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Clarifying application of the General Anti-Avoidance Rules

The Tax Court in *Mr Taxpayer G v Commissioner for the South African Revenue Service* [2025] ZATC 12 (the case) clarified the application of the “general anti-avoidance rules” (GAAR).

The GAAR rules, set out in sections 80A – L of the Income Tax Act 58 of 1962 (**the Act**), grant the South African Revenue Service’s (**SARS**) wide discretionary powers to determine the tax consequences for any party to an “impermissible avoidance arrangement.”

The case addressed a scheme whereby distributable reserves and secondary tax on companies (**STC**) credits were created and “sold” to third party investors. Mr G, (the **taxpayer**) was involved in arranging the underlying transactions pursuant to the scheme and received tax-exempt dividends in return. SARS challenged the scheme in terms of GAAR, and recharacterised the dividend income received as taxable service fee income.

What are the requirements of GAAR?

An “impermissible avoidance arrangement” arises where:

- An arrangement results in a “tax benefit” (i.e. any avoidance, postponement or reduction of tax liability);
- Where the sole or main purpose of such arrangement was to obtain a tax benefit; and
- The transaction exhibits one of the “tainted elements”; namely
 - it lacks commercial substance,
 - it was carried out by means or in a manner which would not normally be employed for *bona fide* business or general purposes other than obtaining a tax benefit (the **abnormality requirement**),
 - it created rights or obligations that would normally not be created between persons dealing at arm’s length (the **non-arm’s length requirement**), or
 - it would result directly or indirectly in the misuse or abuse of the provisions of the Act.

SARS bears the onus to establish that an arrangement which gives rise to a tax benefit exists. If successful, it is presumed that such arrangement was entered into for the sole or main purpose of obtaining such benefit, which may be rebutted by the taxpayer. SARS also generally bears the onus to prove the existence of the “tainted elements”; although there are presumptive factors in relation to a lack of commercial substance (including where a significant tax benefit arises without a corresponding impact on business risk or net cash flow).

Findings of the court

The court held that the scheme constituted an arrangement which resulted in a tax benefit for the taxpayer; namely the receipt of tax-free dividends as opposed to taxable income derived from the provision of services. In determining

whether the arrangement gave rise to a tax benefit, the court rejected the taxpayer's assertion that, as no tax liability was anticipated prior to the scheme, no tax benefit could arise from entering into the scheme. Instead, the court held that where the impugned transaction results in the avoidance, postponement or reduction of tax liability when compared to an appropriate alternative, a tax benefit arises.

The court further confirmed that determining the sole or main purpose of an arrangement was an objective test, where all the relevant facts and circumstances regarding the transaction should be considered (including the subjective purpose of the taxpayer with regards to the arrangement). The court concluded, considering the evidence, that the taxpayers sole or main purpose in entering into the scheme was to obtain tax-exempt dividends.

Notwithstanding the above, the court confirmed that a "tainted element" must be established for the scheme to constitute an "impermissible avoidance arrangement"; as the mere fact that the transaction was entered into for the sole or main purpose of obtaining a tax benefit is insufficient. The court found that the scheme exhibited both abnormality and non-arm's length requirements, particularly considering the establishment of the scheme through journal entries and the unusual rights between the taxpayer and other parties within the scheme. Although only one tainted element is required, the court nevertheless also noted that the scheme lacked commercial substance for the taxpayer, in light of the significant tax benefit generated without significant impact on the taxpayer's business risks or net cash flows.

Key takeaways

The case is the first instance where each of the GAAR elements has been considered, providing insight as to how a court will interpret GAAR challenges in future. Of particular note is that:

- The fact that no anticipated tax liability existed prior to entering into an arrangement is not necessarily sufficient to argue that no tax benefit exists; the structure of the arrangement must also be considered and compared to an appropriate alternative to ascertain whether a tax benefit has arisen from the arrangement;
- Determining the "sole or main purpose" of an arrangement is a holistic objective test in which the subjective intention of the taxpayer is a relevant factor; and
- Having a sole or main purpose of obtaining a tax benefit is, by itself, insufficient for an arrangement to constitute an "impermissible avoidance arrangement"; one or more of the tainted elements also needs to be present.

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