition are subject to GAAR. The courts have also considered the concept of what constitutes a tax benefit and these views can be used to interpret this term within the current GAAR regime. The principles laid down by the courts to be taken into account when determining whether a tax benefit arises from a particular transaction are the following:

- A tax benefit can only arise if a taxpayer can avoid an anticipated liability for tax (*King* case). An existing liability for tax is a debt owed to SARS, as determined by the assessment provided by SARS after the end of the tax year. Stepping out of such a liability for tax would thus constitute tax evasion and not tax avoidance, while stepping out of the way of an anticipated liability for tax would 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. The courts have declined to articulate where the dividing line should be drawn and this is thus open for interpretation. A tax benefit will arise where the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability (*Smith v Commissioner for Inland Revenue* (1964) (1) SA 324 (A) – *Smith* case).
- In determining whether a tax benefit exists, the courts apply the “but for” test. Stated differently, the question to be asked is: Would the taxpayer have suffered tax but for the transaction? (*Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case; *Louw* case).

When applying the requirement of a tax benefit to the facts of cases analysed in chapter 4, all taxes as defined in section 80L are considered. This definition already reflects the intention of the legislator unambiguously. In order to establish whether an arrangement results in a tax benefit, the purpose of the legislation

must be considered if the interpretive approach in paragraph 1.4.5 (page 11) is followed. As the purpose of GAAR is to be interpreted widely to suppress the mischief of taxpayers without leading to absurdities or anomalies, the term “tax benefit” must be interpreted widely. It will firstly be tested whether the taxpayer escaped or prevented an anticipated tax liability that would have arisen from the transaction as it was held in the *Smith* case (refer to Table 2.1 on page 41). Secondly, the ‘but for’ test laid down in *Income Tax Case No 1625* (1996) 59 SATC 383; *Smith* case and *Louw* case will be applied (refer to Table 2.1 on page 41).

2.5.3 Sole or main purpose of the arrangement

An arrangement that results in a tax benefit can only be an avoidance arrangement if its sole or main purpose was to obtain the tax benefit discussed above. The legislator chose to use similar wording to that used in the previous GAAR regime, namely “sole or main purpose”. Therefore, as the requirement of the current GAAR regime (section 80A of the Act) seems largely the same as the sole or main purpose requirement of the previous GAAR regime, the findings of our courts in the past should apply *mutatis mutandis* to an enquiry as to the sole or main purpose of an arrangement in terms of the current GAAR regime. However, section 80G was introduced into the Act and creates a presumption that the sole or main purpose of the transaction is the obtaining of a tax benefit. To this end, the onus of proof as per section 80G of the Act is relevant as follows: “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.”

The mere assertion that a taxpayer’s sole or main purpose was not the avoidance of tax is insufficient to discharge the onus resting upon the taxpayer. A taxpayer is required to discharge this onus through affirmative or conclusive evidence 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, 2010:19.6). In this investigation, the purpose of the transaction is critical. Case law reveals that an

enquiry into the purpose of an arrangement is a subjective one (*Secretary for Inland Revenue v Gallagher* (1978) (2) SA 463 (A) – *Gallagher* case). The view was further held that the dominant intention of the taxpayer should be considered when applying the phrase “solely or mainly” (*Sekretaris van Binnelandse Inkomste v Lourens Erasmus Beperk* (1966) (4) SA 434 (A)).

Whilst the above case law reveals that the purpose requirement of GAAR is a subjective test, there is an alternative view which some tax practitioners and academics subscribe to, in terms of which it is argued that the sole or main purpose is an objective test (De Koker, 2010:19.6; Meyerowitz, 2008:29-12; *Ovenstone v Secretary for Inland Revenue* (1980) 42 SATC 55 (A) – *Ovenstone* case). In this objective test the actual effect of a transaction should be considered rather than the intention of the taxpayer. This approach could provide a taxpayer with a transparent means to discharge the onus referred to earlier rather than a subjective statement of his/her intention. Based on the conflicting views on the interpretation of the current GAAR regime, which is untested legislation, it is impossible to be certain about the manner in which the new GAAR provisions should be applied. Therefore both the subjective test (the stated intention of the taxpayer) as well as the objective test in respect of the effect of the transaction are included within the framework developed in this study (refer to Table 2.1 on page 41) and applied in analysing the case law in chapter 4. It is possible that one taxpayer may enter into a transaction driven mainly by tax considerations whilst another may enter into a similar transaction motivated mainly by business considerations. It then becomes of paramount importance to consider the stated intention of the taxpayer/s in each particular factual circumstance (subjective test). The taxpayer’s stated intention will be tested against the objective view of the factual circumstances (objective test). It should also be noted that, notwithstanding the inconsistency in these views, an attitude has emerged that in the absence of such a plausible non-tax business purpose, the courts will most probably rule in favour of the fiscus (Arendse, 2006:1). 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 1.4.5 (page 11).

Against the above background, when applying this requirement to the cases, the following principles laid down by case law have to be considered. When the court

applies the purpose test, it will take cognisance of the *Conhage* case. In this case, the court 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 context of transactions with a business but also a tax avoidance purpose it was held that “although the agreements of sale and leaseback had served the dual purpose of providing the taxpayer with capital and to take advantage of the tax benefits to be derived from that type of transaction, the raising of finance was the *fons et origo* of the transactions and it remained the underlying and basic purpose thereof”. It was 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 should a taxpayer enter into a particular transaction motivated by normal commercial considerations or objectives and, in doing so, choose to structure the transaction in a manner that will attract the least amount of tax, it would not necessarily result in a finding that the “sole or main purpose” for entering into the transaction was one of tax avoidance. The Zimbabwean case of *R Ltd and K Ltd v Commissioner of Taxes* (1983) 45 SATC 148 (ZH) and the South African *Knuth* case support this principle. The analysis in chapter 4 will therefore not assume that a transaction was entered into mainly or solely to avoid tax when it also has a business purpose.

As the purpose of the GAAR is to suppress the mischief of taxpayers without leading to absurdities or anomalies, the subjective test (as supported in the *Gallagher* case) was considered when applying the GAAR in this study (see chapter 4). The stated intention was tested against the objective view of the factual circumstances (as supported in the *Ovenstone* case) where the actual effect of the arrangement was considered.

2.5.4 Tainted elements

The last requirement to be met for an arrangement to be an avoidance arrangement is that it must contain the so-called tainted elements in the current GAAR regime. This is essentially a revamped version of the previous abnormality requirement of the previous GAAR regime. In order to satisfy this revamped

abnormality requirement one of the tainted elements must be present. Section 80A of the 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)).

If the previous abnormality requirements are compared to the current abnormality requirement, 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. Case law relating to the remaining elements under the previous GAAR regime should therefore remain relevant in the interpretation of the revamped abnormality requirement. It is important to note that the onus of proving the presence of these tainted elements falls on SARS. However, if SARS is able to prove the prevalence of the indicators contained within sections 80C to 80E of the Act, it will effectively discharge this onus (Meyerowitz, 2008:29-11). The analysis of cases in chapter 4 should therefore test every transaction against the indicators laid down in sections 80C to 80E.

The following four tainted elements are each discussed below:

- The abnormality element (refer to paragraph 2.5.4.1 below)
- The lack of commercial substance element (refer to paragraph 2.5.4.2 on page 30)

- The creation of rights or obligations not at arm's length element (refer to paragraph 2.5.4.3 on page 39)
- The misuse or abuse of the Act element (refer to paragraph 2.5.4.4 on page 40).

2.5.4.1 Abnormality element

The previous abnormality test, which contained wording similar to that of the abnormality element, was at the centre of much controversy due to the weaknesses discussed earlier. The fundamental contextual components of the previous GAAR have been retained in the abnormality requirement and the precedents set by the South African courts under the previous GAAR regime would remain relevant in the context of the current GAAR regime. However, the removal of the words “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” from the abnormality requirement implies that the new abnormality requirement must be considered to be an objective test (SARS, 2005:56). In *Income Tax Case No 1712* (2000) 63 SATC 499 (*ITC1712*) it was held that the business purpose test would encompass a comparison between the 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). Another factor to be considered in this regard is that in terms of the new GAAR, an arrangement in a business context should also meet the commercial substance test that is discussed in paragraph 2.5.4.2 below.

When applying this abnormality element in the framework (see chapter 4), the transaction entered into was therefore compared to a normal business transaction entered into for a consideration other than a tax benefit, as suggested by Louw (2007:27). This is aligned with the approach discussed in paragraph 1.4.5 (page 11), in that it must be interpreted as intended by the legislator whilst not giving rise to absurdities or anomalies and is included in the framework of 2.5.5 (refer Table 2.1 on page 41).

2.5.4.2 Lack of commercial substance element

Sections 80C to 80E of the Act explain the term “lack of commercial substance”. Section 80C of the Act contemplates the lack of commercial substance as follows:

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

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

- (a) the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or
- (b) the inclusion or presence of—
 - (i) round trip financing as described in section 80D; or
 - (ii) an accommodating or tax indifferent party as described in section 80E; or
 - (iii) elements that have the effect of offsetting or cancelling each other.”

Though the burden of proving that the sole or main purpose of the arrangement was not the avoidance of tax falls on the taxpayer, the burden of proving that an arrangement lacks commercial substance falls to the Commissioner in terms of section 82 of the Act. Meyerowitz (2008:29-11) notes that the Commissioner will be assisted in discharging this onus to the extent that he is able to point to the indicators contained in sections 80C to 80E. In interpreting the test in section 80C(1), Broomberg (2007:9) maintains that a transaction with a significant tax benefit may either have a significant effect upon the net cash flows or business risks or it may not. The second of these two types of transactions would result in an impermissible avoidance arrangement while the first would not. In expanding upon this test, Broomberg (2007:9) further notes that the inclusion of this test is in essence the inclusion of the “economic substance doctrine” into the GAAR. In the context of GAAR this can be interpreted to mean that if there has been no significant effect upon the net cash flows or business risks there is no commercial

reason to have entered into such a transaction but for the receipt of tax benefits. This interpretation is aligned with paragraph 1.4.5 (page 11) and is included in the framework in paragraph 2.5.5 (refer to Table 2.1 on page 41).

Section 80C(2) provides specific arrangements that will lack commercial substance. In interpreting this section (i.e. the indicative characteristics of a lack of commercial substance) it should be borne in mind that it specifically states that the list is not exhaustive. The list thus provides guidance but does not limit the interpretation of the term “lack of commercial substance”. In commenting on how subsections (1) and (2) are applied, Broomberg (2007:16) notes that from a practical perspective these subsections should be regarded as separate tests (i.e. if the transaction fails subsection (1) or subsection (2) it would result in the transaction having a lack of commercial substance). These provisions were therefore applied as separate tests in the framework described in chapter 4. As each of the indicators in subsection (2) is subject to interpretation, each of these indicators will be discussed separately below.

Substance over form indicator

The Act does not define what is meant by “legal substance or effect ... is inconsistent with, or differs significantly from, the legal form”. If the approach in paragraph 1.4.5 (page 11) is followed, the intention of the legislator should be established. The Explanatory Memorandum explains that this provision is intended to expand the scope of the narrow common law doctrine of substance over form and include it within the scope of the GAAR (National Treasury, 2006:64).

Before determining how this indicator should be applied within the context of GAAR, the principles relating to the common law doctrine of substance over legal 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 contracting parties, or whether the parties disguised the arrangement in a legal form that is different from the real/true intention (simulated or disguised transactions). The principles relating to simulated/disguised transactions require an inquiry as to whether an arrangement reflects the true intention of the contracting parties or whether the parties disguised the arrangement in a legal

form that is different from the parties' real intentions (Olivier, 1997:737). Olivier (1997:737) interprets this to mean 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 if the transaction does 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 a recent case the Supreme Court of Appeal 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 (*Commissioner for South African Revenue Service v NWK Limited* (2010) ZASCA 168 (SCA)).

In expanding on the common law remedies for the Commissioner, it must be recognised that it is not a prerequisite for a disguised transaction to have a sinister or dishonest flavour (*Conhage* case) as confirmed in *Nedcor Bank Limited v ABSA Bank Limited* (1998) (2) SA 830 (W). While it would tend to be viewed an exception, our courts do accept that parties in good faith may have recorded their real intentions erroneously. In terms of the substance over form doctrine, the court will disregard the legal agreements that recorded rights and obligations, which the parties had no intention of pursuing as recorded, 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)). Therefore the purpose of a "disguised transaction" can be said to conceal the fact that the real transaction should be subject to tax in such a way that it conveys the message that it is not subject to tax (Louw, 2007:31; *CCE Randles Bros & Hudson Ltd* (1941) 33 SATC 48 (AD)). Simulated transactions, where the true intention of the parties is not reflected in the legal form of the arrangement, will therefore be regulated under common law and cannot be regulated under GAAR.

In determining how the words "legal substance or effect ... is inconsistent with, or differs significantly from, the legal form" should be applied in the context of GAAR, the intention of the legislator must be considered. In applying the purposive approach to this indicator it is noted that the intention of the legislator is explained as trying 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). Principles for use in determining if a transaction is simulated have been considered by the courts on many occasions, the most recent being *Commissioner for South African Revenue Service v NWK Limited* (2010) ZASCA 168 (SCA). In this case, principles from case law were used to determine if the transactions were simulated, and it was held that the Court must give effect to what the transaction really is and not what in 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. This test was expanded as follows: “if the purpose of a transaction is only to achieve an object that allows the evasion of tax, or of a pre-emptory 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.” In view of these interpretations the test that was included in the framework was to determine if the risks and rewards resulting from the transaction are those that can be expected from such a transaction. In the instance that the risks and rewards are not consistent with the legal form of the transaction, the transaction was considered simulated. This test will be included within the framework included in 2.5.5 (refer Table 2.1 on page 41) and will be applied to the cases in Chapter 4. This approach to applying the indicator reflects the intention of the legislator and therefore the purposive approach discussed in paragraph 1.4.5 (page 11).

Round trip financing indicator

The term “round trip financing” is defined in section 80D of the 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 section 80D of the Act would apply, the avoidance arrangement would have to meet all three of the requirements listed in 80D(1)(a), 80D(1)(b)(i) and 80D(1)(b)(ii) above. The first of these requirements refers to the terms “among” and “between”, which have not been defined within the Act, or the courts, and would therefore have to be interpreted within the ordinary and natural meaning of these words. The shorter Oxford English dictionary (Trumble & Stevenson, 2002) defines the word “among” as “in the assemblage of, surrounded by and grouped with...surrounded by the separate members, components or particles of” and “between” as a “reciprocal action or relation involving two or more agents individually”. The Collins English dictionary (Butterfield *et al.*, 2003) defines the word “among” as “in the midst of...with one another within a group; by the joint action of” and “between” as “in combination; together...indicating reciprocal relation or comparison”. The Webster’s II new college dictionary (Berube *et al.*, 1995) defines the word “among” as “in the group, number, or class of...in the company of...By the joint action of...With one another” and “between” as “by the combined effect or effort of”.

All of these definitions indicate that, for the first requirement of section 80D to be met, the funding would have to be transferred between parties through some sort of reciprocal action (De Koker, 2010:19.7). Support for this submission is to be found in the provisions of section 80D(2) and (3), which require one to ignore aspects such as whether funds can be traced, the timing or sequence of transfers or receipts, the means or manner of transfers or receipts. It is submitted that this

interpretation would meet the purposive approach described in paragraph 1.4.5 (page 11).

The second requirement of section 80D is that the transfer of funds would directly or indirectly result in a tax benefit. This means that even if the arrangement as a whole results in a tax benefit, for section 80D to apply the transfer of funds must also directly or indirectly result in a tax benefit (De Koker, 2010:19.7).

The third requirement refers to three distinct terms, namely “reduce”, “offset” and “eliminate”. The reduction, offsetting or elimination of the business risk must be as a result of the transfer of the funds and the business risk reduced, offset or eliminated must have been incurred in connection with the avoidance arrangement. The concept of “significant business risks” as contemplated under section 80D has not been defined within the Act or the courts and due to the subjectivity that may be developed from one person to another, interpretation is again required. Significant is defined as “important, notable; consequential” (The shorter Oxford English dictionary, Trumble & Stevenson, 2002). The Collins English dictionary (Butterfield *et al.*, 2003) and the Webster’s II new college dictionary (Berube *et al.*, 1995) define the word “significant” as “momentous” or “important”. The ordinary meaning of the word “significant”, within the context of section 80D, can therefore be interpreted to mean a notable or large reduction of the business risks as a result of a transaction. Accordingly, if the transfer of funds results in a reduction in the business risks, it must first be determined if such reduction can be classified as a consequential/large reduction before the provision will apply. Business and risk are defined as “a habitual occupation, a profession, a trade...commercial transactions or engagements” and “risk” as “endanger, put at risk, expose, the chance to injury or loss” (Trumble & Stevenson, 2002). The Collins English dictionary (Butterfield *et al.*, 2003) and the Webster’s II new college dictionary (Berube *et al.*, 1995) define the word “business” as a trade or profession, an industrial, commercial, or professional operation, establishment, the occupation and work or trade in which one is engaged. The Collins English dictionary (Butterfield *et al.*, 2003) and the Webster’s II new college dictionary (Berube *et al.*, 1995) define the word “risk” as the possibility of incurring harm, misfortune or loss; hazard or an element involving uncertain danger. The meaning of the words “business” and “risk” in the

context of section 80D of the Act can thus be said to mean to endanger or increase the chance of loss. This interpretation is confirmed by Deloach (2000:50), who defines 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 would not reduce the risk to a significant extent would not fall foul of the provisions of section 80D of the Act. It is submitted that this interpretation reflects the intention of the legislator.

Accommodating or tax-indifferent parties indicator

The purpose of the inclusion of the term “tax-indifferent party” was noted by SARS (2005:21). It was determined that tax-indifferent parties, by design, work to disable and defeat the balance between tax deductibility in the hands of one party and taxable income in the hands of another. In South African planning circles the inclusion of this term is aimed to prevent the use of these tax-indifferent parties within tax avoidance schemes. Tax-indifferent parties are often aptly referred to as “washing machines”, which describes the roles that these parties fulfil in avoidance arrangements (SARS, 2005:21). Furthermore, it was noted that “these parties 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” by SARS (2005:21) would consider the intention of the legislator and be in line with the method of interpretation suggested in paragraph 1.4.5 (page 11) which complies with the purposive approach to the interpretation

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

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

- (ii) significantly offset either by any expenditure or loss incurred by the party in connection with that avoidance arrangement or any assessed loss of that party; and
- (b) either—
 - (i) as a direct or indirect result of the participation of that party an amount that would have—
 - (aa) been included in the gross income (including the recoupment of any amount) or receipts or accruals of a capital nature of another party would be included in the gross income or receipts or accruals of a capital nature of that party; or
 - (bb) constituted a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by that other party; or
 - (cc) constituted revenue in the hands of another party would be treated as capital by that other party; or
 - (dd) given rise to taxable income to another party would either not be included in gross income or be exempt from normal tax; or
 - (ii) the participation of that party directly or indirectly involves a prepayment by any other party”

As can be seen from the above the term “tax-indifferent party” is widely defined. Section 80E(2) adds to the understanding of this term and states 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. This has the effect that those parties who effectively sell their tax advantages to others are also 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 Act specifically excludes certain parties from being classified as a tax-indifferent party “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 above interpretation based on the ordinary meaning of the words of the section is in accordance with the approach in paragraph 1.4.5 (page 11).

Offsetting or cancelling indicator

Section 80C(2)(b)(iii) of the Act refers to the presence of elements within a transaction that have the effect of offsetting or cancelling each other. This element was introduced because if elements of a transaction have the effect of offsetting or cancelling each other, it would indicate that such parts of the transaction have no real effect and were contrived for the purpose of obtaining a tax benefit (i.e. indicates a lack of commercial substance). Section 80C(2)(b)(iii) is not ambiguous and interpretation based on the ordinary meaning of the words of the section is in accordance with the approach in paragraph 1.4.5 (page 11).

De Koker (2010:19.7) notes that this provision is effectively a “self-neutralising mechanism” which draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called fiscal nullity doctrine. Furthermore, De Koker (2010:19.7) notes that it “is targeted primarily at complex schemes, typically involving complex financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another effectively neutralises the first leg for non-tax purposes”. It is thus obvious that the interpretation of this requirement is aligned with the purpose of GAAR, in that it has been interpreted to suppress the mischief of taxpayers by tainting a transaction where it is evident that cancelling or offsetting has occurred and no change exists other than that of a tax benefit (refer to Table 2.1 on page 41).

2.5.4.3 The creation of rights or obligations not at arm's length element

The non-arm's-length rights and obligations element is the third tainting element. This element has been retained from the previous GAAR regime and thus in interpreting its application it is possible to use the interpretation by the courts for the previous GAAR regime. In the *Hicklin* case it was held 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". Therefore in accordance with the approach in paragraph 1.4.5 (intention of the legislator), the use of the term "arm's length" in the context of rights and obligations can be interpreted to mean what unconnected persons would have done in the same situation (*Geustyn* case; *Hicklin* case). Thus if the parties to a transaction were independent of each other and the transaction would be conceived to be made at market value (i.e. supply and demand) it would be indicative that the parties had transacted at arm's length. Section 80A(c)(i) is not ambiguous and interpretation based on the ordinary meaning of the words of the section is in accordance with the approach in paragraph 1.4.5 (page 11).

Despite the maintenance of this principle in its previous form it is important to note that the test must be made using objective means as opposed to subjective means (i.e. the reference to the circumstances under which the transaction was entered into has been removed and thus changes the test from subjective to objective). This change from subjective to objective was implemented in order to address the weaknesses surrounding the abnormality requirement discussed in paragraph 2.4.2 (page 17) (De Koker, 2010:19.7).

When applying the requirement of arm's-length rights and obligations to the facts of cases analysed in chapter 4, the test of whether unconnected persons would have done the same in this situation was applied (refer to Table 2.1 on page 41). This test already reflects the intention of the legislator unambiguously. In order to establish whether an arrangement has been concluded with arm's-length rights and obligations, the purpose of the legislation must be considered if the approach in paragraph 1.4.5 (page 11) is followed. It must be interpreted widely to suppress the mischief of taxpayers without leading to absurdities or anomalies,

and therefore the interpretation of the term “arm’s-length rights and obligations” as explained above must be used.

2.5.4.4 Misuse or abuse of the Act element

The concept “misuse or abuse of the Act” has not been defined in the Act and would therefore have to be interpreted within the ordinary and natural meaning of these words. This term has been explained in Australia in the *Final report of the Review of Business Taxation* 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,1999:6.2c).

This test was designed in order to bring the South African GAAR legislation in line with international standards and practice, with specific reference to the Canadian GAAR (Louw, 2007:38; National Treasury, 2006:63). The primary difference between the South African and Canadian legislation with regard to the misuse or abuse element is that the Canadian GAAR includes this provision 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 essence, “the Supreme Court of Canada has indicated that the words ‘misuse or abuse’ imply ‘frustrating’ or ‘exploiting’ the purpose of the provisions relied on by the taxpayer” (Van Schalkwyk & Geldenhuys, 2009b:2). This interpretation in a South African context is thus synonymous with the phrase “frustrate the purpose of any provision” (Van Schalkwyk & Geldenhuys, 2009b:2). The intention of the legislator in each case must thus be understood to determine whether the purpose of the transaction was to exploit or manipulate the law on which the taxpayer relied, in order to achieve a result not intended by the legislator (i.e. the intention of the sections of the Act that apply to that transaction must be considered). Such an approach would consider the intention of the legislator and be in line with the method of interpretation suggested in paragraph 1.4.5 (page 11) and was included in the framework developed in this study (refer to Table 2.1 below).

2.5.5 Purposive approach framework

This chapter concludes with a framework that is based on the literature review from case law, authoritative textbooks and academic journals discussed in 2.5.1 to 2.5.4. This framework, set out below, is used to apply the current GAAR regime to the fact patterns from the cases selected in chapter 3.

Table 2.1: 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? 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, escapes or prevented an anticipated liability? (*Smith* case; *King* case)
- Would a tax liability have existed but for this transaction (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 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 non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 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 for the purpose of obtaining 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 which 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 (*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 allows the evasion 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 sort of reciprocal action, resulting directly or indirectly in a tax benefit?
- *Tax-indifferent party test*: Is there a party who effectively sold its tax advantage to others, regardless 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:

- Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? *Hicklin* case

- Would unconnected persons 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?

2.6 Conclusion

This chapter attempted to untangle the components of the previous and current GAAR regimes. In doing so the primary weaknesses of the previous GAAR were identified as both the purpose and abnormality requirements. The purpose requirement was identified as a weakness due to the fact that a taxpayer is able to justify a commercial purpose of transaction with relative ease. The abnormality requirement was identified as a weakness because if a particular form of transaction was commercially acceptable, due to the fact that it was widely used, it did not mean that the abnormality test was passed. In addition to these individual weaknesses, the use of both these tests in conjunction with each other 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.

Following the above, each element of the current GAAR was discussed with reference to court cases, the views of commentators and views from other countries. This discussion culminated in the development of a framework for applying the current GAAR. The analysis reported on in chapter 4 applies this framework to the fact patterns of previous cases. In the next chapter the cases to which this framework was applied are identified.

CHAPTER 3 – SELECTION OF CASE LAW

3.1 Introduction

“[I]t scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers” (*Lord Howard de Walden v Inland Revenue Commissioners* (1942) 1 All ER 287 289). A sample of cases was selected from a population of cases where the Commissioner believed the taxpayers’ fingers should have been burnt for entering into schemes to avoid tax. Whilst chapter 2 included an analysis of the previous GAAR regime, as well as a discussion of its weaknesses, it forms only one part of the integrated study. The critical component of this study is the application of the framework developed in chapter 2 to selected case law to determine if these cases would, under the current GAAR regime, leave the taxpayers with burnt fingers. However, without a set of predefined selection criteria for the case law, the study cannot be considered to be a quality case study design. This chapter provides the basis for the selection of case law to achieve the objectives of the study. The following paragraphs deal with the criteria applied for the selection of case law used in phase 2 of the study.

3.2 The population and selection criteria

The case law selected for use has been determined with reference to all the “tax avoidance” cases reported in the LexisNexis database of South African Tax Cases Reports (LTC). This case law represents actual cases that have come before the courts under the previous GAAR regimes (i.e. the leading cases). In choosing cases Creswell (2007:75) states 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 were considered critical were used for selection purposes as discussed below.

The case law population was determined by identifying the case law that has previously come before the courts in respect of the anti-avoidance rules, thus excluding all those cases where the case was presented before the courts on an

alternative basis (refer to paragraphs 2.4.5 and 2.4.6 on pages 19-20). The population was determined with reference to the cases reported in the LTC Reports at June 2010 and may be considered the most critical cases with regard to tax avoidance. This population of case law provided an impartial platform from which the case law was selected. Based on this criterion, only 46 cases, as noted in the LTC Reports on tax avoidance, came before the courts as listed in Table 3.1 (page 47).

In further applying the principles of the selection of the critical case law in relation to tax avoidance, the following qualitative criteria were used to eliminate case law with the aim of refining the selection of cases:

- 1) Only those cases included within the LTC Reports that had come before South African courts were selected. Therefore, all those cases reported under the Rhodesian High Court, the Zimbabwean Special Court and the Zimbabwean High Court were excluded from the selection in order to maintain the scope and focus of the study in a South African legislative context.
- 2) All those cases in which the anti-avoidance rule was successfully applied (i.e. those cases in which the transactions entered into by the taxpayer were determined by the courts to be within the scope of the anti-avoidance legislation) were excluded from the selection. This criterion is critical to the scope of the study as this study attempts to determine if weaknesses (weaknesses highlighted with reference to case law in which the avoidance legislation failed to stand up to the rigours of court) within the previous GAAR regime have been addressed by the 2006 amendments. Using case law in which the GAAR was successfully applied would not have achieved this purpose.
- 3) Tax cases that reported on the anti-avoidance rules in relation to assessed losses, such as those included in section 103(2) of the Act, were excluded from the selection. This criterion was used to provide for the scope limitations of the study, i.e. the focus is not on specific anti-avoidance legislation but on the general anti-avoidance rules.
- 4) All those cases presented before the courts on the basis of the belief by the Commissioner that a tax benefit was present not in the context of

normal tax (i.e. Estate Duty and Value-Added Tax) were excluded on the basis that the Commissioner may only make an adjustment in terms of section 80B of the GAAR for normal tax (Meyerowitz, 2008:29-6). Therefore, case law presented before the courts on the avoidance of any tax other than normal tax was excluded from the study in order to limit the scope of the study.

- 5) All case law occurring under section 90 of the Act was excluded from the study due to the nature and number of amendments made when the anti-avoidance legislation was amended to be included into section 103 of the Act in 1959. Case law occurring prior to the 1996 amendments was not excluded on the basis that the main criticisms against GAAR have remained intact despite amendments that were enacted before 1996.

The above qualitative criteria aided in effectively selecting those cases which are critical to the GAAR in South Africa. However, in applying the principles of purposeful maximal sampling, only those cases in which the highest level of judicial precedence was made (i.e. those cases appearing before the Supreme Court of Appeal) were selected. Table 3.1 below reflects the cases that met these requirements and that were excluded from testing.

Table 3.1: Case law

Selection elimination criteria

- 1) Cases reported under the Rhodesian High Court, the Zimbabwean Special Court and the Zimbabwean High Court
- 2) Cases in which the transactions entered into by the taxpayer were determined to be within the scope of the anti-avoidance legislation (i.e. revenue authority won)
- 3) Cases reported on section 103(2) of the Act relating to assessed losses
- 4) Cases relating to a tax benefit for tax other than normal income tax
- 5) Cases occurring before the introduction of section 103 of the Act (i.e. section 90 of the Act)
- 6) Cases not handed down under the Supreme Court of Appeal

Case law	Selection elimination criteria met (X)					
	1	2	3	4	5	6
<i>Income Tax Case No 1774 (2003) 66 SATC 255 (G)</i>		X	X			X
<i>Conshu (Pty) Ltd v Commissioner for Inland Revenue (1994) (4) A 603 (A)</i>		X	X			
<i>Smith v Commissioner for Inland Revenue (1964) (1) SA 324 (A)</i>		X			X	X
<i>Income Tax Case No 1554 (1990) 55 SATC 115 (Z)</i>	X					X
<i>Income Tax Case No 1123 (1968) 31 SATC 48 (T)</i>		X	X			X
<i>Commissioner for Inland Revenue v Ocean Manufacturing Ltd (1990) 52 SATC 151 (A)</i>		X	X			
<i>L v Commissioner of Taxes (1975) 37 SATC 116 (RAD)</i>	X	X				
<i>Secretary for Inland Revenue v Geustyn, Forsyth and Joubert (1971) 33 SATC 113 (A)</i>						
<i>Income Tax Case No 1558 (1992) 55 SATC 231</i>		X				X
<i>Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd (1999) 62 SATC 65 (E)</i>						X
<i>Income Tax Case No 1582 (1994) 57 SATC 27 (T)</i>		X				X
<i>Income Tax Case No 1618 (1996) 59 SATC 290 (EC)</i>						X
<i>Income Tax Case No 1513 (1988) 54 SATC 62 (Z)</i>	X					X
<i>Commissioner for Inland Revenue v Louw (1983) 45 SATC 113 (A)</i>		X				
<i>Income Tax Case No 1606 (1995) 58 SATC 328 (C)</i>		X				X
<i>Income Tax Case No 1518 (1989) 54 SATC 113 (T)</i>		X				X
<i>Income Tax Case No 581 (1944) 14 SATC 105 (U)</i>		X			X	
<i>Income Tax Case No 1714 (1996) 63 SATC 507 (G)</i>		X				X
<i>Income Tax Case No 1496 (1990) 53 SATC 229 (T)</i>		X				X
<i>F v Commissioner of Taxes (1975) 37 SATC 372 (R)</i>	X	X		X		X
<i>Commissioner of Taxes v Ferera (1976) 38 SATC 66 (RAD)</i>	X	X		X		
<i>Income Tax Case No 1625 (1996) 59 SATC 383</i>						X
<i>Income Tax Case No 1669 (1999) 61 SATC 479 (Z)</i>	X	X				X

Case law	Selection elimination criteria met (X)					
	1	2	3	4	5	6
<i>Income Tax Case No 1670</i> (1998) 62 SATC 34 (G)						X
<i>Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)</i> (1999) 61 SATC 391						
<i>Donner v Commissioner of Taxes</i> (1974) 36 SATC 191 (R)	X	X				
<i>Income Tax Case No 1227</i> (1974) 37 SATC 61 (R)	X	X				X
<i>Hicklin v Secretary for Inland Revenue</i> (1980) 1 All SA 301 (A)						
<i>H v Commissioner of Taxes</i> (1972) 34 SATC 39 (RAD)	X	X				
<i>Smith v Commissioner for Inland Revenue</i> (1963) 25 SATC 149 (TPD)		X			X	X
<i>Secretary for Inland Revenue v Gallagher</i> (1978) (2) SA 463 (A)				X		
<i>Ovenstone v Secretary for Inland Revenue</i> (1980) 42 SATC 55 (A)		X				
<i>J v Commissioner of Taxes</i> (1992) 55 SATC 62 (ZHC)	X					X
<i>Income Tax Case No 1699</i> (1999) 63 SATC 175 (C)		X				X
<i>Commissioner for Inland Revenue v Bobat and Others</i> (2003) 67 SATC 47 (N)						X
<i>Income Tax Case No 1712</i> (2000) 63 SATC 499 (G)						X
<i>Meyerowitz v Commissioner for Inland Revenue</i> (1963) (3) SA 863 (A), 25 SATC 287		X			X	
<i>Income Tax Case No 1625</i> (1996) 59 SATC 383						X
<i>Commissioner for Inland Revenue v King</i> (1947) 14 SATC 184 (A)					X	
<i>Income Tax Case No 1113</i> (1967) 30 SATC 8 (C)		X			X	X
<i>Income Tax Case No 963</i> (1961) 24 SATC 705 (T)	X				X	X
<i>Kommissaris van die Suid-Afrikaanse Inkomisdienste v Botha</i> (2000) 62 SATC 264 (O)						X
<i>Income Tax Case No 1151</i> (1970) 33 SATC 133 (C)		X				X
<i>Income Tax Case No 1178</i> (1972) 35 SATC 29 (C)		X				X
<i>Income Tax Case No 1307</i> (1979) 42 SATC 147 (T)				X		X

3.3 Case law selected

Subsequent to the application of the aforementioned criteria, three cases remained available for use in this study (refer to Table 3.1 above):

- *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) 61 SATC 391 (A)
- *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 33 SATC 113 (A)
- *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A)

All these cases were presented before the courts on the legislation existing before the 1996 amendments to GAAR. In order to extend the selection criteria, and again use purposeful maximal sampling techniques to enable case law to be selected post the 1996 amendments, the case law collection within the LTC Reports was again considered and all the criteria above were applied once more to the post-1996 cases, excluding the judicial precedence criteria. This extension of the selection criteria enabled the study to determine if the 2006 amendments to GAAR have addressed the weaknesses identified within the GAAR both before and after the 1996 amendments. This thus improves the ability of the study to assess if the 2006 amendments to GAAR have in fact addressed the weaknesses of the previous GAAR regime in accordance with the research question and objectives. Table 3.2 below reflects the cases that met these requirements and were excluded from testing.

Table 3.2: Case law

Selection elimination criteria

- 1) Cases reported under the Rhodesian High Court, the Zimbabwean Special Court and the Zimbabwean High Court
- 2) Cases in which the transactions entered into by the taxpayer were determined to be within the scope of the anti-avoidance legislation (i.e. revenue authority won)
- 3) Cases reported on section 103(2) of the Act relating to assessed losses
- 4) Cases relating to a tax benefit for tax other than normal income tax
- 5) Cases occurring before the 1996 amendments to GAAR

Case law	Selection elimination criteria met (X)				
	1	2	3	4	5
<i>Income Tax Case No 1774</i> (2003) 66 SATC 255 (G)		X	X		X
<i>Conshu (Pty) Ltd v Commissioner for Inland Revenue</i> (1994) (4) A 603 (A)		X	X		X
<i>Smith v Commissioner for Inland Revenue</i> (1964) (1) SA 324 (A)		X			X
<i>Income Tax Case No 1554</i> (1990) 55 SATC 115 (Z)	X				X
<i>Income Tax Case No 1123</i> (1968) 31 SATC 48 (T)		X	X		X
<i>Commissioner for Inland Revenue v Ocean Manufacturing Ltd</i> (1990) 52 SATC 151 (A)		X	X		X
<i>L v Commissioner of Taxes</i> (1975) 37 SATC 116 (RAD)	X	X			X
<i>Secretary for Inland Revenue v Geustyn, Forsyth and Joubert</i> (1971) 33 SATC 113 (A)					X
<i>Income Tax Case No 1558</i> (1992) 55 SATC 231		X			X
<i>Commissioner for South African Revenue Service v Knuth and Industrial Mouldings (Pty) Ltd</i> (1999) 62 SATC 65 (E)					X
<i>Income Tax Case No 1582</i> (1994) 57 SATC 27 (T)		X			X
<i>Income Tax Case No 1618</i> (1996) 59 SATC 290 (EC)					X
<i>Income Tax Case No 1513</i> (1988) 54 SATC 62 (Z)	X				X
<i>Commissioner for Inland Revenue v Louw</i> (1983) 45 SATC 113 (A)		X			X
<i>Income Tax Case No 1606</i> (1995) 58 SATC 328 (C)		X			X
<i>Income Tax Case No 1518</i> (1989) 54 SATC 113 (T)		X			X
<i>Income Tax Case No 581</i> (1944) 14 SATC 105 (U)		X			X
<i>Income Tax Case No 1714</i> (1996) 63 SATC 507 (G)		X			X
<i>Income Tax Case No 1496</i> (1990) 53 SATC 229 (T)		X			X
<i>F v Commissioner of Taxes</i> (1975) 37 SATC 372 (R)	X	X		X	X
<i>Commissioner of Taxes v Ferera</i> (1976) 38 SATC 66 (RAD)	X	X		X	X
<i>Income Tax Case No 1625</i> (1996) 59 SATC 383					X
<i>Income Tax Case No 1669</i> (1999) 61 SATC 479 (Z)	X	X			X
<i>Income Tax Case No 1670</i> (1998) 62 SATC 34 (G)					X

Case law	Selection criteria met (X) elimination				
	1	2	3	4	5
<i>Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)</i> (1999) 61 SATC 391					X
<i>Donner v Commissioner of Taxes</i> (1974) 36 SATC 191 (R)	X	X			X
<i>Income Tax Case No 1227</i> (1974) 37 SATC 61 (R)	X	X			X
<i>Hicklin v Secretary for Inland Revenue</i> (1980) 1 All SA 301 (A)					X
<i>H v Commissioner of Taxes</i> (1972) 34 SATC 39 (RAD)	X	X			X
<i>Smith v Commissioner for Inland Revenue</i> (1963) 25 SATC 149 (TPD)		X			X
<i>Secretary for Inland Revenue v Gallagher</i> (1978) (2) SA 463 (A)				X	X
<i>Ovenstone v Secretary for Inland Revenue</i> (1980) 42 SATC 55 (A)		X			X
<i>J v Commissioner of Taxes</i> (1992) 55 SATC 62 (ZHC)	X				X
<i>Income Tax Case No 1699</i> (1999) 63 SATC 175 (C)		X			X
<i>Commissioner for Inland Revenue v Bobat and Others</i> (2003) 67 SATC 47 (N)					
<i>Income Tax Case No 1712</i> (2000) 63 SATC 499 (G)					
<i>Meyerowitz v Commissioner for Inland Revenue</i> (1963) (3) SA 863 (A), 25 SATC 287		X			X
<i>Commissioner for Inland Revenue v King</i> (1947) 14 SATC 184 (A)					X
<i>Income Tax Case No 1113</i> (1967) 30 SATC 8 (C)		X			X
<i>Income Tax Case No 963</i> (1961) 24 SATC 705 (T)	X				X
<i>Kommissaris van die Suid-Afrikaanse Inkomisdienste v Botha</i> (2000) 62 SATC 264 (O)					X
<i>Income Tax Case No 1151</i> (1970) 33 SATC 133 (C)		X			X
<i>Income Tax Case No 1178</i> (1972) 35 SATC 29 (C)		X			X
<i>Income Tax Case No 1307</i> (1979) 42 SATC 147 (T)				X	X

Subsequent to the application of this additional extension of the selection criteria, only two cases remained available for use in this study with reference to case law appearing before the courts post the 1996 amendments:

- *Income Tax Case No 1712* (2000) 63 SATC 499
- *Commissioner for Inland Revenue v Bobat and Others* (2003) 67 SATC 47

Both of these South African cases came before the courts post 1996, but before the 2006 amendments. In both of these additional cases the GAAR failed to stand up to the rigours of court on the basis of differing aspects of the GAAR as described below:

- In the *Bobat* case it was held that the sole or main purpose of the transactions entered into was not for the deriving of a tax benefit.
- In *ITC1712* it was held that the transactions entered into did not satisfy the abnormality requirement.

The combination of tools used in selecting the case law thus allowed the study to explore both of the critical weaknesses identified within the previous GAAR regime (abnormality and purpose), since some of these cases failed as a result of the abnormality requirement whilst others failed on the purpose requirement.

3.4 Conclusion

The qualitative case study design selected for this study necessitated the use of a three-phased literature study. While the first phase of the literature study (in chapter 2) was designed to gain an understanding of the previous and current GAAR regimes, the second phase of the literature study (in chapter 4) requires the use of case studies, in the form of case law, to which the current GAAR legislation can be applied. In selecting these cases it was recognised that without rigid selection criteria the results that could be drawn from the study could be negatively impacted. To address this fundamental component of the study a combination of purposeful sampling (refer to paragraph 3.2 on page 45) and a selection of the critical cases (refer to paragraph 3.2 on pages 45-47) was used to maintain the objectivity of the study. The criteria were applied to the case law database on tax avoidance and resulted in the selection of five cases for analysis, that did not result in the taxpayers being burnt by the GAAR then in effect (refer to paragraph 3.3 on pages 50-53).

The next chapter forms the next phase of the study (i.e. document review) and the framework developed in chapter 2 is applied to the fact patterns of the selected case law.

CHAPTER 4 - CASE LAW

4.1 Introduction

The fact that judicial decisions are an integral part of income tax law is a fundamental principle used and applied in South Africa (Stiglingh *et al.*, 2011:8). Whilst judicial decisions in the form of case law are used in a non-traditional manner in this study, by applying current legislation to transactions presented before the courts under previous legislation, it remains a critical component of the study. The case study design selected for use in this study is unpacked to its full potential in this chapter by applying the framework developed to the cases selected in chapter 3. In doing so the fact patterns of the cases are analysed in the context of the tax legislation effected at the time of the transactions, with the exception of the GAAR. This chapter thus forms the implementation of research objective iii) in paragraph 1.3 on page 6.

4.2 *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) 61 SATC 391 (A)

4.2.1 Background facts

The taxpayer entered into two separate sale and leaseback agreements with Firstcorp Merchant Bank Ltd for some of its manufacturing plant and equipment, in order to raise capital for the expansion of its business. The first agreement provided for the sale of a considerable number of plant and equipment at a price of R95 750 000, for which ownership would pass to Firstcorp on fulfilment of the agreement. The lease agreement recorded that the taxpayer would lease the same plant and equipment from Firstcorp from 6 May 1992 to 30 June 1996 at a total cost of R135 023 188 over the five-year period. The second agreement provided for substantially similar terms as the first with the sale price of R40 000 000, whilst the lease agreement provided for lease payments totalling R53 215 310 from 16 March 1993 to 15 March 1998. Pursuant to the agreements, Firstcorp paid the taxpayer R95 750 000 and R40 000 000 and the taxpayer paid the agreed rentals on the due dates.

In its income tax return for the year ended 30 June 1992 the taxpayer reflected a taxable recoupment of R3 366 324 consequent upon the sale of the assets to

Firstcorp in terms of the first sale agreement (i.e. the difference between the original price and the tax value of the assets). In its return for the year ending 30 June 1993 the recoupment amounted to R1 794 765. In respect of the 1992, 1993 and 1994 years of assessment the taxpayer claimed as a deduction the rentals paid by it to Firstcorp in each year pursuant to the two lease agreements. Rental renewals for the first and second sale and leaseback transactions were provided at R500 000 and R200 000, respectively. Both the taxpayer and Firstcorp were aware of the tax benefits to be derived from these transactions and decided to follow this course.

The Commissioner for Inland Revenue reversed the recoupments included by the taxpayer and refused to allow the deduction of the rental payments as expenditure incurred in production of income, due to the fact that he considered the transactions to be a loan of the purchase price of the equipment (i.e. the substance of the agreement was different from the legal form). The Commissioner contended that the agreements should not be applied in accordance with their legal form because the parties had no real intention of entering into a sale and leaseback, despite the fact that they honestly believed that it would be sufficient to go through the legal formalities, in order to obtain the tax benefits.

4.2.2 Arrangement

The transactions entered into by the taxpayer (i.e. the sale and leaseback contracts) satisfy point 1 of the framework developed in this study because the sale and leasebacks can be classified as a transaction, operation or scheme as contemplated in section 80L. When presented before the courts the first time, the transactions considered in the *Conhage* case were similarly considered to constitute an arrangement as contemplated under the now repealed GAAR provisions of section 103(1) of the Act. Thus the provisions of the current GAAR provisions would not have a different result with regard to the contemplation of an arrangement.

4.2.3 Tax benefit

From a review of the facts of the case, by entering into the arrangement, Conhage was liable to include the recoupments (1992 - R3 366 324 and 1993 - R1 794 765) in its taxable income but was also entitled to a deduction of rental expenditure actually incurred during the year of assessment that was considerably higher than the taxable recoupments. This deduction allowed the taxpayer to avoid an anticipated liability for tax by reducing its taxable income. Conhage can therefore be described as having stepped out of the way of the anticipated liability for tax (refer to paragraph 2.5.5 on page 41). This is consistent with the 'but for' test where the taxpayer started from a position where eventually it would have received taxable income and subsequently, by entering into this transaction, escaped such tax liability (refer to paragraph 2.5.5 on page 41 and the *Smith* case). The lease transaction entered into by the taxpayer in the *Conhage* case therefore satisfies part 2 of the framework. The lease transactions entered into constitute an arrangement which had the effect of obtaining a tax benefit. Therefore, the transactions constitute an avoidance arrangement as defined in section 80L of the Act.

When previously brought before the courts the transactions contemplated within the *Conhage* case were similarly determined to have the presence of a tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR does not result in a different conclusion on the basis of the facts of the case.

4.2.4 Sole or main purpose of the arrangement

In applying the third requirement of the framework the avoidance arrangement will only constitute an impermissible avoidance arrangement if its sole or main purpose was to obtain the tax benefit. From a review of the facts of the case, the main purpose of the transactions (i.e. entering into the sale and leaseback agreements) was to enable the respondent to raise capital for the expansion of its business (i.e. the stated purpose). The effect of the transaction similarly supports the subjective purpose because Conhage did receive capital as a result of the transaction. Therefore the subjective and objective main purposes of the

avoidance arrangement are consistent with obtaining capital from the business rather than the receipt of the tax benefit.

In addition to the above, the principles noted in the framework regarding the sole or main purpose requirement were considered separately:

- The transaction clearly had two main purposes (i.e. raising capital and obtaining the tax benefit) but the dominant purpose was to obtain capital. In view of the representations made within the case, if not for the necessity to raise capital the arrangement would not have been entered into. Therefore the dominant purpose was to raise capital.
- The same commercial result of the arrangement could have been obtained via a loan instead of the sale and leasebacks. This consideration indicates that the transactions would never have been entered into had it not been for the necessity to raise capital. Furthermore, though two options were clearly present, the taxpayer is entitled to arrange his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be (refer to paragraph 1.1.1 on page 1 and the case of *IRC v Duke of Westminster* (1936) 19 TC 490).
- The taxpayer had a dominant subjective non-tax business purpose for entering into the sale and leasebacks (i.e. the dominant purpose of the arrangement was to obtain capital and not to obtain the tax benefit).

The views expressed above can be confirmed in the decision held in the *King* case where it was noted that there are many ordinary, legitimate transactions and operations which, if a taxpayer carried them out, would have the effect of reducing the amount of his income, but it cannot be imagined that Parliament intended to tax persons who carry out such operations as if they had not carried them out. The appellant is consequently entitled to a reduction in the taxable income when a legitimate transaction has been entered into and thus the respondent in this case discharged the onus of proof required by the current GAAR regime. When previously brought before the courts the transactions contemplated within the *Conhage* case were similarly not considered to meet the sole or main purpose requirement.

4.2.5 Tainted elements requirement

As stated previously, before an avoidance arrangement will be an impermissible avoidance arrangement, it must satisfy all the criteria of GAAR. Although the arrangement has not met the sole or main purpose requirement, a brief discussion of the remaining requirements is included below.

One of the final tests used to determine if an arrangement would be seen to be an impermissible avoidance arrangement would be to establish whether if the arrangement was entered into or carried out by means or in a manner which would not normally be employed in terms of section 80A of the Act (refer to paragraph 2.5.4.1 on page 29). This normality provision has been applied in the context of business due to the fact that the taxpayer claimed the deduction in terms of an arrangement to raise finance for his business. It is noted that the agreement was carried out by means or in a manner which would normally be employed, in that sale and leaseback transactions are not abnormal contracts. In addition to the above, in applying the framework, there is no apparent difference between the transactions entered into by Conhage and a transaction entered into by another taxpayer in the absence of a tax consideration (i.e. it would be considered normal business for any taxpayer to enter into a sale and leaseback to raise capital, regardless of the tax consequences).

Furthermore, from the facts of the case the transactions as a whole did not lack commercial substance (i.e. the attempt to obtain capital for the expansion of the business has commercial substance). In applying the framework each of the tests are dealt with separately as follows:

- It is evident that the transactions did have a significant effect upon the business risks. (Before the transactions Conhage had all the risks and rewards of ownership, whereas after the transaction the bank bore the risk of ownership.) Furthermore, the transactions did have a significant effect upon the net cash flows as Conhage bore the liquidity risk of repayment of the lease rentals but received an immediate sum of capital. The transactions can be considered significant since the court noted that the transactions concerned a considerable amount of plant and equipment.

- In applying the principles laid down in section 80C of the Act (refer to Table 2.1 on page 41) the transactions were carried out and effected as was consistent with their legal form and effect was given to the legalities of the contract. In addition, the risks and rewards of ownership rested with the bank and not the taxpayer. Therefore Conhage was not insulated from the economic risk arising from the sale and leasebacks, because it was required to make the rental repayments in accordance with the contracts and had no right of ownership of the assets.
- There was also no evidence of the presence of round trip financing in the context of section 80C, as although funds were transferred “between or amongst the same parties” (i.e. Conhage received capital from the bank and was required to make repayments to the same bank), the transfer of funds did result in a significant difference in business risk of ownership and lease repayments as discussed above. Therefore the arrangement does not satisfy the round trip financing requirement.
- There is no evidence of the presence of any accommodating or tax indifferent parties within the transactions or arrangement as no party to the transaction effectively sold their tax advantage.
- There is no presence of offsetting or cancelling effects as contemplated in section 80C of the Act other than the deduction against gross income, which is a legitimate transaction.

Regarding the rights and obligations requirement, it is evident from the facts of the case that the equipment was sold to the bank at a lower price than the total lease repayments over the lease term. The differences between these amounts are commonplace in financing arrangements and thus can be expected in transactions of a similar nature between parties dealing at arm’s length. It can therefore be considered that the rights and obligations attached to the arrangement were those which could have been expected in any other similar transactions between parties dealing at arm’s length (refer to Table 2.1 on page 41). No aspects of the transaction have been identified which had the effect of creating rights or obligations which would not normally be created between persons dealing at arm’s length. This can be confirmed by the reference to the

fact that each party was transacting in their own best interest with a view to earning profits (bank) or receiving capital (Conhage).

Lastly, concerning the misuse of the Act requirement, it is clear that the Act was applied correctly in deducting an amount as contemplated in the Act. This is explained by the fact that the lease expenditure was actually incurred in the production of income and was similarly not of a capital nature. However, the question to be answered is whether this expenditure was purely manufactured because of the use of a sale and leaseback agreement. In answering this question it must be considered whether the alternative (i.e. a loan from the bank to raise capital) would have given rise to similar such deductions. The fact patterns of the case do not provide sufficient detail to determine how the funds were to be applied and thus it is not possible to determine if the interest expenditure was of a capital (non-deductible) or revenue nature (deductible). It therefore cannot be determined with certainty whether there was an exploitation of the legislation to achieve an unintended result. In addition, it must be noted that Conhage was entitled to avoid tax by adopting a legitimate course of action (refer to paragraphs 1.1.1 and 2.5.2 for further discussion) and thus it is submitted that there may not have been a misuse of the Act, as contemplated in the provisions of the current GAAR regime.

4.2.6 Conclusion for the *Conhage* case

In collating the findings of the *Conhage* case discussed above, the following table is a representation of the results as applied in accordance with the purposive approach and the framework:

Table 4.1 legend

X Framework requirement not met

✓ Framework requirement met

Table 4.1: Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case
<p>1 - Is there an arrangement?</p> <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case.	
2 - Does the transaction/operation/scheme result in a tax benefit?	✓
<ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case) 	✓
<ul style="list-style-type: none"> 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) 	✓
3 - Is the sole or main purpose to obtain such tax benefit?	×
<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:</p> <ul style="list-style-type: none"> Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) <p>In applying the objective and subjective tests the following principles may be considered:</p> <ul style="list-style-type: none"> If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (<i>Conhage</i> case); or If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which 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 (<i>Conhage</i> case); or 	×

<ul style="list-style-type: none"> • 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	×
<p>- One of the following with regard to business transactions:</p> <p>- <i>Entered into in a manner not normal for bona fide business purposes?</i></p> <ul style="list-style-type: none"> • 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) <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"> • <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) • <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 allows the evasion 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.) • <i>Round trip financing test:</i> Has funding been transferred 	<p>×</p> <p>×</p> <p>×</p> <p>×</p> <p>×</p>

<p>between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit?</p> <ul style="list-style-type: none"> • <i>Tax-indifferent party test: Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties?</i> • <i>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.)</i> 	<p>×</p> <p>×</p>
<p>- One of the following with regard to transactions in any context:</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"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin case</i> • Would unconnected persons have done the same in this situation? <i>Hicklin case</i> <p>- <i>Is there misuse or abuse of provisions of the Act?</i></p> <ul style="list-style-type: none"> • 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? 	<p>×</p> <p>×</p> <p>×</p>

From an evaluation of the facts the transactions entered into in the *Conhage* case (i.e. entering into the sale and leaseback agreements) fall within the definition of an arrangement as given in section 80L of the Act. Furthermore, the arrangement resulted in a tax benefit (i.e. the increased deduction of rental payments) and thus constitutes an avoidance arrangement as defined in section 80L of the Act. In addition, the avoidance arrangement has not been found to have been entered

into for the sole or main purpose of attaining such tax benefit (i.e. it was entered into for the purpose of attaining capital for the expansion of the business).

It is therefore not necessary to determine the remaining requirements of section 80A (i.e. normality, commercial substance, arm's-length rights or obligations or misuse of the Act) because although the scheme is an avoidance arrangement as defined, it does not constitute an impermissible avoidance arrangement due to the fact that it has not satisfied all the requirements of section 80A of the Act (i.e. sole or main purpose). This result may indicate that the fact that the sole or main purpose requirement, which has remained substantially similar to its predecessor, may still inherently include the weaknesses identified in the previous GAAR regime.

When the provisions of the previous GAAR regime were applied, a similar conclusion was reached by the courts and thus it can be said that the current GAAR provisions, when applied to the case, do not result in the requirements of an impermissible avoidance arrangement being met. Thus the new GAAR provisions have not had a significant impact on the transactions entered into in this case.

4.3 *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* (1971) 33 SATC 113 (A)

4.3.1 Background facts

In the *Geustyn* case a company with unlimited liability took over the business of a partnership of consulting engineers from 1 June 1966. The company was formed with R5 000 capital which was allotted in equal shares to the three former partners of the partnership, who became the sole directors of the company. Under the agreement whereby the company took over the business of the partnership, the company undertook to employ the three former partners at an annual salary of R10 000 each and also to pay to the partnership R240 000 for the goodwill of the business (this amount was calculated by aggregating the three years of the partnership profits). No individual service contracts were entered into between the company and the former partners and no guarantee was furnished by it for the payment of the goodwill. The amount of goodwill was credited on loan account to the partners in equal shares at an interest rate of 8.5% p.a. In addition

to this, each former partner received a R7 500 fee for the 1967 year of assessment. During the 1967 year taxable income of R72 840 accrued to the company upon which R29 136 would have been levied in normal tax.

The Secretary for Inland Revenue, being of the opinion that the formation of the company constituted a scheme for the reduction of the tax liability of the former partners, applied section 103(1) of the Act and allocated the company's taxable income to the former partners in equal shares, thus resulting in no taxable income being reflected on the company's assessment.

4.3.2 Arrangement

In applying the framework developed in this study, the transactions entered into by the taxpayer in the *Geustyn* case (i.e. the conversion of a partnership to an unlimited company) constitute a transaction, operation or scheme as contemplated in section 80L. Therefore if presented before the courts, the transactions considered in the *Geustyn* case would similarly be considered to constitute an arrangement as contemplated under the now repealed GAAR provisions of section 103(1) of the Act. Thus the provisions of the current GAAR provisions would not have a different result regarding the contemplation of an arrangement.

4.3.3 Tax benefit

In applying the second requirement included in the framework it is noted that by entering into the arrangement, the former partners reduced their tax burdens by R1 456 by trading in the company as opposed to the partnership (i.e. the former partners effectively got out of the way of R1 456 normal tax). Thus, the conversion of the partnership to an unlimited company reduced the amount of normal tax derived from the consulting business and constitutes the avoidance of an anticipated liability for tax (refer to Table 2.1 on page 41) and resulted in a tax benefit as contemplated in section 80L of the Act. This is consistent with the view held in the *Smith* case where the taxpayers started from a position where eventually the taxpayer would have received taxable income and subsequently, by entering into this transaction, escaped such tax liability. In view of the above it is submitted that the transactions entered into by the taxpayer in the *Geustyn* case constituted an arrangement which had the effect of obtaining a tax benefit.

In addition, by applying the but for test it is evident that the taxpayers would have had a larger tax liability if the arrangement had not been entered into. Therefore, the transactions constitute an avoidance arrangement as defined in section 80L of the Act.

The transactions contemplated within the *Geustyn* case would therefore similarly be determined to have the presence of a tax benefit under the current GAAR regime. Thus the application of the provisions of the current GAAR regime would not have a different result regarding the contemplation of a tax benefit.

4.3.4 Sole or main purpose of the arrangement

In applying the third requirement of the framework the sole or main purpose of the arrangement must be to obtain the tax benefit. In reviewing the facts of the case the stated intention (subjective test) of the transactions (i.e. conversion of partnership to an unlimited company) was to enable the shareholders to take advantage of the considerable benefits to be derived from incorporation, as contrasted with the partnership which was liable to dissolution consequent upon the death or resignation of the individual partners (i.e. no restriction of the number of shareholders and the ability to enter into consortiums of engineers in larger projects etc.). Furthermore, from a review of the facts of the case it is evident that the objective effect of the transaction supports the stated intention as the arrangement did in fact achieve the results anticipated (to enable the shareholders to take advantage of the considerable benefits to be derived from incorporation).

In considering the principles developed in the framework, the following has been considered:

- In addition to the benefits derived from the conversion of the partnership into a company it was submitted that the former partners consulted with their accountants and were advised that although there would be an immediate income tax advantage by forming the company, in the long run there would be little tax advantage to the partners and this tax benefit would be of a purely temporary nature. In view of these representations and the testimony of the accountant it would be unreasonable to conclude

that three professional men, each earning in excess of R30 000 p.a., would enter into such a transaction for the sole or main purpose of obtaining a R1 456 tax benefit when the conversion from a partnership to a company, and the attendant costs, would exceed this temporary tax benefit. Therefore, upon the representations of the former partners and the accountants, it was evident that the presence of a tax benefit was not the sole or main purpose for entering into the transaction.

- The same commercial result could not have been obtained in a different manner because the benefits of forming a company would only have been achieved with the use of a company. However, certain terms may have been entered into in a different manner but, because the taxpayers selected a manner which attracted less tax, this indicates that the obtaining of the tax benefit was not the sole or main purpose for entering into the arrangement.
- Lastly, it is obvious that there is a non-tax business purpose for entering into the arrangement (i.e. converting the partnership into a company to obtain the benefits associated with incorporation) and this similarly indicates that the sole or main purpose of the arrangement was not to obtain the tax benefits.

When previously brought before the courts the transactions contemplated within the *Geustyn* case were determined to not have had the sole or main purpose of obtaining a tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR would not have a different result regarding the contemplation of a sole or main purpose.

4.3.5 Tainted elements requirement

As stated previously, before an avoidance arrangement can be considered an impermissible avoidance arrangement it must satisfy all the criteria of GAAR. Although the arrangement has not met the sole or main purpose requirement, a brief discussion of the remaining requirements is included below.

The first test would be to determine if the arrangement was entered into or carried out by means or in a manner which would not normally be employed in terms of section 80A of the Act (refer to paragraph 2.5.4 on page 27). This

normality provision has been applied in the context of business due to the fact that the restructuring resulted in changes in the manner through which the consultancy business was carried out. It is noted that the South African Association of Consulting Engineers (of which the three former partners were members) expressly sanctioned its members to conduct their practices under unlimited companies and more than half of the members of this association had already adopted the use of unlimited companies. This has the effect that there is no difference between the transaction entered into by the partners and a transaction entered into for *bona fide* business purposes in the absence of a tax consideration. The agreement was therefore carried out by means or in a manner which would normally be employed and is confirmed with the representation that there is nothing abnormal in converting a partnership into a company. The contention was held by the Secretary for Inland Revenue that the disparity between the partnership earnings and the salary of R10 000 p.a., the R240 000 goodwill, the absence of security for the payment of this goodwill and the absence of service contracts indicated the presence of an abnormal transaction. However, the salary, directors' fee and interest earned by each of the former partners were all taxable and thus the Secretary's contention cannot be supported. Furthermore, the calculation of the goodwill at R240 000 was arrived at by aggregating three years' worth of the partnership's profits and was not criticised by the Secretary, who could thus also not prove that this was abnormal. Lastly, the lack of security and service contracts could not be considered to be abnormal since the three former partners were answerable to themselves and thus the "trust" and duties to be derived from these contracts would in themselves have been derived because they retained full control of the company.

The next element to be considered is the lack of commercial substance element. From the facts of the case the transactions entered into for the conversion of the partnership to a company as a whole did not lack commercial substance.

In applying the framework each of the tests are dealt with separately as follows:

- The attempt to conform to engineering practice and to make use of the benefits derived from a company as opposed to a partnership did have a

significant effect on the business risks and cash flows. Thus the transactions did not lack commercial substance.

- In applying the principles laid down in section 80C of the Act (refer to paragraph 2.5.4 on page 31) the transactions were carried out and effected as was consistent with their legal form and had a significant effect upon the economic risks as the risks borne by the former partners were significantly affected by the conversion of the partnership to a company. The true intentions of the parties were reflected within the agreements. Similarly the partners bore the economic risk of the failure of the business in their capacities as shareholders and were not insulated from the risks.
- There is no evidence of the presence of round trip financing in the context of section 80C, as the funds were not transferred “between or amongst the same parties”.
- There is no evidence of the presence of any accommodating or tax-indifferent parties within the transactions or arrangement as any tax benefit was determined to be of a temporary nature and insignificant in proportion to the other related costs. Thus there is no presence of a party to the arrangement who effectively sold its tax advantage to others.
- Finally there is no presence of offsetting or cancelling effects as contemplated in section 80C of the Act other than the taxation of a company, which is a legitimate transaction.

Regarding the rights and obligations element, it is evident from the facts that the parties were striving to gain the utmost advantage from trading as a company as opposed to a partnership. Similarly, the rights attached to the arrangement were those which could have been expected in any other similar transactions between parties dealing at arm's length (refer to paragraph 2.5.4 above and representations made within the facts of the case regarding the taxable income through the use of a partnership and that of the unlimited company). No aspects of the transaction have been identified which had the effect of creating rights or obligations which would not normally be created between persons dealing at arm's length.

Lastly, concerning the misuse of the Act element, it is clear that any tax benefit was determined to be of a temporary nature and insignificant in proportion to the

other related costs. Furthermore, the use of a company rather than a partnership cannot be considered to be an abuse of the Act as the taxable income in either instance would have been subject to much the same provisions of the Act and thus subject to the same inherent intention of the legislator. It cannot be said that either income or expenditure was purely manufactured by the use of such an arrangement, as no specific provisions were attacked by the Secretary for Inland Revenue in his arguments before the court. It can therefore be concluded that the arrangement was not created with such terms and conditions to achieve the end of exploiting loopholes within the Act or abusing the intention of the legislator. The Act was applied correctly in calculating the taxable income for the company and the former partners were perfectly entitled to avoid such tax by adopting a legitimate course of action (refer to paragraphs 1.1.1 and 2.5.2 for further discussion).

4.3.6 Conclusion for the *Geustyn* case

In collating the findings of the *Geustyn* case discussed above, the following table is a representation of the results as applied in accordance with the purposive approach and the framework:

Table 4.2 legend

X Framework requirement not met

✓ Framework requirement met

Table 4.2: Framework for applying sections 80A – 80L to the facts of previous case law	<i>Geustyn</i> case
1 - Is there an arrangement? <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case. 	✓
2 - Does the transaction/operation/scheme result in a tax benefit? <ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an 	✓ ✓

<p>anticipated liability? (<i>Smith</i> case; <i>King</i> case)</p> <ul style="list-style-type: none"> • 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) 	✓
<p>3 - Is the sole or main purpose to obtain such tax benefit?</p> <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:</p> <ul style="list-style-type: none"> • Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) • Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) <p>In applying the objective and subjective tests the following principles may be considered:</p> <ul style="list-style-type: none"> • If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (<i>Conhage</i> case); or • If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which 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 (<i>Conhage</i> 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). 	<p>✗</p> <p>✗</p>

4 - Tainted elements requirement	×
<p>- One of the following with regard to business transactions:</p> <p>- <i>Entered into in a manner not normal for bona fide business purposes?</i></p> <ul style="list-style-type: none"> • 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) <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"> • <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) • <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 allows the evasion 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.) • <i>Round trip financing test:</i> Has funding been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit? • <i>Tax-indifferent party test:</i> Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties? 	<p>×</p> <p>×</p> <p>×</p> <p>×</p> <p>×</p> <p>×</p> <p>×</p> <p>×</p>

<ul style="list-style-type: none"> • <i>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.)</i> 	×
<p>- One of the following with regard to transactions in any context:</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"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin</i> case • Would unconnected persons have done the same in this situation? <i>Hicklin</i> case 	×
<p>- <i>Is there misuse or abuse of provisions of the Act?</i></p> <ul style="list-style-type: none"> • 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? 	×

From the above evaluation of the current GAAR regime, when applied to the facts of the *Geustyn* case, the transactions entered into (i.e. conversion of a partnership into a company) fall within the definition of an arrangement as defined in section 80L of the Act. Furthermore, the arrangement resulted in a tax benefit (i.e. the reduction of tax liability by R1 456 in the 1967 year of assessment) and thus constitutes an avoidance arrangement as defined in section 80L of the Act. The sole or main purpose of the transaction was not to attain such tax benefit (the obtaining of a tax benefit is insignificant in relation to the transaction and was of a temporary nature and was not one of the main reasons for entering into the transaction). The arrangement was carried out by means and in a manner which would normally be employed and the rights and obligations arising from the

transaction were determined to be expected in a transaction of a similar nature. In addition, the transaction was not found to be a misuse or abuse of the provisions of the Act.

Although the scheme is an avoidance arrangement as defined, it does not constitute an impermissible avoidance arrangement because it has not satisfied all the requirements of section 80A of the Act (i.e. sole or main purpose, normality, arm's-length rights or obligations or misuse of the Act). When the provisions of the previous GAAR regime were applied, a similar conclusion was reached by the courts and thus it can be said that the current GAAR provisions do not result in the requirements of an impermissible avoidance arrangement being met. Thus the current GAAR regime has not had a significant impact on the transactions entered into in this case. Notwithstanding the fact that the tainted elements requirements were not satisfied, the fact that the sole or main purpose requirement was not significantly amended may have played a part in the results of the case from the above analysis.

4.4 *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A)

4.4.1 Background facts

In the *Hicklin* case the taxpayer and two others were the shareholders of a company that, by virtue of the disposal of its business, had become dormant. Since incorporation the company had declared no profits and had significant accumulated distributable reserves. The company also had non-distributable reserves comprising a large capital profit realised on the sale of its business. One issue identified by the Commissioner is that, during the period of the life of the company, the shareholders had from time to time borrowed from the company in the form of unsecured, interest-free loans. These loans were not taxable under the legislation at the time of the transactions and thus upon receipt of the funds no tax liability was recognised. Had these funds been distributed to the shareholders in the form of a dividend instead of interest-free loans, these amounts would have been subject to tax. It is important to note that Secondary Tax on Companies and the dividend deeming provisions (section 64C(2)(g) of the Act) that would have addressed this issue were not effective at the time of the

transactions in this case. Therefore, in preserving the existence of the company these loans were not taxable in the hands of the shareholders.

Subsequent to deciding to preserve the existence of the company rather than follow alternative courses of action, which would lead to taxable dividend receipts, an unexpected offer of purchase for the company was received and accepted. In terms of the purchase offer the shareholders agreed to sell the shares in the company at the net asset value of the company less 10% of the distributable reserves. This agreement led to the repayment of the shareholder loans by an exchange of cheques. The purchaser subsequently completed a “dividend-stripping” operation by causing the company to declare all its reserves as dividends followed by deregistration of the company.

The Commissioner claimed that the continual borrowing from the company out of its distributable profits (interest free and unsecured); keeping the company in existence (although dormant) to preserve those loans; their abandoning all intention of declaring dividends out of those profits; their ultimately entering into and carrying out the sale agreement in 1975; and the company’s subsequent dividend declarations all constituted an entire integrated scheme that fell within the scope of the previous GAAR regime. Consequently the Commissioner regarded the distributable reserves as a dividend in the hands of the taxpayer (due to the fact that the profits were taken out of the company by way of the liquidation of the shareholder loans on sale of the shares as opposed to the receipt of taxable dividends).

The provisions of the current GAAR regime are now applied to the facts of the case in order to determine if the provisions would have changed the decision of the court on a balance of probabilities.

4.4.2 Arrangement

In applying the framework developed in this study, the loan agreements and sale of shares agreements entered into in the *Hicklin* case fall within the ordinary meaning of the terms “transaction, operation or scheme”. Furthermore, as the scope of an arrangement has been widely interpreted, the requirement of the presence of an arrangement has been met. Therefore if presented before the

courts, the transactions considered in the *Hicklin* case would be considered to constitute an arrangement as contemplated under the now repealed GAAR provisions of section 103(1) of the Act. Thus the provisions of the current GAAR provisions would not have a different result regarding the contemplation of an arrangement.

4.4.3 Tax benefit

In applying the second requirement of the framework, such an arrangement would need to result in a tax benefit in order for the arrangement to constitute an avoidance arrangement (refer to paragraph 2.5.2 on page 23). From the review of the facts of the case, it is evident that by entering into the sale agreement the taxpayers escaped from the receipt of possible taxable dividends in future (i.e. the taxpayers effectively stepped out of the way of a tax on dividends). However, had the taxpayers not sold the company no tax liability for dividends would have arisen, as the dividends would never have been declared. In view of this the “but for test” cannot be satisfied as no tax would have arisen but for the sale of the company. Notwithstanding this, because the tax liability was contingent on the declaration of dividends by the company and the arrangement avoided the taxation anticipated from receiving taxable dividends in future, the avoidance of taxable dividends in future would constitute the avoidance of an anticipated liability for tax (refer to paragraph 2.5.2 on page 23 and the *King* case) and resulted in a tax benefit as contemplated in section 80L of the Act.

It is submitted that the transactions entered into by the taxpayer in the *Hicklin* case constitute an arrangement which had the effect of obtaining a tax benefit. Therefore, the transactions constitute an avoidance arrangement as defined in section 80L of the Act. The transactions contemplated within the *Hicklin* case would similarly be determined to have the presence of a tax benefit under the current GAAR regime. Thus the application of the provisions of the current GAAR regime would not have a different result regarding the contemplation of a tax benefit.

4.4.4 Sole or main purpose of the arrangement

In applying the third requirement of the framework the sole or main purpose of the arrangement must be to obtain the tax benefit. In reviewing the facts of the case the stated intention (subjective test) of the transactions was to enable the shareholders to rid themselves of the “untidy” company structure. The only reason that the company was not liquidated, dissolved or deregistered is that this would have resulted in taxable dividends being received in the hands of the shareholders. Furthermore, from a review of the facts of the case it is evident that whilst the arrangement did in fact achieve the results anticipated, it would not have had a substantial effect upon the taxpayers, had they decided not to sell the shares for reasons other than receiving the tax benefit. Therefore the objective effect of the transaction does not support the stated intention. In considering the principles developed in the framework, the following has been considered:

- On the basis of the facts of the case it is evident that one of the main purposes of selling the company was to obtain the tax benefit. This can be explained by noting that if the shareholders had purged themselves of the company by dissolving or liquidating it, the distributable reserves would have been subject to tax in the hands of the shareholders as dividends. Therefore, the dominant purpose for entering into the sales transaction can be said to have been the obtaining of a tax benefit, as ridding themselves of the company in any other way would have resulted in a tax liability. However, had the shareholders done nothing as they had originally planned to do (i.e. if the distributable reserves had never been declared as a dividend and the company had remained dormant) they would not have received taxable dividends and would have been in a similar position as if no transaction had been entered into.
- The same commercial result (ridding themselves of the untidy company) could have been achieved by distributing the reserves and liquidating or dissolving the company, which would have resulted in the receipt of taxable dividends in the hands of the shareholders.
- Furthermore, it is evident that the sale of the shares did not in fact achieve some non-tax business purpose. This is explained by the fact that the shareholders were not continuing business within the company and thus

no business purpose was proven to exist other than obtaining a tax benefit. It follows that the obtaining of a tax benefit must have been the main purpose for entering into the sales agreement (as in essence nothing else changed).

When previously brought before the courts the transactions contemplated within the *Hicklin* case were determined to have had the sole or main purpose of obtaining a tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR would not have a different result regarding the contemplation of a sole or main purpose.

4.4.5 Tainted elements requirement

One of the final tests used to determine if an arrangement would be seen to be an impermissible avoidance arrangement would be to establish whether the arrangement was entered into or carried out by means or in a manner which would not normally be employed in terms of section 80A of the Act (refer to paragraph 2.5.4.1 on page 29). The normality of the transaction has been tested against a context other than business as no business was carried out by the shareholders through the company (i.e. the company was dormant). Rather, the personal divesting of shares in the company was done, which would have had the effect of avoiding the receipt of taxable dividends in the hands of the individual shareholders (refer paragraph 4.4.6 for further discussion). In applying this test to the facts of the case it is clear that the sale of shares in a dormant company is a transaction in which taxpayers without a tax consideration would enter into. The purchase offer as drawn up by the purchaser was tendered to the shareholders as an offer which was to be accepted or rejected as it stood, at a price calculated at the net asset value of the company less 10% of the distributable reserves. Further, it is an eminently reasonable consideration for the shareholders to have to pay in order to rid themselves of an untidy dormant company and for the purchaser to receive some reward for fulfilling its aspect of the contract, as was originally held when this case was originally presented before the courts. Therefore, 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 an offer would typically be entered into had it not been for the tax benefits. Therefore the sale of shares cannot be considered abnormal as it is

likely that such a transaction would have been entered into by another taxpayer without a tax consideration.

The remaining tainted elements to be considered are the creation of rights and obligations at arm's length and misuse of the Act. In applying the framework to the facts of the case each test has been considered separately below:

- It can be seen from the facts of the case that the purchaser and appellants entered into the transaction with a view to benefiting from the sale of shares. Thus the transaction was beneficial to both the appellant and the purchaser (refer to paragraph 2.5.5 on page 41).
- It is also noted that the appellant and the purchaser were not connected to each other and the appellant, had no interest in the operations of the purchaser and that they were to incur costs for ridding themselves of the untidy dormant company. The offer to purchase was thus made in the ordinary course of the purchaser's business with the view to make a profit. It can therefore be said that the transactions were entered into and carried out by means and in a manner in which created rights and obligations at an arm's length would normally be employed (i.e. bona fide).

Regarding the rights and obligations requirement, it is noted from the facts of the case that the rights attached to the purchase agreement were those which could have been expected in any other similar transaction between parties dealing at arm's length (refer to paragraph 2.5.4.3 on page 39). No aspects of the transaction are noted which had the effect of creating rights or obligations which would not normally be created between persons dealing at arm's length. This can be confirmed by the reference to an experienced attorney brought before the court as a witness who stated that the form of the agreement was a normal one and would have been ordinarily expected of such an agreement.

Lastly, concerning the misuse of the Act element, it is clear that no provisions of the Act were incorrectly applied. It cannot be said that the retained earnings within the company were in fact dividends for the shareholders since the company had no legal obligation to declare such reserves as dividends. Furthermore, a company is separate from its shareholders in that it has its own

legal persona. In addition, the shareholders were perfectly entitled to avoid such tax by adopting a legitimate course of action (refer to paragraphs 1.1.1 and 2.5.2 for further discussion). The decision made by the shareholders to maintain the existence of the company despite its dormant status is similarly not a misuse of the Act due to the fact that they were aware that should one of the shareholders die it would ultimately result in them dissolving the company by repaying the loans, at which time it would have subjected them to a liability for income tax.

4.4.6 Conclusion for the *Hicklin* case

In collating the findings of the *Hicklin* case discussed above the following table is a representation of the results as applied in accordance with the purposive approach and the framework:

Legend

X Framework requirement not met

✓ Framework requirement met

Table 4.3: Framework for applying sections 80A – 80L to the facts of previous case law	<i>Hicklin</i> case
1 - Is there an arrangement? <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case. 	✓
2 - Does the transaction/operation/scheme result in a tax benefit? <ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case) 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) 	✓ ✓ ✗
3 - Is the sole or main purpose to obtain such tax benefit? <p>In applying the sole or main purpose requirement of the GAAR to</p>	✓ ✓

<p>the facts and circumstances of the case studies the following factors are considered:</p> <ul style="list-style-type: none"> • Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) • Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) <p>In applying the objective and subjective tests the following principles may be considered:</p> <ul style="list-style-type: none"> • If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (<i>Conhage</i> case); or • If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which 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 (<i>Conhage</i> 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). 	
<p>4 - Tainted elements requirement</p>	<p>×</p>
<p>The following with regard to transactions not in the context of business:</p> <ul style="list-style-type: none"> - <i>Has the arrangement been entered into in a manner not normal for bona fide purposes?</i> <ul style="list-style-type: none"> • 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? 	<p>×</p>

(Louw, 2007:27)	
- 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>	×
<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"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin case</i> • Would unconnected persons have done the same in this situation? <i>Hicklin case</i> 	
- <i>Is there misuse or abuse of provisions of the Act?</i>	
<ul style="list-style-type: none"> • 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? 	×

From the above evaluation of the current GAAR regime, when applied to the facts of the *Hicklin* case, the transactions entered into (i.e. loan agreements and sale of shares) fall within the definition of an arrangement as defined in section 80L of the Act. Furthermore, the arrangement resulted in a tax benefit (i.e. the avoidance of the receipt of taxable dividends in the hands of the shareholder) and thus constitutes an avoidance arrangement as defined in section 80L of the Act. The sole or main purpose of the transaction was to attain such tax benefit (the obtaining of a tax benefit was one of the main reasons for entering into the sales transaction). However, as stated in paragraph 2.5.4 (page 27), the arrangement was carried out by means and in a manner which would normally be employed and the rights and obligations arising from the transaction were determined to be expected in a transaction of a similar nature. In addition, the transaction was not found to be a misuse or abuse of the provisions of the Act. However, it is noted that had the arrangement been applied in the context of business for the purposes of the tainted elements requirement the results may have been significantly different as it may have been likely that the transaction lacked commercial substance as there may have been the presence of round-trip

financing, tax indifferent parties and offsetting and cancelling. This case was analysed on the basis that the shareholders were not trading in shares and had discontinued trading in the entity and the transaction was considered a personal divesting of shares as opposed to a transaction in the context of business. In addition to this it is also important to note that there may be differing opinions with regards to the arm's-length rights and obligations element due to that fact that the 10% discount may have been considered to be compensation to the purchaser for assuming the tax liabilities and cost to the shareholders for not incurring a tax liability. This test is highly subjective when applied to the case as it is a matter of judgement whether a 10% discount can be considered to be at arm's-length. The decision made by the court in this regard was that it was an eminently reasonable consideration for the shareholders to rid themselves of a dormant company at cost to themselves. This case was analysed with the view that it was at arm's-length in accordance with paragraph 4.4.5 on page 80.

Although the scheme is an avoidance arrangement as defined, it does not constitute an impermissible avoidance arrangement because it has not satisfied all the requirements of section 80A of the Act (i.e. normality, or arm's-length rights or obligations or misuse of the Act). When the provisions of the previous GAAR regime were applied, a similar conclusion was reached by the courts and thus it can be said that the current GAAR provisions do not result in the requirements of an impermissible avoidance arrangement being met. Thus the current GAAR regime has not had a significant impact on the transactions entered into in this case.

4.5 *ITC1712* (2000) 63 SATC 499

4.5.1 Background facts

In *ITC1712* the appellant leased four tank containers from the bank over a five-year period with the view to sub-lease these containers to third parties overseas. In terms of the lease agreement the appellant was obliged to pay R657 880 in rentals over the five-year term, the bulk of which would be payable within the first two years (43% of which was payable within the first year). The Commissioner allowed a deduction of only R10 785 in relation to the rentals incurred during the 1997 year of assessment as opposed to the deduction of R230 258,15 actually

incurred by the appellant. The Commissioner disallowed the excess rentals on the basis that the transaction “was entered into or carried out...in manner which would not normally be employed for bona fide business purposes other than obtaining a tax benefit”. In particular, the Commissioner contended that the transaction was abnormal due to the uneven spread of the rentals in conjunction with the timing of the transaction (i.e. the initial rental expense was incurred in the same year of assessment as a large payment received from his employer, thus creating a deduction in a year when the taxable income would otherwise have been substantially higher if not for the rental deduction). Furthermore, the facts of the case hold no indication that the sub-lease agreements were also subject to a large up-front payment.

The provisions of the current GAAR regime are applied to the facts of the case in order to determine if the 2006 amendments would have changed the decision of the court on a balance of probabilities below.

4.5.2 Arrangement

In applying the framework developed in this study to the case, the lease agreements entered into would fall within the ordinary meaning of the terms “transaction, operation or scheme” and therefore the transactions entered into by the appellant (i.e. the lease contract) would constitute an arrangement as contemplated in section 80L. When presented before the courts the first time, the transactions considered in *ITC1712* were similarly considered to constitute an arrangement as contemplated under the now repealed GAAR provisions of section 103(1) of the Act. Thus the provisions of the current GAAR provisions would not have a different result regarding the contemplation of an arrangement.

4.5.3 Tax benefit

In addition to the presence of an arrangement, such an arrangement would need to result in a tax benefit as defined in section 80L of the Act for it to be considered an avoidance arrangement (refer to paragraph 2.5.2 on page 23). In applying the framework to the facts of the case, by entering into the arrangement, the appellant was entitled to a deduction of rental expenditure actually incurred during the year of assessment, during a year when the large payment from his

employer would have resulted in a substantially higher amount of tax. This deduction thus had the effect of reducing the anticipated taxable income of the appellant for the relevant years of assessment. Thus the use of this deduction reduced the anticipated tax liability calculated for the 1997 year of assessment and is consistent with the view held in the *Smith* case where the taxpayers started from a position where eventually the taxpayer would have received taxable income and subsequently, by entering into this transaction, escaped such tax liability. It is therefore evident that the taxpayer would have had a larger tax liability but for this transaction as contemplated in *ITC1625*, the *Louw* case and the *Smith* case. The lease transaction entered into by the taxpayer in *ITC1712* constitutes an arrangement which had the effect of obtaining a tax benefit. Therefore, the transactions constitute an avoidance arrangement as defined in section 80L of the Act.

When previously brought before the courts the transactions contemplated within the *ITC1712* case were similarly determined to have the presence of a tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR does not result in a different conclusion on the basis of the facts of the case.

4.5.4 Sole or main purpose of the arrangement

In applying the third requirement of the framework the sole or main purpose of the arrangement must be to obtain the tax benefit. In reviewing the facts of the case the stated intention (subjective test) of the transaction was to enable the appellant, for good commercial reasons, to enter into a profitable sub-lease agreement. Furthermore, from a review of the facts of the case it is evident that the objective effect of the transaction does support the stated intention, which was achieved by allowing the taxpayer to sub-lease the containers for profitable commercial reasons without the consideration of the tax benefit. This view is confirmed in the decision held in the *King* case where it was noted that there are many ordinary, legitimate transactions and operations which, if a taxpayer carried them out, would have the effect of reducing the amount of his income but it cannot be imagined that Parliament intended to tax persons who carry out such operations as if they had not carried them out. The appellant is consequently entitled to a reduction in the taxable income when a legitimate transaction has

been entered into. Furthermore, the same commercial result could have been achieved by using a different means of security which would have resulted in a more even spread of rentals. However, because the taxpayer in this case could not provide this security, the containers were the only form of security that could be used and this indicates that the tax benefit was not the sole or main purpose for entering into the transaction. In addition, the dominant subjective purpose (to enter into a profitable sub-lease agreement) would achieve a non-tax business purpose and would similarly indicate that the obtaining of a tax benefit was not the sole or main purpose for entering into the transaction. Thus the appellant successfully discharged the onus of proof required by the current GAAR regime.

When previously brought before the courts the transactions contemplated within *ITC1712* were not tested against the sole or main purpose requirement due to the fact that the Commissioner had not fulfilled the onus of proving that the transaction was abnormal. The abnormality requirement is discussed below for the sake of completeness.

4.5.5 Tainted elements requirement

As stated previously, before an avoidance arrangement will be an impermissible avoidance arrangement, it must satisfy all the criteria of GAAR. Though the arrangement has not met the sole or main purpose requirement, a brief discussion of the tainted elements requirements is included below.

In applying the framework to the facts of the case, one of the final tests would be to determine if the arrangement was entered into or carried out by means or in a manner which would not normally be employed in terms of section 80A of the Act (refer to paragraph 2.5.5 on page 41). This normality provision has been applied in the context of business due to the fact that the taxpayer claimed the deduction in terms of his business as a container lessor. In testing if the lease agreement would have been entered into by a taxpayer for bona fide business purposes in the absence of a tax consideration, the representations made by a witness (Mr C) are relevant. The representations made by Mr C (an expert in the tank container industry) indicate that the lease agreement and payment terms were carried out by means or in a manner which would normally be employed. In providing his evidence Mr C noted that all banks required payment up front of not less than

35% of the initial value of the contract and a substantial payment in the second year. Mr C further witnessed that the only exception to this is where the client is able to put up substantial security. The facts of the case also confirm that the reason for this is that the banks wish to reduce their exposure to an amount which can, in the event of a default, be serviced by the rental income from the containers. Similarly, the containers themselves are considered by the banks to provide very little security since that they are sent all over the world, making it difficult for banks to repossess them in the event of a default. It is therefore clear that a transaction of this nature would be entered into by a taxpayer for bona fide business purposes in the absence of a tax consideration.

The next element to be considered is the lack of commercial substance. From the facts of the case the lease entered into as a whole did not lack commercial substance. In applying the framework each of the tests for determining if the arrangement lacks commercial substance are dealt with separately as follows:

- The arrangement did have a significant effect upon the cash flows in terms of the lease repayments and the taxpayer would have borne all the risks of loss had the business venture failed.
- The transactions were carried out and effected as was consistent with the legal form thereof. They did have a significant effect upon the business risks as the taxpayer bore the sole risk of the ownership of the containers and the cash flows are considered significant as the lease repayments were considerable.
- There is no evidence of the presence of round trip financing in the context of section 80C, as the funds were not transferred “between or amongst the same parties”.
- There is no evidence of the presence of any accommodating or tax-indifferent parties within the transactions or arrangement.
- Finally, there is no presence of offsetting or cancelling effects as contemplated in section 80C of the Act other than the deduction against gross income, which is a legitimate transaction.

The arrangement as a whole consequently did not lack commercial substance as the attempt to become a lessor had commercial substance in that he would

ultimately benefit from the profits of the sub-leases and this was considered to be in his best interests.

In applying the framework to the rights and obligations at arm's length element, it is evident from the facts of the case that the rights attached to the arrangement were those which could have been expected in any other similar transactions between unconnected parties dealing at arm's length (refer to paragraph 2.5.4.3 on page 39 and representations from Mr C). No aspects of the transaction have been identified which had the effect of creating rights or obligations which would not normally be created between persons dealing at arm's length. This can be confirmed by the reference to the fact that each party was transacting in their own best interest with a view to earning profits.

Lastly, concerning the misuse of the Act element, it is evident that the arrangement was entered into without a consideration as to the tax benefits. Furthermore, the intention of the legislator, in allowing a taxpayer to claim deductions for the lease of equipment, could not conceivably have been to disallow such a deduction where a taxpayer received a large amount of income in that year of assessment, or to disallow such a deduction on the basis that they were not more evenly spread over the lease term. Therefore the arrangement cannot be said to have been entered into with such terms and conditions aimed to exploit loopholes within the Act or to abuse the intention of the legislator. In addition, we note that the taxpayer was perfectly entitled to avoid such tax by adopting a legitimate course of action (refer to paragraphs 1.1.1 and 2.5.2 for further discussion).

4.5.6 Conclusion for *ITC1712*

In collating the findings of *ITC1712* discussed above, the following table is a representation of the results as applied in accordance with the purposive approach and the framework:

Table 4.4 legend

X Framework requirement not met

✓ Framework requirement met

Table 4.4: Framework for applying sections 80A – 80L to the facts of previous case law	ITC1712
<p>1 - Is there an arrangement?</p> <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case. 	✓
<p>2 - Does the transaction/operation/scheme result in a tax benefit?</p> <ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case) 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). 	✓ ✓ ✓
<p>3 - Is the sole or main purpose to obtain such tax benefit?</p> <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:</p> <ul style="list-style-type: none"> Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) <p>In applying the objective and subjective tests the following principles may be considered:</p> <ul style="list-style-type: none"> If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (<i>Conhage</i> case); or If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which 	✗ ✗

<p>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 (<i>Conhage</i> case); or</p> <ul style="list-style-type: none"> • 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	×
<p>- One of the following with regard to business transactions:</p> <p>- <i>Entered into in a manner not normal for bona fide business purposes?</i></p> <ul style="list-style-type: none"> • 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) <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"> • <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) • <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 allows the evasion of tax? (Then it will be regarded as simulated and the mere fact that parties 	<p>×</p> <p>×</p> <p>×</p> <p>×</p>

do perform in terms of the contract does not show that it is not simulated.)	
<ul style="list-style-type: none"> • <i>Round trip financing test</i>: Has funding been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit? 	×
<ul style="list-style-type: none"> • <i>Tax-indifferent party test</i>: Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties? 	×
<ul style="list-style-type: none"> • <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.) 	×
- One of the following with regard to transactions in any context:	×
<ul style="list-style-type: none"> - <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"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin</i> case • Would unconnected persons have done the same in this situation? <i>Hicklin</i> case 	×
<ul style="list-style-type: none"> - <i>Is there misuse or abuse of provisions of the Act?</i> <ul style="list-style-type: none"> • 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? 	×

From an evaluation of the facts the transactions entered into in *ITC1712* (i.e. entering into the lease agreement) fall within the definition of an arrangement as defined in section 80L of the Act. Furthermore, the arrangement has resulted in a tax benefit (i.e. the increased deduction of rental payments) and thus constitutes

an avoidance arrangement as defined in section 80L of the Act. In addition, the avoidance arrangement has not been found to have been entered into for the sole or main purpose of attaining such tax benefit (i.e. it was entered into for the purpose of earning income with a commercially sound business intention).

It is therefore not necessary to determine the remaining requirements of section 80A (i.e. normality, commercial substance, arm's-length rights or obligations or misuse of the Act) because although the scheme is an avoidance arrangement as defined, it does not constitute an impermissible avoidance arrangement due to the fact that it has not satisfied all the requirements of section 80A of the Act (i.e. sole or main purpose). When the provisions of the former GAAR were applied, a similar conclusion was reached by the courts and thus we note that the current GAAR provisions, when applied to the case, do not result in the requirements of an impermissible avoidance arrangement being met. Thus the new GAAR provisions have not had a significant impact on the transactions entered into in this case. It is also important to note that both the abnormality and the purpose requirements were not met, and whilst this may indicate that the weaknesses of the previous GAAR regime have remained intact, it may alternatively indicate that this case should not have been attacked by the Commissioner as the arrangement should not have been considered questionable.

4.6 *CIR v Bobat and Others* (2003) 67 SATC 47 (NPD)

4.6.1 Background facts

In the *Bobat* case the respondents were three taxpayers. One of the respondents and the wives of the remaining two respondents were vested beneficiaries of the EM Moosa Family Trust. The Trust controlled two companies, being Trueart Furniture Sales (Pty) Ltd and KIM Investments (Pty) Ltd. During the 1990 year of assessment these companies were deregistered and in consequence made certain payments to the beneficiaries (two of whom did not disclose such income in their tax returns while the remaining beneficiary included this receipt as a capital distribution). To expand on this, Trueart and KIM were investment holding companies and the group structure included various cross holdings, including cross holdings between Trueart and KIM themselves. The group structure included only one operating entity whilst virtually all the other entities were

essentially dying or inactive. In terms of the provisions of the Trust Deed, in the event of the death of one of the beneficiaries, the capital would go to the children of the beneficiaries and would consequently result in estate duties levied. Therefore, as the Trust's assets increased (by virtue of its holdings in the investment companies) it increased the potential for a higher estate duty in the event of the death of a beneficiary.

In terms of the facts of the case a series of transactions were proposed in order to replace the existing vesting trust with a discretionary trust which would alleviate the potential estate duties on the death of a beneficiary. In addition to the complex structure, the cross holdings between companies within the group caused dams of funds throughout the group referred to as "cash flow dams". The combination of these cash flow dams and cross holdings between entities that were not operating necessitated a simplifying process to eliminate these anomalies ("tidying up" process). This tidying up process included a series of transactions, which included a transaction whereby the operating entity would sell its business to another company within the group who would be a partner in a partnership *en commandite* with the discretionary trust. The replacement of the vesting trust with a discretionary trust and the "tidying up" of the group resulted in the deregistration of both Trueart and KIM. The deregistration dividends resulting from these transactions would have resulted in the receipt of substantial dividends by the trust. These dividends would then have to be distributed to the beneficiaries which would have formed substantial taxable income in their hands, as at the relevant time dividends payable to a company were exempt while those paid to individuals were not. In order to overcome this it was decided to use a third-party company (Facet Investments (Pty) Ltd, which at the time was not taxed on dividend receipts) that would purchase the shares in KIM and Trueart at a premium which would be subsequently reduced via the declaration of share premium capital to the shareholders, resulting in a capital receipt in the hands of the shareholders as opposed to a taxable dividend. The ultimate step required the vesting trust to distribute all its funds to the beneficiaries, who in turn re-advanced them to the discretionary trust. This step thus changed the nature of the trust in which the taxpayers were beneficiaries from a vesting trust to a discretionary trust. This discretionary trust in turn advanced these funds to the partnership between itself and the operating company.

The Commissioner contended that the transactions described above were not entered into for the purpose of tidying up the group or the avoidance of estate duty but were entered into for the purpose of avoiding the tax liability that would have been resultant from the receipt of taxable dividends by the respondents and thus the arrangement was subject to the provisions of GAAR. The Commissioner contended that the transactions were in fact a dividend-stripping exercise for the purpose of avoiding taxation. Upon appeal, the Commissioner raised additional grounds for appeal that the “court a quo alternatively erred in failing to have regard to the effect of the transactions implemented in February 1990 as being the main purpose of the transactions then effected and which in any event fell to be considered as part of the scheme devised in April 1998”. In raising this as an additional ground for appeal the Commissioner was attempting to attack the specific part of the arrangement which dealt with converting the reserves, which would have been a dividend, into share capital, which would not have been taxed as a dividend. This ground for appeal was not consented to by the respondent or the Appeal Court because the Appeal Court will not permit a new point to be raised unless it is clear that the matter had been fully investigated by the court.

The provisions of the current GAAR regime have been applied to the facts of the case in order to determine if the provisions would have changed the decision of the court on a balance of probabilities below. The additional grounds of appeal have not been included in the discussion below as they were not consented to by the court. A brief discussion of the results of the case, had the court allowed these grounds of appeal, has been included in paragraph 4.6.6 for completeness.

4.6.2 Arrangement

In applying the framework developed in this study, the transactions entered into by the respondent (i.e. the change from a vesting to discretionary trust and the restructuring of the group) are a “transaction, operation or scheme” as contemplated in section 80L of the Act. When presented before the courts, the transactions considered in the *Bobat* case were similarly considered to constitute an arrangement as contemplated under the now repealed GAAR provisions of section 103(1) of the Act. Thus the provisions of the current GAAR provisions would not have a different result regarding the contemplation of an arrangement.

4.6.3 Tax benefit

In addition to the presence of an arrangement as defined in section 80L of the Act, such an arrangement would need to result in a tax benefit as defined in section 80L of the Act for it to be an avoidance arrangement (refer to paragraph 2.5.2 on page 23). In applying the framework to the facts of the case, it is evident that by entering into the arrangement the respondents had escaped from the receipt of possible taxable dividends in future (i.e. the taxpayers effectively got out of the way of a tax on dividends), as these dividends were exempted in the hands of Facet Investments (Pty) Ltd, while still receiving the funds. Similarly, the respondents had escaped from the potential estate duty liability, contingent on the death of a beneficiary of the trust, as the assets were now held by a discretionary trust and not a vesting trust (refer also to paragraph 2.5.2 on page 23). Thus the avoidance of taxable dividends and/or estate duty in future can be considered the avoidance of an anticipated liability for tax (refer to paragraph 2.5.2 on page 23 and the *King* case). This is consistent with the but for test where the taxpayers in this case would have been liable for tax in future but for the transaction, and by entering into the arrangement had escaped such tax liability. The transactions entered into by the taxpayer in the *Bobat* case thus constitute an avoidance arrangement as defined in section 80L of the Act.

When previously brought before the courts the transactions contemplated within the *Bobat* case were similarly determined to have the presence of a tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR regime does not result in a different conclusion on the basis of the facts of the case.

4.6.4 Sole or main purpose of the arrangement

In applying the framework to the case it is important to determine if the transactions were entered into for the sole or main purpose of avoiding the tax benefit. In reviewing the facts of the case the stated intention (subjective test) of the transactions was to enable the respondent to avoid the estate duty and to tidy up the group. On the basis of the facts of the case and when considering the supporting evidence provided by the respondent, the arrangement as a whole had a dual purpose: to restructure the group and avoid estate duty upon the

death of a beneficiary. The purpose of the transactions as a whole was not to avoid the tax liability resulting from the deregistration dividends. From a review of the facts of the case it is evident that the objective effect of the transaction does support the stated intention, as the arrangement did in fact achieve the results anticipated by tidying up the group and avoiding estate duty, though many other forms to achieve this were possible. This view is confirmed in the decision held in the *King* case where it was noted that there are many ordinary, legitimate transactions and operations which, if a taxpayer carried them out, would have the effect of reducing the amount of his income but it cannot be imagined that Parliament intended to tax persons who carry out such operations as if they had not carried them out.

In considering the principles developed in the framework, the following has been considered:

- The arrangement did have a dual purpose: to tidy up the group and avoid estate duty. Though the court did not decide which of these was the main purpose, it was held that it would be speculative to conclude that the estate duty problem had dominated the tidying up of the group and that the probabilities do not suggest that the tidying up of the group played a secondary role. Furthermore, the Commissioner's case was limited to the contention that these two purposes had never existed.
- The representations by the witnesses in the case proved that there were many different methods of addressing the estate duty problem and the tidying up of the group, but the route followed was one that also reduced the payment of income tax. This indicates that the achievement of a tax benefit was not the sole or main purpose of the arrangement.
- Due to representations made by Mr Wilson for the taxpayer, the avoidance of income tax was never the sole or main purpose of the arrangement. The dominant purpose was to achieve a non-tax business purpose by tidying up the group and eliminating the cash flow dams. This also indicates that the obtaining of the tax benefit was not the sole or main purpose of the arrangement.

It is noted that when previously brought before the courts the transactions contemplated within the *Bobat* case were determined to not to have been entered into for the sole or main purpose of obtaining an income tax benefit under section 103(1) of the Act. Thus the application of the provisions of the current GAAR would not have a different result regarding the contemplation of a sole or main purpose.

4.6.5 Tainted elements requirement

As stated previously, before an avoidance arrangement will be an impermissible avoidance arrangement it must satisfy all the criteria of GAAR. Though the arrangement has not met the sole or main purpose requirement, a brief discussion of the tainted elements requirements is included below.

In applying the framework to the facts of the case, one of the final tests would be to determine if the arrangement was entered into or carried out by means or in a manner which would not normally be employed in terms of section 80A of the Act (refer to paragraph 2.5.5 on page 41). This normality provision has been applied in the context of business due to the fact that the restructuring resulted in changes in the group structure, which may be considered to be in the context of business. This is confirmed by the fact that it is not abnormal to convert a vesting trust to a discretionary trust and similarly it is not abnormal for a group of companies to undergo a restructuring. Notwithstanding this, the manner in which the restructuring was performed may be considered abnormal due to its complexity and the introduction of a tax-indifferent party to the arrangements. Since the arrangement had failed the purpose requirement, the courts did not consider the normality element of the previous GAAR regime and thus insufficient evidence is presented within the case concerning the normality of the arrangement. This prevents an unequivocal decision to be made regarding the manner in which the transaction was carried out, or if there is a difference between the transactions and transactions entered into by a taxpayer without a tax consideration. However, it is likely that the complexity of the arrangement may indicate that a taxpayer without a tax consideration would not have entered into an arrangement in this manner.

The next element to be considered is the lack of commercial substance. From the facts of the case the restructuring of the group did lack commercial substance. In applying the framework each of the tests for determining whether the arrangement lacks commercial substance is dealt with separately as follows:

- The arrangement did have a significant effect upon the business risks as the risks associated with holdings in companies were significantly affected. However, the net effect of the cash flows cannot be seen to be significant as the taxpayers re-advanced the amounts received by them to the discretionary trust for reinvestment in the operating company.
- The true intentions of the parties were reflected in the agreements and the transactions were carried out and effected as was consistent with the legal form thereof. However, due to the limited information provided within the facts of the case regarding the economic risk, it is impossible to be unequivocal in respect of the risks impacting upon the taxpayers resulting from the arrangement. It is possible that the taxpayers would be considered to be insulated from the economic risks resulting from the transaction.
- There is evidence of the presence of round trip financing in the context of section 80C, as the funds were transferred “between or amongst the same parties” to the arrangement as a whole (e.g. Facet Investments (Pty) Ltd bought the shares in KIM and Trueart at a premium and later received substantial dividend income, which constitutes round trip financing).
- There is evidence of the presence of an accommodating or tax-indifferent party within the transactions or arrangement, as Facet Investments was not taxed on dividend receipts at the time.
- Finally, there is a presence of offsetting or cancelling effects as contemplated in section 80C of the Act due to the presence of temporary loans and dividend declarations, which indicate that such parts of the arrangement were contrived for the purpose of obtaining a tax benefit.

Regarding the rights and obligations element, it is evident from the facts of the case that the rights and obligations attached to the arrangement were not those which could have been expected in any other similar transactions between unconnected persons due to complexity. However, due to lack of information

regarding the rights and obligations occurring between the parties, it is not possible to support this decision without question.

Lastly, concerning the misuse of the Act requirement it is clear that the Act was applied correctly in the receipt of a capital distribution and that the taxpayers were perfectly entitled to avoid such tax by adopting a legitimate course of action (refer to paragraphs 1.1.1 and 2.5.4.4 for further discussion). However, the conversion of dividend to share premium to prevent a tax liability could be considered a frustration of the Act or achieving a result not intended by the legislator.

4.6.6 Conclusion for the *Bobat* case

In collating the findings of the *Bobat* case discussed above, the following table is a representation of the results as applied in accordance with the purposive approach and the framework:

Table 4.5 legend

X Framework requirement not met

✓ Framework requirement met

Table 4.5: Framework for applying sections 80A – 80L to the facts of previous case law	<i>Bobat</i> case
<p>1 - Is there an arrangement?</p> <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case. 	✓
<p>2 - Does the transaction/operation/scheme result in a tax benefit?</p> <ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case) 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) 	✓ ✓ ✓

<p>3 - Is the sole or main purpose to obtain such tax benefit?</p> <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:</p> <ul style="list-style-type: none"> • Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) • Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) <p>In applying the objective and subjective tests the following principles may be considered:</p> <ul style="list-style-type: none"> • If the arrangement has more than one purpose, is the dominant reason for entering into the arrangement for the purpose of obtaining the tax benefit? (<i>Conhage</i> case); or • If the same commercial result could have been achieved in a different manner and the taxpayer selected the manner which 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 (<i>Conhage</i> 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). 	<p>×</p> <p>×</p>
<p>4 - Tainted elements requirement</p>	<p>✓</p>
<p>- One of the following with regard to business transactions:</p> <p>- <i>Entered into in a manner not normal for bona fide business purposes?</i></p>	

<ul style="list-style-type: none"> • 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) 	✓
<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"> • <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) 	✓
<ul style="list-style-type: none"> • <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 allows the evasion 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.) 	✓
<ul style="list-style-type: none"> • <i>Round trip financing test:</i> Has funding been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit? 	✓
<ul style="list-style-type: none"> • <i>Tax-indifferent party test:</i> Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties? 	✓
<ul style="list-style-type: none"> • <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.) 	✓

- 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>	✓
The non-arm's-length rights or obligations element will not be met if one of the following factors is present:	
<ul style="list-style-type: none"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin</i> case • Would unconnected persons have done the same in this situation? <i>Hicklin</i> case 	
- <i>Is there misuse or abuse of provisions of the Act?</i>	✓
<ul style="list-style-type: none"> • 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? 	✓

From the evaluation of the facts, the transactions entered into in the *Bobat* case (i.e. change from vesting to discretionary trust and restructuring of the group) fall within the definition of an arrangement as given in section 80L of the Act. Furthermore, the arrangement resulted in a tax benefit (i.e. the avoidance of estate duty and receipt of taxable dividends in the hands of the beneficiaries/shareholders) and thus constitutes an avoidance arrangement as defined in section 80L of the Act. In addition, the avoidance arrangement has not been found to have been entered into for the sole or main purpose of attaining such income tax benefit (i.e. it was entered into for the purpose of averting estate duty and to restructure the group).

It is therefore not necessary to determine the remaining requirements of section 80A (i.e. normality, commercial substance, arm's-length rights or obligations or misuse of the Act) because although the scheme is an avoidance arrangement as defined, it does not constitute an impermissible avoidance arrangement due to the fact that it has not satisfied all the requirements of section 80A of the Act (i.e. sole or main purpose).

When the provisions of the previous GAAR regime were applied, a similar conclusion was reached by the courts and thus the current GAAR regime, when applied to the case, do not result in the requirements of an impermissible avoidance arrangement being met. Thus the new GAAR provisions have not had a significant impact on the transactions entered into in this case.

Despite the findings of the case study it is important to note that upon appeal, as mentioned before, the Commissioner raised additional grounds for appeal that the “court a quo alternatively erred in failing to have regard to the effect of the transactions implemented in February 1990 as being the main purpose of the transactions then effected and which in any event fell to be considered as part of the scheme devised in April 1998”. In raising this as an additional ground for appeal the Commissioner was attempting to attack the specific part of the arrangement which dealt with converting the reserves, which would have been a dividend, into share capital which would not have been taxed as a dividend. This ground for appeal was not consented to by the respondent or the Appeal Court because the Appeal Court will not permit a new point to be raised unless it is clear that the matter had been fully investigated by the court. Had this ground for appeal been allowed, the results from the case may have been significantly affected because the arrangement has satisfied all the requirements (i.e. arrangement, tax benefit and the abnormality tainted element) of the GAAR with the exception of the sole or main purpose requirement. It is now important to note that all three of these requirements were fundamentally unchanged in the current GAAR regime and these results may similarly have been found in favour of the Commissioner in the previous GAAR regime. Following this, it is evident that, though the arrangement as a whole has not satisfied the sole or main purpose requirement, that specific part of the transaction (insertion of Facet Investments into the group structure) may have been found to have the sole or main purpose of obtaining the income tax benefit rather than tidying up the group structure or avoiding estate duty. Similarly, it is likely that this would again have held true in terms of the previous GAAR regime. This indicates that the application of GAAR to the arrangement as a whole, as opposed to a specific part of the transaction, may have resulted in all the requirements of GAAR not being met for both the current and previous regimes. Although this study has applied the current GAAR regime to the arrangement as a whole, in accordance with the grounds for appeal

that were allowed by the Appeal Court, using the disallowed grounds for appeal would have led to the case study being assessed on a subjective basis.

Following this, it is evident that had the original case been presented before the courts on the basis that a specific part of the arrangement was subject to GAAR, the case may not have been lost by the Commissioner. It further indicates that the ineffectiveness of GAAR may not have been the reason for the loss of the case and the Commissioner should have considered the grounds for taking the case to court more carefully.

In addition, it is important to remember that section 80H of the Act does allow the Commissioner to attack steps in or parts of an arrangement. However, the inclusion of section 80H in the current GAAR regime would not have changed the outcome of the case, as it would not have been allowed as a ground for appeal unless the original grounds were to attack only that part of the arrangement.

4.7 Conclusion

A non-conventional use of case law has been applied in this chapter. Whilst the qualitative case study design necessitated the use of a three-phased literature study, the phase employed in this study can be considered a core aspect to achieving the objectives defined in paragraph 1.3 (page 6). The first phase of the literature study (i.e. literature review included within chapter 2) was designed to gain an understanding of the previous GAAR regime (including its weaknesses) and the interpretation of the requirements of the current GAAR regime while maintaining a high level of objectivity. This chapter formed the second phase of the literature study (i.e. document review) and applied the current GAAR regime to the fact patterns of selected case law. These findings are collated in the next chapter so that the results can be interpreted in a cohesive way in order to identify areas that may have impacted upon the success of the 2006 amendments to GAAR across all five cases. This will enable comparisons to be made and certain generalisations to be proposed that may be indicative of the population of tax avoidance cases as a whole.

CHAPTER 5 - FINDINGS OF CASE LAW IN RESPECT OF THE PURPOSE AND ABNORMALITY TESTS

5.1 Introduction

The key objective of the study is to determine whether the 2006 amendments to GAAR have resolved the weaknesses of the previous GAAR regime (refer to paragraph 1.2 on page 6). Whilst the focus in chapter 4 was on applying the provisions contained within the current GAAR regime to selected case studies, in this chapter the findings from these case studies are collated so that observations can be made about the expected effectiveness of the current GAAR regime as a whole. This chapter thus collates the individual findings of the case studies of chapter 4 in order to achieve research objective iii) in paragraph 1.3 (page 6). This chapter includes phase 3 of the literature study and aids in drawing conclusions from each case study that may be generalised to the greater population of tax avoidance cases. This chapter aims to contribute to the base of knowledge of the effectiveness of the GAAR regime by concluding whether the weaknesses of the previous GAAR have been addressed by the 2006 amendments based on the analysis performed in chapter 4.

5.2 Summary of case studies

The first step to be made in achieving the objectives of this chapter is to collate the individual findings in the previous chapter from which comparisons can be made. The following table is a collation of the findings from chapter 4 on a high level so that trends can be identified within the cases analysed.

Table 5.1: Summarised overview for applying sections 80A – 80L to the facts of previous case law

Legend

- X Framework requirement not met
- ✓ Framework requirement met

Summarised overview for applying sections 80A – 80L to the facts of previous case law	Conhage case (Table 4.1)	Geustyn case (Table 4.2)	Hicklin case (Table 4.3)	ITC1712 case (Table 4.4)	Bobat case (Table 4.5)
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	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>	✗	✗	✗	✗	✓

In collating the findings of the case studies analysed within chapter 4 on a high level, it is evident from Table 5.1 that if these cases had been presented before the courts on the same basis today they would, on a balance of probabilities, have failed if the current GAAR regime was applied using the framework developed in this study. There may be various reasons for this, including that some of these cases should perhaps not have been attacked by the Commissioner. An initial high-level review of the information in Table 5.1 reveals the following:

- All five cases resulted in a tax benefit and satisfied the criteria for the presence of an avoidance arrangement.
- Four of the five cases analysed failed as the taxpayer was able to prove that the sole or main purpose of the arrangement was not to obtain a tax benefit.
- Four of the five cases did not contain any of the tainted elements.

In addition to the above it is important to note that each of the cases analysed in chapter 4 failed on the same basis as when it was originally presented before the courts, despite the 2006 amendments to GAAR. The question that has to be considered is why this is the case. This could indicate that the weaknesses that were intended to be addressed within the previous GAAR regimes may not have been adequately addressed as intended by the 2006 amendments (refer to paragraph 1.2 on page 6). In answering this question it can be seen that the areas where the GAAR failed in its application are those of the sole or main purpose requirement and the tainted elements requirement. It is thus evident that these areas require a more detailed analysis. A more detailed representation from which a more comprehensive discussion can be made is included below.

Table 5.2: Framework for applying sections 80A – 80L to the facts of previous case law

Legend

X Framework requirement not met

✓ Framework requirement met

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
1 - Is there an arrangement? <ul style="list-style-type: none"> 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 <i>Meyerowitz</i> case. 	✓	✓	✓	✓	✓
2 - Does the transaction/operation/scheme result in a tax benefit? <ul style="list-style-type: none"> Has the tax benefit arisen because the taxpayer has effectively stepped out of the way of, escapes or prevented an anticipated liability? (<i>Smith</i> case; <i>King</i> case) 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) 	✓	✓	✓	✓	✓

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
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: <ul style="list-style-type: none"> • Subjective test – Is the stated intention of the taxpayer to enter into an arrangement for the sole or main purpose of obtaining a tax benefit? (<i>Gallagher</i> case) • Objective test – Does the actual effect of the arrangement support the non-tax benefit stated intention of the arrangement? (De Koker, 2010:19.6; Meyerowitz, 2008:29-12 and <i>Ovenstone</i> case) 	X	X	<	X	X
	X	X	<	X	X

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
4 - Tainted elements requirement	X	X	X	X	✓
- One of the following with regard to business transactions:					
- <i>Entered into in a manner not normal for bona fide business purposes?</i>	X	X	N/A	X	✓
<ul style="list-style-type: none"> 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) 					
- <i>Does the transaction lack commercial substance?</i>	X	X	N/A	X	✓
In order to determine whether an arrangement lacks commercial substance the following are applied:					
<ul style="list-style-type: none"> <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) 	X	X	N/A	X	✓

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
<ul style="list-style-type: none"> • <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 allows the evasion 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.) • <i>Round trip financing test</i>: Has funding been transferred between parties, through some sort of reciprocal action, resulting directly or indirectly in a tax benefit? • <i>Tax-indifferent party test</i>: Is there a party who effectively sold its tax advantage to others, regardless of its relationship with any of the contracting parties? 	✗	✗	N/A	✗	✓
	✗	✗	N/A	✗	✓
	✗	✗	N/A	✗	✓

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
<ul style="list-style-type: none"> <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.) 	✗	✗	N/A	✗	✓
<p>- The following with regard to transactions not in the context of business:</p> <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"> 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) 	N/A	N/A	✗ ✗	N/A	N/A

Framework for applying sections 80A – 80L to the facts of previous case law	<i>Conhage</i> case (refer to Table 4.1)	<i>Geustyn</i> case (refer to Table 4.2)	<i>Hicklin</i> case (refer to Table 4.3)	<i>ITC1712</i> case (refer to Table 4.4)	<i>Bobat</i> case (refer to Table 4.5)
<p>- One of the following with regard to transactions in any context:</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"> • Are each of the parties striving to get the utmost possible advantage out of the transaction for themselves? <i>Hicklin</i> case • Would unconnected persons have done the same in this situation? <i>Hicklin</i> case <p>- <i>Is there misuse or abuse of provisions of the Act?</i></p> <ul style="list-style-type: none"> • 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? 	X	X	X	X	✓
	X	X	X	X	✓
	X	X	X	X	✓

5.2.1 Sole or main purpose requirement

The sole or main purpose requirement was identified in paragraph 2.4.3 (page 17) as one of the primary weaknesses of the previous GAAR regime. Table 5.1 has revealed that this requirement of GAAR may remain a weakness within the current GAAR regime. The question to be considered in relation to the sole or main purpose requirement is why the cases that originally did not satisfy the sole or main purpose requirement under the previous GAAR regime did not satisfy this requirement under the current GAAR regime. This observation has been noted with regard to the original judgments made in the *Conhage* case (refer to paragraph 4.2.4 on page 57), the *Bobat* case (refer to paragraph 4.6.4 on page 96) and the *Geustyn* case (refer to paragraph 4.3.4 on page 67).

In answering this question it is important to consider what amendments were made to this requirement. In using the analysis in paragraph 2.5.3 (page 25) it was found that when drafting the current GAAR regime the legislator chose to use similar wording to that used in the previous GAAR regime. Consequently the findings of our courts in the past can be expected to apply *mutatis mutandis* to an enquiry as to the sole or main purpose of an arrangement in terms of the current GAAR regime. The problem that arises is that the weaknesses of this requirement as noted in the previous GAAR regime may then also be evident within the current GAAR regime (refer to paragraph 2.4.3 on page 17). This submission is supported by the fact that four of the five cases that were analysed in this study failed to satisfy the sole or main purpose requirement (refer to Table 5.2, page 108). In using the *Hicklin* case (refer to paragraph 4.4.4 on page 77) as an example of this it is evident, from Tables 5.1 and 5.2 above, that where the courts originally found the purpose requirement to be met, the results remained consistent when analysed under the current GAAR regime. Similarly, when the courts found that the sole or main purpose of the arrangements was not to obtain a tax benefit, the results remained the same under the current GAAR regime. These results indicate that the weaknesses identified with reference to the sole or main purpose requirement may still exist within the current GAAR regime. This finding is confirmed by Louw (2007:24) who states that the purpose requirement has remained much the same as its predecessor. Furthermore, it

was noted that the change in the onus of proof, as included in section 80G of the Act, indicates that when applying the purpose test the effect of the transaction, and not just the purpose of the taxpayer, must be taken into account. However, it has also been identified that in taking into account the judgment in the *Gallagher* case, such an action in effect disadvantages the taxpayer, as no regard will be had for the intention of the taxpayer when entering into such a transaction (Louw, 2007:24). Consequently, it can be seen that the weaknesses noted within the sole or main purpose requirement remain relevant, but an additional factor must be considered in determining whether the purpose requirement is constitutional in view of the fact that it disadvantages the taxpayer as explained by case law.

In further investigating why four of the five cases failed to satisfy the requirements of GAAR, it is submitted that the following factors may have played a role:

- As identified in paragraph 2.4.3 (page 17) the relative ease with which a taxpayer can justify that the purpose of an arrangement was not to obtain a tax benefit was identified as a weakness of the previous GAAR regime. In using the *Conhage* case as an example this weakness is amplified where the raising of capital is part of the arrangement entered into by the taxpayer, as the first three requirements of GAAR are usually present in such a transaction. In the *Conhage* case the taxpayers easily justified that the purpose of the arrangement was the raising of capital and thus it can be concluded that the purpose requirement may inherently include a weakness as it remains relatively easy to justify a commercial purpose of a transaction (refer to paragraphs 2.4.4 on page 18, 4.2.4 on page 57 and 4.2.6 on page 61).
- The results of the analysis may also indicate that, the Commissioner should more carefully consider industry trends when deciding if the sole or main purpose of the arrangement is to obtain the tax benefit as this information is easily used to add to the justification of the purpose of the transaction. In the *Geustyn* case it was noted that the taxpayer's justification was that the purpose of the transaction was to obtain the benefit of trading as an unlimited company. However, the evidence provided regarding the tainted elements requirement provided additional ammunition for the purpose requirement where it was noted that the South

African Association of Consulting Engineers (of which the three former partners were members) expressly sanctioned its members to conduct their practices under unlimited companies and more than half of the members of this association had already adopted the use of unlimited companies (refer to paragraphs 4.3.4 and 4.3.5 on pages 67 to 71 regarding the trends in the engineering industry). This finding similarly holds true in *ITC1712* where the representations made for the taxpayer, by Mr C, added to the justification that the purpose of the transaction was to enter into a profitable sub-lease by noting that all banks required payment up front of not less than 35% of the initial value of the contract and a substantial payment in the second year, and that the only exception to this is where the client is able to put up substantial security (refer to paragraphs 4.5.4 and 4.5.5 on pages 85 and 86 referring specifically to the representations made by Mr C).

Notwithstanding the above, it is important to note that the conflicting views on the interpretation of the sole or main purpose requirement has led to uncertainty about the application of this test in a subjective or objective manner. These conflicting views were derived from the view of case law that the enquiry into the purpose of an arrangement is a subjective one. There is an alternative view which some tax practitioners and academics subscribe to, in terms of which it is argued that the sole or main purpose is an objective test. This study applied this test using both the subjective test (the stated intention of the taxpayer) as well as the objective test (in respect of the effect of the transaction) in order to apply the sole or main purpose requirement in a context that meets the intention of the legislator (purposive approach) but also does not lead to absurdities in its interpretation (refer to paragraph 2.5.3 on pages 25-27). However, whilst this method of application does not impact upon the weakness identified in the sole or main purpose requirement as noted above, it does highlight an additional weakness in that it has led to doubt about the interpretation and application of this requirement. In analysing the application of the sole or main purpose requirement using both the subjective and objective tests, the *Hicklin* case was the only case that met this requirement. In referring back to the details of the *Conhage* case, *Bobat* case, *Geustyn* case and *ITC1712*, all resulted in the subjective purpose other than obtaining a tax benefit being supported by the

objective purpose. The *Hicklin* case, whilst having the subjective purpose of not entering into the transaction for obtaining a tax benefit, met this requirement because the objective test did not support the subjective test.

It can be deduced that the doubt in the interpretation of the purpose requirement (subjective or objective enquiry) may fuel the view that the amendments to the sole or main purpose requirement have not resolved the weaknesses of the previous GAAR regime but may have added to it. Arendse (2006:1) confirms this dilemma when setting out the main points of SAICA's submission to SARS's discussion paper released for comment in 2005. Arendse (2006:1) notes that the "problem (for the fiscus), as we see it, is that where the courts rejected the application of section 103(1) because they felt that its application was not appropriate, as the transactions were ordinary and bona fide, the courts had to justify their approach by interpreting the relevant portions of the section so as to support their conclusion. And in doing so, they have inevitably chipped away at the edifice supporting section 103". Therefore when considering this in light of the sole or main purpose requirement it is evident that the courts may consider the evidence presented and use relevant evidence to justify their view of the application of the sole or main purpose requirement regardless of the contentious issue of the subjective or objective enquiry. It is therefore important to once again realise that GAAR is inherently subjective and would thus need to rely on decisions of the court to clarify each of the individual requirements. In addition to this, Arendse (2006:3) finds that the proposed amendments to GAAR in 2005 did not adhere to the concepts of certainty, simplicity and neutrality. This indicates that the 2006 amendments to GAAR, whilst necessary, may have introduced concepts that may in effect be "chipped away" by the courts when interpreting these requirements.

Thus in summary it can be said that based on the results of the analyses performed in chapter 4 the sole or main purpose requirement remains a weakness in the current GAAR regime as it has inherited weaknesses from its predecessor. However, the weakness is compounded by the conflicting views on interpretation and application.

5.2.2 Tainted elements requirement

The first question to be considered in relation to the tainted elements requirement is why the cases that originally did not satisfy the abnormality requirement so often did not satisfy this requirement under the current GAAR regime. This observation has been noted with regard to the original judgments made in the *Geustyn* case (refer to paragraph 4.3.5 on page 68), the *Hicklin* case (refer to paragraph 4.4.5 on page 79) and *ITC1712* (refer to paragraph 4.5.5 on page 86). In investigating this question it was noted that in comparing the previous and current GAAR regimes the tainted elements requirement is essentially the revamped abnormality requirement of the previous GAAR regime. The most significant amendments to this area were the additional tainted elements in the form of the lack of commercial substance test and the direct or indirect misuse or abuse of the Act test. Despite these changes the results from the case studies (refer to Tables 5.1 and 5.2 above) indicate that where the case failed on the abnormality requirement under the previous GAAR regime the results have remained consistent when analysed under the current GAAR regime.

Table 5.1 (page 107) and Table 5.2 (pages 108-114) also clearly show that where a case analysed under the current GAAR regime failed one of the tests within the tainted elements requirement, it failed all of these tests (specifically referring to the tainted elements of the *Bobat* case represented in Table 5.2 above). The opposite can be said where cases satisfied the tainted elements requirement it also satisfied all of the individual tests. This indicates that the amendments to the abnormality requirement (now the tainted elements requirement) in certain types of transactions may not have added strength to the GAAR.

In confirming these findings Van Schalkwyk and Geldenhuys (2009a:6), whilst specifically referring to the misuse of the Act requirement, note that the current GAAR regime may have been formulated too widely and could thus plunge the current GAAR regime “into a similar predicament than that in which its predecessor, section 103(1), was ... when its ambit was considered to be too wide”. This indicates that, similar to that of the sole or main purpose requirement,

the courts may use evidence to support their view of an avoidance arrangement regardless of the widely formulated GAAR. This view supports that of Arendse (2006:1), namely that the courts may be left with no alternative but to chip away at the edifice of GAAR when cases are presented before these courts. Van Schalkwyk and Geldenhuys (2009a:6) note that the courts could, if they consider the ambit to be too wide, “look negatively, at it which could lead to a very narrow and restricted interpretation of the statute and frustrate the fiscus”. In this case it could cause destruction to the effectiveness of the current GAAR regime similar to that of its predecessor.

In commenting on the effectiveness of the 1996 amendments on the abnormality requirement, Olivier (1997:742) states that the amendment did not bring about clarity as to the objective yardstick against which a transaction should be measured. Similar concerns can be raised in the context of the 2006 amendments due to the fact that though the words “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” have been removed, it remains to be asked, for example, “what is a normal manner for ex-partners to incorporate their practice?”. This again raises the concerns, mentioned in paragraph 2.4.2 (page 17), that a transaction can only be compared to a similar transaction to determine if the transaction being entered into is in fact “normal”. This problem is also highlighted by Meyerowitz (2008:29-11), who cautions that the context of the transaction must be taken into account when contemplating the abnormality requirement and thus may have rendered the removal of the words “having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out” futile.

The views taken by Meyerowitz and Olivier above have been confirmed by SARS (2005:56) in that each of the factors to be considered by the courts must be interpreted objectively, but the facts and circumstances involved must also be considered. These amendments to the abnormality requirement thus still allow the courts to consider the circumstances whilst aiming to eliminate the opportunity to use the defence of “everyone’s doing it”. Though none of the cases selected for use in this study failed because of the “everyone’s doing it” argument, if the purposive approach is applied by the courts when interpreting

the current GAAR regime, this deficiency of the abnormality requirement may have been removed. The question that now remains to be answered is: why has the tainted elements requirement still failed to apply in so many of the cases selected in this study?

Broomberg (2007:6) answers that the amendments to the abnormality requirement in 2006 were intended to address the effects of the *Geustyn* and *Hicklin* cases. However, he points out that the current GAAR regime has retained almost identical requirements and therefore case law in which these tests have been formulated remains relevant. In his discussion he suggests that it would be likely that the objective test required for the rights and obligations element may have resulted in judgments occurring in favour of the Commissioner. However, when taking into account the purposive approach of these changes, and the views of both Meyerowitz and Olivier above, this view is refuted. These changes must thus be presented before the courts to determine which of these views is correct. In addition to this, the tainting elements are also criticised because the list of tainting elements is not exhaustive and leads to confusion amongst taxpayers (Louw, 2007:29).

The findings of the case study regarding the weaknesses within the tainted elements requirement have been confirmed by the literature control. It has given rise to the view that the use of almost identical requirements in the tainted elements provisions has not effectively addressed the weaknesses therein and the views of the courts that previously chipped away at the edifice of the requirement may remain relevant. Nevertheless, it must be noted that the amendments to the abnormality requirement may have contributed to strengthening the GAAR in other types of arrangements where some of the specific characteristics are present, though none were evident from the cases selected in this study.

5.2.3 Combination of the purpose and abnormality requirements

The use of both the abnormality and purpose requirements in conjunction with each other was identified as a weakness of the previous GAAR regime (refer to paragraph 2.4.4 on page 18). In determining whether this weakness remains a valid criticism of the current GAAR regime the *Hicklin* case (refer to

paragraphs 4.4.5 and 4.4.6 on pages 79-83) can be used as an example. It is evident in this case that the Commissioner may not have evaluated each of the requirements of GAAR in isolation before attacking the transaction. This may have led to the case being presented before the courts where the arrangement may satisfy the first three requirements of GAAR (i.e. arrangement, tax benefit and purpose) but does not meet the final requirement of GAAR (i.e. abnormality/tainted elements). This highlights that the weakness noted in paragraph 2.4.4 (page 18) regarding the use of the purpose and abnormality requirements in conjunction with each other is still present within the current GAAR regime.

Notwithstanding the above, an additional finding can be made from the analysis of the *Bobat* case. The Commissioner may have erred in his original attack of the transactions by attacking the transactions as a whole rather than those parts of the scheme that met all the requirements of GAAR (in the *Bobat* case, the imposition of Facet Investments into the group structure). The analysis of the *Bobat* case also revealed that it may have been easier to prove the presence of all four requirements of GAAR when attacking a specific part of an arrangement as opposed to the whole. The Commissioner should thus not only analyse the transactions as a whole, but should also apply the GAAR to specific parts of the transaction before attacking the transactions in court on an incorrect basis (refer to paragraph 4.6.6 on pages 99 to 104). It is possible that the procedures, policies and processes used by the Commissioner in determining whether an arrangement should be attacked in court may be flawed. Although the requirements of GAAR may have been met, by either the whole or for parts of the transaction, they are not considered in isolation and/or attacked on this basis in court.

5.2.4 Other findings

Tables 5.1 and 5.2 clearly show that three of the five cases analysed failed to satisfy two of the requirements of the current GAAR regime (i.e. the *Conhage* case, the *Geustyn* case and *ITC1712*). This observation raises a concern about why these cases were attacked in court in the first place. In identifying what may have caused these three cases to have failed on both the purpose and abnormality requirements it is possible to use *ITC1712* as an example. In

ITC1712, the Commissioner may have viewed a transaction as meeting the requirements of GAAR without obtaining all the facts from the taxpayer. The Commissioner thus did not consider the commercial reasoning for the arrangement, which can be explained by noting that the Commissioner may not have been party to the representations made by Mr C on behalf of the taxpayer before attacking the arrangement in court (refer to paragraph 4.5.5 on page 86). This breakdown in communication between the Commissioner and the taxpayer may have led to cases being taken to court that did not warrant it (refer to paragraph 4.5.6 on page 88).

Further, it is noted that many of the tax avoidance cases that are brought before the courts often progress to more than one level of court. The costs associated with continuing these legal battles result in expenditure (legal costs) that is often a contributing factor to the perceived ineffectiveness of GAAR.

The findings above are confirmed by Louw (2007:12) who says that one of the biggest problems experienced in drafting GAAR is to establish a boundary between the rights of taxpayers to order their affairs in the most appropriate manner, and transactions deemed impermissible. In adding to this Arendse (2006:3) asserts that the Commissioner should be required to apply his mind as to whether the elements of GAAR are present as part of an avoidance scheme, thus suggesting that where evidence exists that may refute one or more of the requirements of GAAR these cases should not be taken to court. Arendse (2006:3) also confirms that transactions or schemes that may be challenged by the Commissioner should be referred to a specialist department instead of using individual assessors to make the final decision.

5.3 Recurring themes

The factors that are included in paragraphs 5.2.1 to 5.2.4 have often included recurring factors that may be categorised into the following areas:

- **Taxpayer position of power:** The fact that so many cases, on a balance of probabilities, would have failed to stand up to the rigours of court indicates that taxpayers are able to justify with relative ease that the transactions entered into do not fall foul of the requirements of GAAR,

specifically the purpose and abnormality requirements (refer to paragraphs 2.4.4 on page 18, 5.2.1 on page 115, 5.2.2 on page 119 and 5.2.3 on page 121).

- **Combination of the sole or main purpose and tainted elements requirements:** The fact that three of the five cases analysed failed on at least one requirement of the current GAAR regime may highlight that these arrangements should not have been attacked by the Commissioner in the first place. Alternatively, this may indicate that the use of both of these requirements in conjunction with each other has led to similar anomalies as were identified in the previous GAAR regime (refer to paragraphs 2.4.4 on page 18, 5.2.3 on page 121 and 5.2.4 on page 122).
- **Research, communication and preparation:** There may be insufficient research and preparation performed by the Commissioner before attacking these arrangements in court, resulting in unfavourable judgments for the Commissioner (refer to paragraphs 5.2.1, 5.2.2, 5.2.3 and 5.2.4 above). This also indicates that breakdowns in communication between the Commissioner and the taxpayers may contribute to the limited information that the Commissioner is able to use in assessing if the arrangement should be attacked in a court of law. In view of these observations policies should be adopted by the Commissioner that will aid in evaluating whether the full facts of the cases have been researched and applied to all the requirements of GAAR (as a whole and in isolation). These policies should also provide for extensive consultation with the individual taxpayers, to establish whether such cases should be taken to court.

The observations noted above indicate that it is imperative that the Commissioner not enter into costly legal battles that he is likely to lose as they add ammunition to the perception that GAAR is an ineffective weapon against tax avoidance. It is thus imperative that the Commissioner attack arrangements that have been subjected to strenuous criteria before being presented before the courts. The use of a framework, such as the one developed in this study (refer to paragraph 2.5.5 on page 41), may thus be a tool in developing strenuous criteria for application to the fact patterns of transactions, before attacking them in court. This more strenuous enquiry into these arrangements will allow for an improved success

rate by the Commissioner and will improve the progression of the development of the case law. Following a less stringent approach may lead to misinterpretation of individual requirements of GAAR by taxpayers, which do not have merit, and which may then be used in future arguments in court that cause the Commissioner to fail in court.

5.4 Conclusion

Both the purpose and abnormality requirements of GAAR remain an area of considerable debate. The views expressed in the works of Meyerowitz, Olivier and Broomberg, as noted in paragraph 5.2.2 (page 119), are often opposing and have led to further uncertainty within the current GAAR regime. However, despite the presence of these opposing views, the changes to GAAR in 2006 have again raised problems which may once again place our GAAR in the same position as its predecessors. This has been eloquently explained by Broomberg (2007:2) who refers to the tainted elements requirement when he cautions that “the adopting of these problem children and including them into our Act may be questioned”. In comparing the findings of the case studies to the literature the following “problem children” have been identified and conclusions can be drawn:

- The conclusions drawn from the sole or main purpose requirement have been supported in the literature control in paragraph 5.2.1 (page 115). These are evidenced by the references to the fact that it remains much the same as its predecessor and thus has inherently included the weaknesses identified in its predecessor.
- The comments made in respect of the fact that the 2006 amendments did not adhere to the concepts of simplicity or neutrality in paragraph 5.2.1 (page 115) support the conclusions drawn about the purpose requirement (i.e. whether determined in an objective or subjective light). This has specific implications regarding the constitutional rights of taxpayers as they may be encroached upon in applying the purpose requirement objectively.
- Specific parts of the GAAR may have been formulated too widely (tainted elements) which may result in placing the current GAAR regime in a similar predicament to its predecessors, and may affect the perceived effectiveness of GAAR once again (refer to paragraph 5.2.2 on page 119).

- Uncertainties about the objective or subjective application of the abnormality requirement has also introduced uncertainties in its interpretation, which will again add to its perceived ineffectiveness (refer to paragraphs 2.5.4.1 on page 29, 2.5.4.3 on page 39 and 5.2.2 on page 119).
- The references to the fact that a taxpayer may refute one or more of the elements of GAAR support the conclusion drawn about the use of the abnormality and purpose requirements in conjunction with each other (refer to paragraphs 5.2.3 on page 121 and 5.2.2 on page 119).
- The conclusions regarding the position of power (refer to paragraph 5.3 on page 123) in which taxpayers find themselves are supported by the views expressed in paragraph 5.2.1 (page 115). This is due to the fact that such a wide application of GAAR may lead to the chipping away of the edifice of these GAAR in their interpretation by the courts.
- The conclusions drawn from the study concerning research, communication and preparation (refer to paragraph 5.3 on page 123) have been supported by the literature control in paragraphs 5.2.1 (page 115) and 5.2.3 (page 121). This is particularly obvious where it was noted that the Commissioner should apply his mind before attacking these arrangements in court.

In conclusion, the literature control has supported the conclusions drawn from the case studies of chapter 4 (refer to paragraph 5.2). In the following chapter the findings of all three phases of the study are collated to determine whether the research objectives have been met.

CHAPTER 6 - CONCLUSION AND IDENTIFICATION OF FUTURE RESEARCH AREAS

6.1 Introduction

The aspiration to minimise one's tax burden, whether legitimately or illegitimately, has been a concern to taxpayers throughout the ages. The concern for revenue authorities worldwide is finding an effective way to balance the taxpayers' right to organise his/her affairs in a way that minimises this tax burden whilst still ensuring taxpayer compliance. Tools available to revenue authorities to address this concern are in the form of both specific and general anti-avoidance legislation. South Africa, like many other countries, includes both specific and general anti-avoidance rules in its fiscal legislation. With specific reference to the general anti-avoidance rules it is noted that the GAAR have been present within the South African context since 1941 in order to provide principles or boundaries to address tax evasion and tax avoidance. Despite the inclusion of these anti-avoidance rules in the tax legislation, the ever-changing economic environment necessitated the amendment of these rules in order to enable the intention of the legislator to remain intact. This study, focusing on GAAR, found that criticisms of GAAR are often the catalyst for these amendments when cases, brought before the courts, hold in favour of the taxpayer and not the Commissioner. In a South African context, the most recent of these amendments occurred in 1996 and 2006. Due to the fact that the current GAAR regime has not been tested extensively in South African courts, the use of hindsight as a tool for determining if the current GAAR regime adequately addresses impermissible tax avoidance is not applicable in the current South African context. The impetus of this study thus originated from the observation that the 2006 amendments to GAAR have not been applied on a practical basis to existing case law. Therefore by applying the current anti-avoidance legislation to the facts from actual case law (where the previous GAAR proved to be ineffective), this study aimed to fill a gap in the tax avoidance research by determining whether the 2006 amendments addressed the weaknesses identified on a practical basis in relation to these cases. The problem statement to be answered by this study was defined as "Have the 2006 amendments to GAAR resolved the weaknesses of the previous GAAR?"

The research objectives (paragraph 1.3 on page 6) pursued in answering this research problem were formulated as follows:

- i) to identify the primary weaknesses of the previous GAAR regime which has been addressed in paragraph 2.4 on page 16.
- ii) to identify what amendments were intended to address the primary weaknesses (refer to paragraphs 2.4.5, 2.4.6, 2.5, 2.5.3, 2.5.4 on pages 19 to 29).
- iii) to apply the current GAAR to the practical reality of facts of selected cases and thus determine if the 2006 amendments have resolved the weaknesses of the previous GAAR in these cases (refer to chapters 4 and 5).
- iv) to recommend aspects that have to be addressed to improve the effectiveness of the current GAAR regime (refer to 6.5 on page 135).

This chapter will conclude on each of these research objectives in order to determine if the 2006 amendments to GAAR have in fact resolved the weaknesses of the GAAR.

6.2 Achievement of research objectives

In order to achieve the research objectives of this study a qualitative research approach was used to gain a detailed understanding of the weaknesses of the previous GAAR regime and the workings of the current GAAR regime in a practical context. Selected case law was used to explore whether the 2006 amendments to GAAR have addressed the weaknesses effectively. The type of case study design that best achieved the purpose of the study was a collective/multiple case study design that focused on one issue (i.e. GAAR) but selected multiple cases to illustrate the workings of the current GAAR regime.

The research problem investigated in the study (refer to paragraph 1.2 on page 6) was: **Have the 2006 amendments resolved the weaknesses of the previous GAAR?** In order to determine if the research problem has been answered is to first determine if the individual research objectives have been met as follows:

- i) To identify the primary weaknesses of the previous GAAR regime which has been addressed in paragraph 2.4 on page 16.
 - *Phase 1 of the literature study* addressed in chapter 2 revealed that the primary weaknesses of the previous GAAR regime were encapsulated within the purpose and abnormality requirements, due to the extensive criticism of these provisions resulting from the decisions of South African courts (refer to paragraph 2.4.6 on page 20).
- ii) To identify what amendments were intended to address the primary weaknesses
 - *Phase 1 of the literature study* revealed that the purpose requirement was not significantly amended in view of the criticisms, but that the abnormality requirement was amended by the inclusion of both tainted elements and commercial substance indicators. Each of the requirements, indicators and tainting elements were interpreted with reference to judgments from case law using the purposive approach to interpretation (refer to paragraphs 2.5.3 on page 25 and 2.5.4 on page 27).
- iii) To apply the current GAAR to the practical reality of facts of selected cases and thus determine if the 2006 amendments have resolved the weaknesses of the previous GAAR in these cases (refer to chapters 4 and 5).
 - *Phase 2 of the literature study* applied the provisions of the current GAAR legislation to the selected cases. This phase of the study revealed that each of the cases analysed did not satisfy one or more of the requirements of GAAR if attacked on the same grounds as when they appeared before the court (refer to chapter 4). Further analysis revealed that four of the five cases analysed failed as the taxpayer was able to prove that the sole or main purpose of the arrangement was not to obtain a tax benefit, whilst four of the five cases did not contain any of the tainted elements. In addition to the

above it is important to note that each of the cases analysed in chapter 4 failed on the same basis as when it was originally presented before the courts, despite the 2006 amendments to GAAR. This indicates that the weaknesses that were intended to be addressed within the previous GAAR regimes may not have been adequately addressed as intended by the 2006 amendments (refer to paragraph 1.2 on page 6). Further it was noted that the areas where the GAAR failed in its application were those of the sole or main purpose requirement and the tainted elements requirement:

- *Sole or main purpose requirement:* The conclusions drawn with regard to the sole or main purpose requirement revealed that where the courts originally found the purpose requirement to be met, the results remained consistent when analysed under the current GAAR regime. Similarly, when the courts found that the sole or main purpose of the arrangement was not to obtain a tax benefit, the results remained the same under the current GAAR regime. These results indicate that the weaknesses identified with reference to the sole or main purpose requirement may still exist within the current GAAR regime. The primary reason for this finding was considered to be the fact that the purpose requirement remained much the same as its predecessor and thus inherently included its weaknesses. In addition to the above, it was noted that the change in the onus of proof, as included in section 80G of the Act, indicated that when applying the purpose test the effect of the transaction, and not just the purpose of the taxpayer, must be taken into account. This change was found to have indicated that such an action would possibly disadvantage the taxpayer, as no regard would be had for the intention of the taxpayer when entering into such a transaction.
- *Tainted elements requirement:* The results from the case studies revealed that where a case failed on the abnormality requirement under the previous GAAR regime the results

have remained consistent when analysed under the current GAAR regime. Further, the results indicated that where a case analysed under the current GAAR regime failed one of the tests within the tainted elements requirement, it failed all of these tests and vice versa. This indicates that the weaknesses of the previous abnormality requirement may still exist despite the 2006 amendments thereto and that the 2006 amendments may not have added strength to the GAAR.

- *Additional findings:* In addition to the specific findings made in respect of the purpose and abnormality requirements additional conclusions were drawn from the case studies:
 - Parts of the GAAR may have been formulated too widely (tainted elements) which may result in placing the current GAAR regime in a similar predicament to its predecessors, and may affect the perceived effectiveness of GAAR once again.
 - Uncertainties about the objective or subjective application of the abnormality requirement also introduced uncertainties in its interpretation, which may again add to its perceived ineffectiveness.
 - The references to the fact that a taxpayer may refute one or more of the elements of GAAR, indicates that the use of both the abnormality and purpose requirements in conjunction with each other may still be a weakness of the current GAAR regime.
 - Taxpayers find themselves in a position of power (refer to paragraph 5.3 on page 123) due to the fact that such a wide application of GAAR may lead to the chipping away of the edifice of the GAAR when interpreted by the courts.
 - The ease with which taxpayers were able to disprove the presence of one or more elements of GAAR with relative ease revealed that the Commissioner may not

communicate, research or prepare an adequate case before attacking these arrangements in court.

- *Phase 3 of the literature study* revealed that similar criticisms of the GAAR exist despite the recent amendments. However, these criticisms also indicate that the original weaknesses contained within the previous GAAR regimes may not have been the only contributing factors to the case study findings (i.e. the taxpayer position of power and the research communication and preparation in paragraphs 5.2.1, 5.2.3 and 5.3).
- iv) To recommend aspects that have to be addressed to improve the effectiveness of the current GAAR regime
- Recommendations that may be used to improve the effectiveness of the current GAAR regime are addressed in paragraph 6.4 on page 133.

Based on the findings from each phase of the literature study, the 2006 amendments to GAAR may not have succeeded in their objectives. Therefore it can be concluded that the 2006 amendments may not have addressed the weaknesses of the previous GAAR. Therefore, through the achievement of the research objectives, it can be concluded that the research problem has been answered. However, although the weaknesses identified have not been adequately addressed by the 2006 amendments, additional factors have been identified that have contributed to the lack of success of the Commissioner when attacking transactions in terms of GAAR (refer to paragraphs 5.2.1 on page 115 and 5.2.4 on page 122).

6.3 Limitations of the study

As highlighted in paragraph 1.4.3 (page 8) certain limitations of this study do exist. The first of these limitations arises from the use of case studies, since it is difficult to generalise the outcomes of the study when using case studies. However, there is an argument that the findings of these case studies may be indicative of characteristics included within the population 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 2006 amendments to the anti-avoidance legislation and the presence of weaknesses within the GAAR.

The following additional limitations of the study have been identified:

- a) The study is South African specific in that it only addresses the 2006 amendments of the GAAR in a South African context and thus provides limited use to other jurisdictions/countries.
- b) The use of interpretation of the provisions of the legislation has also been identified as a limitation, but measures were instituted to limit the impact that this may have had. These measures included: a phased literature study; objective methodology was applied in selecting the cases for the purposes of the study; the population of case law, which provided the platform from where the case law was selected was obtained from an impartial source (i.e. the South African Tax Cases Reports); the case law documentation obtained contained the full facts and details of the case from an objective source and a purposive approach was used when interpreting the legislation and applying it to the facts of the case studies.

6.4 Recommendations

In order to address the factors that may have played a role in the findings of the cases the following recommendations are put forward:

- To mitigate the risk of possible costly errors that may arise by a breakdown in communication, the Commissioner should obtain all the facts from the taxpayer, including the commercial reasoning for entering into the transaction, before attacking the transaction in court (refer to paragraphs 5.2.1 on page 115, 5.2.4 on page 122 and 5.3 on page 123). The Commissioner should also consider industry trends when deciding if the sole or main purpose of the arrangement is to obtain the tax benefit as this information is easily used to justify the purpose of the transaction by the taxpayer. Similarly, the Commissioner should use caution when attacking arrangements where capital is raised as although the abnormality requirement (i.e. round trip financing) may be present, it

remains relatively easy for the taxpayer to disprove the purpose requirement.

- The Commissioner should not only analyse the transactions as a whole, but should also apply the GAAR to specific parts of the transaction before attacking the transactions in court on an incorrect basis (refer to paragraph 5.2.4 on page 122).
- The Commissioner should evaluate each of the requirements of GAAR in isolation before attacking the transaction in court to avoid cases where the arrangement does not meet all of the requirements of GAAR (refer to paragraph 5.2.3 on page 121). In performing this task the Commissioner should attack arrangements that have been subjected to strenuous criteria before being presented before the courts. A framework such as the one developed in this study (refer to paragraph 2.5.5 on page 41) may thus be used as a tool in developing strenuous criteria for application to the fact patterns of transactions, before attacking them in court. This more strenuous enquiry into these arrangements will allow for an improved success rate by the Commissioner and will improve the progression of the development of the case law.
- The use of such similar wording to that of the previous sole or main purpose requirement in the current sole or main purpose requirement has led the study to conclude that the findings of our courts in the past should apply *mutatis mutandis* to an enquiry as to the sole or main purpose of an arrangement in terms of the current GAAR regime. It is evident that the weaknesses noted within this requirement remain relevant but an additional factor must be considered in determining if the purpose requirement is constitutional in the light of case law (refer to paragraph 5.2.1 on page 115).

In addition to the above the studies performed by Meyerowitz, Olivier and Broomberg often revealed opposing views on the interpretation of the current GAAR regime. This has led to further uncertainty within the current GAAR regime and these inconsistencies may once again place our GAAR in the same position as its predecessor.

6.5 Topics for future research

This study has identified numerous potential topics for future research:

- The constitutionality of the current GAAR regime should be studied to determine if the objective application of the sole or main purpose requirement does not infringe upon the rights of a taxpayer as using an objective approach may not allow the relevant facts or circumstances to be considered (refer to paragraphs 5.2.1 and 5.4 on pages 115 and 126).
- A study should be performed to compare of the South African GAAR regime to the GAAR of other countries where their GAAR is perceived to be working effectively. This may be useful to aid in suggesting improvements that may be made to the current GAAR regime by identifying alternatives to the ineffective sole or main purpose requirement (refer to paragraph 5.2.1 on page 115) and the combination of the purpose and abnormality requirements (refer to paragraph 5.2.3 on page 121).
- A study could be performed that will determine the impact of common law principles on GAAR. This could empower SARS to determine which cases should be attacked under these common law principles as opposed to the use of GAAR (refer to paragraph 2.5.4.2 on page 30).

6.6 Conclusion

The main weaknesses of the previous GAAR regimes, as identified within phase 1 of this study, were the abnormality and purpose requirements. The primary criticism of the abnormality requirement stemmed from the fact that transactions may be considered normal due to the popularity of a particular transaction rather than a transaction that would not be entered into for *bona fide* purposes. The primary criticism of the purpose requirement stemmed from the fact that it was relatively easy for a taxpayer to justify that the sole or main purpose of a transaction was not for the purpose of obtaining a tax benefit.

The analysis of the 2006 amendments to the GAAR revealed that the purpose requirement was not significantly amended in view of these criticisms, but that the abnormality requirement was amended by the inclusion of both tainted elements and commercial substance indicators (refer to paragraph 2.5.4 on page 27). The findings of the case studies revealed 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. 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 regime 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 to the GAAR and may in fact have introduced additional areas of concern to the GAAR. Further, it was noted that the cases analysed often failed on more than one of the requirements of GAAR. This may indicate that the GAAR may not necessarily have been at fault when the cases were originally presented before the courts, but other factors may have played a role in the ineffectiveness of GAAR. The recurring themes that revealed these factors were identified as:

- **Taxpayer position of power:** taxpayers are still able to justify with relative ease that the transactions entered into do not fall foul of the requirements of GAAR.
- **Combination of the sole or main purpose and tainted elements requirements:** The fact that three of the five cases analysed failed on at least one requirement of the current GAAR regime may highlight that these arrangements should not have been attacked by the Commissioner in the first place. This may also indicate that the use of both of these requirements in conjunction with each other has led to similar anomalies as were identified in the previous GAAR regime.
- **Research, communication and preparation:** There may be insufficient research and preparation performed by the Commissioner before attacking these arrangements in court, resulting in unfavourable judgments for the Commissioner.

Taxpayers worldwide are constantly seeking ways in which to minimise their tax burdens. In South Africa it is evident that the general anti-avoidance rules may not provide the South African Revenue Service with an effective tool with which to combat impermissible tax avoidance. The effectiveness of the South African GAAR regime thus remains an area of concern despite the recent attempts to address its weaknesses.

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