

# Tax avoidance – Is It Possible To Avoid Tax Legally?

Avoiding the burden of tax is often the focus of conversation. But, is it possible to avoid tax legally? Ettiene Retief, SAIPA's Chairman of Tax Committee, unpacks the basics on how best to avoiding tax legally.

Often the biggest mistake made by taxpayers is the lack of planning. One can't change the facts and nature of a transaction after it has been completed. Therefore, the tax liability is based on those facts and the nature on which the transaction was embarked or concluded on. Proper planning beforehand will help understand the tax liability, the timing of the tax liability, disclosure requirements and, most importantly, possible options or alternatives. However, one should be reminded that simulating a transaction merely to mask its true nature and purpose will not help, as the 'substance over form' rule is available to SARS, so that force will be given to the true transaction and not the simulated or sham transaction that the taxpayer professes it to be. The reality of tax planning and avoidance is that it all boils down to the management and planning of the following four elements:

- Timing (when the tax liability will be due);
- Gross income (tax liability is created by having an income);
  - Income or capital (tax treatment of capital gains is different from that of revenue/ income); and
- Deductions (deductions against the gross income will reduce the taxable income).

Timing of a transaction is a key part of planning, as the relevant tax is often payable before the assessment for that tax year is issued, such as provisional tax or employees' tax. Also, the timing for payment of taxes such as STC or donations tax is triggered by CPD 30 mins 35 Professional Accountant transaction. In planning the timing of a transaction, the availability to cash flow of the taxpayer should be considered so that the tax liability can be settled timeously. Being hit with penalties, interest, and even penalty taxes because taxes have not been paid timeously is counterproductive in your effort to pay less tax. Planning includes understanding the nature of a transaction and terms of the contract. For many years our courts have been occupied with ruling on 'gross income', and the Income Tax Act contains no definition of the words 'receipts or accruals of a capital nature', and as such we have had to look to case law and nature of the transactions in an effort to understand the tax treatment.

The most important question to lead with is: what is the reason for the amount being paid or received? Understanding the associated expenses and capital input required with regards to a transaction, as well as how such expenses or capital is funded, is very important. How the transaction is structured and recorded could make all the difference in the taxpayer's right to claim a deduction or allowance. Where a deduction or allowance is denied, the taxpayer will lose the tax benefits. In this regard, the first step will be to consider the 'general deduction formula' and qualifying provisions of specific deductions or allowances. This all sounds easy enough. It was once said that if someone said that they understood quantum physics, it only showed that that person did not actually understand it at all.

Tax is very similar, as it is not only constantly evolving, it is mainly based on legislation, but interpreted and applied based on many influences, such as case law. South Africa's general anti-avoidance provisions (sections 80A to 80K of the

Income Tax Act, which replaced section 103(1), referred to as the 'GAAR' provisions) are still relatively new and greatly un-tested in our courts. However, often overlooked are the qualifying provisions and limitations written into various sections that have the effect of anti-avoidance. The GAAR provisions consist of 12 complex sections mainly aimed at establishing the type of transactions that are 'impermissible tax avoidance arrangements' and the powers that SARS have with regards to such transactions. Instead of debating tax avoidance versus tax evasion, we now debate whether a transaction is an impermissible avoidance arrangement. The general components of an impermissible avoidance arrangement are:

- There must be an 'arrangement', which is defined as any transaction, operation, scheme, agreement or understanding (whether enforceable or not); and
- Such arrangement contains a 'tax benefit', which, in this context, means any avoidance, postponement or reduction of any tax liability; which
  - Is defined as an 'avoidance arrangement'.
    - Where in addition to an 'avoidance arrangement': – The 'sole or main purpose' of the arrangement is to obtain a tax benefit; and – There is a 'tainted element' to the arrangement (referred to as the abnormality provision);
- The transaction will be defined as an 'impermissible avoidance arrangement'

An 'avoidance arrangement' becomes an 'impermissible avoidance arrangement' when the Commissioner is satisfied that the arrangement was entered into with the sole or a main purpose of obtaining a tax benefit. The Income Tax Act contains a rebuttable presumption that an avoidance arrangement is – 'Presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax

benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

The criteria for an 'avoidance arrangement' are that the sole or main purpose of entering into the 'arrangement' was to obtain a tax benefit and there is an element of abnormality in the arrangement (referred to as a 'tainted element'). In the context of business, a 'tainted element' means that the arrangement:

- Was 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; or
- Lacks commercial substance, in whole or in part (section 80C). In a context other than business, the arrangement was 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. In any context, a 'tainted element' will be if the arrangement:
  - Has created rights or obligations that would not normally be created between persons dealing at arm's length; or
  - Would result directly or indirectly in the misuse or abuse of the provisions of the Act. The test for 'lacking commercial substance' (section 80C) in the context of a business transaction provides that an arrangement will lack commercial substance if it would result in a significant tax benefit for any party to the arrangement but does not significantly affect:
    - The party's business or commercial risks; or
    - Its net cash flows (apart from the tax benefit). The following two characteristics would indicate a lack of commercial substance (not limited to these items):

- The legal substance or effect of the arrangement as a whole is not consistent with or differs significantly from the legal form of the steps which make up the arrangement; or
- There is included in the arrangement or there exists – – Roundtrip financing (section 80D); – An accommodating or tax-indifferent party (section 80E); or – Elements in the arrangement which have the effect of offsetting or cancelling each other out.

Section 80F provides that the Commissioner is entitled, for the purposes of determining whether there is a lack of commercial substance, or to determine whether or not a tax benefit exists, to treat parties who are connected persons in relation to each other as a single party, or disregard any accommodating or tax indifferent party, or combine such a party with any other party in considering the arrangement. Tax avoidance is not obtained by masking or changing the perceived nature of a transaction after the fact, but by understanding the nature, options, and risks before the transaction is concluded. The reality is that tax will still be paid; you can merely structure your affairs in such a way as to pay the least amount of tax permitted by law.