Tax avoidance – Impermissible
tax avoidance arrangements –
more than just a slap on the wrist

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Although not promoted by South African tax law, it is generally legal and acceptable for taxpayers to intentionally apply legal measures to arrange their businesses and activities in a manner that will decrease their tax liability, within an overall framework of commercial justification. In the often-quoted case of IRC v Duke of Westminster, Lord Tomlin summarised the concept of tax planning when he said, “every man is entitled, if he can, to order his affairs so that the tax attaching is less than it otherwise would be”. However, with the great reward of paying less tax, comes the great risk and responsibility to meet SARS’ requirements to allow such arrangements.

Sections 80A to 80L of the Income Tax Act, read in conjunction with sections 80M to 80T define and govern such tax avoidance arrangements.

A taxpayer who enters into a tax avoidance arrangement, is required to report the arrangement to SARS timeously and in the form and manner as prescribed by the Act. However, even if the taxpayer complies with these conditions, SARS still reserves the right to deem the transaction an impermissible tax avoidance arrangement in terms of section 80A of the Act.

The South African tax system is, and always has been, based on the “substance” of a transaction – meaning that the true intention of the taxpayer decides the tax treatment of the transaction. The Act defines and expands the requirements for
transactions to be accepted, but broadly, arrangements or transactions may be considered impermissible under these circumstances:

- The sole or main purpose of the arrangement is or was to obtain a tax benefit
- The arrangement is abnormal, lacks commercial substance, or has created non-arm’s length like rights or obligations.

If an arrangement is found to be impermissible, the best case scenario is that SARS will ignore the arrangement in its entirety and tax the taxpayer according to the transaction’s substance. Furthermore, impermissible tax avoidance arrangements may expose the “guilty” taxpayer to a slap on the wrist, which may mean imprisonment or a penalty of up to R1 million.

Taxpayers are therefore advised to seek professional tax advice when entering into any tax planning arrangement. Specific areas of risk include round-trip financing, the use of tax indifferent parties and the use of so-called tax haven jurisdictions.