Institute of Certified Public Accountants of South Africa

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Law Administration
South African Revenue Service

Submitted by e-mail: policycomments@sars.gov.za

RESPONSE IN TERMS OF CALL FOR COMMENT – DISCUSSION PAPER ON TAX AVOIDANCE AND SECTION 103 OF THE INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962); NOVEMBER 2005

With reference to your call for comment regarding the discussion paper on tax avoidance and section 103 of the Income Tax Act, hereby the comments from the Tax Committee of the Institute of Certified Public Accountants of South Africa.

1. Firstly, we would like to commend the drafters of this document on a well drafted and comprehensive study of anti avoidance and the motivations for the proposed amendments.

2. Section 103(1) has to some extent failed, specifically the *Conhage* (*CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA), 61 SATC 391) case when the Supreme Court of Appeal that made two primary findings: Firstly, within the bounds of anti-avoidance legislation, a taxpayer may minimise his/her tax liability by arranging his/her affairs in a suitable manner. Secondly, in determining whether the sole or main purpose of any transaction, operation or scheme was to obtain a tax benefit, one must look at the transaction or scheme as a whole and not merely at certain elements. Thus as long as the scheme as a whole was done for commercial purposes, individual steps within could not be attacked even if the sole or main purpose of those individual steps was the avoidance of tax. We support the amendment that would effectively override the effects of the *Conhage* case findings. The transactions should be reviewed as isolated elements and as a whole in

establishing if the main purpose of any transaction, operation or scheme is/was to obtain a tax benefit.

3. By merely comparing the number of times SARS was successful in arguing the provisions of section 103 in court, versus the number of times that the taxpayer was successful is not sufficient to determine the efficiency in application of this section. It is a regular occurrence that SARS correspondence highlights the provisions that SARS may impose against a taxpayer. Tax advisors and consultants regularly inform their clients of the risk of SARS attacking schemes or transaction under the provisions of section 103. Many of such clients are discouraged from implementing schemes or transactions that could be attacked under the provisions of the current Section 103. This effect can not be measured, but have found from practice that the majority of taxpayers are discouraged by the mere fact that SARS may attack such transaction or scheme. Furthermore, the corporate environment has dramatically changed in the past few years as corporate governance and disclosure have become the key phrases in management boards and decision making discussions. Directors are more concerned with the issues of governance and compliancy than to risk taking the chances that would drive more aggressive structures and schemes.

4. It was expressed in the discussion paper that impermissible tax avoidance causes revenue losses to the state and national fund, however, no economic study was provided in support of such claims. It is reasonable to express that impermissible tax avoidance would cause some losses, but the extent of such is not quantified!

5. It was expressed in the discussion paper that impermissible tax avoidance is often achieved by, and cloaked by, complicated structures. It was further expressed that these complicated schemes/structures are predominantly done by large organisations; and developed by financial institutions, professional firms, and organisations that traffic such schemes. Changing legislation that would affect all taxpayers across the full spectrum of the law because of a few taxpayers wishing to explore isolated sections of the tax legislation would not be fair to the majority of taxpayers. Our current tax legislation has with great success applied specific tax avoidance provisions. Specific anti avoidance provisions are more structured and allow for more certainty in the interpretation and application of such provisions than that of general anti avoidance provisions that may offer differences in interpretation and application as general anti avoidance provisions are not tailored sufficiently.

6. Perception has dominated for many years that smaller entities, such as close corporations, are mainly involved in schemes of tax avoidance. It is clear from the discussion document that the impermissible tax avoidance that needs to be addressed is that of larger organisations that have more complex structures and more money to allocate

towards provisional assistance in doing so. It should be noted that we have identified that the main cause of trouble with regards to tax liabilities and smaller organisations is that such smaller organisations battle to remain compliant due to the costs of doing so. Specific anti avoidance provisions aimed at larger structures would in many cases not affect the smaller organisations. Where changes, such as proposed in the discussion paper, to the general anti avoidance provisions would complicate the tax compliancy requirements and would require even greater costs of compliancy.

7. The proposed new section 103(1) will probably increase uncertainty for taxpayers, the inhibition of legitimate and/or innovative transactions, and “perhaps most importantly, what has been described as an ‘uneasy tension’ between the general anti-avoidance rule and the rule of law”. An increase cost of compliancy would result in taxpayers having to seek more extensive and time consuming advice and opinions from professionals.

8. “Changes to the Reportable Arrangement rules would also be made in order to capture transactions embodying the factors giving rise to a presumption of abnormality.” The taxpayer, or his tax practitioner, has greater access to information and intentions and therefore would have a different perspective than SARS would have, therefore making this extension of the Reportable Arrangement rules more difficult to comply with. If the provisions of Reportable Arrangement rules would result in the taxpayer feeling exposed when approaching a tax practitioner for advice, the taxpayer may avoid seeking professional advice and would affect compliancy.

9. The proposed section 103(4) places a substantial burden of proof on the shoulders of the taxpayer. This section can easily be abused and applied in nearly all circumstances, even to the extent that the taxpayer may not be in a position to defend its position. The presumption proposes that the taxpayer is guilty of impermissible tax avoidance until proven innocent, merely because the taxpayer may be in the position to obtain a tax benefit. Surely the taxpayer has the constitutional right not be presumed guilty, as well as having the right to structure his/her affairs to best suite his/her needs and minimise the burden of taxation!

10. Presently the legislation allowing SARS to give advance rulings (not yet in force) specifically determines that SARS has the right to refuse to give a ruling on the applicability of section 103. The discussion paper proposes that the system will be “modified as it is phased in so as to permit taxpayers to obtain greater guidance and certainty in respect of the application of the new provisions”. However, this will take some time to offer any real value to the broader spectrum of taxpayers. Uncertainty and possibly excessively aggressive use by SARS of the proposed revised section 103 could lead to more issues of compliance and affect the taxpayer’s perception and willingness to comply. SARS has done a great job at collecting and assessing taxes in the past few

years. In practice we have seen a positive shift of attitude of the taxpayer, as well as the fear of recourses when failing to comply has been restored. This could change if the taxpayer feels that SARS is too aggressive and that tax planning opportunities are removed.

11. We would propose the following additional considerations for the reform of the general anti avoidance provisions:

- Schemes, and all there mechanisms, that are identified by SARS should be made public knowledge. This would remove the marketability of such scheme, as well as indicating to all taxpayers that SARS will be aware of such schemes and that the taxpayer faces a great risk using such a scheme.

- Introduce a method of naming the taxpayers and their facilitators that are found guilty of utilising impermissible tax avoidance schemes, transactions or operation as this would act as a discouragement; and could affect the taxpayer's public perception. Directors of companies would have to explain to their shareholders why the company name has been shamed and facilitators could lose the clients that do not want to be associated with impermissible tax avoidance.

- Some organisations develop schemes of impermissible tax avoidance, and professionals assist taxpayers in applying such schemes. The developed schemes are often applied by multiple taxpayers. If more reliance is placed on the regulation of tax practitioners as was implied when the registration and regulation of tax practitioners where introduced by the Minister of Finance during his budget speech, the development of schemes would be limited and SARS would have increased capacity to not only attack the taxpayer, but the tax practitioner as well. The tax law should make provision to offer legal provisional privilege to the duly registered tax practitioner allowing the taxpayers the freedom to consult and obtain proper advice free of the fear of persecution. Offering such legal provisional privilege would not extend to the level where the tax practitioner is involved in the application or administration of any impermissible tax avoidance scheme, transition or operation. As legal provisional privilege would not interfere with the taxpayer's disclosure obligations, nor the requirements of making available requested documentation or information, SARS could still administer and audit taxpayers without obstruction. The taxpayer can obtain proper advice and certainty, and more reliance can be placed on the advice of tax practitioners, while such practitioners would face additional risks for participating or encouraging the use of impermissible tax avoidance schemes, operation or transactions. What the definition of a "promoter" is, and what the dividing line is between a promoter and an advisor, remains uncertain.

12. In conclusion, we would suggest that more reliance and responsibility could be placed on the shoulders of the tax practitioner, therefore address the primary source of development of complicated impermissible tax avoidance schemes. This may be more effective as a tax practitioner would have more influence on the taxpayer. This could reduce the promotion of such impermissible tax avoidance schemes on a greater scale, while still allowing the taxpayer to structure its affairs in the most efficient manner. We would rather support the continued use and reliance on specific anti avoidance provisions than that of aggressive general anti avoidance provisions that could negatively impact on the taxpayers. The 80/20 principle asserts that a minority of causes, inputs or effort usually lead to a majority of the results, output or reward. Don't implement changes that will affect 80% of the taxpayers that are not implementing complicated impermissible tax avoidance due the actions of the other 20%.

We have no other submissions regarding this discussion paper.

If you require any further information or clarity regarding any of our comments, please do not hesitate to contact us.

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