Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada

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Abstract

General anti-avoidance rules (GAARs) are rules in income tax legislation intended to curtail impermissible tax avoidance. GAARs have another critical function, namely informing taxpayers of the limits of permissible tax avoidance. A GAAR is therefore an important provision which must be effective. A study of the historical and current experience with GAARs in South Africa, Canada, and Australia, however, shows that the efficacy of GAARs is limited. The GAARs of the countries studied show some similarities but also some fundamental differences. In spite of these differences, certain common factors working against the efficacy of these GAARs can be identified. It is argued that these factors entail the inherent weakness of GAARs, controversial indicators of impermissible tax avoidance, uncertainty, the role of the judiciary, taxpayer aggression, and the limitations of the law as a weapon against impermissible tax avoidance. Admittedly, some of these limiting factors are difficult to overcome. For instance, a precise definition of impermissible tax avoidance has proved elusive and this *status quo* is likely to persist. Nevertheless, it is argued that these factors need to be acknowledged and addressed in order to create more effective GAARs in future.

INTRODUCTION

In tax law, the term 'general anti-avoidance rule' (GAAR) is self-explanatory. It refers to a provision in tax legislation which regulates tax avoidance by defining transactions which are prohibited in the avoidance of tax. Tax avoidance can be seen as a continuum that stretches from

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permissible tax avoidance to impermissible tax avoidance. Permissible tax avoidance is the avoidance of tax in a manner that is consistent with statutory purposes and the limits imposed by a GAAR. Impermissible tax avoidance, on the other hand, is tax avoidance that is inconsistent with statutory purpose and is forbidden by a GAAR. What is unclear, however, is the line between the two.

The fact that not all tax avoidance is impermissible means that part of a GAAR's core function is to strike down impermissible tax avoidance, and to inform taxpayers of the limits of permissible tax avoidance.[1] A GAAR, therefore, serves a complex function, namely to target one form of tax avoidance (impermissible tax avoidance) while simultaneously honouring another form (permissible tax avoidance). Implicit in the definition of a GAAR above, is the significant role it plays in a tax system. A GAAR protects the tax base from impermissible tax avoidance and its many harmful effects.[2] It also plays a significant role in determining the extent to which taxpayers can avoid tax. It is therefore imperative that a GAAR is effective in fulfilling its key roles. An analysis of the historical and current GAARs in South Africa, Australia, and Canada, however, shows that GAARs have not always been effective in this regard.

Referring to international experience with GAARs, Cooper notes that

> [t]he history [of GAARs] tells a curious story. There are, as tax advisers always asserted there would be, the unexpected hits on targets that were never envisaged. More interestingly, there are the expected hits that did not eventuate. In other words, a GAAR can be a "loose canon" on the tax ship of State, injuring friend and foe alike. But the history shows that on balance the experience with a GAAR does not support the worst fears of tax advisors, just as it has not proved to be the panacea for revenue authorities.[3]

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1 See generally *CIR v BNZ Investments* 2002 1 NZLR 450.

2 According to the *SARS Discussion Paper on Tax Avoidance and Section 103(1) of the Income Tax Act 1962* (2005) 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 (last accessed 10/11/2014) at 9, these harmful effects entail revenue loss, inequality, complication of the tax laws, the creation of impunity for the tax laws, discouraging taxpayer compliance and a significant limitation of the government's ability to implement economic policies through taxation.

3 Cooper 'International experience with general anti-avoidance rules' (2001) 54 *SMU Law Review* 83 117.

This article analyses former and current GAARs in South Africa, Australia, and Canada, and identifies factors that have limited their efficacy. It is argued that if more effective GAARs are to emerge, these factors need to be considered in the drafting of new GAARs in these countries.

THE SCOPE AND STRUCTURE OF GAARs IN SOUTH AFRICA, AUSTRALIA, AND CANADA

The structure of first-generation GAARs

Of the countries analysed in this article, only South Africa and Australia have a significant history with GAARs. In South Africa, the first GAAR appeared in section 90 of the Income Tax Act[4] (section 90), and the second in section 103(1) of the Income Tax Act[5] (section 103(1)). In Australia, section 260 of the Income Tax Amendment Act[6] (section 260) was one of the first GAARs. Section 260 was preceded by a similarly worded section 53 in the Commonwealth Income Tax Act (Cth).[7] It has been stated that section 53 was itself preceded by similar sections in the Commonwealth Land Tax Assessment Act (Cth),[8] the Income Tax Act (Vic),[9] and the Land and Income Tax Act (NSW).[10]

Of the historical GAARs identified above, section 90 and section 260 in South Africa and Australia, respectively, are analysed. Section 90 provided as follows:

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

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4 31 of 1941.
5 58 of 1962 (the Act).
6 1936 (ITAA).
7 1915.
8 1910.
9 1895.
10 1895. See Pagone *Tax avoidance in Australia* (2010) 24.

Section 260 in Australia provided as follows:

> Every contract, agreement or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the effect of in any way, directly or indirectly–
> a. altering the incidence of any income tax;
> b. relieving any person from liability to pay any income tax or to make any return;
> c. defeating, evading or avoiding any duty or liability imposed on any person by this Act; or
> d. preventing the operation of this Act in any respect; and
> e. be absolutely void as against the Commissioner, or in regard to any proceeding under this Act but without prejudice to such validity as it may have in any other respect or for any other purpose.

These two GAARs share a fundamental similarity: both targeted all tax avoidance transactions without distinguishing between the permissible and impermissible. For a transaction to fall foul of these GAARs, all that was required was a purpose to avoid tax. It is clear that a taxpayer who wishes to avoid tax, does so intentionally, and instances where tax is avoided by chance are rare, if they arise at all. These GAARs could, therefore, apply to any transaction in that an intention to avoid tax is shared by all forms of tax avoidance.

The structure of modern GAARs

The era of wide GAARs was followed by an era of GAARs that were more focused on impermissible tax avoidance. In South Africa, section 90 was amended by section 17 of the Income Tax Act.[11] After this amendment section 90 effectively targeted transactions with the following characteristics:

- a transaction, operation or scheme;
- tax benefit;
- purpose; and
- abnormality as indicated by any one of the below:
  i) the transaction, operation or scheme had to be entered into or carried out by means or in a manner that would not be employed when entering into a similar transaction, operation, or scheme;
  ii) the transaction, operation or scheme has created rights or obligations which would not normally be created between persons dealing at arm's

[11] 78 of 1959.

length under a transaction, operation, or scheme of the transaction, operation or scheme in question.

When the Act was introduced to replace the 1941 Act, section 90 was replaced by section 103(1) of the Act. Section 103(1) of the Act basically adopted the provisions of section 90 as amended. Section 103(1) of the Act was amended in 1996. These amendments were made to the abnormality provision. After this amendment section 103(1)(i)(aa) of the Act provided that a transaction, operation, or scheme in the context of business, would be abnormal if it was entered into or carried out 'in a manner which would not normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit'.

Section 103(1) of the Act was itself replaced by section 80A – L of the Act.[12] This GAAR is currently in force in South Africa and will apply if the following have been established:

- an arrangement;
- a tax benefit;
- a sole or main purpose to avoid tax; and
- any one of the following tainted elements:
  - i in the context of business the tainted elements are as follows:
    - a. the arrangement must be entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit;
    - b. the arrangement must lack commercial substance, in whole or in part, taking into account the provisions of section 80C;
  - ii in any context that is not business the tainted elements are as follows:
    - a. the arrangement must have been entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit;
  - iii in any context (which also includes business or any context that is not business) the tainted elements are as follows:
    - a. the arrangement must have created rights or obligations that would not normally be created between persons dealing at arm's length; or

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[12] The GAAR was inserted by section 34(1)(a) of the *Revenue Laws Amendment Act* 20 of 2006. This GAAR applies to transactions entered into or carried out after 2 November 2006.

b. the arrangement must result directly or indirectly in the misuse or abuse of the provisions of this Act including the provisions of the GAAR.

The South African GAAR defines impermissible tax avoidance broadly depending on the context in which the arrangement exists.

In Australia section 260 was replaced by section 177A – G of the Income Tax Assessment Actof 1936 (the ITAA) after it which makes up Part IVA of the ITAA.[13] Part IVA is the current GAAR in Australia. This GAAR targets schemes with a tax benefit and a sole or dominant tax-avoidance purpose. This tax-avoidance purpose is determined objectively by reference to eight factors listed in section 177D(b) of the ITAA. The Australian GAAR thus identifies impermissible tax avoidance as schemes with an objective sole or dominant purpose of avoiding tax. Taxpayers can rely on the defence in section 177C(2) of the ITAA if their schemes are consistent with statutory purposes. In terms of this section, a tax benefit does not include tax benefits obtained by the exclusion of income from taxable income if this exclusion is attributable to, *inter alia*, the exercise of an option expressly provided for by the Act. Section 177C(2)(ii) of the Act qualifies this provision and states that it shall not apply where the taxpayer artificially creates the circumstances or conditions necessary to enable compliance with the provisions relied on to obtain the tax benefit.

In Canada the GAAR is found in section 245 of the Income Tax Act.[14] This GAAR is the first and only Canadian GAAR to date. It targets transactions with the following elements:

- an avoidance transaction;
- a tax benefit that arises from the avoidance transaction; and
- direct or indirect misuse or abuse of the provisions of the Canadian Income Tax Act (CITA).

The third element of the Canadian GAAR is based on section 245(4) of the CITA. This section provides that the GAAR will 'not apply to a transaction where it may reasonably be considered that the transaction would not result

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[13] Part IVA was added into the ITAA by the Income Tax Laws Amendment Act (No 2) of 1981. This amendment removed s 260 by providing that it would not apply to schemes or transactions entered into after 27 May 1981.

[14] RSC 1985 c 1 (5th Supp) (CITA).

directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.'

From the above it can be seen that the GAARs in the three countries analysed have three common elements: the transaction; the tax benefit; and the tax purpose. The 'transaction' is defined differently in the three countries.

In South Africa it was initially defined as transaction, operation, or scheme in section 103(1). In the current South African GAAR, it is referred to as an 'arrangement' which, in turn, is defined in section 80L of the Act as 'any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property.' In Australia it is referred to as the 'scheme', while in Canada it is known as the 'avoidance transaction'.

These common elements provide a starting point in the application of the GAARs studied. The elements are, however, insufficient to establish impermissible tax avoidance because they are universal to tax avoidance in general in that permissible tax avoidance transactions also involve transactions with a tax benefit and a tax purpose.

After providing for the basic structure of tax-avoidance transactions, each of the GAARs analysed takes a different direction in identifying impermissible tax-avoidance transactions. This is what differentiates these GAARs from the historical GAARs discussed above. In South Africa, impermissible tax avoidance transactions are those characterised by the tainted elements which involve abnormality, the absence of commercial substance, and misuse or abuse. In Australia Part IVA of the ITAA provides that impermissible tax avoidance consists in transactions that have a sole or dominant purpose of avoiding tax. In Canada, section 245 of the CITA provides that impermissible tax avoidance transactions are those that avoid tax in a manner that misuses or abuses the provisions of the CITA.

The Experience with historical and modern GAARs

The experience with GAARs in the countries studied has been characterised by failure, limited success, or controversy as will be shown below through a country-by-country discussion of the countries' respective experience.

In South Africa, the wide section 90 of the 1941 Act was only invoked in one major case: *CIR v King*.[15] Here the court dismissed the Commissioner's challenge and interpreted section 90 restrictively. Section 103(1) of the Act had a better record, even though some commentators have alluded to the fact that this section polarised opinion regarding its efficacy[16] The Commissioner was unsuccessful in some half the major cases in which section 103(1) was invoked.. These cases are *CIR v Geustyn, Forsyth and Joubert*,[17] *SIR v Gallagher*,[18] *Hicklin v SIR*[19] and *CIR v Conhage (Formerly Tycon) (Pty) Ltd.*[20] When section 103(1) of the Act was replaced by the current GAAR in section 80A–L of the Act, it was stated in relation to this section that

> the GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance that certain advisors and financial institutions are putting forward and some taxpayers are implementing. In addition it has become clear that the GAAR has not kept up with international developments. Finally, uncertainty has arisen with respect to the application of the GAAR in the alternative due to the conflicting court decisions in this regard.[21]

Regarding section 80A–L, it must be stated that this is a relatively new GAAR which has to date attracted no case law. This GAAR has, however, proved controversial because of the uncertainty it creates. According to Broomberg,[22] the breadth and uncertainty of this GAAR is such that it 'is now in an even more vulnerable condition. One can therefore anticipate a hostile judicial reaction and this could prove costly to the *fiscus.'*

In Australia, the restrictive interpretation of the wide section 260 led to failure in a series of cases.[23] The experience with this GAAR can be said to

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15 1947 2 SA 196 AD.

16 Kruger and Scholtz *Broomberg on tax strategy* (2003) 229.

17 1971 3 SA 567 (A).

18 1978 2 SA 463 (A).

19 1980 1 SA 481 (A).

20 1999 4 SA 1149 (SCA).

21 *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006 (Explanatory Memorandum)* 62.

22 Broomberg 'Then and now – IV' (2008) 22 *Tax Planning* 31 32.

23 See par 3.4 below. After the period in which the court restricted the scope of section 260 this section did experience a partial revival. In *Federal Commissioner of Taxation v Student's World (Aust) Pty Ltd* (1978) 8 ATR 356 Mason J attempted to reverse this restrictive interpretation by stating that '[a]lthough the traditional rule has been that clear words are required to impose a tax, so that the taxpayer has the benefit of any doubts or ambiguities, a provision introduced by way of an attack on tax avoidance should be given

be a classic example of how the courts can restrict the scope of a wide GAAR. Its successor, Part IVA, has had more success in the courts. The first case on Part IVA was *Federal Commissioner of Taxation v Peabody*[24] which resulted in a loss for the Commissioner. However, two years later the Commissioner successfully invoked Part IVA in *Federal Commissioner of Taxation v Spotless Services Ltd.*[25] Other cases in which Part IVA has been successfully invoked include *Federal Commissioner of Taxation v Hart;*[26] *Federal Commissioner of Taxation v Consolidated Press Holdings Limited;*[27] *Spotlight Services Pty Ltd v FCT;* and[28] *Cumins v Federal Commissioner of Taxation.*[29] According to Evans: [30]

> After Peabody, the High Court has subsequently heard three cases (Spotless, Consolidated Press Holdings and Hart) relating to the application of Part IVA. In addition there have been many cases on Part IVA heard in the lower Federal and Full Federal Courts. The Commissioner has enjoyed success in most of these Part IVA cases. In particular, outright High Court victory in Spotless and in Hart, and partial success in Consolidated Press Holdings, has provided the Commissioner with a weapon of mass destruction that is

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the wide meaning evidently intended; it should not be cut down in the interests of precision.' This revival however came too late and section 260 was replaced by Part IVA in 1981.

24 (1994) 181 CLR 359.

25 1996 34 ATR 183. In this case the taxpayer made use of a complex scheme which had commercial purposes in order to obtain a tax benefit. The court stated that the elaborate nature of the transaction was more indicative of a tax avoidance purpose than a commercial purpose. It was stated at 194 that the 'attendant circumstances of the scheme led 'inevitably to the conclusion that the scheme was not merely tax driven but that its purpose was to enable the taxpayer to obtain a tax benefit by participating in the scheme.' The potential effect of Part IVA on commercial transactions with a tax avoidance effect was notable after this case. The decision in this case was however supported by Michael Carmody, then Federal Commissioner in 1997 in his speech titled 'Part IVA – Where to Draw the Line' delivered at the 13th National Convention of the Taxation Institute of Australia, see: http:// www.ato.gov.au/corporate/content.asp?doc=/content/00105535 (last accessed 21.10 2012). An approach similar to the one in *Spotless Services Ltd* was adopted in *Federal Commissioner of Taxation v Consolidated Press Holdings* (2001) 207 CLR 235. In this case the court noted at 264 that '[t]he fact that the overall transaction was aimed at a profit making does not make it artificial and inappropriate to observe that part of the structure of the transaction is to be explained by reference to a s177D purpose'.

26 2004 55 ATR 712.

27 2001 207 CLR 235.

28 2004 55 ATR 745.

29 2007 66 ATR 57.

30 Evans 'The battle continues: recent Australian experience with statutory avoidance and disclosure rules' on www.sbs.ox.ac.uk/sites/default/files/Business.../2007/evans.pdf (last accessed on 10/11/2014).

> not only perceived to be a potential threat, but which actually is a powerful threat.

This success cannot, however, conceal the controversy that characterises Part IVA. Certain commentators have expressed reservations about the potential of Part IVA to affect commercial transactions with a tax-avoidance effect. In this regard, Orow[31] notes that '[i]f Pt IVA is considered to be directed at transactions which can truly be described as tax avoidance, being transactions which result in a tax benefit contrary to the purpose and policy of the Act, then its presence in the Act cannot be justified.' To support this contention he argues that:

> [I]t is necessary to read down Part IVA in order to provide for the intended operation of the ordinary and charging provisions of the Act. It is submitted that the interpretation of Pt IVA by the High Court in *Spotless* cannot stand because it leaves the provision with an undefined broad operation that is not conducive for certainty and consistency. *Spotless* is as it were 'as good as it gets' and it is predicted that the ordinary operation of the legal system and the doctrine of precedent would ultimately prove to be a major force that militates against such breadth, leading to the gradual reduction in its scope. It is neither inconceivable nor should it be surprising that Pt IVA may suffer the same fate as that of its predecessor s 260.

In Canada, section 245's early existence was characterised by some adverse comments made by certain judges in certain Canadian tax court cases. In *Jabs Construction v Canada*,[32] the court noted that a GAAR is an 'extreme sanction'. In *Hill v The Queen*, it was noted that the GAAR is the 'ultimate weapon',[33] while in *Canada Trustco Mortgage Company v The Queen*,[34] it was noted that the GAAR is 'tax legislation to be applied with utmost caution.' In *Fredette v The Queen*,[35] it was stated that '[s]ection 245 is a powerful tool for discouraging and preventing flagrant abuses of the Act. It cannot serve as a tool for the Minister to force taxpayers to structure their

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31 Orow 'Part IVA: seriously flawed in principle' (1998) 1 *Journal of Australian Taxation* 57 at: http://www.buseco.monash.edu/blt/jat/1998-issue1-orow.pdf (last accessed 10 November 2014). Also see Dabner 'The spin of a coin – in search of a workable GAAR' (2000) 3 *Journal of Australian Taxation* 232 at http://www.austlii.edu.au/au/journals/JATax/2000/15.html (last accessed 10 November 2014).

32 99 DTC 729 (TCC) par 48.

33 [2003] 4 CTC 2548 par 68.

34 [2003] 4 CTC 2009 par 77.

35 [2001] 3 CTC 2468 par 76.

transactions in the manner most favourable to the tax authorities.' According to Arnold,[36] 'these statements suggest clearly that some judges regard the GAAR with considerable suspicion and that, because of its nature, they see their role in a fundamental sense as one of limiting its application.' These statements also show the controversy created by the Canadian GAAR.

FACTORS THAT LIMIT THE EFFICACY OF GAARS

An analysis of the experience with the GAARs in the countries considered shows that certain factors have worked and continue to work against these GAARs. This section will establish and explain these factors.

The inherent weakness of GAARs

It has been stated that a GAAR is enacted to target impermissible tax-avoidance transactions. Impermissible tax avoidance has, however, never had a universally accepted definition or been defined with precision. The fact that the GAARs in the three countries mentioned above identify impermissible tax-avoidance differently, reinforces the notion that there is no universally acknowledged definition of impermissible tax avoidance. Apart from the diversity in defining impermissible tax avoidance, '[n]o country has yet succeeded or is likely to succeed, in framing its tax laws in such a way that it is clear how tax liability will be calculated on any conceivable set of facts.'[37] The fact that there is no clarity on the precise constituents of impermissible tax avoidance means that GAARs are drafted without precision as to what they will target. In this regard, Cooper notes:

> What can and ought to be the focus of anti-avoidance rules? And more importantly...can text be drafted which can still be called a rule, but for which there is no clear target, and, what is worse, not even agreement on what the target should be? How can the drafter prepare a weapon against something that in the opinion of some cannot be adequately defined and certainly cannot be defined *ex ante*? [38]

This is an inherent weakness in GAARs which may not be corrected by finding a precise definition alone as this definition must still be expressed in a clear legislative provision. As Cooper notes, '[d]eciding what are the

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[36] Arnold 'The long, slow steady demise of the general anti-avoidance rule' (2004) 52 *Canadian Tax Journal* 488 491.

[37] Wheatcroft quoted in Cooper 'Conflicts, challenges and choices – the rule of law and anti-avoidance rules' in Cooper (ed) *Tax avoidance and the rule of law* (1997) 13 13.

[38] *Id* at 26.

distinguishing features that go to make up tax avoidance is an enormously difficult task, even before one even attempts the task of expressing that idea in writing in a law.'[39]

It can be argued that the absence of a precise and universally accepted definition of impermissible tax avoidance has led to the creation of wide GAARs, for example section 90 of the 1941 Act, and section 260 of the ITAA in South Africa and Australia, respectively. These GAARs failed, and similar GAARs cannot now be enacted because, *inter alia*, taxpayers have a right to avoid tax. This right is acknowledged in many jurisdictions including South Africa,[40] Australia,[41] the United Kingdom,[42] and Canada.[43] In the United States, in the case *Gregory v Helvering*[44] – described as one of

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39 *Id* at 27.

40 *CIR v Estate Kohler and Others* (1953) 18 SATC 354 361 where Centlivres CJ stated that '[i]t is true that the device adopted was designed in order to escape death duties, but it has long been a well recognised principle of law that a person may so order his affairs to escape taxation'. Also see *Hicklin v SIR* n 19 above at 494F–G and *CIR v Conhage* n 20 above at 1155G.

41 See generally *IRC v Duke of Westminster* 19 TC 490 511 520, *IRC v Fisher's Executors* [1926] AC 395 (HL) 412, *Craven (Inspector of Taxes) v White and Related Appeals* [1988] 3 All ER 495 500, *IRC v Wesleyan Assurance Society* [1948] 1 All ER 555 (HL) 557 and *IRC v Brebner* [1967] 1 All ER 779 784.

42 See generally *Eastern Nitrogen v Commissioner of Taxes* (2001) 46 ATR 474 and *FCT v Metal Manufacturers* [2001] FCA 365 and Krever 'The ghost of the Duke of Westminster laid to rest in Australia?' 1997 *Canadian Tax Journal* 122. In *Spotless Services Ltd* n 25 above at 186, the court apparently dismissed the reference to the so called *Duke of Westminster* principle and stated that '[p]art IVA is to be construed and applied according to its terms, not under the influence of muffled echoes of old arguments concerning other legislation'. The court at 188 however referred to two US cases namely *CIR v Brown* 1965 380 US 563 579 – 580 and *Frank Lyon Co v United States* 435 US 561 580 when acknowledging the right to avoid tax.

43 See generally *Shell Canada Products Ltd v Her Majesty The Queen* [1999] 3 SCR 622, *Lipson v Canada* 2009 SCC 1 par 21 and *Canada Trustco Mortgage Company v Canada* 2005 SCC 54 par 31. According to Krishna *The fundamentals of Canadian income tax* (2002) 849 'It is a fundamental principle of Canadian tax law that a taxpayer is entitled to arrange his or her affairs to minimise tax'. Honourable John Mackay, secretary to the Minister of Finance in 2004 as quoted in Quoted in Kearl and Lemons 'GAAR in the tax court after C*anada Trustco*: a practitioner's guide' (2007) 55/4 *Canadian Tax Journal* 745 747 stated in support of this right that '[e]veryone in this country is entitled to arrange his or her affairs...or his or her company's affairs to avoid taxes, to minimise the impact of taxes. That is lesson number one in law school and accounting school. Tax avoidance is an expectation on the part of government and taxpayers are entitled to arrange their affairs accordingly'. Also see Trombitas 'The conceptual approach to tax avoidance in the 21st Century: when the statute gives but the GAAR can take away' (2009) 15/4 *New Zealand Journal of Taxation Law and Policy* 353 412

44 69 F 2d 809 810.

the most cited tax cases ever,[45] Judge Learned Hand stated that '[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes or altogether avoid them, by means which the law permits cannot be doubted'. Further affirmation of the taxpayer's right to avoid tax in the United States can be found in *Commissioner v Newman*[46] where Judge Learned Hand stated

> [o]ver and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands, taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

The existence of this right means that GAARs cannot simply circumvent the problems associated with the absence of a precise definition of impermissible tax avoidance, by outlawing all tax avoidance. This right also means that a GAAR must be capable of informing taxpayers of the extent of their right to avoid tax. This is an essential requirement for a GAAR, and yet it complicates its role because it means that a GAAR, which cannot define impermissible tax avoidance precisely, must target it effectively while simultaneously honouring permissible tax avoidance. Krishna notes that

> [t]ax avoidance falls into two categories: … tax mitigation and abusive avoidance. In the former case, transactions achieve the desired result of tax minimisation and therefore, are effective. In the latter cases, abusive transactions may be ignored for tax purposes and do not achieve the desired goal of tax minimisation. What is not always clear, however, is the line between the two. When does lawful tax mitigation cross over and become abusive tax avoidance?[47]

The questions asked by Krishna are not effectively answered by the GAARs currently in force in the countries considered above. As stated by the court in *Canada Trustco*,[48] '[t]he GAAR draws a line between legitimate tax minimisation and abusive tax avoidance. The line is far from bright. The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act. But

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45 Likhovski 'The duke and the lady: *Helvering v Gregory* and the history of tax avoidance adjudication' (2003–2004) *Cardozo Law Review* 953 958.

46 159 F 2d (2d Cir 1947) 848 850–851.

47 Note 43 above at 848.

48 Note 43 above at par 16.

precisely what constitutes abusive tax avoidance is the subject of debate. Hence these appeals.'

Controvertible indicators of impermissible tax avoidance

The fact that there is no precise definition of impermissible tax avoidance means that the GAARs considered in this article rely on indicators of impermissible tax avoidance. These indicators are naturally controvertible, (which means disputable) to a certain extent because they are imprecise. This in turn leads to the creation of wide GAARs which do not adequately inform taxpayers of the limits of their right to avoid tax.

In South Africa, section 103(1) of the Act and section 90, as amended, of the 1941 Act, used the 'abnormality of the transaction' to identify impermissible tax avoidance. It is submitted that this was both inadequate and problematic. Abnormality as an indicator of impermissible tax avoidance was inadequate in the sense that it was too dependent on the circumstances of the transaction and could be countered by taxpayers arguing that the transaction was common and therefore normal. The Margo[49] and Katz Commissions[50] noted this danger, and indicated that the abnormality requirement could be inadequate where a particular scheme was so widely used that it had come to be accepted as normal in business dealings. This was compounded by the inflexibility of the concept – a consideration highlighted by the Margo Commission[51] in the following terms

> [t]he nature of anti-avoidance provisions must obviously be sufficiently flexible to be effective while being not so vague as to undermine or impair proper planning of the taxpayer's affairs. Measured against these criteria the existing s 103(1) is, in the Commission's view, defective and, in many cases, ineffective from the Commissioner's point of view.[52]

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49 *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (RP 34/1987) par 27.28.

50 *Third Interim report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* par 11.2.2.

51 Note 49 above at *par* 27.15.

52 An analysis of some of the cases on section 90 as amended and section 103(1) tells a curious story of the efficacy of the abnormality indicator. The transactions in cases such as *SIR v Geustyn, Forsyth and Joubert* n 17 above*, Hicklin* n 19 above*, and ITC 1635* (1997) 60 SATC 260 were found to be normal. In cases such as *CIR v Meyerowitz* 1963 3 SA 863 (A), *CIR v Louw* 1983 (3) SA 551 (A), *ITC 1496* (1990) 53 SATC 229 and *ITC 1582* (1994) 57 SATC 27, the transactions were found to be abnormal. In the latter cases, the transactions were blatantly abnormal. For instance, in *Meyerowitz*, the taxpayer arranged his affairs in such a way that income from his labour would be received by his

Abnormality was problematic in the sense that it was not adequately defined in either GAAR which left it to the courts to determine its scope. In *Hicklin*,[53] Trollip JA stated that a normal arm's-length transaction is one where the parties are independent of each other and seek to obtain the best for themselves from the transaction. This explanation of normality persists. However, it is submitted that it is limited in that it was formulated in the specific context of the transaction in *Hicklin.* Although it has been argued that the test advanced by Trollip JA was adequate for the facts in the *Hicklin* case which involved independent parties who had no existing relationship,[54] where two or more of the parties involved have an existing relationship, it might be incorrect to consider only a single transaction between them, and to analyse the rights and obligations flowing from that transaction. Emslie states that a party in transaction A may forego some advantages for himself knowing well that in transaction B he will be able to obtain a greater advantage. Emslie concludes that the entire relationship between the parties must be analysed and the court must probe whether each party is, in the greater scheme, independent and seeking to obtain maximum benefit.[55] Emslie's argument highlights the problems which arise when excessive reliance is placed on courts to determine the scope of GAAR provisions.

The abnormality provision was amended in 1996 to provide that a transaction in the context of business is normal if it has been entered into or carried out by means that are normal for a *bona fide* business purpose.[56] This provision is retained in the current GAAR in section 80A–L of the Act.

In Australia, the relative success of the Commissioner in invoking Part IVA of the ITAA, does not automatically mean that this GAAR is founded on an incontrovertible indicator of impermissible tax avoidance. The Part IVA-distinction between permissible and impermissible tax avoidance, is founded

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children and not by him. In *Louw*, the taxpayer had, inter alia, received a loan instead of a salary. These cases raise legitimate questions whether the abnormality provision was only applicable to blatantly abnormal transactions.

53 *Id* at 495A–D.

54 Emslie 'Dealing at arm's length; how long the limb' (1988) 3 *Tax Planning* 127 127.

55 *Ibid*.

56 To cater for the recommendations of the Katz Committee the legislature in 1996 effected these amendments to section 103(1) through section 29 of the Revenue Laws Amendment Act 36 of 1996. The new abnormality provision was not judicially considered before section 103(1) was replaced by section 80A–L. See generally Clegg 'Dropped before playing; proposed amendments to s 103' (2005) 19 *Tax Planning* 53.

on the Privy Council's decision in *Newton v FCT*.[57] In this case the court introduced the 'predication test' as a way of limiting the wide section 260 of the ITAA. It stated that '[i]n order to bring the arrangement within the section you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax'.[58] The predication test demands an objective analysis of the circumstances surrounding the scheme. If the particular methods used by a taxpayer in a scheme can justify a reasonable inference that the taxpayer used these methods in order to avoid tax, the scheme will be deemed to constitute impermissible tax avoidance.

Part IVA is based on this foundation, and uses a list of eight factors in section 177D(b) of the ITAA to direct the inquiry into the 'objective sole or dominant purpose' of the scheme. The focus on the objective sole or dominant purpose means that Part IVA can apply to commercial transactions that have a tax avoidance purpose and effect, if the tax purpose can objectively be said to be the dominant purpose. The experience with Part IVA shows that using a scheme's objective purpose to determine whether it constitutes permissible or impermissible tax avoidance, can be problematic. This problem emanates from the uncertainty as to the stage at which a commercial transaction with a tax purpose, morphs into a commercial transaction with a dominant tax purpose. Two cases – *Spotless Services Ltd*[59] and *Eastern Nitrogen*[60] – illustrate this problem.

In *Spotless Services Ltd*, the taxpayer invested a large sum of money in the Cook Islands and obtained a significant return on this investment. The commercial aspects of the scheme were indisputable. The taxpayer's argument that the purpose behind the scheme was commercial in securing the investment of a large sum, was rejected by the court. The court stated that the required purpose lay in the particular means the taxpayer adopted to obtain the commercial advantage. It held that the presence of a rational commercial decision was irrelevant to the question of whether a taxpayer had operated a scheme with a dominant purpose to obtain a tax benefit.[61] It was concluded that the prevailing or dominant purpose of the scheme was

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57 (1958) 98 CLR 1.
58 *Id* at 8.
59 Note 25 above.
60 Note 42 above.
61 Note 25 above at 184.

tax avoidance. A similar approach was taken in *Consolidated Press Holdings*[62] and in *Hart.*[63]

These cases can be contrasted with the *Eastern Nitrogen Ltd* case in which the taxpayer took advantage of a sale and leaseback financing scheme which had a lower tax implication than other finance mechanisms. The court rejected the Commissioner's arguments for the application of Part IVA and stated that

> [d]ue and proper management of the business required assessment to be made of the net cost of finance after taking into account the extent to which any outgoings associated with that cost were allowable deductions from assessable income. In the circumstances of this case, to say that the appellant was attracted by a proposal that provided finance at a lower after-tax cost than other means of obtaining funds for the business would not, without more, support an objective conclusion that the appellant obtained finance for the dominant purpose of obtaining the tax benefit constituted by the deductibility from assessable income the outgoings incurred in connection with the obtaining of that finance. To show that a business which depends upon financiers to provide the recirculating capital needed for the operation of the business has obtained that finance at a net cost after taking into account the provisions of the Act, that is less than the net cost of obtaining finance by another method, will not, in itself, show that the dominant ruling or supervening purpose of the operator of the business is to obtain the tax benefit constituted by the extent to which deductible outgoings incurred in respect of that borrowing will be greater than the deductible outgoings that would have been incurred under another method of obtaining finance.[64]

The court in this case honoured the commercial aspects of the scheme, and reaffirmed the principle that a taxpayer is entitled to pursue commercial objectives in the most tax-effective manner. Together with the *Metal Manufacturers*[65] case, this case illustrates that Part IVA is not inherently against all commercial transactions having a tax purpose. It is, however, clear that Part IVA is controversial insofar as it does not establish certainty

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62 Note 25 above.
63 Note 26 above
64 Note 42 above at 478.
65 Note 42 above.

regarding the extent to which taxpayers may seek tax benefits through commercial transactions.[66]

In Canada the GAAR is founded on the 'misuse or abuse' provision. Section 245(4) does not provide for the steps to be taken when determining whether or not a transaction is abusive. The court in *Canada Trustco*[67] identified two steps in this determination. The first step involves a contextual, textual, and purposive interpretation of the provisions in question. This is clearly a question of law. The second step, which is a factual inquiry,[68] involves a determination of whether the transaction is consistent with the purpose of the provisions in question. If it is not, then it automatically follows that an abuse of the provisions has occurred and the GAAR can be used to strike the transaction down.

According to Arnold, the misuse or abuse approach 'presupposes that a legislative scheme or purpose can be identified'.[69] This is where the problem with a purposive approach lies. A statutory purpose cannot always be established, and where it can, universal consensus on what it is, is not always present. It has been seen in Canada that the courts may erroneously use unworkable methods of establishing a statutory purpose, with the result that it becomes unascertainable. In *OSFC Holdings v Canada*,[70] it was stated that:

> It is also necessary to bear in mind the context in which the misuse and abuse analysis is conducted. The avoidance transaction has complied with the letter of the applicable provisions of the Act. Nonetheless, the tax benefit will be denied if there has been a misuse or abuse. This is not an exercise of trying to divine Parliament's attention by using a purposive analysis where the words used in a statute are ambiguous. Rather, it is an invoking of a

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66 Prebble & Prebble 'Does the use of general anti avoidance rules to combat tax avoidance breach principles of the rule of law? A comparative study' (2010) 55/21 *St Louis University Law Journal* 21 23 notes that 'useful definitions of the point at which tax mitigation becomes tax avoidance are elusive'. The authors also criticise Part IVA and state that it does not sufficiently define impermissible tax avoidance and all it states is that 'tax avoidance arrangements are those arrangements that look like tax avoidance arrangements.'

67 Note 43 above at par 44

68 For a discussion of the purposive approach required by the GAAR see generally Arnold 'Reflections on the relationship between statutory interpretation and tax avoidance' in Erlichman (ed) *Tax avoidance in Canada the general anti avoidance rule* (2002) 46.

69 *Id* at 56.

70 001 4 CTC 82 par 67.

> policy to override the words Parliament has used. I think, therefore, that to deny a tax benefit where there has been strict compliance with the Act, on the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous. The court will proceed cautiously in carrying out the unusual duty imposed upon it under subsection 245(4). The court must be confident that although the words used by Parliament allow the avoidance transaction, the policy relevant provisions of the Act as a whole is sufficiently clear that the court may safely conclude that the use made of the provision or provisions by the taxpayer constituted a misuse or abuse.

The court required the establishment of a clear and unambiguous policy backing the legislation, before determining whether the transaction was abusive or inconsistent with the policy. This approach imposed an onerous and unjustifiable onus on the revenue authority because no policy could be established. This led to a series of losses for the revenue authority in cases where it sought to apply section 245.[71]

Uncertainty and its duplicitous nature or circular effect

The imprecision of the indicators of impermissible tax avoidance in the GAARs of the countries discussed above, inevitably creates uncertainty with regard to transactions that are impermissible. Regarding GAARs in general, it has been stated that '[a]lthough a number of countries have GAARs, the legislation adds little to the common understanding of what constitutes tax avoidance. In most jurisdictions, there is uncertainty as to which transactions fall inside the GAAR.'[72] A question that arises is whether the problem of impermissible tax avoidance justifies the creation of a rule that creates uncertainty.[73] Some scholars answer this question in the affirmative and argue that certainty is neither a weakness nor is it of paramount importance. Freedman notes

> [i]t is considered whether the time has come to go beyond the concerns about line drawing. A precise boundary is clearly impossible and even undesirable, given that such boundary would be an instant target for tax

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71 These cases entail *Hill v The Queen* [2003] 4 CTC 2548, *Canada Trustco* n 34 above, *Canada v Jabin Investments Ltd* [2003] 2 CTC 25, *Canada v Produits Forestiers Donohue Inc* [2002] FCA 422 and *Canada v Imperial Oil Ltd* [2004] FCA 36. In these cases, the court did not find the transactions abusive because it could not be proved that these transactions had violated any clear and unambiguous policy.

72 Prebble & Prebble n 66 above at 28.

73 Cooper n 37 above at 19.

> 'planning' activity. Could it be that what matters now is not whether the boundary lines are clear but how we deal with the inevitable lack of clarity?[74]

Some scholars dismiss uncertainty as immaterial. Weisbach[75] contends that a more serious objection to anti-shelter doctrines is that they would create great uncertainty. But the argument is usually just left at that, as if it were self-evident that uncertainty is a bad thing that should be avoided at all costs. But this is not the case. First, note that even if uncertainty is bad, there is a trade-off between the good of a substantive disallowance rule and the bad of uncertainty, and it is not clear that the race should necessarily go to uncertainty. In addition, businesses deal with uncertainty all the time, and it is not clear why tax uncertainty is any worse than uncertainty about, say, the weather or about the standard of due care under a negligence rule.

In *Lipson*,[76] the court noted that uncertainty is not paramount, and that the search for certainty should not exclude the need for a GAAR. The court noted that:

> To the extent that it may not always be obvious whether the purpose of a provision is frustrated by an avoidance transaction, the GAAR may introduce a degree of uncertainty into tax planning, but such uncertainty is inherent in all situations in which the law must be applied to unique facts. The GAAR is neither a penal provision nor a hammer to pound taxpayers into submission. It is designed, in the context of the *ITA*, to restrain abusive tax avoidance and to make sure that the fairness of the tax system is preserved. A desire to avoid uncertainty cannot justify ignoring a provision of the *ITA* that is clearly intended to apply to transactions that would otherwise be valid on their face.

In South Africa, the approach of the South African Revenue Service (SARS) seems to be that 'certainty and predictability are undeniably important in the tax arena' but 'they are not absolute values'.[77] SARS also argues that 'there is a growing recognition that a GAAR cannot be overly precise if it is to be

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74 Freedman (ed) *Beyond boundaries: developing approaches to tax avoidance and tax risk management* (2008) 1.

75 Weisbach 'The failure of disclosure as an approach to tax shelters' (2001) 54 *SMU Law Review* 73 81.

76 Note 43 above at par 52.

77 SARS *Discussion paper* note 2 above 46 quoting Lord Templeman and Richardson P in *CIR v Challenge Corporation Ltd* [1987] AC 155 and *CIR v BNZ Investments* note 1 above, respectively.

effective', and that 'any uncertainty created by a stronger GAAR would leave the overwhelming majority of ordinary taxpayers and business transactions unaffected'.[78] To support SARS' position, one can refer to the fact that the uncertainty of GAARs can serve as a deterrent which may help to counter impermissible tax avoidance by restricting tax-avoidance transactions to transactions that are clearly permissible.

It is submitted that the views indicated above supporting or tolerating uncertainty can be countered. The view that the uncertainty of a strong GAAR would not affect the 'overwhelming majority of taxpayers' can be countered on the basis that a GAAR should have sufficient certainty to guide all taxpayers, and not merely the 'overwhelming majority' of taxpayers. The view that a broad and uncertain GAAR is an effective deterrent does not take account of the fact that a rule that operates '*in terrorem'* fails in one of the functions of the law, that is, to guide people.[79] According to Adam Smith

> The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experiment of all nations, is not near so great as a very small degree of uncertainty.[80]

It is conceded that absolute certainty is virtually impossible to achieve in the GAARs considered. It is also acknowledged that GAARs created to curtail impermissible tax avoidance, will have cases on the boundary between what is accepted and what is not. This is because lawmakers cannot predict all circumstances that may arise in relation to tax avoidance in general. It is therefore true that GAARs will have 'core' situations where there will be no

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78 *Ibid*.

79 Prebble and Prebble n 66 above at 31.

80 Smith *An inquiry into the nature and causes of the wealth of nations* (2003)(reprint) 1043–1044.

question about their application, and 'penumbra' situations where their application will be uncertain.[81] The uncertainty created by GAARs, however, makes them arguably 'nothing but penumbras'.[82] This means that the uncertainty of the GAARs studied must be limited because, as it is, it renders the GAARs incapable of reasonably informing taxpayers of the limits of their right to avoid tax.

A further criticism that can be levelled at uncertainty is that it is duplicitous or has a circular effect. This is because it can work as a deterrent which may please revenue authorities, but it will equally affect revenue authorities negatively and limit the efficacy of the GAAR. According to Kirchler, '[u]ncertainty in the tax law makes it difficult for both taxpayers to follow the law and tax authorities to decide unequivocally what is illegal and what is at the fringe of tax law'.[83] If the revenue authorities cannot use the GAAR to identify impermissible tax avoidance, they may challenge transactions they should not challenge, resulting in litigation losses. These losses may, in turn, spur greater tax avoidance. In certain instances, the losses may lead to the demise of the GAAR in question. In South Africa, the Commissioner challenged a legitimate transaction in *CIR v Conhage*[84] and the loss in this case has been said to have resulted in the emasculation of section 103(1) of the Act by the court.[85] Mazansky[86] notes that the dilution of the scope of section 103(1) alleged by SARS, has been helped in many cases by the way in which 'the Commissioner misused the provision by attacking legitimate transactions'. In Canada, the courts have stated that the difficulty in identifying the abusive transactions targeted by the GAAR has an effect on the tax authorities. In *Geransky v The Queen*,[87] the court stated that '[w]hat is misuse or an abuse is in some instances in the eye of the beholder. The Minister seems to be of the view that any use of a provision is a misuse or

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81 Prebble and Prebble n 66 above at 29.

82 *Ibid*.

83 Kirchler *The economic psychology of tax behaviour* (2007) 12. In this quotation Kirchler refers to Seldon (ed) *Tax evasion: the economic, legal and moral inter-relationship between avoidance and evasion* (1979); and Braithwaite *Markets in vice, markets in virtue* (2005).

84 Note 20 above.

85 Liptak 'Battling with boundaries: the South African GAAR experience' in Freedman (ed) *Beyond boundaries: developing approaches to tax avoidance and tax risk management* (2008) 23.

86 Mazansky 'New GAAR initial observations' (2006) 20 *Tax Planning* 130.

87 [2001] 2 CTC 2147 par 40. Also see Kellough 'Tax avoidance 1945 – 1995' (1995) 43 5 *Canadian Tax Journal* 1819 1832.

an abuse if the provision is not used in a manner that maximises the tax resulting from the transactions.'

The role of the judiciary

The courts, too, have played a role in limiting the efficacy of GAARs in the countries studied by either

- generally expressing an unwillingness to enhance the provisions of any inadequate provisions in a GAAR; or
- limiting the scope of broad and uncertain GAARs.

Regarding the first point, it is generally acknowledged that impermissible tax avoidance is a scourge on the tax systems of the jurisdictions here analysed. The courts have, however, often stated that they will not assist in the fight against impermissible tax avoidance by strengthening weak or uncertain anti-avoidance provisions. This approach was described in *Vestey's (Lord) Executors and Another v Inland Revenue Commissioners*[88] where it was stated that:

> Parliament in its attempts to keep pace with the ingenuity devoted to tax avoidance may fall short of its purpose. This 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. Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.

In *Shell Canada*,[89] it was stated that

> … this court has made it clear in more recent decisions that, absent a specific provision to the contrary, it is not the court's role to prevent taxpayers from relying on the sophisticated structure of their transaction, arranged in such a way that the particular provisions are met on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way … unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on

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88 [1949] 1 All ER 1108 1120.

89 Note 43 above at par 59.

> what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.

In *Atinco Paper Products Ltd v The Queen*,[90] it was stated that '[i]t is trite law to say that every taxpayer is entitled to arrange his affairs so as to minimize his tax liability. No one has ever suggested that this is contrary to public policy. It is equally true that this court is not the watchdog of the Minister of National Revenue.' These views show that the courts will not disregard a transaction merely because impermissible tax avoidance is a scourge on tax systems.[91]

Regarding the second point, the courts have regularly interpreted broad and uncertain GAARs restrictively. In South Africa, the court in *CIR v King*[92] devoted much effort to interpreting section 90 in a way that would restrict its breadth and uncertainty. The court reasoned that, literally interpreted, section 90 would result in the absurd consequence of outlawing all tax avoidance. Watermeyer CJ stated that '[i]t is necessary therefore to search for some other meaning of sec. 90 which will not lead to unsatisfactory results and, as I shall show, such a meaning can be found'. It was stated that section 90 did not target transactions aimed at avoiding tax as a literal reading provides, but those with the sole or main purpose of avoiding tax.[93] The court stated that section 90 was intended to be applied to transactions with abnormal elements, something that was clearly absent from section 90.[94] Regarding section 80A–L, it can be argued that the uncertainty created by this GAAR can invite a restrictive interpretation by the courts. Section 90 and section 80A–L are vastly different in detail, but distinctly similar with regard to the reliance placed on the courts to provide clarity on the scope of

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90 78 DTC 6387 (FCA) 6395.

91 The courts have on the other hand occasionally stated that anti-avoidance rules should be interpreted widely in order to curb impermissible tax avoidance. In *COT v Ferera* 1976 (2) SA 653 (RAD) 657H, MacDonald JP stated that the judiciary is under obligation to interpret the GAAR in such a way as to 'suppress the mischief' that is impermissible tax avoidance and 'to suppress subtle inventions and evasions for the continuance of the mischief...and to add force and life to the cure and remedy according to the intent of the Act'. In *CIR v Ocean Manufacturing Ltd* 1975 4 SA 715 (A) 727 's 103(2) should be construed in such a way as to advance the remedy provided by the section and suppress the mischief against which it is directed. The Commissioner's powers should not be restricted unnecessarily.' Also see generally *Commissioner of Taxation v Student's World (Aust) Pty Ltd* note 23 above.

92 Note 15 above at 208.

93 *Id* at 198–199

94 *Id* at 216.

the respective provisions. Broomberg notes that the complexity of the GAAR is such that 'much litigation will ensue before any degree of certainty is achieved in interpreting these new provisions'.[95] It is submitted that in the South African context, the historical experience with section 90 shows that where a GAAR relies on the courts to clarify uncertain provisions, the probability of restrictive interpretation to limit this uncertainty is strong. This restrictive interpretation has in the past proved decisive in the failure of GAARs in South Africa.

As with section 90 in South Africa, section 260 in Australia had a troubled existence from the outset. In *FCT v Newton*,[96] the court described section 260 as a 'difficult provision' which was 'inherited' and which required an overhaul by 'someone who will take the trouble to analyse his ideas and define his intentions with precision before putting pen to paper'.[97] The judicial 'annihilation' of section 260 reached its zenith in a series of cases which advanced the so-called 'choice doctrine'. This doctrine was created by the courts in *WP Keighery Pty Ltd v Federal Commissioner of Taxation*[98] as a way of limiting the scope of section 260. It was held in this case that the GAAR could not be applied in cases where a taxpayer avoided tax in a manner that amounted to making tax-saving choices provided for in tax legislation.

In excluding section 260 from tax avoidance transactions that were consistent with statutory purpose, the choice doctrine's tenet was sound. This tenet, however, morphed and degenerated into an entitlement for taxpayers to create the conditions necessary to enjoy tax benefits provided for in tax legislation. In *Mullens v Federal Commissioner of Taxation,*[99] Barwick CJ stated that in terms of the choice doctrine '[t]he Court has made it quite plain in several decisions that a taxpayer is entitled to create a situation to which the Act attaches taxation advantages for the taxpayer'. This approach was affirmed by Barwick CJ in *Slutzkin v Federal Commissioner of Taxation*.[100] The choice doctrine was also applied in

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95 Broomberg 'Then and now VIII' (2008) 22 *Tax Planning* 135 136.

96 (1956) 96 CLR 577 596.

97 Before this case, the court in *DFC of T v Purcell* 1921 29 CLR 464 had stated that section 53 of the Commonwealth Income Tax Act of 1915, section 260's similarly worded predecessor, was too broad and would lead to the outlawing of all tax avoidance transactions without exception and needed to be limited.

98 (1957) 100 CLR 66.

99 (1976) 135 CLR 290 298.

100 (1977) 140 CLR 314.

Cridland v Federal Commissioner of Taxation[101] where the court stated that the choice doctrine was not as narrow as postulated initially in *WP Keighery Pty Ltd*. The court stated that 'the taxpayer is entitled to create a situation by entry into a transaction which will attract tax consequences for which the Act makes specific provision'.[102] The cumulative effect of the cases in which the choice doctrine has been used to exclude the application of Part IVA, is the total annihilation of section 260. The precedent set in the series of cases affirming the choice doctrine was dangerous because taxpayers could create transitory or artificial conditions to allow themselves to comply with statutory provisions conferring tax benefits.

In Canada, the adverse judicial comments made in certain Canadian tax court decisions referred to above, were sustained in *Lipson v Canada*.[103] Binnie J's dissenting judgment noted that the GAAR threatened the health of the taxpayer's right to avoid tax. He stated as follows:

> How healthy is the Duke of Westminster? There is cause for concern. Although this court in *Canada Trustco Mortgage Co v Canada*... affirmed... the continuing viability of the principle that taxpayers are entitled to arrange their affairs to minimise the amount of tax payable (a principle enshrined in *Commissioners of Inland Revenue v Duke of Westminster* [1936] A.C. 1 (H.L.) the traditional approach is now tempered by the application of the general anti-avoidance rule ('GAAR'). The question in these appeals, as it was in *Canada Trustco*, is where the appropriate balance is to be struck.[104]

Binnie J also stated that '[t]he GAAR is a weapon that, unless contained by the jurisprudence, could have a widespread, serious and unpredictable effect on legitimate tax planning. At the same time, of course, the GAAR must be given a meaningful role'.[105] Part of the jurisprudence limiting the scope of

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101 (1977) 140 CLR 330.

102 339. The involvement of Barwick CJ in two of the cases which severely restricted section 260 has led to an argument that he played a central role in the judicial annihilation of section 260; see generally Lehmann 'The income tax judgments of Sir Garfield Barwick: a study in the failure of the new legalism' (1982 – 1983) *Monash Law Review* 115. It is submitted that this conclusion is unfair on Barwick CJ because section 260 failed because of its own uncertainty which provoked judicial activism against it. This judicial activism was initiated earlier in cases such as *DFC of T v Purcell* n 97 above and *FCT v Newton* n 96 above.

103 Note 43 above.

104 *Id* at par 54.

105 *Id* at par 55.

the GAAR can be found in *Canada Trustco*[106] where it was stated that the GAAR should only apply to a transaction which is undoubtedly abusive.

The approach of the courts to broad and uncertain GAARs also proves the circular effect or duplicitous nature of uncertainty. Over and above adversely affecting taxpayers and tax authorities alike, uncertainty also adversely affects GAARs in the sense that it can provoke restrictive judicial interpretation which has persistently limited the efficacy of GAARs. The manner in which the courts in South Africa, Canada, and Australia have responded to broad and uncertain GAARs, counters the contention made by SARS that a GAAR cannot be certain if it is to be successful.

Taxpayer aggression

Many taxpayers across the world generally dislike paying tax.[107] As Trixier[108] notes:

> The attempt to avoid paying taxes is a reaction against the constraints imposed by any tax. It is universal and an inevitable consequence of the very existence of taxes. Tax and evasion are as inseparable as a man and his shadow. Payment of taxes symbolises submission it provokes a feeling of powerlessness by creating a direct bufferless relationship between, defenceless individual and the state Moloch. It is experienced as a restriction on a person's freedom and interference with his fundamental aspirations for power and prestige. It strikes at the very core of the taxpayer's being, provoking an affective and wholly irrational reaction similar to a child's reactions to parental domination.

This aversion motivates certain taxpayers to have resort to tax avoidance. In seeking to avoid taxes, many taxpayers have searched for 'imaginative and

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106 Note 43 above at par 69.

107 Kruger and Scholtz n 16 above at 1 describe the attitude to tax by stating that '[a] modern Midas might complain that everything he touches turns into tax'. These authors also state that '[m]ost people, at the best of times, dislike paying tax'. Also see Freedman 'Defining taxpayer responsibility: in support of a general anti avoidance principle' (2004) *British Tax Review* 332 334; Barker 'The three faces of equality: constitutional requirements in taxation' 2006–2007) *Case Western Reserve Law Review* 1 3; *Pollock v Farmers Loan and Trust Company* 157 US 429 156; Lymer and Oats *Taxation policy and practice* (2009/2010) 1 and Balestrino and Galmarini 'Imperfect tax compliance and the optimal provision of public goods' (2003) 55 1 *Bulletin of Economic Research* 37 51.

108 Quoted in Barker 'The ideology of tax avoidance' (2009) 40 *Loyola University Chicago Law Journal* 229 236.

at times unimaginable ways to reduce their tax expenditures'.[109] For instance, instead of a straightforward loan, taxpayers in South Africa, Australia, and Canada have opted for a sale and leaseback transaction in *Conhage*, *Eastern Nitrogen,* and *Canada Trustco* respectively. The dynamism that characterises tax-avoidance transactions makes it difficult to formulate a precise definition of impermissible tax avoidance. This is because tax avoidance in general, and impermissible tax avoidance in particular, is constantly evolving and for a GAAR, it is essentially a moving target. Liptak,[110] who played a central role in the drafting of the current South African GAAR, stated as follows:

> Do we really know 'impermissible tax avoidance' when we see it? Particularly in South Africa, the answer seems to be 'no'. Not only was there disagreement between SARS and practitioners, but there was widespread disagreement among practitioners themselves.

In *Federal Commissioner of Taxation v Hancock,*[111] Dixon CJ supported this view and stated that '[t]he resource of ingenious minds to avoid revenue laws has always proved inexhaustible and for that reason it is neither possible nor safe to say in advance what must be found, after a scheme is struck down under section 260, before a consequential assessment can be justified'. The dynamism of impermissible tax avoidance necessitates the creation of broad and flexible GAARs which may counter this dynamism. These GAARs are, however, uncertain and bring on the ills of uncertainty discussed above. Taxpayer aggression thus initiates a vicious cycle which culminates in the limitation of the efficacy of GAARs.

The limitations of the law in curbing impermissible tax avoidance

It is submitted that the GAARs studied are laws which have the following limitations as tools in the curbing of impermissible tax avoidance:
they are subject to avoidance by taxpayers seeking to avoid tax; and
they do not address the root causes of impermissible tax avoidance.
Regarding the first point, McBarnet[112] notes that:

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109 Eustice 'Abusive corporate shelters: old "brine" in new bottles' (2002) 55 *Tax Law Review* 135 140. The desire by companies and individual taxpayers to reduce taxes is described here as 'powerful' and a 'fact of life'.

110 Liptak n 85 above at 26.

111 1961 AITR 328 333.

112 McBarnet 'Law, policy, and legal avoidance: can law effectively implement egalitarian policies?' 1988 *Journal of Law and Society* 113 113.

> Enforcers cannot enforce laws unless they are violated. What regulation studies have underplayed is the extent to which the regulated do not violate but merely avoid the law. Responses to law are not just a matter of breaking it (crime) and obeying it (compliance) it is also possible to use legal techniques to achieve non-compliance with the intent of the law without technically violating its content. The law is not broken but it is, nonetheless, entirely ineffective in achieving its aims. Despite the legislature, despite the enforcers, law becomes merely symbolic.

GAARs, as legislative mechanisms, can be avoided by taxpayers seeking ways to reduce their tax burden. It is impractical to introduce a new GAAR every year. This means that taxpayers have ample opportunity to study and analyse a particular GAAR and seek ways to avoid it. In South Africa, section 103(1) needed to be amended in 1996 because taxpayers had discovered that a transaction which is common, is normal and would pass the abnormality test required by this GAAR. In the US, the experience with the business-purpose doctrine shows that taxpayers often work business purpose into their tax avoidance transactions in order to comply with the business-purpose doctrine when in actual fact these transactions are inherently tax motivated.[113]

Regarding the second point, tax avoidance is often seen as a 'battle of wits' between taxpayers and their advisors on one side, and the revenue authorities and parliament on the other.[114] The latter create and enforce tax laws, whilst the former seeks ways to circumvent these laws. This situation could easily mislead one into believing that impermissible tax avoidance is a purely legal problem that can be solved effectively by legal means. This is not necessarily the case. Tax avoidance in general, is much more complex. To curb impermissible tax avoidance effectively, an holistic approach that addresses its root causes is required.[115] This is because impermissible tax

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[113] See generally Bankman 'The cconomic substance doctrine' (2000) 74/5 *Southern California Law Review* 5 and Summers 'A critique of the business purpose doctrine' (1961–1962) 41 *Oregon Law Review* 38.

[114] Orow 'Structured finance and the operation of the general anti-avoidance rule' [2004] *British Tax Review* 410 415.

[115] The root causes of impermissible tax avoidance can be said to involve the general dislike for taxes discussed above, the perception that tax is confiscatory and the perception that public finance is wasted by governments. Evans 'Taxpayer compliance in developing countries: challenges and constraints' in *National Tax Conference 2009 Tax Administration in an African Context* (2009) 38 43. Evans notes at 59 that 'tax morale is built where taxpayers feel that they are getting a fair deal from the exchange relationship with the state'.

avoidance is a systemic problem rather than a purely legal problem. GAARs are a legal response to a much wider systemic problem. This means that their efficacy is limited because they do not address the root causes of impermissible tax avoidance.[116]

CONCLUSION

To conclude, it is important to highlight the following questions raised by Cooper.

> There is an underlying question that is more curious: why is it that the legal framework has proven to be, or has been perceived to be, inadequate to meet the challenge of tax avoidance? Why is there a failure of the usual legal process in the case of tax? It is a strange admission by legislators to introduce a law which says, in effect: parliament is enacting a rule to reverse something which it does not otherwise prohibit and cannot foresee, and so must either prevent by deterring *ex ante* or else cure by *ex post* reversal. What are the sources of the failures that have led to this decision?[117]

This article responds to these questions by explaining the limited efficacy of GAARs in curbing impermissible tax avoidance, in South Africa, Australia, and Canada. It does this by showing that the cause of this limited efficacy lies in the fact that impermissible tax avoidance has never found a universally accepted or precise definition. This had an effect on historical GAARs in that it led to the enactment of wide GAARs which targeted all forms of tax avoidance in both South Africa and Australia in section 90 and section 260, respectively. These GAARs failed spectacularly and were replaced by what can be described as the modern GAAR which relies on indicators to target and isolate impermissible tax-avoidance transactions. The fact that modern GAARs rely on indicators of impermissible tax avoidance means that they do not precisely define impermissible tax avoidance. It also means that these GAARs inevitably create uncertainty as to the boundary between permissible and impermissible tax avoidance. This adversely affects the taxpayers' right to avoid tax as taxpayers are not adequately informed of the limits of permissible tax avoidance. The

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[116] Broomberg 'Tax avoidance then and now' (2007) 21 *Tax Planning* 112 113 notes that it is critically erroneous to assume that impermissible tax avoidance is caused by the marketers of impermissible schemes. He notes further that where impermissible tax avoidance is prevalent there is a systemic problem that requires attention and that changing the tax laws in such circumstances is unlikely to solve the problem

[117] Note 3 above at 86.

limitation of the right to avoid tax has often led to judicial activism in defence of the right to avoid tax by interpreting GAARs restrictively in order to limit their uncertainty. The factors limiting the efficacy of GAARs in the countries considered are therefore interconnected in certain respects.

The limiting factors identified and discussed in this article need to be overcome in order to create more effective GAARs. Certain factors may never be completely overcome. For instance, it is probably impossible to define impermissible tax avoidance with precision. It is, however, possible to create less aggressive GAARs with limited uncertainty. This could limit the possibility of restrictive judicial interpretation which, it is submitted, is the biggest threat to the efficacy of a GAAR. It is also critical for countries to note the importance of other non-legal measures that address the causes of impermissible tax avoidance.