UNIVERSITY OF KWAZULU-NATAL

A critical analysis of the balance between effective tax collection and permissible tax avoidance provided by legislation.

Prepared by

Chrichan de la Rey

218049549

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Supervisor: Mr Chris Schembri

Co-Supervisor: Prof Shannon Bosch

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‘A person doesn't know how much he has to be thankful for until he has to pay taxes on it.’

I would have to pay various types of tax for all the people that I am thankful for:
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ABSTRACT

Tax avoidance means the 'arranging of a taxpayer's affairs in such a way that his tax liability is reduced or he has no obligation to pay tax at all'.[1] The harm caused by tax avoidance has the potential to harm government programs: for every loophole utilised to reduce tax liability, less funds are raised by tax collection and therefore available for the use of these programs. It is submitted that tax avoidance is universal. It was done by the Egyptians, the Lords and today by taxpayers who wish to minimise their tax liability.[2]

Tax avoidance is facilitated by vague tax legislation. Courts turn to precedents because the legislation is too uncertain. It was held that plain words of the statute must be applied,[3] however these often give rise to several ambiguities.

There are vast amounts of money which the fiscus is entitled to, but do not receive in the tax collection process. This is questioned to be due to either tax avoidance or an ineffective tax collection procedure. The study acknowledges that tax evasion is also to blame, however it does not delve into this are of tax law. The fiscus must simultaneously balance tax collection and avoidance on the one hand, and tax collection and morality on the other hand. The balance lies in more effective and efficient administrative action from SARS, including educating taxpayers about paying tax.

[1] JMP Venter *et al* 2017: 510-511.
[2] JMP Venter *et al* 2017: 510-511.
[3] *IRC v Duke of Westminster* 1936 AC 1 HL:524.

TABLE OF CASES AND STATUTES

	CASES
1	*Commissioner for South African Revenue Service v NWK Ltd* [2011] 2 All SA 347 SCA
2	*Case No* 13276/15
3	*Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd*) (606/97) [1999] ZASCA 64 (17 September 1999)
4	*Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64
5	*CIR v African Products Manufacturing Co Ltd* 1994 TPD 248 (13 SATC 164)
6	*Commissioner for South African Revenue Service v Bosch* [2014] ZASCA 171 (19 November 2014)
7	*Case no* 13065/13
8	*Dadoo v Krugersdorp Municipality Council* 1920 AD 530
9	*ITC 1611* 59 SATC 12
10	*L V Commissioner of Taxes; W V Commissioner of Taxes* [1961] 3 All SA 13 (SR)
11	*Michau v Maize Board* 2003 (6) SA 459
12	*Rhodesia Railways Ltd v Income Tax Collector, Bechuanaland* (1933) 6 SATC 225
13	*Secretary for Inland Revenue v Gallagher* [1978] 3 All SA 1 (A)
14	*Vestey's Executors v IRC* [1949] 1 All ER 1108 (HL)
15	*Zandberg v Van Zyl* 1910 AD 302

	STATUTES
1	Financial Intelligence Centre Act 38 of 2001
2	Income Tax Act 58 of 1962
3	South African Revenue Service Act 34 of 1997
4	South African Constitution

TABLE OF CONTENTS:

1 CHAPTER 1: THE CONTEXT

1.1 Background and Introduction:

According to the Minister of Finance,[4] South Africa's tax system is based on principles of certainty, efficiency and equity.[5] The South African Revenue Service Act[6] anticipates that the tax policy aiming to raise revenue will be done in a manner that is efficient and effective.[7] In the Strategic Plan of 2015/16-2019/20 the Minister concedes that in order to do this, the tax base must be broadened.[8] He guarantees this through ensuring taxpayers who are liable will fully and timeously meet their legal responsibilities.[9] The Legislature however allows for tax avoidance, creating an anomalous situation.

Tax avoidance means the 'arranging of a taxpayer's affairs in such a way that his tax liability is reduced, or he has no obligation to pay tax at all'[10]. It is critical to note that, unlike tax evasion, in certain cases, tax avoidance is a permissible and a legal way of avoiding tax. [11] Tax evasion refers 'to illegal actions intentionally entered into by a taxpayer to absolve himself from a tax burden'[12]. This study will not investigate tax evasion. Nevertheless, a fine line exists between tax evasion and tax avoidance. This is due to the abuse of tax avoidance often resulting in tax evasion. Legislation and common law derived from case law are both used to deal with tax avoidance, however legislation and the General Anti-avoidance Rules (GAAR) govern tax avoidance. Several authors have discussed the transition between the new and old provisions and speculated as to the success of it.[13] Various cases will be discussed to illustrate how taxpayers' transactions have narrowed the definition of tax avoidance and what may be utilised to reducing legal obligations.[14]

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[4] Minister NM Nene.
[5] SARS *Strategic Plan 2015/16 - 2019/20* (2015) 4.
[6] Act 34/1997.
[7] Act 34/1997: sec4(2).
[8] SARS *Strategic Plan 2015/16 - 2019/20* (2015) 4.
[9] Ibid 8.
[10]JMP Venter *et al* 2017: 510-511.
[11]JMP Venter *et al* 2017: 510.
[12] Ibid 11.
[13]DJ Benn *Tax Avoidance in South Africa: An analysis of general anti-avoidance rules in terms of the Income Tax Act 58 of 1962, as amended* and Dlamini 2011 *Analysis of Tax Avoidance Legislation in South Africa: Developments Over a Five-Year Period.*
[14]Such as *Smith v CIR* 1964 (1) SA 324 (A); 26 SATC 1 and *CIR v Challenge Corp Ltd [*1986] 2 NZLR 513.

This research will investigate whether the tax avoidance used by taxpayers damages the fiscus by virtue of ineffective tax collection. This tax collection is mainly sustained by Personal Income Tax ('PIT'), which increased by R36.6 billion from 2007/08 to 2016/2016. [15] 'As a percentage of total tax revenue, PIT increased from 29.6% in 2007/08 to 37.2% in 2016/17'.[16] SARS collected R8.13 trillion total revenue for the fiscal years from 2007/08 to 2016/17.[17] Tax revenue collected in the 2017 tax year amounted to R1 144.1 billion.[18] It is well established that PIT is one of the three main tax instruments which together are responsible for more than 80% of the revenue.[19] By allowing taxpayers the freedom to manage their affairs, the fiscus is at risk of reducing one of its main sources of revenue. The exemptions contained in section 10[20] provide for a list of receipts and accruals exempt from normal tax.[21] Deductions based on section 11[22] deliver another range of possible amounts that can legally be deducted from the income of the taxpayer. Capital allowances also provide a scope of deductions for various trades. Taxpayers merely need to interpret their affairs to fall within the ambit of these legislative provisions to reduce their taxable income, which in turn will minimise the amount collected by the fiscus. This is one simple way in which tax avoidance will affect PIT. The problem the fiscus faces is that it must balance allowing taxpayers the freedom to manage their affairs while simultaneously ensuring that the main source of tax collection is not threatened. This study aims to evaluate whether this balance is possible.

The definition of tax avoidance has been discussed in great depth by various scholars and in judgments: *Smith v CIR*[23] discussed the ordinary meaning of avoiding liability as to prevent or escape an anticipated liability. *CIR v Challenge Corp Ltd*[24] took the previous judgments further. Tax avoidance relates to more than stated in *Smith* because a taxpayer involved in tax avoidance obtains an advantage by reducing his income. The previous research sheds light on various interpretations of tax avoidance in order to comprehend the full extent of it. The present research aims to investigate more than the definition of avoidance, but will focus on the harm

[15] SARS *2017 Statistics* (2017) 5.
[16] Ibid 15.
[17] Ibid 15.
[18] Ibid 15.
[19] This study will not investigate the effect of tax avoidance on the other main instruments, namely corporate income tax and VAT, but the principles of effective and efficient tax collection applies to all.
[20] Act 58/62.
[21] Act 58/62.
[22] Act 58/62.
[23] 1964 (1) SA 324 (A); 26 SATC 1.
[24] [1986] 2 NZLR 513.

it may cause in South Africa, and whether it is possible to strike a balance between allowing a degree of tax avoidance while at the same time protecting the interests of the fiscus.

The harm that could be caused by tax avoidance has not been investigated as SARS does not measure the impact of tax avoidance in its statistics, so effectively one has to turn elsewhere to gauge the harm. As the government's largest source of income, the tax revenue collected funds improvements in health, education and other government programs every year.[25] The possible harm caused by tax avoidance will consequently harm these government programs: for every loophole utilised to reduce tax liability, less funds are raised by tax collection and therefore available for the use of these programs. A counter argument could be made that tax avoidance is legal but Treasury has implemented a range of anti-avoidance measures indicating that tax avoidance is not welcome, despite being legal.[26] It is submitted that if SARS and the Legislature continue to develop more anti-avoidance measures in order to stay abreast of the new tax avoidance schemes created, more revenue will possibly be collected and the government programs will improve.

1.2 Research Goals:

One of the goals of this research is to show what tax avoidance is and how it is used to limit a taxpayer's liability. The research also aims to explore the applicability of the historical case law on which the allowance for tax avoidance is based. A potential outcome of the study is that tax avoidance will need to be limited more than what it already is, by possibly adding more anti-avoidance measures. It is conceded that the limitation of avoidance borders on referring to tax evasion. Tax evasion refers to illegal methods used to create or move accruals that fall outside the Act[27], which means no tax liability is created.[28] This research will not examine tax evasion. Another potential outcome of the study is that tax avoidance could be balanced within the realms of efficient and effective tax collection by improving tax compliance or the tax collection process. The words 'efficient' and 'effective' will be investigated in great depth. Their ordinary meaning is to 'achieve maximum productivity with minimum wasted effort or

[25] Kumarasingam 'Tax Avoidance and Tax Evasion explained and exemplified' (2010) *SATax Guide* available at <http://www.sataxguide.co.za/tax-avoidance-and-tax-evasion-explained-and-exemplified/>, accessed on 28/02/2018.
[26] *Act* 58/1962: sec80A-L.
[27] *Act* 58/1962.
[28] JMP Venter *et al* 2017: 512.

expense'[29] and 'being successful in producing a desired result'[30]. An attempt will be made to find the balance, which will consequently allow taxpayers more freedom to arrange their affairs. This study is accordingly critical of the allowance of tax avoidance. The study asserts that tax avoidance is based on uncertainties created by tax legislation and its ever-changing nature. Lack of defined principles and reliance on case law to set the parameters contribute to the uncertainty. However, SARS relies on the changing nature of the legislation to combat the loss of revenue, with an annual Budget Speech and legislative changes.

1.3 Research Methodology:

The research for this dissertation is desk-top based. The dissertation will use a range of sources such as journal articles, legislation, textbooks and case law. The findings are mainly based on case law and the way the courts have in the past evaluated their decisions and reasons for the way they reached their conclusions. The findings reached at the end are in no way conclusive and are a matter of opinion reached from conducting this research.

1.4 Study Outline:

The next chapter investigates the definition of tax avoidance by analysing case law. Some case law 'assists' the legislation by aiding in its interpretation, the other 'supplements' the legislation by providing common law tests applicable to tax avoidance, such as substance over form which assists the legislation. The assistance needed is attributed to the legislation's vagueness and lack of defined principles, creating uncertainty. The language used in legislation is questioned as it is this uncertainty created that forms the base of tax avoidance. The chapter will also critically examine the applicability of the leading tax avoidance case, questioning whether its principles are still relevant in the modern economy and legal system. The application of the substance over form principle will be analysed and discussed.

Having established what tax avoidance is, chapter 3 analyses the harm caused by tax avoidance to the fiscus by relying on various statistics and journals. Case law is also referred to, to illustrate the amount of revenue that would not have been collected had the taxpayers

[29] Merriam Webster 2018. 'Efficient' available at <https://www merriam-webster.com/dictionary/efficient>, accessed on 20/06/18.
[30] Merriam Webster 2018. 'Effective' available at <https://www.merriam-webster.com/dictionary/effective> accessed on 20/06/18.

not been personally investigated or audited.
Chapter 4 critically investigates the words ‘efficient’ and ‘effective’ in order to establish what to expect from efficient and effective tax collection. The perimeters of the tax collection process have to be identified in order to investigate whether the process followed by SARS is effective and efficient. Tax compliance is a big part of tax collection, whereof tax morality plays a role. Tax morality must be balanced within the equation of avoidance versus collection. The chapter will also question the productivity and success of SARS over the years.

After both tax avoidance and tax collection have been discussed, chapter 5 explores the difference between permissible and impermissible tax avoidance. GAARs are investigated as a possible solution and their efficiency is discussed. This chapter attempts to find the balance between damaging tax avoidance and effective and efficient tax collection. The difference between permissible and impermissible tax avoidance is explored as a possible solution to the study’s problem.

Finally, chapter 6 seeks to bring the discussion to a conclusion by recapping the previous chapters and further analysing the approach decided on in chapter 5.

2 CHAPTER 2: WHAT IS TAX AVOIDANCE

2.1 Introduction

By continually paying attention to transactions entered into throughout the tax year, taxpayers can plan their tax affairs. [31]

> Tax avoidance is an example of tax planning.[32] Avoidance means to arrange a taxpayer's affairs by legal means in such a way that his tax liability is reduced or he has no taxable income on which to pay tax at all, [33] whilst evasion refers to illegal actions intentionally entered into by a taxpayer to absolve himself from a tax burden.[34] The most important difference is that one is deemed illegal, the other not.[35]

This chapter aims to show what tax avoidance is and how it has been fleshed out by referring to various judgments. It was submitted in the previous chapter that case law needs to supplement our legislation due to undefined principles and the wide possibilities of interpretation created thereby. It is argued that due to this ambiguous situation created, tax avoidance arises from the freedom taxpayers are given. The universality of tax avoidance will also be tested. This will be done by investigating *IRC v Minster van Duke*[36] and *Commissioner for South African Revenue Service v NWK Ltd*[37] to determine whether the founding principles of tax avoidance from 1936 could still be applicable to modern day tax legislation.

For the last 5000 years, individuals i.e. taxpayers have been endeavouring to avoid tax.[38] Tax avoidance is a global occurrence, with some countries disallowing it and others abusing the system.[39] An example of a country disallowing tax avoidance would be the United States of America. [40] This principle dates back to the late 1930's when the Treasury Secretary H. Morgenthau characterized the wealthy individuals' purchase of tax-exempt bonds as 'moral

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[31] 'Tax Planning' (2014) *Tax Consulting South Africa* available at <http://www.taxconsulting.co.za/tax-planning accessed on 4/4/2017.
[32] C Theron *Critically consider the key differences between the concepts of tax planning, tax avoidance and tax evasion. A brief consideration of the significance of the concepts to lawyers* (unpublished LLB thesis, University of Free State, 2017) 4.
[33] *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (606/97) [1999] ZASCA 64 (17 September 1999).
[34] *Izak Jacobus Nel Engelbrecht v S* (44/10) [2011] ZASCA 068 (17 May 2011).
[35] C Theron (note 32 above) 4.
[36] *(1936) AC 1 HL.*
[37] *Commissioner for South African Revenue Service v NWK Ltd* [2011] 2 All SA 347 SCA.
[38] Theron (note 32 above) 4.
[39] Blankson *A Brief History of Taxation* (2007) 3-25.
[40] Blankson *A Brief History of Taxation* (2007) 6.

fraud'.[41] However, the war against tax avoidance was lost when President Franklin Delano Roosevelt in addressing his Message to Congress in 1937, blurred the line between avoidance and evasion because 'the decency of American morals is involved'.[42]

An example must also be given of a country abusing the tax system. Samual Blankson describes this in his book *A Brief History of Taxation:*[43] In 167 BC after the Roman Empire conquered Macedonia, the tax revenue base included mines and residents of the 4 new Roman client republics in Macedonia. Local magistrates were responsible for collecting taxes, who in turn employed tax farmers to do so. The tax collection for a particular region was put to tender, and tax farmers would offer their services to advance the expected annual tax. This would take the form of a loan earning interest. The interest was repayable to the tax farmer upon settlement of the contract. The excess collected would be awarded to the tax farmer. Despite this system being very lucrative for the tax farmers and the Empire, the corruption and abuse caused some provincials to be in debt with growing tax debts. The system was abolished, and the sole ruler replaced the system with a 1% Wealth Tax and a flat rate Poll Tax for all adults which required regular census taking. Again, the country abused the tax system; it allowed many individuals to avoid paying their taxes because the census information was out of date. Therefore, the wealth of the citizens often exceeded that which determined their taxes due.

The first tax evasion and avoidance principles were first found in Egypt, 3000 BC.[44] Livestock, cooking oil, grain, personal livelihood and transportation on the Nile River were taxed by the Ancient Egyptians.[45] Sanctions for failing to declare income or fraudulent declarations included death or flogging.[46] This tax system had no exemptions and all classes of society were liable to pay; including rich nobles and tax collectors.[47] In order to limit their tax liability, citizens would make use of substituted oil, instead of the oil being taxed.[48]. As an anti-avoidance measure Scribes audited each household's cooking oil consumption, in order to

[41] Blankson *A Brief History of Taxation* (2007) 6.
[42] Bank quoted from Tax Laws and Morals, WALL ST. J., June 2, 1937, at 4. (quoting Pres. Roosevelt).
[43] Blankson *A Brief History of Taxation* (2007) 17-19.
[44] Ibid 43.
[45] Ibid 43.
[46] Ibid 43.
[47] Ibid 43.
[48] 'History' (2006) *Tax World* available at <http://www.taxworld.org/History/TaxHistory htm>, accessed on 17/3/2017.

guarantee the use of taxed oil.[49] The Egyptians were possibly the first taxpayers to avoid tax.[50]

The precedent setting English law case wherein the court considered 'tax avoidance' is *IRC v Duke of Westminster*. Lord Tomlin stated:[51]

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

This case is relevant because South African law is directly impacted by the English Law influence in our Roman-Dutch Law. This Chapter will question whether the principles applied should still be relevant a millennium later, as this will show that tax avoidance is universal and despite the many economic changes from 1936 until 2019, tax avoidance could still be allowed on the same basis.

A more recent South African case referring to 'tax avoidance' is *Commissioner for South African Revenue Service v NWK Ltd*:[52]:

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

The main legislation used to deal with tax avoidance is the general anti-tax avoidance measures. Section 103(1) of the Income Tax Act[53] governed these measures for a number of years but was subsequently replaced by sections 80A-L - the new provisions governing impermissible avoidance arrangements. 'Section 103 had too many inherent weaknesses, which lead to taxpayers abusing the system set in place by SARS.'[54] A taxpayer will organize his financial affairs by using the loopholes provided by legislation. A factor contributing to the existence of the loopholes or grey areas would be the language used in legislation. The result of the uncertain language is that case law must be utilised to identify transgressions. The problems

[49] Blankson *A Brief History of Taxation* (2007) 4.
[50] Ibid 49.
[51] *IRC v Duke of Westminster* 1936 AC 1 HL:41.
[52] *NWK* supra note 37 at 42.
[53] Act 58/1962.
[54] Van Zyl 2016: 812.

with the language-element must be identified and addressed.

2.2 Language

Lord Russell held that taxation cases must be decided according to the plain words of the statute applicable to the circumstances and facts of the case.[55] It is submitted that the language used in the tax legislation contributes to the existence of the loopholes or grey areas which leads to cases such as *Duke of Westminster* discussed below.

Judge Hand said:[56]

> In my own case the words of such an Act as the Income Tax, for example, dance merely before my eyes in meaningless procession: cross-reference, exceptions upon exception - couched in abstract terms that offer no handle to seize hold of - leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which is within my power if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at all times I cannot help recalling a saying of William James about certain passages of Hegel: That they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness.

Terms such as 'Received By', 'Accrued To', 'Capital' and 'Revenue' are not defined by the Act[57], yet they form part of the crucial definition of Gross Income. These terms are all further defined or explained by case law. However, difficulties remain and the application of these terms is still not clear as each case has to be investigated and decided on the specific facts. It is submitted that these broader definitions provided by cases are not necessarily applicable to each case to be decided.

Another example is Section 11(*d*),[58] the operation of which hinges on the crucial term 'Repairs', yet the section contains no definition of the term. This gives rise to uncertainty about whether expenditure will qualify as 'Repairs' or whether it constitutes expenditure on 'Improvements', which are not claimable under the section. Although case law has set out various tests to determine whether the expenditure falls within this section's ambit, there is still

[55] *Westminster* supra note 51 at 524.
[56] A Cox 'Judge Learned Hand and Interpretation of Statutes (1946 - 1947) 60 H*arvard Law Review 370* at 389 - 90'.
[57] Act 58/1962.
[58] Act 58/1962.

an element of ambiguity for every case.

One such test entails differentiating between restoring subsidiary parts of a whole, versus reconstructing an entirety. [59] This includes substantially the whole subject and is not necessarily only the whole under discussion.[60] *Rhodesia Railways Ltd v Income Tax Collector, Bechuanaland*[61] had to distinguish between 'subsidiary parts' and the 'entirety'. 'Railways replaced rails and sleepers on 33 miles of a railway line'.[62] The railway's total length was 394 miles.[63] Had all 394 miles been replaced, it would definitely constitute an 'entirety', the court held that 33 miles of the 394 constituted a 'subsidiary part'.[64] However, it further went to state that:[65]

> The contrast between the cost of relaying the line so as to restore it to its original condition and the cost of relaying the line so as to improve it is well brought out in the passage just quoted, and while the former is recognised as a legitimate charge against income, the extra cost incurred in the latter case in the improvement of the line is equally recognised as a proper charge against capital. In the present instance the renewals effected constituted no improvement; they merely made good the line so as to restore it to its original state.

Despite the elements of capital in nature or income also included considerations, repair is inevitably an improvement on the asset being repaired. *CIR v African Products Manufacturing Co Ltd*[66] stated that 'Repair is restoration by renewal or replacement of subsidiary parts of a whole'.[67]

These cases cannot be used as confirmatory blanket tests to determine whether it was a renewal or repair. Notwithstanding that SARS published an Interpretation Note[68] to shed light on this uncertainty, it merely affirms that there are no set determined rules that can be provided for the distinction and each case will have to be decided on its own facts.

The terms 'Machinery' or 'Plant' are also frequently used throughout the Act[69] and are key concepts in the sections in which they are used, but yet again there is no statutory definition.

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[59] *ITC* 617 (1946) 14 SATC 474.
[60] *ITC* 617 (1946) 14 SATC 474.
[61] *Rhodesia Railways Ltd v Income Tax Collector, Bechuanaland* (1933) 6 SATC 225.
[62] Ibid 61.
[63] Ibid 61.
[64] Ibid 61.
[65] Ibid 61.
[66] 1994 TPD 248 (13 SATC 164).
[67] *CIR v African Products Manufacturing Co Ltd* 1994 TPD 248 (13 SATC 164) at 169.
[68] SARS. *Interpretation Note No: 74 Deduction and Recoupment of Expenditure Incurred on Repairs. (*2015) 1.
[69] Act 58/1962: section 8; 11; 12B; 12C; 12E; 23A.

Judgments include references to the Oxford Dictionary, but again, each case's facts are different and must be treated as such. A taxpayer's ability to mould his transactions so that it falls within these terms, and thus qualifies for a deduction or an allowance, is what gives rise to tax avoidance. If taxpayers are able to do this the revenue due to the fiscus is reduced.
Section 26[70] provides that 'persons carrying on pastoral, agricultural or other farming operations' shall determine their taxable income differently than normal taxpayers. These taxpayers qualify for certain special deductions and capital allowances, which are found in the First Schedule to the Income Tax Act, as well as in section 12B and section 12C. However, 'Farming Operations' is not defined, leading to another grey area. Once again it is left to case law to provide a measure of certainty.[71]

Passive income is another concept that is not defined. The Katz Commission has considered defining this concept separately or providing a definition of active income.[72] Thus anything that is excluded from the 'Active Income' definition will automatically be 'Passive Income'.

Law must be clear and certain. With certain key words in tax legislation undefined and left to the courts to determine, the law will never be clear nor certain.
When drafting statutes, the legislator is expected to cover every possibility with precision. This impossible task creates the grey areas which enable taxpayers to arrange their tax affairs. Often terms are used inadequately in a statute to describe what the Legislature intended.[73] This leads to confusion, ambiguity and consequently, uncertainty.[74] It is submitted that uncertainty provides taxpayers the opportunity to fall within the intended sections of the Act[75] and qualify for deductions, exemptions or capital allowances which were not intended to apply to their situation, and which would not have been applicable to them, had the terms been narrowly defined.

If hypothetically, the tax legislation were to be made more certain and all-encompassing definitions published, innovative and complex agreements will be entered into by taxpayers to

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[70] Act 58/1962.
[71] *R Koster & Son v CIR* 1985 (2) SA 831 (A), 47 SATC 23.
[72] South African Treasury *Basing the South African Income Tax System on the Source or Residence Principle-Options and Recommendations* 21-22.
[73] G Goldswain. *Hanged by a Comma, Groping in the Dark and Holy Cows – Fingerprinting the Judicial Aids used in the Interpretation of Statutes*. (2011) 30-56.
[74] Ibid 55.
[75] Act 58/1962.

fall out of the definitions.[76] 'Thus it is accepted that tax legislation cannot foresee every possible circumstance or scheme that will arise.[77] It is stated that no country has succeeded in doing so and the ability to find precise wording is also not available to even the best Legislature.'[78]

It is not this study's aim to provide solutions to these undefined concepts. These are merely examples of where the tax legislation is not certain, creating opportunities for tax avoidance. Words are by nature capable of having multiple meanings.[79] Although the meaning of the words depend on the Legislature's intention when drafting the statute, guidance will be sought from the tax courts when judgments are handed down. It is submitted that this does not add certainty or clarity as the subjectivity of the judges makes this guidance unreliable to a certain extent. This scepticism is supported by *Cape Brandy Syndicate v Inland Revenue Commissioners*[80] were it was held that judges ought to 'look at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied.' [81]

When scrutinizing legislation, judges are expected to merely look at the language used. [82] However, should a tax avoidance scheme come under scrutiny of a judge, they are expected to investigate the intendment. Contrary to when looking at legislation, Substance over Form must be considered when taking into account words used in avoidance schemes. It must be kept in mind that there are both statutory ant-avoidance measures as well as common law i.e. substance over form. The substance over form principle is discussed below.

2.3.1 IRC v Duke of Westminster 1936 AC 1 HL

This case was decided in 1936 and set a precedent that has been cited in almost every subsequent avoidance case.

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[76] Theron (note 32 above) 25.
[77] SARS 'Discussion Paper on Tax Avoidance Section 103 of Income Tax Act' available at <http://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf.>, accessed on 04/04/2017.
[78] Theron (note 32 above; 25).
[79] TLC Maliti. *An Analysis of the Approach of the Courts in Determining the capital or revenue nature of Income and Expenditure.* (2002) 2-3.
[80] *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64: 71.
[81] Ibid 80.
[82] Ibid 80.

2.3.1.1 Facts:

The Duke entered into a Deed of Covenant with his employees.[83] Although it is held that the deeds were not identical, they were all similar.[84] They stated that in recognising the services rendered faithfully to the Duke over the years, the Duke wished to make provision for them notwithstanding that they 'may re-engage or continue in the Appellant's service in which event they will become entitled to remuneration in respect of such future service'.[85] In consideration of the employees' past services the Duke contracted to pay them during the joint lives of himself and them or for a weekly sum for a period of years.[86] Admittedly, under the deed all the employees were paid out the quantities which they would have received as salary or wages if they survived the period plus continued their service.[87] However, if they terminated the employment, the payments were still secured by the deed.[88]

According to the legislation at the time, all payments made under a deed would be allowed as a deduction from the income.[89] The Duke was liable for Super-tax and these payments ought to have been deducted, consequently minimising his tax liability.[90] The Commissioners of Inland Revenue held that all payments under the separate deeds entered into with employees still in his service, were expenditures for services to be rendered, thus not allowable as deductions.[91] If the employees were not in the Duke's service anymore, these payments under the deed could be a proper deduction.[92] The Duke appealed this decision and brought the matter before 9 High Court judges.[93]

2.3.1.2 Judgment by appeal court:

Minority Judgment:

The three judges held that the deeds were not part of a device or strategy entered into to avoid the tax liabilities the Income Tax Acts imposed.[94] It was not contested that the recipients were

[83] *Westminster* supra note 51 at 5.
[84] *Westminster* supra note 51 at 5.
[85] *Westminster* supra note 51 at 5.
[86] *Westminster* supra note 51 at 5.
[87] *Westminster* supra note 51 at 6.
[88] *Westminster* supra note 51 at 6.
[89] *Westminster* supra note 51 at 9.
[90] *Westminster* supra note 51 at 9.
[91] *Westminster* supra note 51 at 10.
[92] *Westminster* supra note 51 at 10.
[93] *Westminster* supra note 51 at 10.
[94] *Westminster* supra note 51 at 502.

ordinarily entitled to their remuneration as they had over a period rendered services to the Duke.[95] These payments would be an allowable deduction in terms of the Duke's Super-tax liabilities.[96]

The Judge in the court *a quo* said that 'Looking, not at the form, but at the substance, of a thing, this must be regarded, in the case of the servants remaining in His Grace's employ, as wages.'[97] The minority did not agree with this stating that it was dangerous to use the word 'substance' loosely[98] and that by regarding the substance, not the form, and arriving at the conclusion that the sums are provided as remuneration, the judges are impermissibly re-writing contracts between parties.[99] It was acknowledged that the real nature of the transaction must be looked at.[100] The nature of the transaction may be analysed and this must include the surrounding circumstances of both the payee and the payer.[101] When examining the whole of the substance, judges must utilize the viewpoint of the Legislature and analyse the effect it has as a legal relation.[102]

Majority Judgment:

The majority however dismissed the appeal. They held that as long as the servants remain in the Duke's service, the payment will be for the services they render.[103] Once they retire or leave the Duke's employment it becomes a different matter because then the payment will not be for services rendered.[104]

Lord Tomlin dealt specifically with the substance-principle:[105]

> It is said that in Revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called 'the substance of the matter' and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages and that, therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its

[95] *Westminster* supra note 51 at 503.
[96] *Westminster* supra note 51 at 503.
[97] *Westminster* supra note 51 at 507.
[98] *Westminster* supra note 51 at 507.
[99] *Westminster* supra note 51 at 509.
[100] *Westminster* supra note 51 at 507.
[101] *Westminster* supra note 51 at 507.
[102] *Westminster* supra note 51 at 507.
[103] *Westminster* supra note 51 at 500.
[104] *Westminster* supra note 51 at 500.
[105] *Westminster* supra note 51 at 520.

> support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled and the supposed doctrine given its quietus the better it will be for all concerned, for the doctrine seems to involve substituting 'the uncertain and crooked cord of discretion' for 'the golden and straight mete wand of the law'.

He stated that: 'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.'[106] This statement gave rise to tax avoidance. If the taxpayer is successful it must be allowed, regardless of the Commissioner of Inland Revenue. [107] Contrary to his final judgment, Lord Tomlin considered the doctrine of substance as a forceful manner to order all taxpayers to pay tax which is not legally claimable.[108] It is permissible to do so when the documents were not bona fide and merely served as a veil, however this was not suggested in the Duke's case.[109] He erroneously held that the deeds were given their proper legal operation because they were not used to conceal another transaction.[110] Accordingly, he did not look at the substance of the matter.[111]

He submitted that by investigating the substance of a matter, the true legal position is overlooked and another legal right or liability takes the place of what is agreed upon by the parties.[112] He believed that taxation cases must be taxed according to the plain words of the statute applicable to the circumstances and facts of the case, not according to what the Court viewed the substance of the transaction was.[113]

2.3.1.3 Conclusion:

Both majority and minority found that the money was paid under the deeds. The minority reached their conclusion by noting that the legal document cannot be seen differently whether the recipients are employed or not. The nature of the document is to be consistent. The real nature of the transaction must be examined as a whole and both substance and form must be regarded. It is submitted that the majority did not apply this principle as the letters complicated the matter. The legal effect of the standing contract was also not determined by the majority, who instead determined what the legal effect might be were the words of the deed disregarded.

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[106] *Westminster* supra note 51 at 520.
[107] *Westminster* supra note 51 at 520.
[108] *Westminster* supra note 51 at 520.
[109] *Westminster* supra note 51 at 520.
[110] *Westminster* supra note 51 at 520.
[111] *Westminster* supra note 51 at 521.
[112] *Westminster* supra note 51 at 522.
[113] *Westminster* supra note 51 at 524.

The majority did not consider the substance of the transaction, stating that support for this doctrine is because of a misunderstanding of the language used in prior cases. By allowing this application they would disregard the true legal position. The majority preferred to use the wording of legislation only.

It is submitted that the majority judgment was erroneous. Had this case been decided in 2019 the common law principle 'substance over form' would be applied as the minority did.

The general principle is that our court gives effect to the real transaction if the results were intended. A more recent case to demonstrate the application of the 'Substance over Form' principle is *Commissioner for South African Revenue Service v NWK*.[114] This case will be discussed to illustrate how the courts follow the minority judgment in *Westminster.*

2.3.2 Commissioner for South African Revenue Service v NWK Ltd [2012] 2 All SA 347 SCA

2.3.2.1 Facts:

In this case:

> The Supreme Court of Appeal included the legal doctrine of substance over form in the interpretation of the law.[115] The taxpayer obtained a loan from Slab Trading Company, which is a subsidiary of FNB.[116] The taxpayer had to deliver maize after 5 years, in order to repay the capital sum.[117] Interest on the loan was payable every 6 months.[118] The interest was payable by issuing promissory notes.[119] The same maize the taxpayer would have would have used to reimburse Slab, was sold to the taxpayer by FNB, as a result of all the complex agreements entered into.[120] The taxpayer subtracted the interest payments made in terms of S11(a) for the 1999-2003 years of assessment.[121] SARS argued that both capital and interest payments were included in the promissory notes and that the actual loan given to the taxpayer was R50 million.[122] The notes that related to the settlement of capital was therefore not allowed as expenditure actually incurred in the production of the income.[123] The court had to decide whether 'simulated transactions' were entered into regarding the loan agreement and the

[114] *NWK* supra note 37.
[115] *NWK* supra note 37 at *1*.
[116] *NWK* supra note 37 at *1*.
[117] *NWK* supra note 37 at *8.*
[118] *NWK* supra note 37 at *11*.
[119] *NWK* supra note 37 at *11*.
[120] *NWK* supra note 37 at *12*.
[121] *NWK* supra note 37 at *24*.
[122] *NWK* supra note 37 at *32*.
[123] *NWK* supra note 37 at *32.*

forward sales and cessions between the parties.[124] Alternatively, the court had to consider whether the transaction constituted a 'transaction, operation or scheme' without commercial substance in terms of section 103(1), now replaced by sections 80A to 80L.[125]

2.3.2.2 Judgment by appeal court:

When the *NWK* matter was appealed, it was confirmed that the principle of entering into tax-effective arrangements was valid.[126] However the court found fault with disguising a transaction if the purpose thereof was to avoid or evade tax.[127] It was held that the transaction lacked commercial substance and therefore the anti-avoidance section could be applied.[128]

SARS's capability to attack transactions in terms of the substance over form doctrine was amplified by the *NWK* judgment.[129] The common law protects the fiscus to the extent that courts will break the transaction down and uncover the true nature and substance of the contract.[130] It will disregard what was specifically set out in writing.'[131] In order to accomplish this, SARS must prove that the parties had[132] '… a real intention, definitely ascertainable, which differs from the simulated intention.[133]

2.3.3 Interpretive assistance offered by case law

When comparing the *Duke of Westminster* case with the *NWK* case, certain similarities appear because both cases dealt with transactions that possibly lacked commercial substance. In both instances the taxpayer entered into exorbitant transactions to achieve simple outcomes which limited their tax liability.

Despite the Legislature's new addition to the tax avoidance battle[134], most cases are decided by making use of the common law provision of 'substance over form'. It was also this provision

[124] *NWK* supra note 37 at *33*.
[125] Theron (note 32 above).
[126] *NWK* supra note 37 at *42*.
[127] *NWK* supra note 37 at *42*.
[128] *NWK* supra note 37 at *92*.
[129] Dachs and Du Plessis 'CSARS v NWK' (17 February 2011) available at <https://www.ensafrica.com/newsletter/briefs/14_02_11%2001%2001lr1402law_al_2.pdf>, accessed on 26/08/2017.
[130] SAICA 'Acceptable tax planning' (2009) available at <https://www.saica.co.za/integritax/2009/1733_Acceptable_tax_planning htm.>, accessed on 26/08/2017.
[131] Theron (note 32 above) 11.
[132] H Louw 'Tax Alert' (14 January 2014) available at <https://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/news/publications/2014/tax/downloads/Tax-Alert---17-January-2014.pdf.>, accessed on 26/08/2017.
[133] *Zandberg v Van Zyl* 1910 AD 302.
[134] Section 80A-L.

which was applied in the leading tax avoidance case of *Duke of Westminster*[135]. Although this case applied the principle in 1936, the changing economy and legal system could possibly have changed the way it would apply today. However, *NWK* applied the same principles to a recent situation, confirming their validity today. Both courts considered the transaction as a whole. It is submitted that *NWK* crystalized the Substance over Form principles which were considered in *Westminster.*

Furthermore, it is submitted that the definition of tax avoidance must be supported by various case law which assists the legislation: when transactions should be included within tax provisions but are designed by the parties to be excluded, the courts must validate the true intention of the transaction. The transaction must express its true nature since that is what the court will give effect to. The general limitation set out by the various case law principles is that taxpayers may engage in a bona fide transaction which results in tax avoiding.

The case law sets more in-depth limitations and restrictions than legislation or tax avoidance's definition: [136]

> *Dadoo Ltd v Krugersdorp Municipality Council*[137] stated that a transaction is false when it is intended to fall outside the provisions of the law, but truthfully should be included within those provisions.[138] Substance instead of form is regarded by the courts and the law.[139]
>
> In *Zandberg v Van Zyl*[140] the court validated the true intention of the transaction. Normally parties express their rights and obligations agreed to in the contract, but the real intention is concealed by disguising the transaction's form.[141] The true nature of a transaction may not be concealed by taxpayers, the transactions cannot be given another name or shape to disguise its true nature as per *Michau v Maize Board*. A court will give effect to the true nature of the agreement.

The assistance afforded by case law is needed due of the legislation's vagueness and lack of defined principles, creating uncertainty. This assistance is derived from the common law, which encompass case law, and supplements the statutory remedy.

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[135] *Westminster* supra note 51.
[136] Theron (note 32 above) 25.
[137] *Dadoo Ltd v Krugersdorp Municipality Council* 1920 AD 530.
[138] *Dadoo* supra note 137.
[139] *Dadoo* supra note 137.
[140] *Zandberg v Van Zyl* 1910 AD 302.
[141] *Zandberg* supra note 140.

2.4 Conclusion

It is submitted that tax avoidance is universal. It was done by the Egyptians, the Lords and today by taxpayers who wish to minimise their tax liability.[142]

The concept of tax avoidance is very broad, and legislation has failed to limit its scope, thus case law has also been utilised to narrow the scope. The end result is that tax avoidance is permissible, if what was entered into was a bona fide transaction,[143] and that no legislation prohibits the transaction,[144] and various other limitations set out by a handful of cases.[145]

It is submitted that tax avoidance is facilitated by vague tax legislation. Courts turn to precedents because the legislation is too uncertain. It was held that plain words of the statute must be applied,[146] however these often give rise to several ambiguities.

It is submitted that the language impediment is moot. By either strictly defining concepts in a narrow sense or seeking guidance from the court in order to widely define terms, taxpayers will avoid tax. Admittedly the definitions will create a too narrow and strict approach, which will exclude many taxpayers from rightfully making use of the exemptions or deductions available to them, whilst a very wide and vague approach opens the flood gates.

Tax avoidance is thus inevitable regardless of the harm it causes, because it is impossible to cover every situation comprehensively and accurately. The next chapter will analyse the harm caused by tax avoidance to the fiscus by relying on various statistics and journals. This study will be amplified by investigating amounts due in past cases and determining the average tax which would not have been paid to the fiscus. Unfortunately had the taxpayers in the following cases have not been chosen to be audited or assessed by SARS, the money would never have been recovered.

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[142] JMP Venter *et al* 2017: 510-511.
[143] *Westminster* supra note 51 at 520.
[144] Theron (note 32 above) 12.
[145] Such as the cases discussed above limiting the definition of 'repair', or *Blue Circle Cement Ltd. v Commissioner for Inland Revenue* (39/84) [1984] ZASCA 14 which dealt with the definition of 'machinery'.
[146] *Westminster* supra note 51 at 524.

3 CHAPTER 3: WHAT IS THE HARM OF TAX AVOIDANCE

3.1 Introduction

The definition of tax avoidance has been discussed in great depth by various scholars and in judgments as described in Chapter 2.[147] The harm that tax avoidance might potentially cause in South Africa must now be investigated. SARS has published Tax Statistics covering 20 years' tax collection. While these statistics reveal the actual amounts collected, they do not examine the effects tax avoidance had on these statistics.[148] This is an issue that needs to be examined.

As discussed in the introduction, South Africa's tax revenue funds various 'government programs every year as it is the government's biggest source of income'[149]. It was also submitted that the vast range of anti-avoidance measures indicate that tax avoidance is not welcome, despite being legal.[150] This chapter seeks to submit that every opportunity utilised by taxpayers to avoid their tax liability results in funds which would have been collected by SARS being redirected to the taxpayers and not the fiscus. Despite this being beneficial to tax morality, it restricts the aid governmental programs can offer to the poor.

3.2 The Harm of Tax Avoidance

The interests the fiscus must balance is allowing taxpayers the freedom to manage their affairs while simultaneously ensuring that the primary source of tax collection is not threatened. In order to investigate the balancing act, the main source of tax collection must be determined:

'The total revenue collected by SARS for the fiscal years from 2007/08 to 2016/17 amounted to R8.13 trillion'.[151] Tax revenue collected in the 2017 tax year amounted to R1 144.1 billion.[152] 'This tax collection was mainly supported by Personal Income Tax ('PIT'), which grew by R36.6 billion'.[153] 'Revenue from PIT, as a percentage of total tax revenue, increased from 29.6% in 2007/08 to 37.2% in 2016/17'.[154] By contrast in 2016/17 VAT, the next biggest

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[147] Benn (note 13 above) 8-9.
[148] SARS 'Tax Statistics' (2017) available at <http://www.sars.gov.za/About/SATaxSystem/Pages/Tax-Statistics.aspx>, accessed on 03/16/2018.
[149] Kumarasingam 'Tax Avoidance and Tax Evasion Explained' (2010) available at <http://www.sataxguide.co.za/tax-avoidance-and-tax-evasion-explained-and-exemplified/>, accessed on 28/02/2018.
[150] *Act* 58/1962: sec80A-L.
[151] SARS (note 148 above).
[152] SARS (note 148 above).
[153] SARS (note 148 above).
[154] SARS (note 148 above).

contributor, contributed 25.3%, Other 19.4% and Corporate Income Tax contributing the smallest amount of 18.1%.[155]

It has been stated that 'tax avoidance is a rich person's game'.[156] 'Statistics are published by National Treasury showing that individuals in the top income bracket account for the lion's share of the PIT collected each year'.[157] 'Despite the evidence stating that the main source of tax collection is personal income tax, it is unfortunately based on a taxpayer's reported taxable income rather than their true economic income.'[158] It is submitted that these statistics would thus not account for the millions lost to tax avoidance. 'The damage from abusive tax avoidance has already been done, prior to the statistics being published'.[159] Considering the general poverty and skewed wealth distribution in South Africa, it is vital that the nation is provided with public goods i.e. education, infrastructure, health and national security.[160] However, for the government to provide such services, the funding used is found in a skewed tax base. [161] This results in a cost ineffective exercise, despite the merit of the expenditure. [162]

In an attempt to investigate statistics that could display the harm of tax avoidance, the following is submitted:

- In 2005 South Africa had approximately 44 million residents; [163]
- Of these only 3.8 million were registered taxpayers;[164]
- Of these only 500 000 admitted to earning annual income exceeding R180 000 in their 2004 tax returns. [165]

In order to appreciate these statistics, it must first be established how many individuals actually earned above the R180 000 threshold.

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[155] SARS (note 148 above).
[156] E Liptak 'Failure, More Failure and Some Success: GAAR Ten Years On' (2017) 60 *TaxTalk:* 59.
[157] SARS (note 148 above).
[158] Liptak (note 156 above) 59.
[159] Liptak (note 156 above) 59.
[160] N.J. Schoeman1 and Y. van Heerden 2009. *Finding the Optimum Level of Taxes in South Africa: A Balanced Budget Approach* 28.
[161] Ibid 160.
[162] Ibid 160.
[163] L Killbourn 'Tightening the tax-collecting net' (2005) *LexisNexis.*
[164] SARS 'Tax Statistics' (2008).
[165] Killbourn (note 163 above).

	% of Taxpayers	Taxable income	Tax liability
R0 – R80 000	44 %	14 %	5 %
R80 001 – R130 000	28 %	24 %	16 %
R130 001 – R180 000	11 %	14 %	13 %
R180 001 – R230 000	6 %	9 %	10 %
R230 001 – R300 000	5 %	10 %	12 %
R300 001 and above	6 %	29 %	44 %

Source: An Empirical Dissemination of the Personal Income Tax Regime in South Africa Using a Microsimulation Tax Model for the year 2004/05[166]

As the table shows, the largest number of taxpayers fall within the lowest income group of earning less than R80 000. A total of 17% of taxpayers earn above R180 000 annually. If calculated on the abovementioned 4 million registered taxpayers, it is submitted that 680 000 individuals actually earned above the R180 000 threshold. Furthermore, this same group pays 56% of the total tax liability.

It is submitted that the statistics National Treasury used to determine 2006 Tax Collection was incorrect as 180 000 individuals failed to disclose their income or pay tax accordingly. This was calculated by considering that only 500 000 registered taxpayers admitted to earning annual income exceeding R180 000 in their 2004 tax returns, [167] whilst the Microsimulation Tax Model determined that 17% of taxpayers earn above the R180 000 threshold (680 000 individuals). It is conceded that this failure could be due to tax avoidance or another cause, but regardless, the fiscus is still harmed. The governmental programs rely on this skewed information to budget for the proceeding years. It is submitted that the projects envisaged by these programs could have a far better reach if the actual funds it is entitled to, are declared and paid.

If in 2017, 37.2% of the R1 144.1 billion collected was not based on the taxpayers' true economic income, it means that roughly R425.6 billion was the least amount of income generated by the fiscus from PIT and that more is owing to it. As these statistics show, tax avoidance will cause revenue loss.[168] As previously stated, tax avoidance is a rich man's game and as in 2005, it is submitted that the higher income bracket taxpayers are more likely to avoid

[166] N.J. Schoeman1 and Y. van Heerden 2010. *An Empirical Dissemination of the Personal Income Tax Regime in South Africa Using a Microsimulation Tax Model*: 21.
[167] Killbourn (note 163 above).
[168] K Thersby 'SARS tightens screws on tax-avoidance schemes' (2005) *Tax Breaks* 12 1.

their tax liability. It is further submitted that because of the tax avoidance, revenue loss must be restored and this will be done by taxing other aspects of the economy leading to an unfair shift of the tax burden.[169] The recent increase in VAT is a good example of this shift of the tax burden.[170]

Another harm caused by tax avoidance flows from the shift of the tax burden as taxpayer compliance is discouraged.[171] SARS is of the view that the compliance ethos of the taxpayers is lower than expected due to several factors combined (for example South Africa's economic marginalisation). The result is that large parts of the population remain uneducated about tax.[172] An emerging disrespect for the law and the tax system could also be to blame for the lack of compliance.[173]

By focussing on case law dealing with the crisp issues of tax avoidance, it can be seen that when compared to the year the cases were heard, relatively large amounts of money were collected due to SARS assessing or auditing taxpayers who attempted to mitigate their tax liability:

Case no 13065/13 concerned 'the analysis of supply agreements entered into between the appellant and some of its foreign subsidiaries'.[174] The tax liability included the assessed amount, additional tax and interest for the 2005 to 2007 years of assessments, which amounts to a total of R 335 253 655.[175]

R820 000 was collected in *ITC 1611 59 SATC 126,* where the taxpayer entered into a scheme comprising packages of agreements, which resulted in the acquisition of two stands and then the subsequent leasing of the property to a provident fund which owned the taxpayer.

Secretary For Inland Revenue v Gallagher [1978] 3 All SA 1 (A) held that a subjective test must be applied as the 'purpose which those carrying out the scheme intend to achieve by means of the scheme' is of prime importance versus the objective test which as regard to the effect of the scheme. The taxpayer, through the workings of a scheme, donated all his shares

[169] Thersby (note 168 above).
[170] SARS 'SARS Ready to Implement VAT Rate Increase' (2018) available at <https://www.sars.gov.za/Media/MediaReleases/Pages/27-March-2018---SARS-ready-to-implement-VAT-rate-increase.aspx>, accessed on 08/04/2019.
[171] Thersby (note 168 above).
[172] SG Nienaber 'Factors that could influence the ethical behaviour of tax professionals' *(*2010) 18(1) *Meditari Accountancy Research* 34.
[173] Thersby (note 168 above).
[174] Case 13065/13.
[175] Case 13065/13.

in a company ('SPH') to three trusts created for the benefit of his children.[176] Thereafter he sold all his shares in a public company to the SPH company on loan accounts which remained due and payable.[177] The Commissioner included the income the SPH company had earned from the assets it acquired via loan account, to the taxpayer's income as follows:[178]

Year of Assessment	*Tax avoided by Respondent*	*Tax payable by SPH*	*Net Loss*
1969	R6659	R2990	R3669
1970	5173	2450	2723
1971	6046	3552	2494
	R17878	R8992	R8886

Therefore, the entire R17 878 was included as gross income and collected by the fiscus.[179]

3.3 Conclusion

All statistics published by SARS merely reveal the actual amounts collected, and do not account for tax avoidance or what the true economic income of taxpayers are. It is submitted that not only is the fiscus being harmed by avoiding tax liability, but other social initiatives, such as assistance to the poor. It is submitted that this could even be said to contradict the philosophy of 'ubuntu'.

It has been stated that although tax avoidance is legal, the various anti-avoidance measure SARS have implemented should be a clear indication that it is being discouraged.

The Legislator has relentlessly changed the law to keep abreast of the development of new tax avoidance methods. South Africa's previous anti-avoidance legislation was based on outdated legal form and intent. After SARS challenged a number of aggressive tax avoidance schemes in 2005/06, the Commissioner collected a further R1bn.[180] It is submitted that this is ample evidence of the harm that tax avoidance can cause. As the case law illustrates, when the fiscus do assess taxpayers, large amounts become due and payable to SARS. In addition, based on this, it is further submitted that there are vast amounts of money which the fiscus is entitled to, but do not receive in the tax collection process. It should be questioned whether this is due to

[176] Secretary for Inland Revenue v Gallagher [1978] 3 All SA 1 (A).
[177] Ibid 176.
[178] Ibid 176.
[179] Ibid 176.
[180] M Vanek 'SARS exceeds its expectations but wants more' 2006 *Tax Breaks* 2.

tax avoidance or an ineffective tax collection procedure. The next chapter will investigate at what cost the anti-avoidance schemes are implemented and will determine whether this tax collection is efficient and effective.

4 CHAPTER 4: THE EFFECTIVENESS AND EFFICIENCY OF THE TAX COLLECTION PROCEDURE

4.1 Introduction

The South African Revenue Service (SARS) was established as an organ of state within the public administration in 1997.[181] The institution was established by legislation[182] in order to fulfil the main objectives of collecting revenue and controlling the manufacture, import, export, storage, movement, or use of certain goods.[183] According to the South African Revenue Service Act these objectives were to be carried out both efficiently and effectively.[184] The words 'efficient' and 'effective' will be investigated in this chapter. The start and end of the tax collection process must also be ascertained. As stated in Chapter 1, SARS must perform its functions in a manner that is the most cost-efficient and effective. These functions must also be performed whilst keeping the values and principles mentioned in section 195[185] of the Constitution in mind.[186] It is important to note that the Act[187] states that SARS 'may do all that is necessary or expedient to perform its functions properly'.[188] Despite these objectives, SARS allows for some degree of tax avoidance.

The interests the fiscus must balance is allowing taxpayers the freedom to manage their affairs while simultaneously ensuring that the main source of tax collection is not threatened, as discussed in the previous chapter.

4.2 Tax Collection

Before the effectiveness and efficiency of SARS' tax collection can be investigated, the limitations of the concept of tax collection must first be covered.

Tax collection includes but is not limited to, the registration of persons as taxpayers, ensuring the number of tax defaulters whose returns are outstanding decrease, reducing the number of unassessed income returns and auditing taxpayers.[189] These examples of tax collection will be discussed below with reference made to 1997 statistics and goals set when SARS was

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[181] *South African Revenue Service Ac*t 34/1997: sec2.
[182] Act 34/1997.
[183] Act 34/1997: sec3.
[184] Act 34/1997: sec4(2).
[185] S195 administers the basic values and principles governing public administration as found in Chapter 10 of the South African Constitution.
[186] Act 34/1997: sec4(2).
[187] Act 34/1997.
[188] Act 34/1997: sec5.
[189] L Mitchell 1998. *Income Tax Reporter*. Vol 37 5.

transforming itself, as well as comparing same with the statistics of 2017/2018 for accountability.

4.2.1 Tax registration:

SARS has been actively campaigning to identify and register tax evaders since 1997. This is described as 'broadening the tax base'. In 1998 a total of 3 671 129 taxpayers were registered.[190] At the end of 2018 the total of taxpayers registered amounted to 4 895 565.[191] The mere 1.2 million taxpayers registered within the last 10 years seems inadequate. However, in 1998 the Advisory Board were of the opinion that by broadening the tax base and eventually lightening the load on these taxpayers, it would contribute to the compliance of the taxpayers.[192] Despite these ambitious goals set when SARS was transforming 1997, in 2018 '13% of the South African population of 56 million people were the persons paying income tax'.[193] Regardless of the aim of lightening the load on the taxpayers, the approximate 1% of the taxpayers (these are the 480 000 persons who earned more than R750 000 per annum) are responsible for 61% of the total tax bill, which is a significant burden on a small portion of the population.[194]

4.2.2 Outstanding income returns and assessments issue:

In 1997 2 676 516 cases were open for outstanding tax returns (PAYE, VAT and IT). It was reported that a year later the number had declined to 235 721.[195] In 2018 SARS 'embarked on a hunt with the National Prosecuting Authority to prosecute non-compliant taxpayers, this included taxpayers who failed to submit tax returns'.[196] The intensification of SARS' Outstanding Return Project is due to the increase in non-submission of returns (PAYE, VAT, CIT and PIT). Ten cases were finalised and taxpayers sentenced and fined, whilst approximate

[190] Mitchell (note 189 above).
[191] SARS. 'Tax Statistics' (2018) available at <http://www.sars.gov.za/Media/MediaReleases/Pages/20-December-2018---Tax-Statistics-2018.aspx>, accessed on 08/04/2019.
[192] Mitchell (note 189 above).
[193] Mitchell (note 189 above).
[194] J Coomer 'This is who is paying South Africa's tax' (2017) available at <https://businesstech.co.za/news/finance/207631/this-is-who-is-paying-south-africas-tax/>, accessed on 08/14/2019.
[195]Mitchell (note 189 above).
[196]SARS 'SARS, NPA To Prosecute Taxpayers for Outstanding Returns*'* (2018) available at <http://www.sars.gov.za/Media/MediaReleases/Pages/16-April-2018---SARS-NPA-to-prosecute-taxpayers-for-outstanding-returns.aspx>, accessed on 08/04/2019.

49 cases are still pending.[197] 'There is approximately 30 million returns outstanding, in many cases multiple returns due by a single taxpayer'.[198] When comparing the 30 million with the past two decade's 235 721 outstanding returns, and considering that there is an additional 1.2 million registered taxpayers, it is incomprehensible that the tax collections had become so inefficient or mismanaged.

4.2.3 Tax Debtors:

In 1997 over R12 billion was due and payable to SARS which seems irrelevant,[199] when compared to the R143 billion book debt SARS had due to it in 2018.[200] SARS maintains that there is a reduction in the amount of the older debts but decreasing the backlogs of unassessed cases, increased successes with audits and assessments and additional taxpayers registering has resulted in new debts increasing.[201] Apparently, this can already be seen by the exceeded new debt of 1998 amounting to 259% more than in 1997.[202]

Despite the annual tax collection strategies ranging from 1997 to 2018, SARS has consistently experienced a decrease in tax collection and fallen short of the budget target for the last five years. For the 2018/2019 fiscal year, SARS collected R14.6 billion less than estimated or budgeted R1.302 trillion.[203] It is conceded that it still represents a growth of 5.8% from the previous fiscal year. When investigating these amounts, the refunds paid out to taxpayers must be considered. SARS thus overall collected a gross amount of R1 575 trillion, higher refunds might have lowered the net tax collection for the fiscal year, but SARS maintains that money was put back in the economy. [204]

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[197] SARS (note 191 above).
[198] SARS (note 191 above).
[199] Mitchell (note 189 above).
[200] I Lamprecht 'SARS may not be able to collect 40% of its R143bn debt book' (2018) available at <https://www moneyweb.co.za/mymoney/moneyweb-tax/sars-may-not-be-able-to-collect-40-of-its-r143-billion-debt-book/>, accessed on 08/04/2019.
[201] Mitchell (note 189 above).
[202] Mitchell (note 189 above).
[203] S Menon 'SARS undershoots revenue target, again' (2019) available at <https://www.businesslive.co.za/bd/national/2019-04-01-sars-undershoots-revenue-target-again/>, accessed on 08/14/2019.
[204] National Treasury 'Budge Speech 2019' (20 February 2019) available at <https://www.gov.za/speeches/budget_vote>, accessed on 08/04/2019.

During the budget review, Treasury said that economic weakness reduced PIT and CIT, but administrative weakness in collection was a contributing factor.[205] Despite the demotivating figures from the previous years, SARS set a 2019/2020 budget target of R1 422 trillion.[206]

4.3 'Efficient' and 'Effective'

The words 'efficient' and 'effective' are used in the legislation governing SARS, without a definition provided. This chapter will investigate the prescribed manner in which SARS must fulfil its objections, before a balance can be found between tax avoidance and tax collection.
'Efficient' in its ordinary meaning is 'productive of desired effects; capable of producing desired results with little or no waste (as of time or materials)'. [207] 'Effective' in its ordinary meaning is 'producing a desired effect, capable of bringing about an effect'.[208]

Tax avoidance is based on uncertainties created by tax legislation and its ever-changing nature, as discussed in Chapter 2. SARS also relies on changing legislation in order to combat the loss of revenue. It is submitted that the changes to legislation need to be 'both capable of producing desired results with no waste of resources as well as capable of bringing about an actual effect'.[209]
Unfortunately, as stated by Lord Normand in *Vestey's Executors v IRC*.[210]

> Parliament in its attempt to keep pace with the ingenuity devoted to tax avoidance may fall short of its purpose. That is a misfortune for the taxpayers who do not try to avoid their share of the burden, and it is disappointing to the Inland Revenue. But the Court will not stretch the terms of taxing Acts in order to improve on the efforts of Parliament and to stop gaps which are left open by the statutes.

If the terms of taxing Acts will not be stretched to cover the gaps left open by statutes, the question is whether SARS should spend resources on anti-avoidance measures or just make all tax avoidance schemes impermissible. The cost of collection of tax must be reasonable in relation to its revenue productivity, in order to maintain efficient i.e. produce the desired effect with little waste.[211] In a general tax reform process, the cost of tax administration is an

[205] National Treasury (note 197 above).
[206] National Treasury (note 197 above).
[207] Merriam Webster (note 29 above).
[208] Merriam Webster (note 30 above).
[209] Ibid 208.
[210] [1949] 1 All ER 1108 (HL): 1120.
[211] J. vd S. Heyns 1991. *South African tax policy in the 1980s*: 166.

important consideration. It is stated that 'a given fiscal authority should employ only those taxes it can best manage and no others.'[212] Unfortunately the past has shown that the country could not succeed with implementing new legislation to reduce avoidance. In the early 1980's, South Africa had a prevalent feeling that the taxing system was unfair and inefficient. The taxpayers felt that the system was too complicated. This resulted in deterioration in the public attitude towards tax morality.[213] It is further submitted that tax collection cannot be discussed without referring to tax morality. There is clearly a direct correlation between the sharp decline in SARS' effectiveness and the decline in tax morality. An editorial in the Business Day even goes as far as stating that 'tax morality is surely an issue, and who can blame taxpayers for avoiding tax any way they can, given the scandalous conduct of the tax authority itself in recent years, not to mention the capture of the state itself?'.[214]

Metcash Trading Ltd v Commissioner for the SA Revenue Service and Another[215] dealt specifically with tax morality. Legislation at that time gave SARS the power to ensure payment from a taxpayer without reference to a court of law[216] as set out by Judge Kriegler as follows:[217]

> …case concerns the constitutional validity of section 36(1) and subsections (2)(a) and (5) of section 40 of the Value-Added Tax Act 89 of 1991 (the Act). The question is whether these provisions unjustifiably limit the right of access to courts protected by section 34 of the Constitution.

The only option available to the Applicant was to pay the amount due prior to the dispute being settled by courts.[218] When considering that SARS had completely disallowed his input-VAT of R77 667 722.27 and were claiming a total amount of R265 934 943.04, which included penalties, interest and additional tax, this predicament was extremely prejudicial towards the Applicant.[219]

SARS attempted to justify the limitation by arguing that the State has the capacity to impose and collect revenue in an efficient system. Apparently, these provisions of the legislation ensured an efficient system of taxation as it discourage dishonest and careless returns. SARS maintained that due to South Africa having such a small tax base, it was important that those

[212] M Grote 2000. *Aspects of Fiscal Devolution in South Africa*: 71.
[213] J. vd S. Heyns 1991. *South African tax policy in the 1980s*: 166.
[214] *Business Day.* 14 May 2018.
[215] 2000 (3) BCLR 318 (W).
[216] Sections 36(1), 40(2)(a) and 40(5) of the VAT Act explicitly excluded the need for recourse to a court of law and excludes the powers of the courts to interfere with that process regardless of the demands of justice.
[217] *Metcash Trading supra* at 1.
[218] *Metcash Trading supra* at 5.
[219] *Metcash Trading supra* at 7.

who were mandated to pay tax, do so.[220]

The High Court held that the denial of recourse destroys the ability to do 'effective budgetary and macro-economic planning', and would simply further erode an already poor tax morality.[221] This in turn would deprive the fiscus of considerable amounts and damage our economy.[222] The sections were declared to be in breach of the Constitution. [223]

The fiscus must simultaneously balance tax collection and avoidance on the one hand, and tax collection and morality on the other hand.

SARS has been attempting to transform since Administrative Autonomy was achieved on 1 October 1997:[224]

It reports that the process of transformation, which includes drafting a strategic business plan, approving transformation processes and staffing a transformation unit, means a more efficient and service orientated organisation with better tax collection.[225] It is worrisome that despite 20 years passing, SARS still has not reached their goal. It is important to note that whilst the state of the economy might play a role in tax collection, administrative efficiency drives the collection process. SARS address its efficiency in that it wishes to have little waste, but not its effectiveness. If SARS had not reached its budget for the last 5 years[226], it is submitted that it has not been effective as it has not produced the desired result of collecting revenue to the fullest of its ability.

In 2001 SARS reduced the extension periods for submission of income tax returns, this was done to ensure more effective tax collection.[227] SARS is commended for taking this hands-on administrative step in improving tax collection. It is submitted that administrative action, and not two-decade old transformation speeches, is what is required to be more efficient and effective. An example of excellent administrative action by the Legislature, enabling SARS more effective and efficient tax collection, is the introduction of the Tax Administration Act ('the TAA'). Prior to the enactment of this Act, each tax Act was governed by its own

[220] *Metcash Trading supra* at 9.
[221] *Metcash Trading supra* at 28.
[222] *Metcash Trading supra* at 33.
[223] *Metcash Trading supra* at 31.
[224] L Mitchell 2000. *Income Tax Reporter.* Vol 39 1. South Africa: Press Release.
[225] Ibid 215.
[226] Menon (note 203 above).
[227] R Stretch. *Taxgram.* Taxbriefs 2001.

administrative provisions. When aligning the administration of the tax Acts in the TAA to a possible practical extent (for example prescribing obligations and rights to taxpayers, or prescribing duties and powers of persons involved), certainty is created. It is submitted that this certainty also boosts tax morality.

In 2016 Minister of Finance, Mr Gordhan, praised SARS for improving the tax collection processes.[228] The new operating model SARS had implemented was the cause of success and promised that it was a key role player for SARS to achieve its R1 trillion budget target at the time. This model also re-aligned the organisation: Customs and Excise was made a branch on its own; branches now dealt with business and individual taxes and SARS implemented a human resource unit. Administrative action led to SARS' increase in efficient and effective tax collection.

4.2 Conclusion

As previously stated, administrative effectiveness and efficiency is what is required to improve tax collection. Various authors have different opinions as to how to give effect to this. Daniel Erasmus voiced his opinion in the Cape Times,[229] according to his experience as a specialist in income tax, the problem in South Africa is that the tax base is too small and carried by a small part of the economically active population. Should this base not be broadened, he is of the belief that 'getting the golden goose to keep on laying more eggs would lower tax morality as people would tire of continuing to fork out for few perceived benefits'. His recommendation is partly supported: simplify the Income Tax Act and conduct mass education programmes about the benefits of paying tax as a means to broadening the tax base.

Should the Income Tax Act or any other tax Act be simplified, the language used could create more loopholes enabling tax avoidance as discussed in Chapter 2. It is submitted that mass education programmes are an excellent way of effectively and efficiently collecting tax. Studies have been done as to the success of including tax education in secondary school syllabus as the present's scholars will be the future's taxpayers.[230]

In the 2018 Budget Speech, the Minister of Finance stressed that tax morality is a crucial component of a healthy democracy. Further steps SARS has undertaken to do to improve the

[228] Ibid 218.
[229] D Erasmus. *Cape Times.* 13 December 2001.
[230] L Koster *The Incorporating of Basic Tax Education in the Secondary School Curriculum.* (unpublished Magister Commercii in Taxation dissertation, University of Pretoria, 2012) 5.

administrative efficiency is to give effect to some of the Davis Tax Committee's recommendations, which included those on the accountability of SARS to the Minister of Finance and strengthening the office of the Tax Ombud.[231]

It is interesting to note that a year later, in the 2019 Budget Speech it was conceded that:[232]

> …problems with tax administration, as highlighted in the findings of the SARS Commission, partly explain poor revenue-collection performance. Improving collections hinges on restoring the efficiency of SARS. In the short term, such improvements may be more effective in raising revenue than further substantial tax increase.

It is submitted that when comparing 'effective' and 'efficient' there will be some overlapping territory.[233] Whilst 'efficient' could be applied to both things and people, it is commonly used when referring to organizations such as SARS, systems or machines. The focus of this word is on how little is lost or wasted, while producing the desired results. 'Efficient' would be used to describe things that work as it intended to, such as SARS policies and techniques. This word could also be used to describe people who accomplish what they set out to do.

SARS have been attempting to be efficient for decades now, it is encouraging to see specific action plans put in place over the years such as specifically giving effect to recommendations, educating taxpayers at workshops and the implementation of the TAA, instead of a mere 'transformation plan'. Whether the changes are effective and produces a desired effect, is another matter. However, the final realisation in the 2019 Budget Speech that the improvement of the efficiency of SARS will produce greater results in tax collection that the increase of taxes, could be an indication of a rise in effectiveness.

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[231] National Treasury 2018. *2018 Budget Speech.*
[232] National Treasury 2019. *2019 Budget Speech.*
[233] Merriam Webster (note 29 above).

5 CHAPTER 5: THE BALANCE BETWEEN EFFECTIVE AND EFFICIENT TAX COLLECTION AND PERMISSIBLE AND IMPERMISSIBLE TAX AVOIDANCE

5.1 Introduction

When balancing tax collection with tax avoidance, tax morality has to be considered. It has been submitted in the previous chapter that administrative effectiveness and efficiency is the best solution for optimal tax collection. Tax collection starts with registration of a taxpayer and concludes with assessing or auditing the taxpayer and physically collecting the funds. In this extreme balancing act, it has been said that the answer to the research question may lie in the distinction between permissible and impermissible tax avoidance. SARS has penalised impermissible tax avoidance whilst admitting that is tax avoidance is not illegal. This chapter will discuss impermissible and permissible tax avoidance, as this could possibly be where the balance lies, for which this study is searching.

5.2 Impermissible tax avoidance

Impermissible tax avoidance is defined in section 80A[234] as follows:

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

The section adds more requirements: 'should the arrangement be made for a mere tax benefit and, in the context of a business, either the manner it was done by would not normally *bona fide* be for business purposes or it lacks commercial substance, the arrangement is impermissible'.[235] Should it be made, other than in a business context, and the manner of arrangement would not normally be used as a *bona fide* purpose other than for the tax benefit, the arrangement would also be classified as impermissible.[236] It is submitted that the first two subsections of section 80A is rather narrow with specific contexts in mind. However, subsection (c) provides for an arrangement in any context whereby rights or obligations are created that 'would not normally be created between persons dealing at arm's length'[237], alternatively 'would result directly or indirectly in the misuse or abuse of the provisions of this Act'[238]. These provisions are extremely wide and encompassing. When SARS and National

[234] Act 58/62.
[235] Act 58/62: section 80A(a)(i)-(ii).
[236] Act 58/62: section 80A(b).
[237] Act 58/62: section 80A(c)(i).
[238] Act 58/62: section80A(c)(ii).

Treasury had hearings on the Discussion Paper on Tax Avoidance in March 2006, various taxpayer representatives criticised the implementation of the legislation. It was submitted by the Law Society of South Africa that impermissible tax avoidance was an ill-defined foreign concept that SARS had imported. SARS justified their position by referring to the changed environment which included financial deregulation, globalisation and sophisticated information technology. SARS further maintains that from a global experience, impermissible tax avoidance causes varied and pervasive harm.[239] International commerce is an integral and essential part of the modern world we inhabit.[240] There is also a global shift towards more compliance and transparency regarding tax avoidance.[241] Anti-avoidance measures are given more attention globally.[242] Tightening the tax net has led to more imaginative tax avoidance schemes when considering such in the context of globalisation.[243] The shortcomings include that anti-avoidance measures are complex and an administration burden. Given globalisation of economies, it is important that legal trends remain similar. Aside from the inequalities, increased tax burdens, disrespect and misallocated resources, when governments accommodate the structures that facilitate this avoidance, it could also be used to conceal unlawfully obtained money.[244] Tax avoidance challenges the apparent social fairness as well as shifts funds from the public purse.[245]

Emphasis was placed on the commercial substance needed for transactions not to qualify as impermissible arrangements. It is submitted that the legislation, to an extent, codified the common law Substance over Form principle discussed at great lengths in this study.

Ineffective tax collection and difficult legislation pre-1994 have allowed South Africa's taxpayers to avert large amounts of revenue that should be subject to income tax in South Africa to 'off-shore' tax shelters and tax havens.[246] This amounts to tax avoidance. Historically, however, SARS was not *'*adequately equipped to deal with certain of these transactions, and remained frustrated and relatively powerless in this respect *'*.[247] If this damaging practice is

[239] Thersby (note 168 above).
[240] Case No 13276/15: para 1.
[241] N Lord 'Tax avoidance might be legal, but it's time we seriously questioned its ethics' 2008 *Tax Breaks* 385 2.
[242] Law Reform 2000. *Tax and Privilege*: 86.
[243] W Maroun et el 2011. *Does Capital Gains Tax Add to Or Detract From The Fairness of The South African Tax System?*: 436.
[244] Lord (note 241 above).
[245] Lord (note 241 above).
[246] SG Nienaber 2010. *Factors that could influence the ethical behaviour of tax professionals*: 34.
[247] Ibid 237.

legal, the ethics of it must be questioned if it leads to such a growing inequality.[248] By focussing on the harm it causes to society, instead of its legal definition, it is easy to both find faults with the practice and question how much of the much-needed resources are misallocated.[249] There is an inappropriate transfer of funds away from the public purse.[250] Unfortunately this will probably not be rectified as tax avoidance also weakens Parliament and Treasury's ability to make and implement better economic policies.[251]

As mentioned previously, there are specific statutory anti-avoidance measures as well as common law anti-avoidance provisions i.e. Substance over Form or GAAR. The common law provisions will be discussed next. However, cognisance must be taken of the various statutory measures put in place throughout the legislation, such as Section 45(5)[252] which in essence provides specific consequences should the intra-group transaction be used within 18 months of a previous transaction. The Legislature envisaged impermissible tax avoidance schemes and therefore inserted the anti-avoidance provision. When considering the Income Tax Act[253] there are various sections with subsections inserted as an anti-avoidance measure.

5.3 GAARs

General anti-avoidance rules (GAARs) are believed to be SARS' most efficient and effective methods to curtail the harm of tax avoidance and impermissible tax avoidance itself. Thus, it plays a critical role in any tax system. The GAARs can only curtail impermissible tax avoidance as the legislation stands. The avoidance information supplied to taxpayers by the GAARs is another important function. GAARs are effective in that they are able to bring about an effect by also informing taxpayers where the line between permissible and impermissible avoidance lies.[254] It determines to what extent taxpayers are allowed to avoid tax. It has a complex dual function of simultaneously targeting impermissible avoidance and honouring permissible avoidance, regardless of how fine that line is. From the above, it is clear that it is imperative that the GAARs must be effective in fulfilling these roles.

[248] Lord (note 241 above).
[249] Lord (note 241 above).
[250] Lord (note 241 above).
[251] Thersby (note 168 above).
[252] Act 58/1962.
[253] Act 58/1962.
[254] B T Kujinga 'Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada'. (2014) 47 3 *CILSA* 1.

As effective as GAARs are, a study, covering from the historical to the current experiences GAARs have had in selected countries, has found that they lack efficiency.[255] Supporting the claims that tax avoidance is a global problem, it was found that all the countries' anti-avoidance rules had similarities. Conceding the fundamental differences based on the different economic stances of the countries, they all have identifiable common factors that work against the GAARs' efficiency.[256] Aggressive taxpayers, the judiciary's role, GAARs inherent weakness and the various indicators of impermissible tax avoidance all form part of these common factors.[257] As per *Vestey's Executors*, mentioned above, the limitations of the law in how far it can be stretched as a defence against tax avoidance, is another crippling factor against the efficiency of GAARs.[258] The study merely concluded that the factors need to be acknowledged and addressed first, before more efficient GAARs can be created.[259]

Many of these factors would be invalidated if a precise definition for 'impermissible tax avoidance' could be given.[260] With taxpayers having a right to arrange their affairs and GAARs performing a dual function of informing taxpayers of the extent of this right, the GAARs role is complicated; the lack of precise definition for 'impermissible tax avoidance' being the cause.[261] As discussed in Chapter 2, this solution will not necessarily be successful as defined principles leave room for taxpayers to manipulate their affairs so as to fall out of the definition. SARS approaches this situation acknowledging the importance of predictability and certainty in a tax system but states that these values are not absolute. SARS recognises that a GAAR will not be able to be overly precise in order to be effective.[262]

The opposite can be used against this argument. If taxpayers avoid falling within the realms of the GAAR, their tax burden will be reduced. There is ample time for taxpayers to study and scrutinize GAARs in order to find ways to avoid the restrictions. These stay unchanged as they are not made annually. Examples of this practice includes exploiting the business-purpose doctrine available in the United States.[263] Taxpayers claim transactions made inherently with tax motivations, are made with a business purpose in order to comply. In South Africa, section

[255] Ibid 3.
[256] Ibid 5.
[257] Ibid 6.
[258] Ibid 5.
[259] Ibid 8.
[260] Ibid 10.
[261] Ibid 13.
[262] Ibid 8.
[263] Ibid 29.

103(1) was exploited by easily passing the abnormality test as transactions merely needed to be common or normal. [264]

This tug of war between taxpayers and their tax advisors versus SARS and government is what creates tax avoidance. It seems that, broken down to the elementary principles and excluding state corruption, the one force creates and enforces tax legislation whilst the other attempts to circumvent that same legislation. The limitation of this right to circumvent tax laws has often resulted in judicial activism, with courts defending the right by interpreting the rules restrictively to limit the uncertainty.[265]

Despite these circumstances, GAARs still need to be efficient and effective. The near-moot situation is believed to be solved by legal means as impermissible tax avoidance is virtuously a legal problem.[266] It is submitted that tax avoidance is not a simple problem and requires an extremely complex solution. To be effective and efficient, a holistic approach must address the root causes of tax avoidance. Impermissible tax avoidance is a universal problem, not an alleged legal problem.[267] Unfortunately GAARs are an attempted legal reaction to the universal problem.[268] This is where the rules lack efficiency: legal resources are wasted on a universal problem without addressing the root causes of tax avoidance. [269]

In spite of the waste of legal resources, the fiscus still owes the general body of taxpayers a legal duty to act fairly when dealing with the discretionary powers. [270] This can be done by efficient and economic use of resources, maintaining and promoting professional ethics, responding to taxpayers' needs in an unbiased manner with a service that is impartial and fair. [271] Lastly, the public must be provided with accurate, accessible and timely information. This legal duty is also subject to the requirements of respectable management. [272]

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[264] Ibid 29.
[265] Australia and Canada's case law has reference: *FCT v Peabody (1994 181 CLR 359)* held that a single step within a large arrangement should not be isolated if doing so robs the step of practical meaning. In *Copthorne Holdings Ltd v The Queen (2011 SCC 63*), it was held that when dealing with a sub-arrangement, 'it must be viewed in the context of the series to enable the court to determine whether abusive tax avoidance has occurred. In such a case, whether a transaction is abusive will only become apparent when it is considered in the context of the series of which it is part and the overall result that is achieved.'.
[266] Ibid 29.
[267] Ibid 30.
[268] Ibid 30.
[269] Ibid 30.
[270] J Silke 'Taxpayers and the Constitution: A Battle Already Lost' 282 Acta *Juridica* (2002) 309.
[271] Ibid 31.
[272] Ibid 31.

5.4 Conclusion

SARS's efficiency and effectiveness were discussed and criticised in the previous chapter whilst this chapter placed more focus on impermissible and permissible tax avoidance and the GAAR's efficiency.

Although GAARs are seen to be effective, their efficiency is limited. The factors limiting this efficacy are interconnected in certain aspects, regardless of the country. It is also these factors that need to be identified and overcome to create greater GAARs.[273] It is submitted that certain factors will never be overcome. The lack of an exact description of impermissible tax avoidance is an example. SARS believes that less aggressive GAARs can still be created while using the limited uncertainty. Judicial interpretation remains the greatest threat to an efficient GAAR, as well as not acknowledging other measures not relating to law, that could address the universal cause of impermissible tax avoidance.[274]

Tax avoidance could simply be made illegal if Parliament legislated it, but this would result in very complex legislation, and an increase in complex tax legislation will simultaneously increase the compliance burden on all, including the lower income brackets.[275] In a country already struggling with compliance issues, this would be counter-productive.

Broadening the tax base was previously submitted as a solution to improved tax collection, however due to South Africa's small tax base, this stance has been criticised as being too burdensome on the tax morality of the taxpayers that do pay tax. This study does not believe this to be the solution. In order to manage the balancing act, SARS would have to administratively improve their efficiency. It is further submitted that by restricting the wasted costs determining impermissible tax avoidance and rather educating the taxpayers as to how the taxation system works, including what permissible tax avoidance entails, tax morality will be higher and more taxpayers will be willing to submit their returns.

[273] Ibid 31.
[274] Ibid 31.
[275] Thersby (note 168 above).

6 CHAPTER 6: CONCLUSION

This study focussed on efficiency, effectiveness and certainty. SARS has routinely maintained that in order to collect taxes, the tax base must be broadened. This study also focussed on tax avoidance, which the small tax base use to reduce their legal obligations to pay tax.
As stated in Chapter 1, the problem the fiscus faces is that it must balance allowing taxpayers the freedom to manage their affairs while simultaneously ensuring that the main source of tax collection is not threatened. This study aimed to evaluate whether this balance was possible.

Tax avoidance considers two legal principles that were discussed in Chapter 2. *IRC v Duke of Westminster* set the precedent, which was also relied on in *CIR v Estate Kohler & others*.
It was held that 'taxpayers are permitted to legally arrange their affairs so as to remain outside the provisions of a particular statute'.[276] The same principle was investigated in the *NWK* case, where the court emphasized that 'the law will not be deceived by the by the form of a transaction and will rend aside the veil in which the transaction is wrapped and examined its true nature and substance'.[277] Various other cases have been discussed which relied on these principles proving the substance over form principle to be universal and still applicable. When the courts have to hand down an order as to whether the taxpayer successfully avoided the ambit of the legislation by arranging his affairs, they look at the substance (as opposed to the form) of a transaction.

It was submitted that if SARS and the Legislature continued to develop more anti-avoidance measures, more revenue might be collected. However, it is concluded that this will not be effective or efficient use of SARS' resources as impermissible tax avoidance is a universal problem, to which there is no simple solution. It is submitted that limiting tax avoidance more than what it already is, does not find application in the balancing act required from SARS. SARS could apply the resources to administrative actions which will render them far greater returns regarding tax collection.

Thus, the outcome the study concludes upon is that tax avoidance could be balanced within the realms of efficient and effective tax collection by improving tax compliance or the tax collection process. It is submitted that were the tax collection process be improved, tax

[276] *R Koster & Son v CIR* 1985 (2) SA 831 (A), 47 SATC 23.
[277] *NWK* supra note 37.

compliance and tax morality will improve too. *Gregory v. Helvering, 293 U.S. 465* takes the argument a step further by discussing patriotic duty. As discussed in the study, tax morality must be considered. The case held that taxpayers may arrange their affairs, as taxpayers are not bound to arrangements that will collect the most revenue for treasury. There is no moral duty on any taxpayer to pay tax nor a public duty to pay more than what the law requires.

The harm of tax avoidance was investigated in Chapter 3. Tax avoidance does cause harm to the fiscus, but it was found that there is also a probability that many taxpayers did not do their returns or were not registered. These issues can be classified as SARS' administrative problems and will fall squarely in the ambit of efficient and effective tax collection should it be rectified. As auditing and assessing taxpayers also fall within the ambit of tax collection, the amounts collected by SARS by taxpayers who attempted to mitigate their tax liabilities, is an administrative action, rather than fighting tax avoidance.
It is submitted that the harm of inefficient tax collection far outweighs the harm of tax avoidance, as inefficient tax collection could be rectified at a smaller cost than more anti-avoidance measures would cost.

The study focussed on uncertainties. It concluded in Chapter 4 that a big part of GAAR's inefficiency is the lack of impermissible tax avoidance's definition. The lack of defined terms throughout that tax Acts also contribute to the uncertainty of tax avoidance. It was held prior in the study that the language argument is moot. However, as held by Wallis JA in *CSARS v Bosch:* 'If the revenue authorities regard any particular form of tax avoidance as undesirable they are free to amend the Act, as occurs annually, to close anything they regard as a loophole. That is what occurred when s 8C was introduced.'[278] The advised action is limited, as GAAR not only causes uncertainty for the taxpayers, but for SARS as well. SARS may challenge avoidance arrangements that it cannot, or honour arrangements that it should challenge. Should SARS only employ the taxes it can best manage and no others, SARS will clearly focus on efficient tax collection, instead of spending resources on anti-avoidance measures and amending the legislation annually which contributes to uncertainties.

The study wholly agrees with philosopher Annie Besant: 'A people can prosper under a very

[278]*CSARS v Bosch [2014] ZASCA 171* (19 November 2014).

bad government and suffer under a very good one, if in the first case the local administration is effective and in the second it is inefficient.'[279]

[279] A Besant 1913 *Essays and Addresses.*

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