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GAARs in Australia and South Africa: Mutual Lessons

Teresa Calvert and Justin Dabner*

ABSTRACT

While the South African and Australian general anti-avoidance rules (‘GAARs’) differ in their structure and design, each is directed towards the same end. Although the South African GAAR was substantially amended in 2006 to address perceived inadequacies, there has yet to be any judicial consideration of the ‘new’ provision. While it is a highly prescriptive provision (at least in comparison with its Australian counterpart) considerable uncertainty as to its effectiveness remains, especially as an earlier attempt to remedy many of the same deficiencies in 1996 was spectacularly unsuccessful.

Meanwhile, after a slow start, the jurisprudence on the Australian 1981 GAAR continues to gather momentum. Although many of the application and interpretative issues have gradually been resolved, others seem insoluble.

In this paper the authors examine these two GAARs with a view to identifying if any lessons for their application and interpretation can be gathered from each other. The authors argue that, notwithstanding design differences, there are some remarkably similar issues to be resolved. Some of the Australian case law may therefore be instructive as to the approach that could be adopted in South Africa, while some of the prescriptions in the South African legislation could be of value in assisting the Australian judiciary to direct their attention to relevant considerations or, possibly more likely, could form the basis for further legislative prescriptions in the Australian GAAR.

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I Introduction

The South African income tax legislation has contained a general anti-avoidance rule ("GAAR") since 1941, with its most recent version dating from 2006. Meanwhile, the modern Australian GAAR dates from 1981.

The comprehensive 2006 amendments to the South African GAAR were designed to address perceived inadequacies that were not adequately addressed by earlier amendments in 1996. Notwithstanding the 1996 amendments, the provision continued to be unsuccessful in countering tax avoidance activities. Interestingly, there have been no cases that have considered the effect of the 2006 revision, and considerable uncertainty as to the effect of these amendments exists. On the other hand, the legislation is much more prescriptive as to what might constitute an unacceptable tax avoidance scheme than, for example, the Australian GAAR.

While the Australian GAAR has been subject to minor amendments in the past 30 years, its essential design and framework have remained unchanged. Most of the action has been at the case law level. Again interestingly, the Australian GAAR remained untested in the courts for eight years before what has become an avalanche of cases commenced. Following a shaky start, these cases have mostly strengthened the robustness of the provision. Nevertheless, great uncertainty as to its boundaries remains, with the Australian Tax Office ('ATO') now apparently adopting the practice of adding a Part IVA assessment to any sizeable substantive issue, as if to suggest that anything done by a large enough taxpayer carries an immediate presumption that Part IVA applies.¹

This paper considers whether any guidance as to the application of the respective GAARs can be gleaned from the experience in the other country. In particular, it will examine whether the Australian case law might provide any indication as to how the post-2006 South African GAAR will be interpreted. This case law may be of particular significance given that the 2005 discussion paper, which preceded the 2006 amendments, made specific reference to the Australian experience. Furthermore, the prescriptive elements now expressed in the South African GAAR might be of some assistance in shedding light on when an Australian arrangement might fail that country's GAAR.

The paper is divided into six sections. In Section II, the background of the South African GAAR is outlined, to identify the inadequacies in the legislation that the 2006 amendments sought to remedy. The new prescriptive elements of the GAAR are detailed. This leads into Section III, in which the interpretative issues arising from the new legislation are explored. The Australian GAAR is introduced in Section IV, focusing on the primary features associated with its application that have been highlighted by the cases. Section V explores how the cases have dealt with these issues. In Section VI, the penultimate section of the paper, the authors postulate what the Australian experience could mean for the interpretation of the South African GAAR and to what extent the

prescriptive elements of the South African GAAR could be of value in providing some
guidance as to the future application of the GAAR in Australia. Section VII concludes that,
notwithstanding the differences in the design of the GAARs in the two countries their
application requires the respective courts to focus on similar factual elements.

II THE DEVELOPMENT OF THE SOUTH AFRICAN GAAR

The South African GAAR has been amended several times since its incorporation into the
South African legislation in 1941. Before the 2006 amendments, it was contained in
s 103 of the Income Tax Act 1962 (‘ITA’). In that form, it included four key requirements:

• a transaction, operation, or scheme;

• that resulted in the avoidance, reduction, or postponement of tax;

• entered into or carried out in a manner not normally employed for business
purposes, other than obtaining a tax benefit (the abnormality requirement); and

• the transaction must have been entered into solely or mainly for the purpose of
obtaining a tax benefit (the purpose requirement).²

A The 2005 Discussion Paper

In 1995, the Katz Commission had reported on the inadequacies of s 103 and had made
recommendations for its amendment.³ Unfortunately, the resultant changes failed to
adequately address the limitations of the provisions, with the South African Minister of
Finance stating in 2005 that ‘What we can’t accommodate is a rule which is intended to
limit avoidance that is so abused and tatty with wear.’⁴ Shortly after this statement, the
South African Revenue Service (‘SARS’) released a discussion paper on s 103,⁵ in which it
highlighted the primary weaknesses of the GAAR. These weaknesses were classified
under four main categories and are summarised below:

• Not an effective deterrent: The aggressive and increasingly sophisticated schemes
entered into by taxpayers, often marketed by boutique financial institutions, had
resulted in the exploitation of the GAAR. In addition to this, the significant
commitment of time and resources to detecting and combating these schemes had
proven to be costly, and lengthy battles over these schemes had had a negative
impact on the relationship between the SARS and taxpayers.⁶

² Income Tax Act 1962 (SA) s 103(1).
³ Katz, M, Third Interim Report of the Commission into certain aspects of the Tax Structure of South Africa,
⁴ Engel, K (Chief Director, Tax Legislation – National Treasury), The GAAR proposal: A National Treasury
⁵ South African Revenue Service, Discussion Paper on Tax Avoidance and section 103 of the Income Tax Act,
⁶ Ibid 41–42.
Abnormality requirement: Two fundamental weaknesses of the abnormality requirement were identified both before and after the 1996 amendments to the GAAR. The first of these weaknesses stemmed from the realisation that transactions entered into bona fide were often hijacked or replicated by scheme promoters for the purposes of impermissible tax avoidance. The second weakness was closely related because promoters of these schemes found it relatively easy to manufacture a plausible sounding business purpose.

Purpose requirement: The problems identified within the abnormality requirement were compounded by the existence of the purpose requirement as it left the Commissioner in the difficult position of having to disprove a taxpayer’s assertion that the predominant purpose of entering into the transaction was not to obtain a tax benefit. This weakness was often abused by taxpayers in light of CIR v Conhage (Pty) Ltd 1999 (the Conhage case), where the raising of capital for an overall commercial transaction was sufficient to inoculate each step in the larger scheme.

Procedural and administrative issues: Two main concerns were identified, as follows:

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

As observed above, many of these weaknesses were identified both before and after the 1996 amendments to GAAR, and though the legislator attempted to address some of these criticisms in 1996, the amendments did not achieve their purpose. For example, the Katz Commission had suggested that the abnormality test, in the context of business dealings, should be amended to include a bona fide business purpose test, as opposed to a normality test. The amendments did include the words ‘bona fide business purposes’ but the word ‘normal’ was still left intact, which again aided in rendering the GAAR an ineffective deterrent to tax avoidance.

In addition to the above, another weakness had been recognised because both the abnormality and purpose requirements needed to be present before a scheme could

---

7 This weakness was identified by the Katz Commission and the subsequent proposals suggested that the GAAR should be amended to make it clear that if a particular form of transaction was commercially acceptable due to the fact that it was widely used, this did not mean that the abnormality test was passed.
8 South African Revenue Service, above n 5, 42–43.
9 CIR v Conhage (Pty) Ltd 1999 (4) SA 1149 (SCA), 61 SATC 391.
10 South African Revenue Service, above n 5, 43.
11 See CIR v Louw 1983 (3) SA 551 (A), 45 SATC 113.
12 South African Revenue Service, above n 5, 44.
successfully be attacked. This meant that a taxpayer could, with impunity, enter into a transaction with the (subjective) sole purpose of avoiding tax, provided that there was no (objective) abnormality in the means or manner, or in the rights and obligations which it created. Conversely, a taxpayer could, with impunity, enter into a transaction which was objectively ‘abnormal’, provided that he/she did not have the sole or main purpose of tax avoidance.\textsuperscript{14}

\textbf{B The 2006 GAAR}

Subsequent to the release of the 2005 discussion paper, the GAAR was significantly amended in 2006 in an effort to address these weaknesses. The provisions of the South African GAAR, incorporating those amendments, are now contained in Part IIA of the \textit{Income Tax Act 1962}. Section 80A is the operative section and identifies the features of an impermissible tax avoidance arrangement as follows:

- there must be an arrangement;
- that results in a tax benefit;
- the sole or main purpose of which was to obtain the tax benefit; and\textsuperscript{15}
  - in the context of business, the arrangement:
    * was carried out in a manner not normally employed for \textit{bona fide} business purposes; or
    * lacks commercial substance; or
  - in a context other than business, the arrangement was carried out in a manner not normally employed for \textit{bona fide} purposes; or
  - in any context, the arrangement:
    * creates rights and obligations not normally arising between parties dealing at arm’s length; or
    * results directly or indirectly in the misuse or abuse of the provisions of the Act.\textsuperscript{16}

Section 80B identifies the steps that the Commissioner may take upon concluding that an arrangement infringes the GAAR, which essentially enable the cancellation of the tax benefit. Thereafter, the part primarily contains definitional provisions. Section 80C(1) explains the term 'lack of commercial substance' as being a circumstance in which the avoidance arrangement results in a significant tax benefit but does not have a significant effect upon either the business risks or net cash flows apart from any effect attributable to the tax benefit.\textsuperscript{17}

\begin{itemize}
\item \textsuperscript{14} \textup{South African Revenue Service, above n 5, 44.}
\item \textsuperscript{15} The last requirements of the 2006-amended GAAR that indicate in which context the requirements must be applied are commonly referred to as the tainted elements.
\item \textsuperscript{16} \textit{Income Tax Act 1962} (SA) s 80A.
\item \textsuperscript{17} \textit{Ibid} s 80C.
\end{itemize}
In addition to this s 80C(2) provides a list of characteristics of avoidance arrangements that indicate a lack of commercial substance,\(^\text{18}\) namely:

- the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or

- the avoidance arrangement exhibits the inclusion or presence of:
  - round trip financing; or
  - an accommodating or tax-indifferent party; or
  - elements that have the effect of offsetting or cancelling each other.\(^\text{19}\)

1 Round Trip Financing

The first indicator of a lack of commercial substance (round trip financing) is defined in \textit{Income Tax Act 1962} s 80D and consists of three parts. The first part defines round trip financing as an avoidance arrangement where funds are transferred between or among the parties (round tripped amounts) and the transfer of the funds would result, directly or indirectly, in a tax benefit and would significantly reduce, offset, or eliminate any business risk incurred by any party in connection with the avoidance arrangement.\(^\text{20}\) In order to determine whether s 80D would apply, the avoidance arrangement would have to meet all of these requirements. However, many of the terms included within this provision have not been defined and so there is some uncertainty as to their meaning.\(^\text{21}\)

Furthermore, the context suggests that for the first requirement of s 80D to be met, the funding would have to be transferred between parties through some type of reciprocal action.\(^\text{22}\) In addition to this, the transfer of funds would be required to directly or indirectly result in a tax benefit. Accordingly, even if the arrangement as a whole results in a tax benefit, for s 80D to apply, the transfer of funds must also directly or indirectly result in a tax benefit.\(^\text{23}\) Similarly, the transfer of funds would be required significantly to reduce, offset, or eliminate the danger or chance of loss in the context of business before it would satisfy the definition of round trip financing.

\(^{18}\) The list of characteristics that are provided in s 80C of the \textit{Income Tax Act 1962} (SA) is commonly referred to as the commercial substance indicators.

\(^{19}\) \textit{Income Tax Act 1962} (SA) s 80C.

\(^{20}\) \textit{Ibid} s 80D.

\(^{21}\) Potentially problematic terms include ‘between’, ‘among’, ‘significantly’, ‘reduce’, ‘offset’, ‘eliminate’ and ‘business risk’. As an example of how some of these terms may prove problematic, in using the concept of ‘significant business risks’, it is important to note that this concept has not been defined in the Act, nor by the courts. Its inclusion in the GAAR introduces an additional degree of subjectivity in the application of the GAAR. Introducing subjectivity to such a large degree may lead the courts to consider the ambit to be too wide and therefore ‘look negatively at it which could lead to a very narrow and restricted interpretation of the statute and frustrate the fiscus’: Van Schalkwyk, L and Geldenhuys, B, ‘The Income Tax Act. Section 80(c)(III) of the Income Tax Act: Round-tripping between the draft version and the enacted version – part 1’, \textit{(2009) Accountancy SA} 6. In this case, it could cause destruction of the effectiveness of the current GAAR regime similar to that of its predecessor.


\(^{23}\) \textit{Ibid}.
The second part of s 80D provides guidance on what circumstances should not be taken into consideration in determining whether the avoidance arrangement has the presence of round trip financing in the context of commercial substance. This part has the effect of eliminating any consideration of:

- whether or not the round tripped amounts can be traced to funds transferred to or received by any party in connection with the avoidance arrangement;
- the timing or sequence in which round tripped amounts are transferred or received; and
- the means by, or manner in which, round tripped amounts are transferred or received.\(^\text{24}\)

The third part of s 80D provides guidance as to what would constitute funds in the context of the round trip financing indicator.\(^\text{25}\)

2 Accommodating or Tax-Indifferent Parties

The second indicator (accommodating or tax-indifferent parties) is defined in *Income Tax Act 1962* s 80E. The need to include this aspect in the GAAR was noted by SARS in the 2005 discussion paper,\(^\text{26}\) where it was stated that tax-indifferent parties, by design, work to disable and defeat the balance between tax deductibility in the hands of one party and taxable income in the hands of another. Tax-indifferent parties are often aptly referred to as ‘washing machines’, a term that describes the roles that these parties fulfil in avoidance arrangements.\(^\text{27}\) Furthermore, it was noted that ‘these parties typically receive a fee (often in the form of an above-market return on investment) for the service of absorbing income or otherwise selling their tax-advantaged status to the other participants in the scheme.’\(^\text{28}\)

In incorporating the concept of a tax-indifferent party into the GAAR, the law defines the main characteristics of an ‘accommodating or tax-indifferent party’ as follows:\(^\text{29}\)

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

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

i) not subject to normal tax; or

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

\(^{24}\) *Income Tax Act 1962* (SA) s 80D.

\(^{25}\) Ibid s 80D: ‘includes any cash, cash equivalents or any right or obligation to receive or pay the same.’

\(^{26}\) South African Revenue Service, above n 5, 21.

\(^{27}\) Ibid.

\(^{28}\) Ibid.

\(^{29}\) *Income Tax Act 1962* (SA) s 80E.
b) either—
   
i) as a direct or indirect result of the participation of that party an amount that would have—

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

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

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

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

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

As is evident from the definition, the term ‘accommodating or tax-indifferent party’ is widely defined notwithstanding that s 80E(3) specifically excludes certain parties from being classified as such if either:

   a) the amounts derived ... are cumulatively subject to income tax by one or more spheres of government of countries other than [South Africa] which is equal to at least two-thirds of the amount of normal tax which would have been payable in connection with those amounts had they been subject to tax under this Act; or

   b) the party in question continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months,

   : Provided these activities must be attributable to a place of business, place, site, agricultural land, vessel, vehicle, rolling stock or aircraft that would constitute a foreign business establishment ... if it were located outside the Republic and the party in question were a controlled foreign company.

This exclusion from the definition of ‘accommodating or tax-indifferent party’ thus allows ‘legitimate’ business operations to continue without risk of being considered an indicator of lack of commercial substance.

3 Offseting or Cancelling

The last indicator (offsetting or cancelling) is not defined in the law and was introduced because if elements of a transaction have the effect of offsetting or cancelling each other it would indicate that such parts of the transaction have no real effect and were contrived for the purpose of obtaining a tax benefit (thus indicating a lack of commercial substance). Essentially, the provision is referring to ‘self-neutralising mechanisms’ and

30 Ibid s 80E(3).
draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called fiscal nullity doctrine.\textsuperscript{31} It is targeted primarily at complex schemes, typically involving financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another effectively neutralises the first leg for non-tax purposes.\textsuperscript{32}

In comparing the requirements of the GAAR after its amendment in 2006 with that of the amended 1996 GAAR, it is evident that the fundamental principles of the previous GAAR regime remain intact,\textsuperscript{33} while additional tainted elements and commercial substance indicators have been included in the legislation. The amendments that were intended to address the weaknesses can be identified as follows:

- **Not an effective deterrent** – The inclusion of the commercial substance indicators into the GAAR were intended to address the aggressive and sophisticated schemes marketed by the boutique financial institutions after the 1996 amendments to the GAAR.

- **Abnormality requirement** – The previous abnormality test contained wording similar to that of the current abnormality element. However, the removal of the words ‘having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out’ suggests that the new abnormality requirement must be considered to be solely an objective test. It is probable, therefore, that the hijack techniques employed by promoters were the weakness that this amendment addressed.

- **Purpose requirement** – Section 80G was introduced into the GAAR and creates a presumption that the sole or main purpose of the transaction is the obtaining of a tax benefit. This amendment was introduced for the purpose of eliminating the onus upon the Commissioner of having to disprove a taxpayer’s assertion that the predominant purpose of entering into the transaction was not to obtain a tax benefit. It in essence reverses the onus of proof from the Commissioner to the taxpayer.

- **Procedural and administrative issues** – The inclusion of s 80H into the GAAR specifically addressed the uncertainty about the extent to which the GAAR could be applied to individual steps within a larger transaction. It states that ‘the Commissioner may apply the provisions of the Part to steps in, or parts of, an

\textsuperscript{31} De Koker, above n 22, [19.7].

\textsuperscript{32} Ibid. The problem anticipated with the inclusion of this provision is the impact that it has on the scope of the GAAR. Typically, this provision would have the effect of including financing or hedging transactions within the scope of the GAAR, but these were never intended to be considered as ‘impermissible avoidance transactions’.

\textsuperscript{33} ‘Arrangement’, as defined in the current GAAR regime, is similar to that of a transaction, operation, or scheme included in the previous GAAR regime. ‘Tax benefit’, as defined in the current GAAR regime, is similar to the avoidance, reduction, or postponement of tax, as included in the previous GAAR regime. The ‘sole or main purpose’ requirement, as included in the current GAAR regime, is similar to that of the ‘purpose’ requirement existing in the previous GAAR regime. The ‘abnormality tainted’ element included in the current GAAR regime is similar to the abnormality requirement included in the previous GAAR regime.
arrangement.'\textsuperscript{34} Similarly, the inclusion of s 80I into the GAAR specifically addressed the uncertainty as to whether the Commissioner had the authority to apply the GAAR in the alternative where another provision was also in dispute. It provides that ‘the Commissioner may apply the provisions of the Part in the alternative for, or in addition to, any other basis for raising an assessment.’\textsuperscript{35}

It is notable that no specific amendment was made to the GAAR to address the ease with which plausible sounding business purposes could be manufactured by promoters in relation to the abnormality requirement. The weakness identified in relation to the reliance on both the purpose and abnormality requirements in conjunction with each other was not attended to, with the previous structure remaining fundamentally intact, thus still requiring both of these requirements to be present before an avoidance arrangement could be successfully attacked using the GAAR.

\textbf{III The Elements of the South African GAAR and Ongoing Interpretative Issues}

The amendments made to the GAAR in 2006 resulted in the inclusion of novel, untested legislation without a body of case law to aid in the interpretation of the new concepts. A considerable number of issues can be identified.

\textbf{A Purpose Test – Subjective or Objective}

In interpreting how the ‘sole or main purpose’ requirement should be applied, it is noted that the legislator chose to use similar wording to that used previously. Therefore, as this requirement of the GAAR (contained in s 80A) seems largely the same as the sole or main purpose requirement of the previous GAAR regime, the findings of the South African courts in past cases should apply \textit{mutatis mutandis} to an enquiry as to the sole or main purpose of an arrangement in terms of the current GAAR regime. The sole or main purpose requirement, thus, necessitates that a taxpayer is required to discharge their onus on the balance of probabilities to the effect that in light of the relevant facts and circumstances the obtaining of the tax benefit was not the sole or main purpose of the arrangement.\textsuperscript{36}

In this investigation, the purpose of the transaction is clearly critical. While case law suggests that an enquiry into the purpose of an arrangement is a subjective one,\textsuperscript{37} there is an alternative view, which some tax practitioners and academics subscribe to, that the ‘sole or main purpose’ test is an objective test.\textsuperscript{38} In this objective test, the actual effect of a transaction should be considered, rather than the intention of the taxpayer. The existence of an objective test is possibly supported by the terms of s 80G, which effects the change in the onus of proof. This provision suggests that when applying the purpose

\begin{footnotesize}
\begin{enumerate}
\item Income Tax Act 1962 (SA) s 80H.
\item Ibid s 80I.
\item De Koker, above n 22, [19.6].
\item Secretary for Inland Revenue v Gallagher (1978) (2) SA 463 (A).
\end{enumerate}
\end{footnotesize}
test, the effect of the transaction, and not just the purpose of the taxpayer, must be taken into account.\textsuperscript{39}

An objective approach could provide a taxpayer with a more effective means to discharge the onus than merely relying on an assertion as to their subjective intention. On the other hand, case law\textsuperscript{40} has identified that such a test could disadvantage a taxpayer, as no regard will be had to their actual intention when they entered into the transaction.\textsuperscript{41} Based on the conflicting views on the interpretation of the current GAAR regime it is impossible to be certain about the manner in which it should be applied.

\section*{B Commercial Substance Tests – Alternatives or Cumulative}

The commercial substance indicators listed in \textit{Income Tax Act 1962} s 80C prove to be an additional item of concern with regards to the effectiveness of the GAAR. As explained above, s 80C identifies specific arrangements that will lack commercial substance. Although this list merely provides guidance and is not intended to limit the interpretation of the term ‘lack of commercial substance’,\textsuperscript{42} it is uncertain as to how ss 80C(1) and (2) should be applied. In this regard it is not clear if these subsections should be regarded as separate tests or are cumulative. That is, it is unclear whether, if a transaction merely fails one of the subsections, it would result in the transaction being considered to have commercial substance. Commentators have indicated that these should be regarded as separate tests from a practical perspective but the drafting of this aspect of the GAAR has left the matter unclear.\textsuperscript{43}

\section*{C Round Trip Financing – ‘Significant’ Business Risks}

The inclusion of the round trip financing indicator within the GAAR has generated uncertainty as to how these terms will be applied by the courts. In defining the term ‘round trip financing’, s 80D includes the proposition that an avoidance arrangement would include round trip financing if the transfer of funds significantly reduces, offsets, or eliminates any business risk. However the concept of ‘significant business risks’ has not been defined within the law, nor interpreted by the courts, and may introduce uncertainty into the GAAR. The inclusion of these terms, without sufficient explanation, leaves it again impossible to be certain about the manner in which the provision would be applied.

\section*{D Non-arm’s Length Rights and Obligations — Relevance of Subjective Elements}

The third tainting element is focused on those arrangements where the parties have included rights and obligations within an arrangement that are not at arm’s length.

\begin{footnotes}
\item[39] By virtue of the reference to the need to reasonably consider ‘the relevant facts and circumstances’ in disproving the predominance of a tax avoidance purpose.
\item[40] \textit{Secretary for Inland Revenue v Gallagher} (1978) (2) SA 463 (A).
\item[42] \textit{Income Tax Act 1962} (SA) s 80C.
\end{footnotes}
Theoretically, the introduction of non-arm's length rights and obligations into an arrangement would indicate that the arrangement is abnormal and may have been motivated with a view to impermissible tax avoidance.

This element has been retained from the previous legislation, and it is therefore appropriate to refer to the interpretation of its predecessor by the courts. Case law suggests that the test connotes that 'each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself.'\textsuperscript{44} Despite the maintenance of this principle in its previous form, it is arguable that the test must now be applied using objective means as opposed to subjective means.\textsuperscript{45} This change from subjective to objective was implemented in order to address the weaknesses surrounding the abnormality requirement, discussed above.\textsuperscript{46} However, notwithstanding the change from subjective to objective, the 2006 amendments, similar to the 1996 amendments, have not brought about clarity as to the objective yardstick against which a transaction should be measured.\textsuperscript{47} Though the words ‘having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out’ have been removed, commentators have noted that it remains to be asked, for example, ‘what is a normal manner for ex-partners to incorporate their practice?’\textsuperscript{48} That is, it is unclear as to what extent subjective considerations may inform the objective test.

\textbf{E Misuse or Abuse – Uncertainty of Meaning}

The concept ‘misuse or abuse’ of the Act has not been defined in the law, and would therefore have to be interpreted according to the ordinary and natural meaning of these words. When originally included in the draft version of the current GAAR regime, this provision read ‘it would frustrate the purpose of any provision of this Act’ (emphasis added). The enacted version of this section substituted the words ‘misuse or abuse’ for the word ‘frustrate’. Though these words may be considered synonyms for each other, it is also arguable that the use of different words in the enacted version of the section must be considered in the light of the presumption that where the legislature uses a different word or expression, this has been designed to provide for a different outcome. It might be suggested that the reference to ‘misuse or abuse’ presupposes that there is some identifiable non-abusive use for each provision of the Act (and for the Act as a whole), which can be used as a yardstick against which to measure misuse or abuse.\textsuperscript{49}

Commentators note that the inclusion of the concept of misuse or abuse is derived from the Canadian GAAR.\textsuperscript{50} However, whereas the South African use of this concept is cast in

\textsuperscript{44} Hicklin v Secretary for Inland Revenue (1980) 1 All SA 301 (A).
\textsuperscript{45} The reference to the circumstances under which the transaction was entered into has been removed, and thus arguably changes the test from subjective to objective.
\textsuperscript{46} De Koker, above n 22, [19.7].
\textsuperscript{47} Olivier, above n 13; Meyerowitz, above n 38, 29–11.
\textsuperscript{48} Olivier, above n 13.
\textsuperscript{49} Clegg, D, ‘Use it or abuse it’ (2007) 21 South Africa: Tax Planning 37.
positive language, the Canadian GAAR uses it in the negative. The Canadian GAAR thus applies the concept as a limitation on the operation of the GAAR, which arguably has the effect of preventing the GAAR from being too broad.\textsuperscript{51} However, as a positive limb of the South African GAAR, the possible wide interpretation of this vague provision could plunge the current GAAR into a similar predicament that faced its predecessor when its ambit was considered to be too wide.\textsuperscript{52} This may lead to instances where the courts will be left with no alternative but to chip away at the edifice of the GAAR\textsuperscript{53} leading to a narrow and restricted interpretation of the statute. This could destroy the effectiveness of the current GAAR regime, as happened to its predecessor.\textsuperscript{54}

It is also of note that, in defining an avoidance transaction, the Canadian legislation provides that the transaction will not be impeached if it could \textit{reasonably} have been considered to have been undertaken for \textit{bona fide} purposes other than to obtain a tax benefit.\textsuperscript{55} The use of the term \textit{reasonably} is noticeably absent from the South African version. One possible implication of this is that, while the Canadian GAAR directs the Revenue, and ultimately the courts, to adopt a fair and sensible application of the provision, the absence of such an instruction to the South African courts may result in a more strident application of the GAAR.\textsuperscript{56}

There is also debate amongst Canadian commentators as to whether the misuse and abuse limb does any more than codify the purposive approach to statutory interpretation.\textsuperscript{57} If not, this aspect of the South African GAAR may mark no substantive change in the law, given that the purposive approach has long received judicial support in South Africa.\textsuperscript{58} This point will be taken up further in the penultimate section of the paper.

\textsuperscript{51} Louw, above n 41, 40.
\textsuperscript{52} Van Schalkwyk and Geldenhuys, above n 21.
\textsuperscript{54} Van Schalkwyk and Geldenhuys, above n 21.
\textsuperscript{55} \textit{Income Tax Act 1985} (Canada) s 245(3).
\textsuperscript{56} The word ‘reasonably’ is defined in the South African Concise Oxford Dictionary as a ‘fair and sensible consideration’. The use of this phrasing in the context of misuse or abuse in the GAAR leads one to the conclusion that use of this term in the Canadian context requires a less severe application than the South African version, where the terms ‘reasonable’, ‘fair’ and ‘sensible’ are not used: Geldenhuys, B, \textit{An analysis of Section 80(c)(ii) of the Income Tax Act No 58 of 1962 as amended} (MAcc (Taxation) Thesis, University of Stellenbosch, 2009) 39.
\textsuperscript{57} In fact, three possible approaches to this element of the Canadian GAAR have been identified, with the most likely approach to treat it as simply codifying the common law rule mandating a purposive interpretation of the tax laws: Arnold, BJ, and Wilson, JR, ‘The General Anti-avoidance Rule — Parts 1, 2 & 3’ (1988) 36 \textit{Canadian Tax Journal} 831, 1123, 1369. (The views expressed in these articles are neatly summarised in Arnold, BJ, ‘The Canadian general anti-avoidance rule’ [1995] \textit{British Tax Review} 541.) The leading Supreme Court decision would seem to have fulfilled this prophecy: \textit{The Queen v. Canada Trustco Mortgage Company} [2005] SCC 54, discussed in Bernstein, J, Wrondl, B, and Leung, K, ‘Canadian Supreme Court’s Pronouncement on GAAR: A Return to Uncertainty’ <http://taxproftypepad.com/taxprof_blog/files/2005-21313-1.pdf>.
\textsuperscript{58} Li, J, and Picolo, D, ‘Reviving the Modern Rule of Interpretation of Tax Statutes: Baby Steps Taken in Canada Trustco, Mathew, Placer Dome and Imperial Oil’ <http://ssrn.com/abstractid=1020653>;
In light of the conflicting opinions with regards to the interpretation of the GAAR, the decisions of the courts will be critical in clarifying its application. The broad terms of the provision leave the courts free to refer to the strong body of overseas precedents for guidance as to the circumstances in which the GAAR should apply. Given an express reference to the Australian GAAR in the 2005 Discussion Paper that lead to the 2006 amendments, it could be expected that developments in Australia may be highly instructive. In addition, the prescriptive nature of the South African GAAR might provide some useful guidance in relation to the resolution of future GAAR cases in Australia or as to the direction of future amendments. In the next two sections, the authors will outline the Australian GAAR and consider the jurisprudence on the provision and lingering issues.

IV The Australian GAAR

The Australian GAAR is contained in Part IVA of the Income Tax Assessment Act 1936. Its application requires the Commissioner to make a determination as to the existence of the following elements:

- **Scheme**: this element is defined broadly to encompass any agreement, arrangement, understanding, promise or undertaking whether express or implied and whether or not enforceable, and any scheme, plan, proposal or action whether or not unilateral;

- **Tax benefit**: while the definition is couched in a number of disparate sections and has been broadened over time, essentially this element focuses on where there has been a reduction in a taxpayer’s tax liability, where that reduction would not reasonably have been expected to have occurred had the scheme not been entered into. Notably, a tax benefit does not include the circumstances where the tax liability has been reduced by virtue of the taxpayer making an election or choice expressly provided for in the legislation, provided the scheme was not entered into in order to create the circumstances where the election thereby became available;

- **Dominant purpose to obtain a tax benefit**: whether the dominant purpose behind entering into the scheme was to obtain the tax benefit is to be assessed by reference to a number of criteria including:

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Geldenhuys, B, above n 56, 9, where it is suggested that Income Tax Act 1985 (Canada) s 245(4) sparked a revival of the purposive approach to interpretation in Canada. However, the purposive approach to interpretation has been continually applied since the enactment of the South African Constitution in 1996 and thus the possible inclusion of this principle via the GAAR is nothing more than an enshrinement of the purposive approach into the legislation.

59 Arendse, above n 53.

60 Income Tax Assessment Act 1936 (Cth) (ITAA 1936), ss 177A(1), (3).

61 ITAA 1936, ss 177C(1), 177CA. The reduction in liability is prescribed to have occurred by either an amount of assessable income (or capital gain) not being included, a deduction, capital loss or foreign tax credit being available, or withholding tax not being payable.

62 ITAA 1936, ss 177C(2), (2A), (3) (with some expressed exceptions).
the manner in which the scheme was carried out;
the form and substance of the scheme;
the timing of the scheme;
the result that would otherwise have been achieved by the scheme;
any change in the taxpayer’s financial position or that of a person connected with the taxpayer as a result of the scheme;
any other consequences for the taxpayer or a connected person of the scheme; and
the nature of the connection.  

Where the Commissioner determines that Part IVA applies, the scheme can be set aside for tax purposes and the taxpayer’s affairs reconstructed with the resultant (negative) tax implications (that is, the tax benefit is cancelled) and penalties applied.  

V Issues Arising in the Australian Case Law

The terms of Part IVA are expressed very broadly and, on the face of it, the provisions could conceivably apply to any transaction or arrangement where the minimisation of the payment of tax was a feature. However such a broad drafting had proved to be the nemesis of the forerunner to the 1981 GAAR, with the courts taking a restrictive approach to its interpretation. Possibly with the fear that Part IVA would meet a similar fate, it remained on the statute books for eight years before the Australian Tax Office (‘ATO’) engaged in any substantial litigation in relation to it and a further five years before the first High Court decision.

A The Dominant Purpose Element

The primary response to the enactment of the provision by tax advisers has been to focus on the requirement that the tax benefit be the ‘dominant’ purpose of the scheme. It was considered that this requirement imported an essentially ‘business purpose’ defence into the part such that, if it could be established that the overall focus of the scheme was on achieving a commercial end, then the existence of tax minimisation elements would not offend the GAAR. This view was supported by reference to observations made by the Treasurer in his second reading speech when introducing the

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63 ITAA 1936, ss 177D, 177A(5).
64 ITAA 1936, ss 177F(1), (2A). The Commissioner also has the power to make compensating adjustments including, for example, to exclude income from another person’s assessable income: ITAA 1936, s 177F(3).
65 See Taxation Administration Act 1953, sch 1, sub-div 284–C. The base penalty amount is 50% of the amount of tax avoided under the scheme, although only a 25% penalty will apply if it is reasonably arguable that Part IVA does not apply.
66 ITAA36 s 260.
68 Case W58 89 ATC 524.
70 Although prior to amendments to the definition schemes that eluded the initially narrow definition of ‘tax benefit’ were devised, for example by converting a revenue amount into a (less) taxable capital gain.
Bill containing the part to Parliament, when he stated that the part was not intended to apply to ordinary business and family dealings but rather only to schemes of a 'blatant, artificial or contrived kind'.\textsuperscript{71} One reaction to this in practice (at least from the experience of one of the authors) was the preparation of lengthy (it was hoped self-serving) advices that would elaborate on all the non-tax advantages of a particular structure or arrangement, with only a brief mention of the (apparently incidental) tax benefits.

However, there were early indications that the requirement that the tax avoidance purpose be ‘dominant’ might not be the tax planner’s panacea. Firstly, there was no definition of ‘dominant’ and so some debate as to whether it meant dominant as against the combined force of all the other purposes of an arrangement or merely the greatest purpose when viewed against each other purpose individually.\textsuperscript{72} Secondly, while the literal interpretation of tax statutes that had plagued the precursor to Part IVA was losing favour in the courts, giving way to a more purposive approach, there was no guarantee that the courts would look to the second reading speech for guidance in the application of the part. Notwithstanding common law developments in support of a more contextual approach to interpretation,\textsuperscript{73} and the enactment of ss 15AA and 15AB of the \textit{Acts Interpretation Act} 1901, which specifically endorsed a reference to Parliamentary proceedings as an aid to interpretation, the meaning of the words of the legislation were to remain paramount, and reference to these external sources would only be mandated where the wording of the Act was ambiguous or obscure or the ordinary meaning led to a manifestly absurd or unreasonable result. Thus, it was always open to the courts to sidestep any reference to this ancillary material by asserting that the meaning of the Part was clear in any event, as indeed they subsequently did.\textsuperscript{74}

Thirdly though, and much more significantly, the potential limitations on the requirement for any tax avoidance purpose to be dominant were inherent in the reference in s 177D to the fact that in ascertaining whether a dominant purpose existed reference was to be had to the features of the scheme ‘or any part’ thereof. Thus, it was always conceivable that the Commissioner might be selective in determining the elements of the scheme in such a way as to focus on any tax minimisation features to the exclusion of other commercial elements or aspects motivated by family concerns. For example, while a taxpayer might seek to justify the existence of a discretionary trust through which to conduct a family business by reference to asset protection and succession planning, the existence of tax effective distributions of income might be selected out as the impugned scheme, with the ready conclusion that the amounts of the

\textsuperscript{71} Commonwealth, Parliamentary Debates, House of Representatives, 27 May 1981, 2683–2684 (The Hon John Howard, Treasurer). The Explanatory Memorandum to the Bill that inserted the part confirmed that it was not intended to apply to ‘arrangements of a normal business or family kind’: Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth), 3.

\textsuperscript{72} The case law supports the view that the dominant purpose is the ‘ruling, prevailing or most influential purpose’: \textit{FCT v Spotless Services Ltd} 96 ATC 5201, 5206. This is, notwithstanding that the Explanatory Memorandum to the Bill that inserted the part suggested a higher standard that the dominant purpose was one that outweighed all the other purposes put together: Income Tax Laws Amendment Bill (No 2) 1981 (Cth), cl 7.

\textsuperscript{73} \textit{Cooper Brookes (Wollongong) Pty Ltd v FCT} (1981) 11 ATR 949.

\textsuperscript{74} For example, see \textit{Case W58} 89 ATC 524.
distributions (especially to children and a non-working spouse) could only have been justified on tax minimisation grounds. This presented the Commissioner with a ready means to elude the dominance requirement of the tax avoidance purpose specified in the Part.

Initial opinions sought to avoid this result by suggesting that the scheme at issue had to encompass all the elements that hung together to form it. In fact, early case law gave some encouragement to this view, stating a test that the elements of the scheme identified by the Commissioner must be such that they were capable of standing on their own without being robbed of all practical meaning.\(^\text{75}\) The position established by subsequent case law on this point is problematic. While there is an acknowledgement, on one hand, that the terms of the legislation authorise the Commissioner to select out the elements of the scheme as he sees fit (and, indeed, he may allege differently defined schemes in the alternative), other cases have emphasised that in applying the Part to the scheme the context in which the scheme occurs has a bearing on determining what the dominant purpose was. Indeed, the latest High Court decision focusing on this point\(^\text{76}\) is unsatisfactory, with the various judges stating the requirement in different ways, leaving most commentators free to take whatever they wish from the case.\(^\text{77}\)

### B No Business Purpose Defence

Meanwhile, subsequent case law developments rejecting any overall business purpose defence (most famously \textit{FCT v Spotless Ltd})\(^\text{78}\) brought initial howls of derision from the tax advising community, accompanied even by some suggestions that it was now incumbent on taxpayers to select the form of a transaction that resulted in the greatest amount of tax payable. However, subsequent analysis of the facts of \textit{Spotless} by some commentators suggested that it had features of ‘a blatant, artificial or contrived scheme’, of which the then Treasurer had complained about some 15 years earlier.\(^\text{79}\) The judiciary, possibly fearing that they may have gone too far in rejecting a business

\[^{75}\text{FCT v Peabody 94 ATC 4663.}\]
\[^{76}\text{FCT v Hart 2004 ATC 4599.}\]
\[^{78}\text{96 ATC 5201.}\]
purpose defence, also retreated from too broad an application of Spotless in subsequent cases, and a dichotomy in the case law began to develop between artificial schemes that made no commercial sense in the absence of the tax benefits, where Part IVA was readily applied, and more commercial arrangements, where its application was less certain. So, on one hand, there have been cases where the application of the Part to what has become known as 'mass marketed schemes' was uncontroversial, while on the other hand, the establishment of business structures for asset protection purposes, sale and leaseback arrangements, stapled security capital raising arrangements, group finance company structures, pre-disposal reconstructions, and elements of a global reconstruction have all been held to be outside the reach of the Part.

C. Objective Test of Purpose

These cases have also confirmed that the test contained in Part IVA is a predication test, that is, it is the objective purpose of the scheme that is at issue and the taxpayer’s subjective purpose is irrelevant. Thus, the eight objective factors stated in s 177D(b) are the sole focus criteria with a view to determining what was the purpose of the scheme. These factors include the intention of a taxpayer’s adviser to the scheme, which anecdotal evidence suggests encouraged some ‘tax advisers’ to reinvent and

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80 The arrangements in these cases are often characterised by elements of non-arm’s length dealings, the ‘round-robin’ of funds, book entries effecting the scheme, and the lack of commercial sense but for the tax benefit. For example, see: FCT v Sleight 2004 ATC 4477, Pridecraft Pty Ltd v FCT; FCT v Spotlight Stores Pty Ltd 2005 ATC 4001, and FCT v Lenzo [2008] FCAFC 50. Contrast Cooke v FCT 2002 ATC 4937, where the otherwise suspect arrangement was saved by the fact that it was expected to make a commercial return to the investors irrespective of any tax advantage. Also see Citigroup Pty Ltd v FCT [2011] FCAFC 61, where an arrangement involving the acquisition of bonds and the subsequent sale of the right to receive the coupons on those bonds, structured to access foreign tax credits, was struck down due to its artificial air and the fact that it made no commercial sense absent the entitlement to the tax credits. Similarly, in British American Tobacco Australia Services Ltd v FCT [2010] FCAFC 130, Part IVA applied to a scheme to avoid capital gains tax on the disposal of a business by establishing circumstances where the taxpayer could avail itself of rollover relief. This is an unusual case, in which the broader purview of the relevant scheme actually damaged the taxpayer’s case rather than enhanced it.

81 Mochkin v FCT 2003 ATC 4272.

82 Eastern Nitrogen v FCT 2001 ATC 4164.

83 Macquarie Finance Ltd v FCT 2005 ATC 4829.

84 FCT v Ashwick (Qld) No 127 Pty Ltd [2011] FCAFC 49.

85 Futuris Corporation Ltd v FCT [2010] FCA 935, FCT v AXA Asia Pacific Holdings Ltd [2010] FCAFC 134 (scrip-for-scrip rollover in lieu of sale), and RCI Pty Ltd v FCT [2011] FCAFC 104 (asset revaluation and dividend up prior to sale).

86 Noza Holdings Pty Ltd v FCT [2011] FCA 46.

87 FCT v Spotless Services Ltd 96 ATC 5201, 5210.

88 Viewed in a holistic way, without any need to prioritise between them or detail any respective weights to be attached to each factor: for example, see FCT v Consolidated Press Holdings Ltd (No 1) 99 ATC 4945, 4971.

89 The GAAR subsequently inserted in the goods and services tax legislation, whilst drawing on Part IVA, put this beyond doubt by stating that the question is as to the sole or dominant purpose or the principal effect of the scheme: A New Tax System (Goods and Services Tax) Act 1999, div 165.

90 FCT v Consolidated Press Holdings Ltd (No 1) 2001 ATC 4343, 4360.
market themselves as ‘business consultants’ in an attempt to avoid an adverse inference being drawn from their engagement.91

D The ‘Alternative Postulate’ Issue

More recently the primary issue that has emerged with the application of Part IVA has become known as the ‘counterfactual’ or ‘alternative postulate’ issue. This arises by virtue of the way in which the definition of ‘tax benefit’ is couched. For example, a tax benefit arises by virtue of s 177C(1)(a) where an amount is not included in the assessable income of a taxpayer where it might have reasonably been expected to have been included but for the scheme. Thus, this requires a consideration of the alternative ways in which a transaction might have been carried out, and requires the taxpayer — on whom the onus of proof rests — to demonstrate that, while there may have been a number of plausible (not merely possible)92 alternative ways of effecting the transaction, the tax outcomes would have been the same.93 The enquiry will typically resolve itself in the taxpayer seeking to establish that the alternative postulated by the Commissioner is not a reasonable alternative.94

It is in relation to this enquiry that there is often disagreement amongst the judiciary,95 and on this point reasonable people will often reasonably disagree: hardly much consolation for a taxpayer seeking some certainty in the application of the tax laws. On some occasions, the Commissioner’s alternative postulate will be rejected by the courts as unreasonable in that no reasonable business person would adopt such an approach given the tax cost should alternatives exist.96 In fact, it has proven to be a source of irritation to the Commissioner that taxpayers have sometimes successfully been able to argue that the only reasonable alternative to the transaction they effected would have been to have done nothing, in which case no assessable income would have been derived, and so no tax benefit within the terms of s 177C(1)(a) had arisen by virtue of the scheme.97 The Government had announced in 1999 its intention to remove the

91 Note that the part is triggered where it could be concluded that a person who entered into or carried out the scheme did so for the specified purpose, and this person need not be the taxpayer obtaining the tax benefit: Grollo Nomonees Pty Ltd v FCT 97 ATC 4585 and De Simone v FCT [2009] FCAFC 181.
92 See FCT v Peabody 94 ATC 4663.
93 Not that the alternatives themselves may have amounted to unacceptable tax avoidance schemes: discussed in Cooper, above n 1; see also Dabner and Burton, ‘Hart – the death of tax planning?’, above n 77, and Futuris Corporation Ltd v FCT [2010] FCA 935.
94 See, for example, Futuris Corporation Ltd v FCT [2010] FCA 935 and FCT v AXA Asia Pacific Holdings Ltd [2010] FCAFC 134, although note RCI Pty Ltd v FCT [2011] FCAFC 104 (discussed below), where the Full Federal Court has cast doubt on this way of describing the issue seemingly downplaying the onus on the taxpayer.
95 For example, see Hill J at first instance in Macquarie Finance Ltd v FCT 2004 ATC 4866, where his Honour also acknowledged the interpretative uncertainties with the part following the then most recent High Court decision in FCT v Hart 2004 ATC 4599.
96 For example, see RCI Pty Ltd v FCT [2011] FCAFC 104.
97 Ibid, where one of the alternatives postulated by the taxpayer – and accepted by the Court – was that they would not have proceeded with the transaction (ie would have done nothing) had the only way to effect it been in the form proposed by the Commissioner.
availability of the 'would have done nothing' argument but no amendment has been forthcoming.\(^{98}\)

By way of further illustration of the alternative postulate principle, a tax benefit also arises by virtue of s 177C(1)(b) where a deduction is available to a taxpayer where it might have reasonably been expected not to have been available but for the scheme. Again, this requires a consideration of whether the taxpayer might have reasonably achieved a deduction from an alternative transaction. There is some dispute in the case law as to whether any alternatives postulated by the taxpayer must result in a deduction of the same or similar kind.\(^{99}\) If the deduction must be of the same kind then it might be more difficult for a taxpayer to avoid the finding that a tax benefit exists.

The most recent decision on the alternative postulate principle is the Full Federal Court decision in RCI Pty Ltd v FCT.\(^{100}\) The issue was whether the taxpayer had achieved a tax benefit within the meaning of Part IVA when it sold its shareholding in a foreign subsidiary to another company within the corporate group as part of a restructuring. Prior to the sale, it had arranged for the subsidiary to revalue its assets and pay up a (non-taxable) dividend, thereby reducing the value of the shares to be sold, and hence the amount of assessable capital gain derived on the sale. At first instance, the Trial Judge rejected the taxpayer’s argument that the Commissioner’s alternative postulate of selling the shares without the asset revaluation and dividend strip was unreasonable, the taxpayer having suggested that the true reasonable postulate was that it would have done nothing rather than crystallise a massive tax liability. However, this decision was reversed by the Full Federal Court on the basis that the true enquiry is not whether the taxpayer had proved that the Commissioner’s alternative was unreasonable but rather what the taxpayer might have reasonably been expected to have done had it not entered into the scheme. The Court was of the view that, given the size of the potential tax liability from a straight share sale, ($207 million or 15% of market capitalisation) this compelled the conclusion that there was ‘no possibility, let alone an expectation’ that the sale would have taken place in the form suggested by the Commissioner.\(^{101}\) In the event that they were wrong on this point, their Honours also examined the issue of the dominant purpose of the arrangement, concluding that they could not be satisfied that it was to obtain any suggested tax benefit. Notably their Honours in RCI acknowledged the inherent uncertainty in the outcome in Part IVA cases, suggesting that this criticism should be directed at the architecture of the legislation rather than the processes of the court.\(^{102}\)


\(^{99}\) Contrast the differently constituted Full Federal Court decisions of *FCT v Trail Bros Steel & Plastics Pty Ltd* [2010] FCAFC 94 (need not be of the same kind) and *FCT v Lenzo* [2008] FCAFC 50.

\(^{100}\) [2011] FCAFC 104.

\(^{101}\) Ibid, 145. For a similar reaction by the courts to the Commissioner’s very tax ineffective alternative postulate see *FCT v News Australia Holdings Pty Ltd* 2010 ATC 20–191. Thus, there is a tension here that the Commissioner is required to assert a less tax effective reasonable alternative postulate in order to establish a tax benefit, but if it is too tax ineffective, then the court may conclude that it was, in fact, not reasonable: discussed in Cooper, above n 1. Cooper suggests that this new battleground for Australian Part IVA cases has witnessed experts playing an increasing role opining on what was commercial (normal) or plausible.

\(^{102}\) *RCI Pty Ltd v FCT* [2011] FCAFC 104, 140.
VI POSSIBLE LESSONS FOR THE INTERPRETATION OF THE RESPECTIVE GAARS

While the Australian and South African GAARs have different design features, the authors argue that there is a commonality in the essential elements, namely:

- there must be an arrangement (SA) or scheme (Aus);
- there must be a tax benefit amounting to less tax being paid;\(^\text{103}\)
- the avoidance arrangement or scheme must have been entered into for the sole or main purpose (SA) or dominant purpose (Aus) of obtaining a tax benefit; and
- with this determined by reference to specified factors (Aus) or if the arrangement was not normal or there has been a misuse or abuse of the provisions of the Act or (in a business context) the arrangement lacks commercial substance by reference to prescribed circumstances (SA).

It is clear that the greatest divergence between the two GAARs is in relation to the fourth element. However, upon delving deeper into the Australian case law, the differences may be more apparent than real.

Firstly, as noted above, a dichotomy has arisen within the Australian jurisprudence between schemes that make no sense but for the tax benefits and other arrangements that might be explained on more commercial or domestic considerations. Many of the failed schemes have involved promoters who mass market the arrangement. Typical features of these arrangements are that there is considerable doubt as to whether the taxpayer will generate a pre-tax return, the arrangement, or part of it, is effected by book entries or a round robin of funds, and there are non-arm’s length entities or transactions. In South African GAAR terms it could be said that such arrangements lack commercial substance.\(^\text{104}\) Interestingly, many of the criteria identified in ss 80C–80E as indicators of a lack of a commercial substance have been focused upon by the Australian courts upon a consideration of the factors mandated by s 177D(b). So, for example, whether the arrangement has a real effect on the financial position of the taxpayer, or some other consequence, is a factor made relevant by both sets of legislation.\(^\text{105}\) Similarly, a consideration of differences arising from the form and substance or the arrangement is expressly mandated by both GAARs.

The South African legislation is more prescriptive than the Australian. This may subsequently prove to be both a curse and a blessing, depending on whether the South

\(^{103}\) Although see above n 61.

\(^{104}\) Although it is to be observed that many of the Australian mass marketed schemes do not occur in a business context and so the commercial substance element of the South African GAAR would not strictly be relevant. The rationale for the restriction of this element to the business context is questionable. Indications of the reason for this restriction may be evident in the 2005 Discussion Paper, in which SARS describes the common characteristics of avoidance schemes. In this discussion, it is clear that SARS was particularly concerned with the trend that businesses were viewing the tax department as a ‘profit centre’, resulting in the increased use of avoidance schemes. Otherwise no express explanation has been provided for the restriction of Income Tax Act 1962 (SA) ss 80C, 80D, and 80E to arrangements within a business context.

\(^{105}\) Obvious examples caught by both sets of legislation would involve a round-robin of funds or some type of reimbursement agreement.
African courts feel constrained in referring to broader considerations. The benefit is in the greater guidance given to the courts. Indeed, while the Australian judiciary has readily focused on round robin financing (cf SA GAAR, s 80D) and offsetting and cancelling elements (cf SA GAAR, s 80C(2)), a detailed reference to ‘accommodating or tax-indifferent’ parties (cf SA GAAR, s 80E) has not been a consideration that has been necessarily focused on by the Australian courts. While the terms of s 177D(b)(vi) might conceivably encourage a consideration as to whether such entities are at play, no Australian case has, to the authors’ knowledge, yet made reference to such entities in its Part IVA deliberations. Certainly, the detail in s 80E assists in focusing the courts’ attention on the possible application of the GAAR in circumstances where a counter party to a transaction is tax-indifferent, and especially where they may be resident in a tax haven.

While the misuse/abuse limb of the South African GAAR has no express Australian equivalent, apparently being drawn from the Canadian provisions, it was observed earlier that commentators on the Canadian GAAR have questioned whether this element of their GAAR adds anything beyond the general legislative interpretative principles. In an environment where the dominant approach to statutory interpretation is to adopt a purposive approach, arguably arrangements directed at avoiding or inappropriately taking advantage of substantive provisions of the tax laws are less likely to be countenanced without the need to fall back on a GAAR. In fact, one of the authors has questioned elsewhere the need for a GAAR where an (expanded) purposive approach to interpretation (together with other legislative elements) is adopted.

The Australian judiciary has been inconsistent in its adoption of a purposive approach to the interpretation of tax statutes, with the less judicially active literal approach that prevailed in the 1970s and early 1980s still occasionally finding some support. Nevertheless, the case law is replete with examples of a purposive approach being adopted, typically acknowledging the application of a substantive provision to an

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106 The legislation specifically provides that it is stating a non-exclusive set of considerations.

107 Examples of Australian GAAR decisions where round robin financing was found to be a significant to the application of the provision include FCT v Sleight 2004 ATC 4477 and Pridecraft Pty Ltd v FCT; FCT v Spotlight Stores Pty Ltd 2005 ATC 4001. In a sense, the case of Citigroup Pty Ltd v FCT 2011 FCAFC 61 might also be viewed as having elements of an offsetting nature in that the taxpayer had essentially acquired foreign and bonds and sold the right to receive the coupons on the bonds in order to attract foreign tax credits. The acquisition and part disposal partially offset each other from the perspective of the taxpayer’s financial exposure.

108 The need to consider the application of the GAAR in such circumstances may be more paramount in South Africa than Australia given that the transfer pricing provision in Income Tax Act 1962 s 31(2) is more curtailed, its application being restricted to connected persons, whereas the Australian provisions have no such limitation: ITAA36 s 136.

109 See above n 56.


111 One member of the High Court has spoken out against judicial activism on a number of occasions, for example: Heydon, D, ‘Judicial Activism and the Death of the Rule of Law’ (2003) XLVII (1–2) Quadrant Magazine 9.
arrangement designed to circumvent it.\textsuperscript{112} This supports the view that a purposive approach could now be expressed as the predominant statutory interpretation rule adopted by Australian tax courts.

Given that the South African courts have had less hesitation adopting a purposive approach (at least since the 1996 Constitutional reforms),\textsuperscript{113} the insertion of the misuse/abuse limb should merely serve to reinforce the need, at least where an avoidance arrangement is established, to consider whether the arrangement seeks to defeat the purpose to which a substantive provision is directed. Ultimately, the approach adopted in both countries should be similar.

On an initial consideration, the ‘normality’ element would seem to be peculiarly South African and to have no Australian equivalent. Thus, an avoidance scheme entered into for the sole or main purpose of obtaining a tax benefit will be caught by the South African GAAR, where it was entered into by means or in a manner which would not normally be employed for bona fide (business) purposes other than to obtain a tax benefit or it created rights or obligations that would not normally be created by parties dealing at arm’s length. The difficulties encountered by the South African courts in ascertaining what is a normal arrangement were referred to in Parts II and III of this paper. It is now clear that just because the arrangement is commonly employed will not render it normal.\textsuperscript{114} However, it remains unclear to what extent the circumstances of the taxpayer can be taken into account in determining the dividing line between normality and abnormality, although the intent of the 2006 amendments was arguably to render the test solely objective. Similarly untested is the significance of the reference to bona fide (business) purposes. If the intention was to create a business purposes defence, then this is inconsistent with the approach that has been adopted in Australia. On the other hand, the insertion into the GAAR, by way of s 80H, of an acknowledgement that the Commissioner may apply the GAAR to parts of an arrangement might enable SARS to both elude the sole or main purpose criterion, and also thereby possibly play down the significance of any business purpose elements of an arrangement, as it was explained in Part IV of this paper is a feature of the Australian environment.

While the Australian legislation avoids an express carve out for ‘normal’ arrangements, this language has entered the Australian GAAR vernacular by virtue of both the second reading speech and explanatory memorandum that accompanied the introduction of the Bill that inserted Part IVA into the legislation. It was said that the provisions were not intended to apply to ‘ordinary’ or ‘normal’ business or family dealings. While these documents have been held to have only a limited relevance to the application of the Australian GAAR, the undertone remains.\textsuperscript{115} Arguably, where the sentiment has

\textsuperscript{112} One example is the decision at first instance in \textit{Macquarie Finance Ltd v FCT} 2004 ATC 4866, where Hill J held that ‘interest’ payments under a stapled securities arrangement were not deductible under the substantive provisions, but had they been, then Part IVA would have applied in any event.

\textsuperscript{113} Geldenhuys, above n 56, 91.

\textsuperscript{114} Compare the position established in Australia in the very first Part IVA case, \textit{Case W58 89 ATC 524}, in response to the argument relying on the second reading speech that an arrangement was a ordinary business or family dealing because it was commonly carried out.

\textsuperscript{115} Even though no Australian court has embraced the extrinsic material for the purpose of limiting the application of the part, the language in this material has found a place in Australian lore and practice. So,
manifested itself to the greatest extent, is in the identification of a tax benefit. As discussed above, this necessitates a comparison between the tax position achieved under the scheme and the tax position that would have been achieved had alternative reasonable arrangements been adopted (the alternative postulate). In the terms of the legislation, it requires a consideration of how the taxpayer might reasonably have been expected to have structured the transaction. Put this way, the similarities with the normality question in South Africa are obvious. Inherent, therefore, in the Australian GAAR is an implicit consideration as to whether the transaction engaged in by the taxpayer is normal in the sense of being a reasonable commercial response to the circumstances. As illustrated in Part IV, this aspect of the application of the Australian GAAR has been especially plagued with doubt, with reasonable people reasonably disagreeing.

If our analysis is correct, and the two GAARs have essentially the same purview, then the considerable Australian case law on Part IVA should be of value in giving some indication of the circumstances in which the South African GAAR should have an application. This case law might also assist in some interpretative issues. Thus, it could be suggested that a ‘no overall business purpose’ defence should be available in South Africa, notwithstanding aspects of s 80A, and especially because of s 80H. Furthermore, the test should be solely objective: a consideration of what was the purpose of the arrangement by reference to objective factors, rather than a consideration as to the taxpayer’s subjective purpose. And while the existence of four elements that are more prescribed than the more generally drafted the three Australian elements, might initially at least found a concern that the South African GAAR could continue to be weakened, the overall similarities with the Australian position might alleviate these fears.116

Finally, from an Australian perspective, while there is as yet no South African jurisprudence on the GAAR to which to refer, the legislation is much more prescriptive than the Australian GAAR, the lack of which provides very little guidance for the courts. While many of the issues associated with the interpretation of the Australian provisions have now been resolved, nevertheless the detail in the South African GAAR on circumstances where the lack of commercial substance could be presumed might be usefully referred to in future Australian GAAR cases or, possibly more likely, in amendments to the provisions to differentiate between those arrangements with a contrived and artificial flavour and those less likely to be impugned by the legislation. Certainly, Australian jurisprudence referring to round robin elements and transfers by book entries already exists. However, the express recognition of ‘accommodating or tax-indifferent’ parties, together with the extensive definition of these terms, might provide a valuable reference point for Australian judges.

for example, there is a compact between the ATO and taxpayers that salary sacrifice arrangements are not impugned by the legislation: but see Yip v FCT 2011 ATC 10–214, discussed in Dabner, J, ‘Yippy Yi Yo (An analysis of Yip’s case)’ (2011) CCH tax Week Issue 46 [1048].

116 The authors acknowledge the limitations in transplanting principles developed in a different statutory and social context, but nevertheless suggest that, in a global environment where tax law harmonisation is increasingly being seen as important, a consideration of the approach adopted in similar foreign jurisdictions is appropriate.
VII Conclusion

The global phenomenon of tax avoidance shows no sign of abating. With the emergence of a global community, even larger multinational conglomerates and more sophisticated transactions, the risks for national treasuries are growing. Governments have responded with more complex and robust tax legislation. Typically a GAAR is part of the arsenal that is employed, often appearing as the centre piece. Both Australia and South Africa have sought to counter tax avoidance in this way. However, the GAAR has been no magic bullet and both countries have had to respond to its limitations and seek to enhance its robustness. Over the last two decades, success in the courts has demonstrated that the post-1981 Australian GAAR has been up to the challenge. Meanwhile, the South African Government has had to continue to tinker with its provision in an effort to address inadequacies. The last amendments were in 2006, but in the absence of case law since then, it is unclear whether these were effective.

A comparison between the two sets of provisions reveals considerable design differences. However, on closer analysis, and with the aid of the Australian case law, the differences might merely be cosmetic. If so, the Australian case law may afford some insight into the nature of the arrangements that the South African GAAR might subsequently impugn, and how it might be applied. In particular, it is conceivable that it could have an application premised on purely objective factors and will not be curtailed by an overall business purposes defence.

Given that the Australian jurisprudence appears to have distinguished between schemes with no true commercial substance (which are readily struck down) and those with a more commercial motivation, the prescriptive elements in the South African GAAR illustrating circumstances where a lack of commercial substance can be presumed could be of assistance in guiding the application of the Australian GAAR in future cases. In particular, the focus on round trip financing, offsetting and cancelling elements, and ‘accommodating and tax-indifferent’ parties could be referred to by the Australian courts in their identification of relevant considerations.

Finally, the difficulties that continue to be encountered by the Australian judiciary in establishing a bright line rule in the application of the ‘alternative postulate’ principle do not bode well for any clarification in South Africa of the ‘normality’ principle. On the other hand, some clear South African jurisprudence identifying parameters to distinguish between normal and abnormal transactions might, therefore, be equally welcomed in Australia.