Prepare a memorandum to Dr John Rentalittle in which you discuss whether the agreement between himself and Richard constitutes an 'impermissible avoidance arrangement' and, if so, what implications this would have for John.

| MEMORANDUM |
|------------------|------------------|
| **To** | Dr John Rentalittle |
| **From** | Trainee Accountant |
| **Date** | July 2013 |
| **Subject** | Impermissible avoidance agreement |

Note: Section 11A does not limit the section 13 sex allowance.

The following prerequisites must be satisfied for an impermissible avoidance arrangement to exist:

- There must be an arrangement:
  - In terms of section 80L the word ‘arrangement’ means an ‘arrangement, operation, scheme, agreement or understanding (whether enforceable or not), including all steps in it, or parts of it’...’
  - The agreement or understanding between yourself and your son, Richard, is therefore an ‘arrangement’ as defined.

- The next step is to determine if this arrangement is an avoidance arrangement:
  - An ‘avoidance arrangement’ is also defined in section 80L and means an arrangement that results in a tax benefit. A ‘tax benefit’ is defined in section 80L as including an avoidance, postponement or reduction of a liability for tax. The word ‘tax’ is also defined in section 80L. It includes a tax, levy or duty imposed by the Income Tax Act or any other law administered by the Commissioner.
  - Prior to entering into the agreement with Richard, you were paying normal tax on the rentals received from your tenants. After the agreement, your rental taxable income increased, resulting in an increased normal tax liability. But you now enjoy an allowance previously unavailable to you, resulting in an annual tax saving of R24 000 ((R78000 – R18000) x 40%). You have therefore obtained a tax benefit.
  - This means that this agreement is an ‘avoidance arrangement’.

- The sole or main purpose of this arrangement must be to obtain a tax benefit (the meaning of a tax benefit was already explained above):
  - In terms of section 80G(1), 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 its sole or main purpose.
  - Section 80G(2) then states the purpose of a step in, or part of, an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole.
  - It must be remembered that the taxpayer bears the onus of proof in this regard:
    - With regard to the ‘purpose’ you will have to prove that the sole purpose of the arrangement was not to obtain a tax benefit. In this regard Judge Lewis in the NWK case) stated: ‘If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated.’ In arriving at a conclusion on such a matter a court of law must, according to the judge, examine ‘...the commercial sense of the transaction: of its real substance and purpose’.
    - From the facts provided you will find it difficult to prove that the sole purpose of the arrangement was not to obtain a tax benefit.
  - The next requirement is then to test for the so-called ‘tainted element’.
    - The Act distinguishes between an arrangement in the context of business and one which is in a context other than business. And then it also provides a general test to be applied in any context. An application of the various tests follows:
      - **Business purpose:** It is noted that you started charging you son rentals only after you realised that you could obtain a tax benefit. It is therefore submitted that this...
The arrangement has not been entered into for a purpose other than that of obtaining the tax benefit.

- **Abnormal rights and obligations:** It is submitted that the agreement between yourself and your son would not give rise to abnormal rights and obligations due to the special nature of the relationship between a father and a son.

- **Misuse or abuse of the provisions of the Act:** It is clear that your son may well be an accommodating party as envisaged in section 80E(1)(a). The contribution to his maintenance is free for any tax.

- **Since the ‘business purpose’, and the ‘misuse or abuse of the provisions of the Act’ criteria are met (see above) it matters not that abnormal rights or obligations do not exist.**

### Conclusion

There are three tests under section 80A(1)(b) and (c) and provided one is present, the fourth prerequisite is present. In this arrangement it would seem that two of the three tests have been met. Since all four prerequisites are present, the Commissioner will be able to successfully apply the provisions of section 80B against yourself.

- **Implications:**
  - The Commissioner is most likely to apply the provisions of section 80B(f). This would allow the Commissioner to restructure the agreement to its true form. The end result would be that you would not qualify for the capital allowance under section 13sex of R78000 ((R195000 x 4) x 10%).
  - You would, however, not be required to include the R18 000 rental received from your son in your gross income either.
  - The agreement between John and your son seems to be a sham transaction.
  - The comments by Judge Lewis (mentioned above) are relevant. It is widely accepted that these comments should be read in the context of the facts of the NWK case, but it is equally well known that SARS will use these arguments in a dispute. As soon as the court established that the substance of the arrangement is to achieve a tax saving it may find that the transaction is simulated.

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<th>Available</th>
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<th>Communication skills – logical argument; clarity of expression; layout and structure</th>
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**TOTAL MARKS FOR QUESTION**

20