A BRIEF OVERVIEW THROUGH A SERIES OF ARTICLES ON THE ANTI-AVOIDANCE PROVISIONS OF THE INCOME TAX ACT 58, 1962

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This is the first of a series of short articles on the anti-avoidance provisions of the Income Tax Act[1] ("the ITA") including specifically the provisions of section 31 (which deals with thin capitalisation), together with its effect on section 64C (3) (e) of the ITA. Thin capitalisation provisions were introduced into the ITA in 1996 when it became clear that there was a gap in the law which, in theory, could disguise the payment of dividends to off shore shareholders as the payment of interest and would, not only result in the avoidance of the payment of Secondary Tax on Companies ("STC"), but would also allow the deduction of certain payments as loans by on shore companies and prevent this from being taxable income. The detail around this provision will be discussed later in this series of articles.

It is fitting at this early stage to explain the important distinction between tax evasion and tax avoidance. Tax evasion refers to illegal activities deliberately undertaken by a taxpayer to free himself of a tax burden. An example of tax evasion is where a taxpayer fails to include all of their income in their annual income tax return[2] or where they conceal their income[3]. Tax evasion is subject to severe penalties in terms of sections 75 and 76 of the ITA[4]. Tax avoidance, on the other hand, usually denotes a situation in which the taxpayer has arranged their affairs in a perfectly legal manner with the result that they either reduce their income or that they have no taxable income[5]. The principle of tax avoidance is clearly described by Lord Tomlin in Duke of Westminster V IRC 1953 where it was held that "Every man is entitled if he can order his affairs so that the tax attaching under the appropriate act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers maybe of his ingenuity, he cannot be compelled to pay an increased tax"[6].

The ITA contains certain provisions to combat the practice of tax avoidance. The specific anti –avoidance provisions contained in the ITA include without limitation section 1(c)[7], sections 7(1) – 7(7)[8], section 8E which deem certain dividend accruals to be interest, section 9A, 9C and 9D[9], section 22(8) which deals with the donation or private consumption of trading stock, section 31 which deals with transfer pricing and thin capitalisation (to be discussed in greater detail later in this series of articles), and sections 54 to 64 relating to donations tax. In addition to the above-mentioned provisions, there is a general anti-avoidance provision, which can be found in section 103(1) of the ITA and is used as a "catch all" provision where schemes to avoid tax are employed. Debates have arisen around the application of section 103(1)[10] as to how far reaching it can be and conflicting case law has been established in this respect. Part 2 of this series of articles to be published on our website in December will deal briefly with the application of section 103 (1) of the ITA. In the meantime, we trust that this article has adequately provided the reader with a brief and succinct distinction between tax evasion and tax avoidance.

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[1] Income Tax Act 58,1962 as amended from time to time
[2] Arendse JA, Jordan J, Kolitz MA, Steyn M: Silke: South African Income Tax, 1999, Butterworths, 1998, at 470
[3] David Meyerowitz: Meyerowitz on Income Tax; The Taxpayer, 2002, at 29-1
[4] ITA 58 of 1962

[5] Op cit note 2, at p470
[6] Duke of Westminster V IRC 1953, at p520
[7] ITA 58 of 1962, section 1(c) of the definition of “gross income” which deals with the receipt and accrual by a person of amounts for services rendered or to be rendered by another person.
[8] Which deals with situations where donations are made to others and may be subject to donations tax in the hands of the donor
[9] which deals with certain investment income from foreign sources
[10] of Act 58,1962