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SOUTH AFRICA

- The Constitutional Court redraws the boundaries of GAAR participation



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The Constitutional Court redraws the boundaries of GAAR participation

In a recent Constitutional Court judgment concerning the modern general anti-avoidance rules (GAAR), available [here](#), the court delivered its first substantive interpretation of sections 80A to 80L of the Income Tax Act 58 of 1962 (Act) following their introduction through the 2006 amendments to the Act.

At the centre of the dispute were several interpretive questions regarding the modern GAAR provisions. These included whether the enquiry into “sole or main purpose” under section 80A is objective or subjective in nature, the degree of participation or knowledge required before a taxpayer can constitute a “party” to an arrangement under section 80L, and how “tax benefit” should be assessed in commercial arrangements involving interconnected transactional steps.

What is GAAR?

GAAR is intended to protect the integrity of the tax system by enabling the South African Revenue Service (SARS) to challenge “impermissible avoidance arrangements” that comply with the literal wording of tax legislation but undermine its underlying purpose. The modern GAAR provisions were introduced in 2006 to strengthen SARS’ ability to address increasingly sophisticated avoidance arrangements following concerns regarding the limitations of the earlier section 103(1) regime.

Section 80A applies where an arrangement results in a tax benefit and has, as its sole or main purpose, the obtaining of a “tax benefit”. Concepts such as “purpose”, “arrangement”, “party” and “tax benefit” therefore form central jurisdictional requirements for determining whether an arrangement constitutes an “impermissible avoidance arrangement” under GAAR.

If GAAR applies, section 80B gives SARS remedial powers to determine the tax consequences of the arrangement. These powers include disregarding, combining or re-characterising steps in the arrangement, or treating the arrangement as if it had not been entered into or carried out.

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Objective purpose, participation and “wilful blindness”

A central feature of the judgment was the Constitutional Court’s adoption of a strongly purposive and objective approach to sections 80A and 80L.

In assessing whether an arrangement had, “as its sole or main purpose”, the obtaining of a tax benefit under section 80A, the court focused on the objective features, implementation and commercial consequences of the arrangement as a whole rather than treating the taxpayer’s stated commercial rationale as determinative.

The taxpayers indicated that their involvement was confined to specific contractual components of the overall structure and that they lacked knowledge of the downstream aspects of the arrangement relied upon by SARS. This argument went directly to whether they could properly be regarded as a “party” to the alleged impermissible avoidance arrangement for purposes of section 80A.

In addressing that issue, the Constitutional Court adopted a broad interpretation of “arrangement”, which section 80L defines to include “any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof”. The court held that a taxpayer need not have explicit knowledge of every downstream component of an arrangement before it can constitute a “party” to an impermissible avoidance

arrangement. Instead, participation in a constitutive step of the broader arrangement may suffice for purposes of section 80A.

The judgment therefore confirms that courts will from now on assess both purpose and participation by reference to the objective features and commercial effect of the arrangement as a whole. Legitimate commercial features within a transaction will not necessarily prevent GAAR from applying if the arrangement, viewed objectively, is directed at obtaining a tax benefit.

The court repeatedly warned against allowing taxpayers to benefit from arrangements while disclaiming knowledge of downstream tax avoidance features and expressed concern that a narrower interpretation could incentivise taxpayers to remain deliberately ignorant of the broader structure through which returns are generated.

The decision accordingly broadens potential GAAR exposure for banks, institutional investors, funders and other participants in layered commercial transactions involving multiple parties, advisers and transactional layers where participants may have differing levels of visibility over the broader structure. Sophisticated financing and investment arrangements frequently involve compartmentalised information and reliance on third-party structuring, creating uncertainty regarding when ordinary commercial reliance or limited visibility may become vulnerable to characterisation as “wilful blindness” for GAAR purposes.

Rogers J’s dissent highlighted precisely this concern. In his view, participation necessarily presupposes awareness of the arrangement itself and a person cannot meaningfully participate in an arrangement of which it is unaware. The dissent accordingly cautioned against an interpretation that could potentially extend GAAR consequences to taxpayers whose involvement is commercially limited or confined to isolated transactional steps within a broader arrangement.

A broader approach to “tax benefit”

The judgment also addresses “tax benefit”, which section 80L broadly defines to include “any avoidance, postponement or reduction of any liability for tax”. Whether a taxpayer has obtained a “tax benefit” therefore directly affects whether section 80A may apply at all.

The taxpayers contended that the relevant tax benefit arose elsewhere in the structure and that they themselves received, at most, an economic or financial benefit. The Constitutional Court rejected this narrow approach and instead applied a counterfactual enquiry that stripped away the alleged avoidance features of the arrangement and assessed the substantive commercial effect of what remained.

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On that approach, the court reasoned that the relevant returns were, in substance, equivalent to taxable interest rather than tax-exempt dividends. The court therefore did not confine the enquiry to the formal legal characterisation of the returns actually received by the taxpayers, but instead evaluated the broader commercial substance and economic effect of the arrangement once the allegedly impermissible features had been stripped away.

The judgment accordingly confirms that the enquiry into “*tax benefit*” does not necessarily end merely because the assessed taxpayer did not itself directly avoid tax in the conventional sense. The risk for taxpayers is that GAAR may apply where a taxpayer receives an exempt or otherwise tax-favoured return under the implemented legal structure, but the broader arrangement, viewed objectively, indicates that the return forms part of a wider avoidance structure. In this regard, Judge Rogers expressed concern that this approach may narrow the distinction between a taxpayer obtaining a tax benefit itself and merely deriving a commercial advantage from another participant’s tax position.

Conclusion

The Constitutional Court’s judgment signals a broader and more objective application of the modern GAAR provisions than was traditionally associated with section 103(1). In particular, the judgment expands the potential scope of participation in an “*impermissible avoidance arrangement*” by indicating that explicit knowledge of every downstream component of the arrangement is not necessarily required before a taxpayer may constitute a “*party*” thereto for purposes of section 80A.

The decision accordingly increases potential GAAR exposure for participants in integrated commercial arrangements involving multiple parties, transactional layers and differing levels of visibility over the broader structure. At the same time, the judgment leaves important questions regarding the limits of objective participation and the extent to which limited visibility or ordinary commercial reliance may become vulnerable to characterisation as “*wilful blindness*” for GAAR purposes.

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