SECTION 80A (c) (ii) OF THE INCOME TAX ACT AND THE SCOPE OF PART II A:

THE BIG BOOM Part 1

According to the economist Adam Smith in his book, The wealth of nations – 1776, one of the basic principles of any tax system should be that individuals can determine the amount of tax payable by them with certainty.

Part I 1. Introduction 1 Similarly, Cilliers notes that all taxpayers ‘are entitled to be placed in a position where they are able to reasonably ascertain, before committing to a certain transaction or course of action, ‘the exact area within which they will be trespassers”.2 Both these academics, it is submitted, prescribe that the scope of a taxing provision be certain and within reasonable bounds.

Part II A of the Act contains the general anti-avoidance rule, the South African Revenue Services’ ‘weapon’ against impermissible tax avoidance arrangements, in section 80A thereof. It is inherent to a general anti-avoidance rule, that it be of a wide scope. The reason for this is that government suffers from the first mover disadvantage: it lays out rules, which are then analysed and parsed by taxpayers. Taxpayers thus have an advantage because government must ‘put their goods on show for all to see’.3 In order to combat impermissible avoidance arrangements effectively, it is thus, understandably, necessary to formulate a general anti-avoidance rule widely. However, as can be deduced from the opinions of Cilliers and Smith, it is dangerous to formulate a general anti-avoidance rule too widely: it creates uncertainty with regard to the amount of tax payable by taxpayers, and the area within which they will be regarded as trespassers.
Section 80A(c)(ii) of the Act is crucial to the operation of section 80A, since it applies ‘in any context’ and would therefore apply in both situations ‘in the context of business’ and situations ‘in a context other than business’. Cilliers therefore indicates that section 80A(c)(ii) can be described as ‘the heart of section 80A’. The objective of this two-part article is to evaluate whether section 80A(c)(ii), which contains the misuse or abuse concept, results in the scope of Part II A being too wide. If Part II A is considered to be too wide, this could place it in a similar position as that in which its predecessor, section 103(1), was before the judgment in CIR v King. If the Court looks similarly upon Part II A, this could lead to a very narrow and restricted interpretation of the statute — in effect to a certain extent destroying the effectiveness thereof.

In order to achieve the above purpose the evolution of the misuse or abuse concept, and its corresponding effect on the scope of Part II A, will be examined. The concept is not completely unknown to our law. It was introduced in the Third Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa, 1995 (the Katz Commission). The first part of this article will examine the recommendation by the Katz Commission and the intended effect thereof on the scope of section 103(1) of the Act. The second part will then explain how the misuse or abuse concept evolved and manifested in section 80A(c)(ii) of the Act and the corresponding effect thereof on the scope of Part II A.

2. The recommendation by the Katz Commission and the scope of section 103(1) The Katz Commission identified the following concern with regard to section 103(1) of the Act: ‘Concern has been expressed about the use of the business test as a basis for the normality requirement in that transactions, which, for example, utilise a tax incentive, granted by the legislation to encourage the very transaction in question, could be a victim of the provision.’ In order to address the above
concern, the Katz Commission examined section 245(4) of the Canadian Federal Income Tax Act (Canadian Act). This provision contains the misuse or abuse concept, which provides a basis for distinguishing between legitimate tax planning and abusive tax avoidance. Section 245(4) of the Canadian Act reads as follows: (4) For greater certainty, subsection 245(2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole. Section 245(4) of the Canadian Act is cast in negative language. It indicates that section 245(2) may not be applied when a transaction does not directly or indirectly result in a misuse or abuse. The Canadian Explanatory Notes state the following with regard to section 245(4) of the Canadian Act: ‘... subsection 245(4) contains an important limitation to the application of section 245. Even where a transaction results, directly or indirectly, in a tax benefit and has been carried out primarily for tax purposes, section 245 will not apply if it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole.’ The Canadian Act, therefore, applies the misuse or abuse concept as a limitation on the scope of section 245. This prevents section 245 from being too broad and hitting transactions that the legislature could never have intended to attack.

The Katz Commission, consequently, recommended that the general anti-avoidance provision, contained in section 103(1) of the Act, be remedied as follows: ‘The provisions of section 103(1) must not apply where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act, read as a whole.’ In effect, the Katz Commission required that section 245(4) of the Canadian Act be incorporated into the Act. The
recommendation was also cast in negative language and thus aimed at establishing an appropriate line of limitation on the scope of section 103(1). Its proposed purpose was to avoid transactions, ‘which, for example, utilize a tax incentive, granted by the legislation to encourage the very transaction in question,’ from falling victim to section 103(1). By utilising the misuse or abuse concept, it is submitted, the Katz Commission enhanced its recommendation’s capacity as a line of limitation. See Figure 2.1. This is due to the misuse or abuse inquiry, presumably, being a very wide and incomprehensive inquiry: reference to a misuse or abuse ‘presupposes that there is some identifiable non-abusive use of each provision of the Act (and the Act as a whole), which can in some way be used as a yardstick against which to measure misuse or abuse.’ The misuse or abuse inquiry, in addition, has a very subjective undertone to it: ‘abuse is in the eye of the beholder’. Consequently, the inquiry has been referred to as an ‘invisible yardstick, a stealthful nocturnal assassin’.

The recommendation by the Katz Commission was, however, not adopted by the legislature when section 103(1) of the Act was amended in 1996. A decade later, in its Discussion Paper on Tax Avoidance and Section 103(1) of the Act (Discussion Paper) the South African Revenue Services (SARS), again, referred to section 245(4) of the Canadian Act. This led to the formulation of the draft version of section 80A(c)(ii) of the Act. Part II of this article will evaluate how the misuse or abuse concept evolved in section 80A(c)(ii) of the Act and the effect thereof on the scope of Part II A.