

A race to the door

The release of the final version of government's proposed taxation "general anti-avoidance rule" has, not surprisingly, generated some strong predictions of the-end-of-civilisation-as-we-know-it from tax advisers and strong support from revenue officials.

Is SA commerce really on a collision course, resulting in uncertainty, unsustainable compliance costs and potential financial ruin? Or is the hyperbole being generated by a small minority of taxpayers who are concerned that the new law will affect their attempts to push the boundaries of legitimate tax planning?

General anti-avoidance rules have become common features in many tax laws. SA is a relative old-timer in the world of general anti-avoidance provisions, as its Income Tax Act has contained such a rule for 65 years.

Why, then, propose a new version? The answer is that the current rules are insufficient to deal with the sophistication of modern tax planning techniques. As SA has reintegrated into the world economy, taxpayers have gained access to a dizzying array of commercial and financing techniques.

An effective general anti-avoidance rule is one that inhibits no legal commercial deals, but prevents taxpayers from entering deals that seek to avoid tax payments for tax, and not commercial, reasons. Critics of the proposed rule say it steps beyond legal norms, allowing the SA Revenue Service (Sars) to intervene even when taxpayers have correctly complied with the letter of the law.

Supporters, on the other hand, contend the rule merely allows Sars to apply the law, read literally, to an actual deal — not the obfuscating paper trail laid down to disguise the true transaction. A simple example is the classic multistep deal where a single arrangement is broken into several elements, so that different tax rules can apply to the different parts. If the transaction were considered in its commercial entirety, an entirely different result would apply. The taxpayer and tax authority may agree the law should be applied "literally", but the question remains whether it is applied to the overall

transaction, or separately to each of the steps. The anti-avoidance rule mandates the former.

So the crucial question is: when can Sars invoke the rule and when not? Globally, general anti-avoidance rules follow two basic models. In the extreme case (an example is New Zealand), the tax commissioner can strike down and recharacterise a deal where the effect of the original transaction is to deliver a tax benefit to a taxpayer. Further along the spectrum are countries using a "purpose" test — the anti-avoidance rule can be invoked when tax minimisation is the dominant (Australia) or primary (Canada) purpose of a transaction.

Perhaps in response to concerns that tests based on subjective intent are inherently unstable and unfair, the proposed SA rule contains a two-pronged test: a deal will be caught by the proposed rule only if its "sole or main purpose" was to obtain a tax benefit, and one of four further secondary conditions for business taxpayers (or three secondary conditions for non-business taxpayers) is met.

Not only does the initial threshold set a bar for Sars as high as is found anywhere, but the additional conditions are taxpayer-friendly. Sars must show that the taxpayer had the main purpose of obtaining a tax benefit, and further that the deal was not bona fide, lacked commercial substance, created abnormal rights and obligations, or frustrated the application of another tax measure.

Governments worldwide have attempted to draw the line between legal tax planning and unacceptable tax avoidance, and the question is not whether it should be done, but how it is done. Viewed from other jurisdictions with general anti-avoidance rules, the draft SA version looks remarkably mild. ■

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