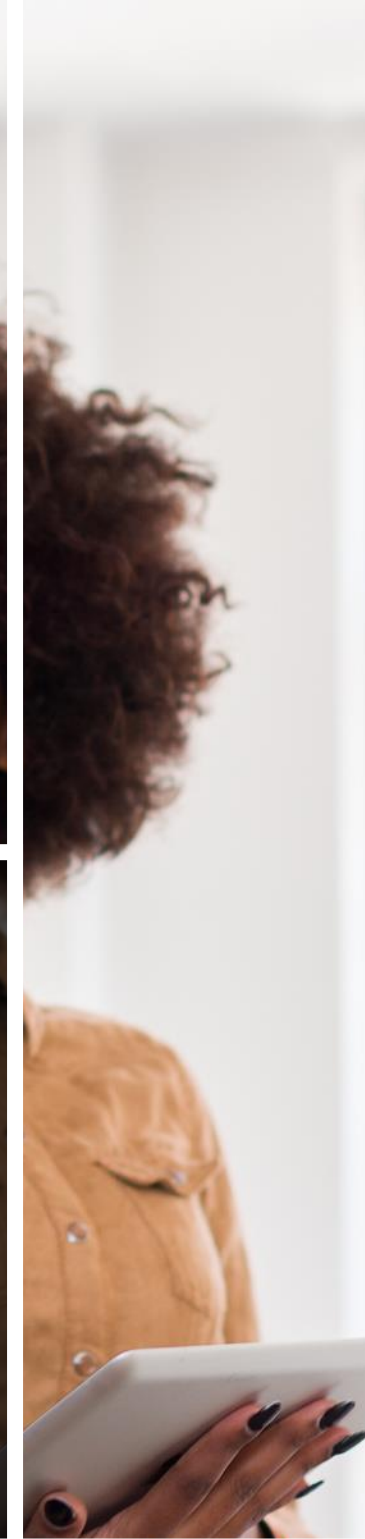




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Tax Controversy & Dispute Resolution

Africa Insight Series



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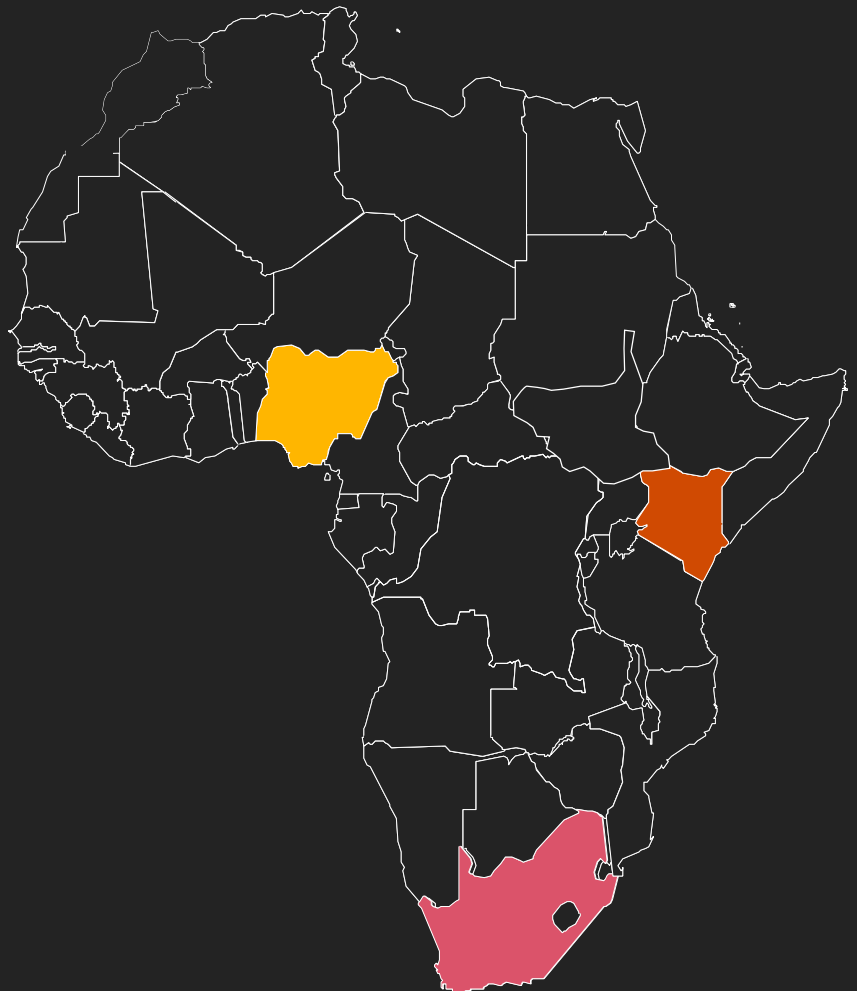
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Welcome

We are delighted to share insights from recent tax cases from the Tax Appeal Tribunals and Courts in Kenya, Nigeria and South Africa. This seminal publication from PwC's Tax Controversy & Dispute Resolution Team aims to bring businesses and taxpayers up to date with landmark tax decisions.

Some of the cases analysed from Kenya include cases relating to the definition of exported services for VAT purposes, taxpayer's right to VAT refunds for exported services where no agency relationship exists, definition of "interest" for the purpose of the Excise Duty Act 2015 and whether interchange fees earned by banks issuing credit / debit cards are subject to VAT.

From Nigeria, we analysed decisions relating to the extent of the executive's power to make or amend tax statutes, applicability of Double Tax Treaty Commentary to the France-Nigeria Double Tax Treaty with respect to income from shipping operations, the applicability of Value Added Tax to commercial and residential leases as well as the precedent setting decision on the applicability of Withholding Tax to sales in the ordinary course of business, an appeal in which our Tax Controversy & Dispute Resolution team represented the taxpayer.

Finally, cases analysed from South Africa include cases relating to the Voluntary Disclosure Programme (VDP), particularly on the question of whether interests can be remitted and the definition of "voluntary" and "disclosure" under the VDP, instances where VAT refunds would be made to taxpayers and potential liability of representative taxpayer or withholding agent for taxes of third party taxpayer.

If any of these cases impact you or your operations directly or indirectly, we would be delighted to discuss them further with you. Please contact any member of our Tax Controversy & Dispute Resolution teams in the respective offices.



Elle-Sarah Rossato
Lead, Tax Controversy and
Dispute Resolution
PwC South Africa
+27 (0) 11 797 4938
elle-sarah.rossato@pwc.com



Janet Lavuna
Senior Manager/Lead, Tax
Controversy & Dispute
Resolution
PwC Kenya
+254 (20) 285 5000
janet.lavuna@pwc.com



Folajimi O. Akinla
Senior Manager/Lead, Tax
Controversy & Dispute
Resolution
PwC Nigeria
+234 802 846 3369
folajimi.akinla@pwc.com

CMA CGM Delmasa SA v. FIRS

TAT/LZ/CIT/028/2017



Tax Appeal Tribunal rules that Commentary to Model Tax Convention is not applicable to Article 8 of the France-Nigeria Double Tax Treaty

Background

Section 14 of CITA provides special rules for taxing income from shipping activities which limits the taxable profit to income from outbound transport.

Article 8 of the OECD Model Tax Convention (MTC) allocates the taxing rights to the resident state of a shipping company on income arising from Shipping and Air Transport (in international traffic). The Double Tax Treaty (DTT) between France and Nigeria is modelled after the MTC. However, Article 8(2) of the DTT deviates from Article 8(2) of the MTC. It provides that income derived by the resident of a State from such activities in another State are exempt from tax in the other State, but where enterprises of only the State of resident carry on international traffic, tax at 1% of “earnings” is to be imposed by the other State from which the income is earned. MTCs are always supplemented by Commentaries which are intended to aid interpretation of DTTs modelled after the MTCs. These Commentaries are updated from time to time.

Facts of the appeal

In *CMA CGM Delmasa SA v. FIRS*, the taxpayer, an international shipping company, earned income from shipping activities including carriage of goods, demurrage, container cleaning, shipping line agency charge (SLAC), bonded terminal commission etc. FIRS assessed the taxpayer to tax on the income of over N1 billion for the years 2014 and 2015. The FIRS issued a notice of refusal to amend after the taxpayer objected.

Questions before the Tribunal

The questions for determination before the Tribunal were:

- Whether the sums in dispute (demurrage, cleaning fees, container sales, shipping line agency commission, bonded terminal commission and NIMASA levy), being directly connected and ancillary to the carriage of goods from foreign countries into Nigeria are taxable in Nigeria?
- Whether the Appellant is liable to penalty and interest in respect of the sums in dispute?

Taxpayer arguments:

- By Article 8 of the DTT and the accompanying Commentary, such income, being ancillary to in-bound freight were exempt from tax in Nigeria,
- According to the MTC Commentary, income from ancillary or non-freight activities such as leasing of containers, storage etc. are defined as arising from international traffic so are tax exempt.
- Interest and penalty would not apply given that the assessment had not become final and conclusive.

FIRS' arguments:

- By specifically listing the exempt income, Article 8 does not extend to non-freight income therefore such income would be taxable under the CITA regardless of whether they arise from in-bound or out-bound transport,
- Since Nigeria was not a member of the OECD, the Commentaries could not be relied on to interpret the France-Nigeria DTT,
- The taxpayer was subject to interest and penalty for failure to pay the tax in question as and when due.

The decision

The Tribunal held that based on treaty supremacy, the DTT would apply in place of section 14 of CITA. However:

- the Commentaries were supplementary to DTTs and provided guidance only when the provisions of the DTT are similar with the MTC,
- in this appeal, Article 8 of the DTT was substantially different from Article 8 of the MTC therefore the Commentaries could not be relied on to interpret Article 8,
- the income in question – non-freight income was not covered by the provisions of Article 8 therefore, the income was subject to tax under CITA,
- Finally, interest and penalty only stop to accrue once an appeal is filed but they attach upon payment of tax as and when due.

Analysis and takeaway

The crux of the appeal was whether the Commentaries to the MTC would apply when interpreting Article 8 of the France-Nigeria DTT. The question of whether the Commentaries are binding would usually depend on whether the Commentaries are static (extant at the time of negotiating the DTT) or ambulatory (amended after the DTT has come into force).

Generally, Commentaries in existence at the time DTTs are negotiated should be relied on by courts when interpreting DTTs. The rationale is that States are presumed to have intended to be bound by these except they registered reservations during treaty negotiations. Ambulatory commentaries may also be binding if it can be established that during treaty negotiations Contracting States expressed an intention to be bound by the terms consistent with the updated commentaries.

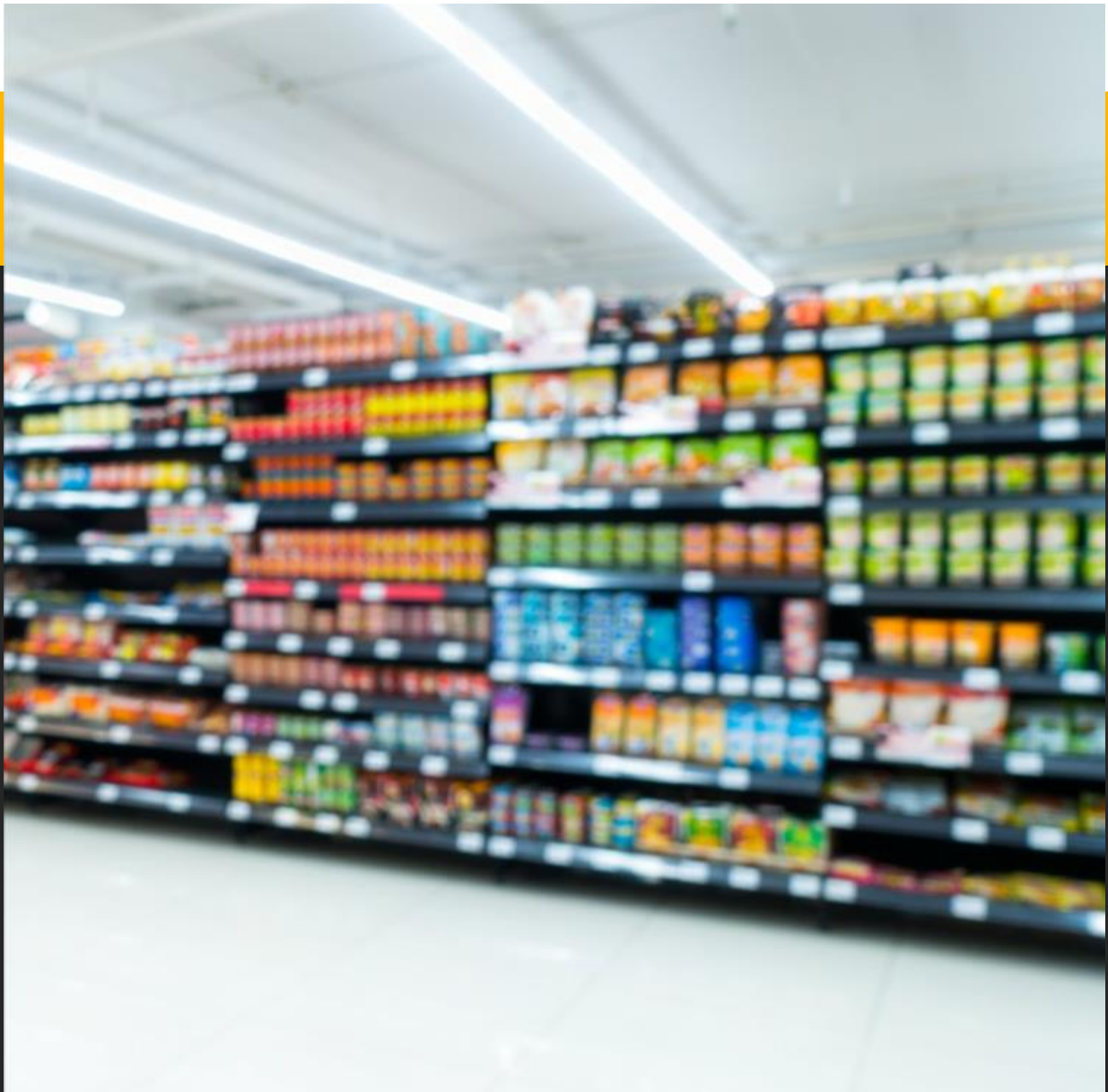
It is also necessary to note that courts and tribunals may be reluctant to apply Commentaries where the provisions in DTTs are not identical with the MTC. So, taxpayers intending to rely on the Commentaries must inquire whether DTT provisions are consistent with the text of the MTC. They must also find out whether any of the Contracting States made reservations or objections during negotiations. Where there are reservations or objections, it is less likely that the Commentaries are binding.

However, an examination of Article 8(1) of both the DTT and MTC show that both Articles are similar as they both allocate taxing rights to the State of residence of the shipping company. Therefore, the Commentary to Article 8(1) which defines the “profits” of such companies to include profits arising directly or ancillary to shipping operations such as renting containers, providing services etc. should be relevant for the purpose of interpreting Article 8(1) and the Tribunal should have relied on it. Taxpayers may, as an alternative to litigation, also explore the Mutual Agreement Procedure under DTTs.

It is instructive that the Finance Act 2020 has introduced a new subsection (5) to the section 14 of CITA which expands the category of taxable income of shipping and airline companies. Per the amendment, all incidental or non-freight income such as leasing income are taxable under CITA. It will be interesting to see how the amendment impacts Article 8 of DTTs.

Tetra Pak v. FIRS

TAT/LZ/WHT/007/2019



Tax Appeal Tribunal rules that sales in the ordinary course of business not subject to WHT

Background - legal basis and FIRS practice

The Companies Income Tax (Rates, Etc., of Tax Deducted at source) Regulations 1997 (WHT Regulations) requires that tax is withheld on payment for certain qualifying services. The rates are either 2.5%, 5% or 10% depending on the specific service.

The WHT Regulations provide that “*all types of contracts and agency arrangements other than sales in the ordinary course of business*” are subject to WHT at 5%. This means that sales in the ordinary course of business would not be subject to WHT. However, the WHT Regulations do not define what amounts to “sales in the ordinary course of business” (SITOCOB).

However, the Federal Inland Revenue Service (FIRS) takes the view that taxpayers must deduct WHT on all payments constituting a contract whether or not they are in respect of “sales in the ordinary course of business”. This imposes a practical burden on low margin businesses (like trade and manufacturing). To avoid assessments and penalties from FIRS, many businesses that make such purchases deduct WHT on the payments.

Facts of the appeal

The principal activities of Tetra Pak (“the Company”) involved importing and sale of packaging equipment and spares, installing equipment and providing after sales repairs.

The Company’s customers deducted WHT on its fees for sales provided in the ordinary course of its business. As a result, the Company paid companies income tax (CIT) via WHT in years where it did not make a profit. This impacted the Company’s cash flows considering that FIRS did not refund the WHT as it is required to do by the Companies Income Tax Act (CITA) and the Federal Inland Revenue Service (Establishment) Act (FIRSEA).

To manage the impact, the Company wrote to FIRS for confirmation that such sales should not be subject to WHT. FIRS ruled otherwise relying on some WHT Information Circulars. The Company appealed to the Tax Appeal Tribunal (TAT) challenging FIRS’ position and asking for a refund as well as interest on the WHT.

Taxpayer’s arguments

The Company argued that:

- “SITOCOB” should be given its literal meaning since it was not defined either in CITA or WHT Regulation. In addition, FIRS was wrong to attempt to define the phrase via its Information Circulars on WHT in a manner that was inconsistent with the WHT Regulations,
- the rule of interpretation that a specific provision would override the general should be applied distinguishing SITOCOB from “all types of contracts”,
- SITOCOB was a question of fact which can be determined from what a business does routinely.
- The Company further relied on a Court of Appeal decision in *Nigerian Breweries v Oyo State Board of Internal Revenue* where the court alluded to the fact that such sales should not be subject to WHT.

FIRS’ arguments

Interestingly, FIRS did not deny that the Company sold packaging equipment or spares routinely. However, it argued that once a sale was completed via a formal contract, it was no longer exempt from the WHT regime but had “forayed into

contract” with rights and obligations and therefore subject to WHT. In support, FIRS asked the Tribunal to apply the *ejusdem generis* rule.

The decision

Are SITOCOB liable to WHT - The TAT agreed with the Company that SITOCOB are not liable to WHT. In arriving at its decision the TAT held that although the WHT regime is a collection device, the primary objective is to prevent evasion. Therefore, in this case, there was no occasion for tax evasion as claimed by FIRS, since the taxpayer was not tax anonymous.

The TAT also held that SITOCOB was a question of fact and a tax authority has the responsibility of determining whether a business activity amounted to a SITOCOB. The TAT provided some guidance in determining whether an activity was a SITOCOB –

- whether the activity was contained in the memorandum and articles of association,
- the type of industry the taxpayer operates in,
- the history and antecedents of the taxpayer and
- the frequency of carrying out the activity.

Refund and payment of interest by FIRS - The TAT refused to make an order for refund of the excess WHT and interest on the ground that these were not specifically pleaded by the Company.

Review of WHT rates - From an administrative perspective, the TAT held that the WHT regime should consider the effective tax rates (ETR) of different industries before imposing WHT to ensure that companies do not suffer more tax than necessary.

Analysis and takeaway

The TAT has finally resolved a long standing, but seemingly straightforward question, of whether SITOCOB should be subject to WHT. The argument by the FIRS that once a contract is established, it would not constitute a SITOCOB is flawed because by saying “...other than sales in the ordinary course of business”, the WHT Regulations acknowledge that SITOCOB are contracts but specifically excludes them from WHT. Taxpayers and tax authority can now apply the tests provided by the TAT instead of the contradictory position in various FIRS circulars.

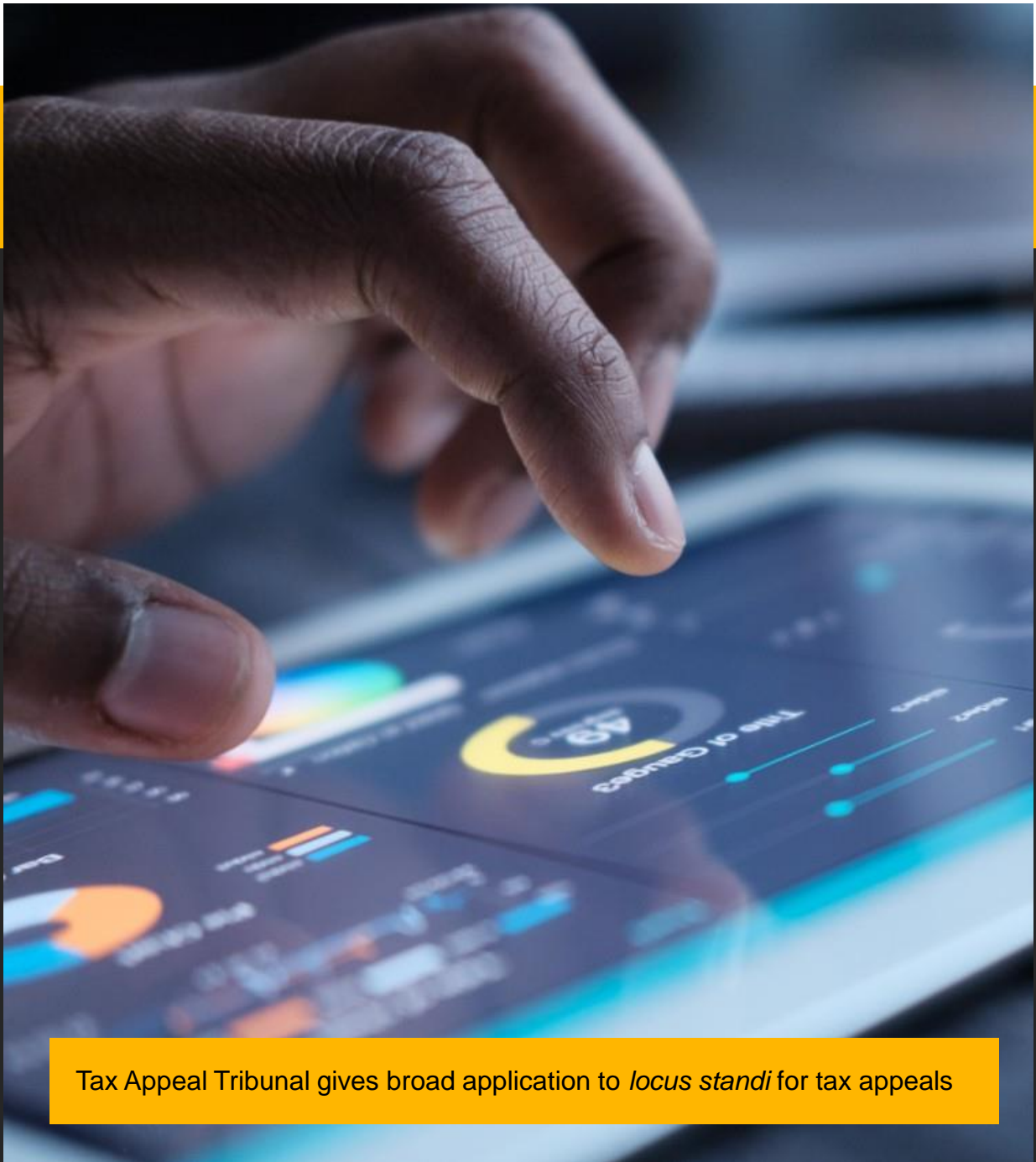
With respect to WHT remitted to FIRS before the decision, taxpayers are entitled to refunds per sections 81(7) of CITA and 40 of the FIRSEA which provide that any WHT collected should be refunded to the taxpayer within 90 days. Therefore, the authority has a responsibility to refund such taxes within 90 days.

Though the TAT did not grant the claim for a refund, there is a duty on FIRS to do so within a specific time. Therefore, to give effect to its decision. the TAT could have made a consequential order directing FIRS to refund within the statutory period any WHT wrongly remitted to and collected by the FIRS.

The TAT also commented on the legality of information circulars as being mere opinions of the tax authority on the meaning of the law as such they do not have the force of the law and are not binding on taxpayers. However, the TAT did not comment on whether, like other jurisdictions, these circulars form promissory estoppel against FIRS or whether they are sufficient to create legitimate expectations. It is possible that FIRS may appeal the decision.

Incorporated Trustees of Digital Rights Lawyers Initiative v. FIRS

TAT/LZ/VAT/031/2019



Tax Appeal Tribunal gives broad application to *locus standi* for tax appeals

Background

Locus Standi is a Latin phrase which means 'right to sue'. It means possessing the legal capacity to file a suit or commence an action in court or a tribunal. It is also defined as having "sufficient interest" to file an action.

The issue of locus standi does not often come up in the typical tax appeal which is usually preceded by a tax assessment, a series of correspondence between taxpayer and tax authority and a Notice of Refusal to Amend issued by the tax authority.

In ***The Incorporated Trustees of Digital Rights Lawyers Initiative v. FIRS***, the Federal Inland Revenue Service [FIRS], through a preliminary objection, challenged the Appellant's *locus standi* to file an appeal against a decision by FIRS to impose Value Added Tax (VAT) on online transactions.

Facts of the Case

On 26 August 2019, the Executive Chairman of FIRS at that time announced at a technical workshop of the African Tax Administrators Forum (ATAF) that the FIRS would ask Nigerian banks to start charging Value Added Tax (VAT) on online transactions from January 2020.

The Incorporated Trustees of Digital Rights Lawyers Initiative (ITDRLI) filed an appeal at the Tax Appeal Tribunal ('TAT' or 'the Tribunal') arguing that FIRS' decision to charge VAT on online transactions violates the provisions of sections 2,3,9 and 14 and Parts 1 and 2 of the First Schedule to the VAT Act.

In response, FIRS filed a reply challenging the jurisdiction of the Tribunal to entertain the appeal on the grounds that the Appellant lacked the necessary *locus standi* to institute the appeal and that the appeal was an abuse of the judicial process.

FIRS' arguments

FIRS' argued that at least one of the following conditions must exist before a taxpayer can file a tax appeal:

- a) an assessment,
- b) a demand notice by the FIRS on the taxpayer
- c) an action by the FIRS and
- d) a decision made by the FIRS.

FIRS further argued that ITDRLI had not demonstrated that it either had any legal right to sue for injury that it suffered by the Executive Chairman's announcement.

Taxpayer's arguments

ITDRLI argued that by virtue of Paragraph 11 of the Fifth Schedule to the FIRS Establishment Act (the Act setting up FIRS), the Tribunal has the jurisdiction to adjudicate on disputes and controversies from the VAT Act. By disagreeing with FIRS' proposed action, ITDRLI maintained that a dispute or controversy existed which could be determined by the Tribunal.

ITDRLI further argued that being a tax paying corporate citizen with a Tax Identification Number that would be affected by any VAT imposed on online transactions, it had demonstrated sufficient interest to file an appeal. Finally, ITDRIL also argued that since the appeal related to the interpretation of the VAT Act it was not frivolous.

The decision

The Tribunal held that:

- paragraph 11 of the Fifth Schedule to the FIRS Establishment Act vests the Tribunal with jurisdiction to adjudicate on **disputes** and **controversies** arising from the VAT Act. In the instant appeal, disputes would include all proclamations, notices and steps taken by relevant tax authorities in Nigeria.
- *Locus standi* should be construed liberally so as not to deny taxpayers access to the Tribunal.
- The decision to charge VAT on online transactions will affect all Nigerians including ITDRLI. Therefore, ITDRLI has sufficient *locus standi* to challenge FIRS' proposed action as announced by FIRS' Executive Chairman.

The Tribunal therefore ruled that it had the jurisdiction to hear the appeal on its merit.

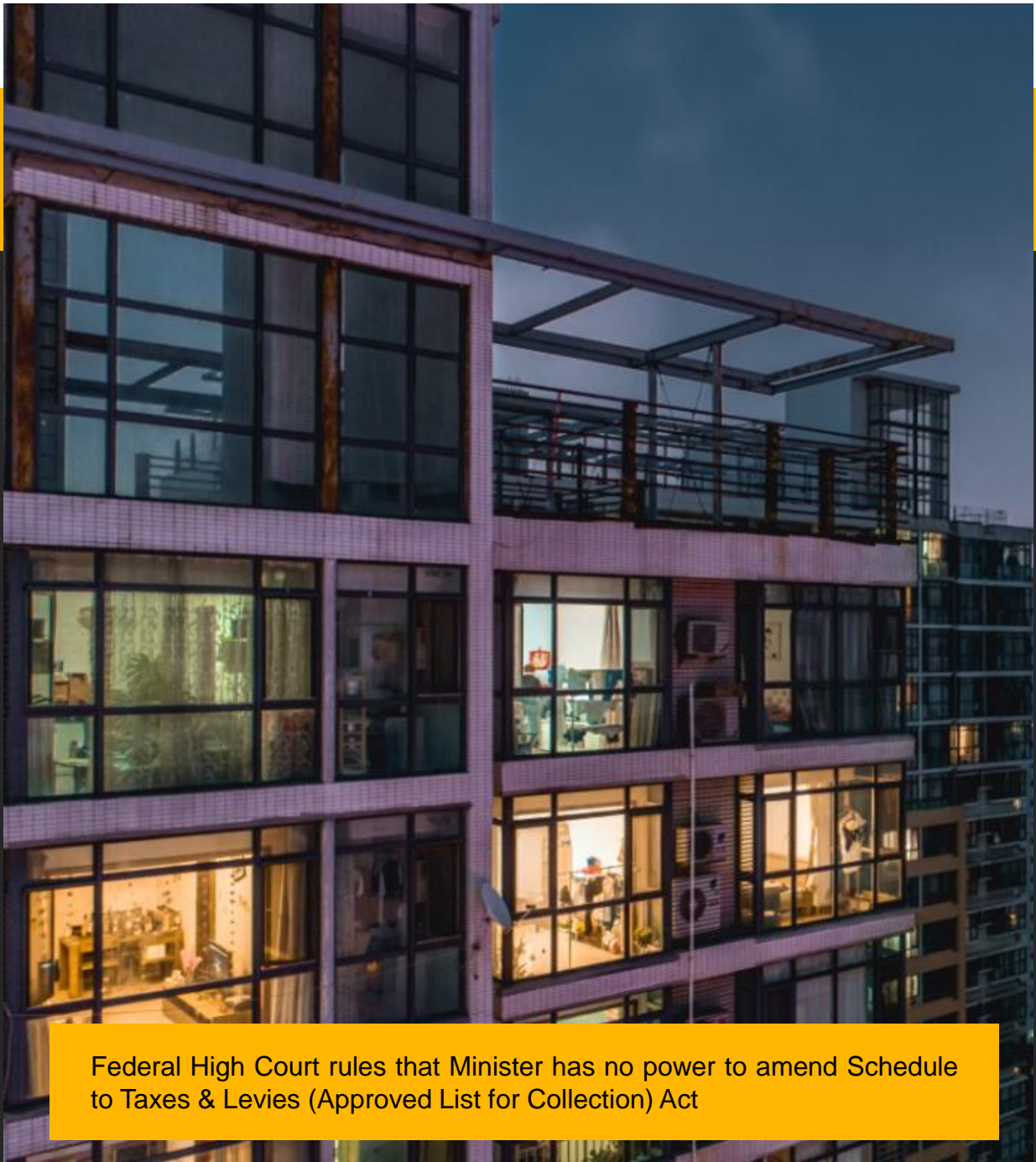
Analysis and takeaway

The ruling is an indication of the Tribunal's policy to, as much as possible, allow taxpayers exercise their right to challenge decisions of the tax authorities thereby guaranteeing taxpayer's access to justice. The ruling is consistent with the earlier decision of the Tribunal in ***United Capital v. FIRS*** where the Tribunal held that payment under protest of an assessed tax liability does not rob the taxpayer of the *locus standi* to challenge the same assessment. Additionally, the ruling is indicative of the fact that administrators could be held accountable for statements made in their official capacity.

Parties intending to challenge actions, decisions or proposed actions of tax authorities must still demonstrate a sufficient interest and what impending or actual injury suffered by such decisions or proposed actions.

The Registered Trustees of Hotel Owners and Managers Association of Lagos v. Attorney General of the Federation and Minister of Finance

FHC/L/CS/1082/19



Federal High Court rules that Minister has no power to amend Schedule to Taxes & Levies (Approved List for Collection) Act

Background

The Taxes and Levies (Approved List for collection) Act [the Act] was enacted to allocate power to collect taxes and levies among the different tiers of Government. The Schedule to the Act lists out the taxes to be collected by each tier.

S. 1(2) of the Act provides that the Minister of Finance may, on the advice of the Joint Tax Board [JTB] and by Order in the Gazette amend the Schedule.

Based on this provision, the Minister on the advice of the JTB published the Schedule to the Taxes and Levies (Approved List for Collection) Act (Amendment) Order 2015 [Amendment Order] published in the official gazette. The amendment introduced the Hotel Occupancy and Restaurant Consumption tax as a tax that may be collected by the States.

Questions for determination

The Registered Trustees of Hotel Owners and Managers Association of Lagos (Plaintiff) filed a suit at the Federal High Court, Lagos division challenging the Minister's act of amending the Schedule. The questions before the court can be summarized as follows;

1. Whether by virtue of Section 4 of the 1999 Constitution, the legislative powers of the Federal Republic are vested in the National Assembly?
2. Whether the Minister of Finance has constitutional powers to amend an Act of the National Assembly?
3. Whether the provision of S.1(2) of the Act is inconsistent with the provisions of the 1999 Constitution and therefore null and void?
4. Whether the Amendment of the schedule to the Act by the Minister is inconsistent with the provisions of the 1999 Constitution and therefore null and void?

Parties' arguments

The Plaintiff argued that;

- the Schedule to an Act is a part of the Act and therefore any amendment to the schedule is an amendment of the Act.
- the Legislature may lawfully delegate its power to make laws to any person, but such subsidiary legislation must remain within the control of the Legislature and the Legislature cannot abdicate its constitutional duty to make laws

In response, the Defendants argued that

- the plaintiff has no right to institute the case on the basis that their civil rights and obligations were not in issue.
- the action of the Minister is an administrative step aimed at carrying out the intentions of the Legislature and not a usurpation of the Legislature's duties.
- The Minister can modify an existing law under S.315 of the Constitution.

The decision

The Court held that the Plaintiff is entitled to challenge the amendment to the Schedule since the amendment ultimately affects the business of its members. The FHC held that a Schedule to an Act cannot be delegated legislation since it is part of the Act and has the same force as the Act itself.

Therefore any act that affects the wording of the Schedule is an amendment of the Schedule, which is an exercise of legislative powers. The Court therefore held that the amendment of the Schedule by the Minister as unconstitutional, null and void.

Analysis and takeaway

Nigeria's Constitution recognises the doctrine of separation of powers which guarantees the distinction of powers between the three arms of government (executive, legislature and judiciary) – each arm is precluded from exercising powers ascribed to other arms. The doctrine admits certain exceptions and encourages a system of checks and balances.¹

The ruling puts a focus on similar powers of the Minister contained in several other tax laws such as:

- section 19 of the Personal Income Tax Act (PITA) which grants the Minister power to vary the class of persons listed in the 3rd Schedule and thereby exempt the income of those persons from tax, in pursuance of a treaty or arrangement involving the federal government.
- section 38 of the Value Added Tax Act (VATA) which grants the Minister power to, by Order, amend the VAT rates and vary the list of exempt goods and services provided in its 1st Schedule.
- sections 24 and 63 of the Petroleum Profits Tax Act (PPTA) which grants the Minister power to make rules that modify the Act in order to ascertain profits and tax due on companies that participate in joint ventures/partnerships as well as and power to amend the 1st Schedule to the Act.
- section 25(6) of the Companies Income Tax Act (CITA) grants the Minister the power to amend the 5th Schedule which provides a list of eligible funds and institutions that can receive tax deductible donations in Nigeria. The FIRS has exercised this power by Regulation.

The ruling raises a concern that such powers may be challenged on constitutional grounds. The Minister may have to review the exercise of these powers to identify and remediate any constitutional breaches. Going forward, it is also expedient for the legislature to be mindful of the powers "donated" to the executive arm so as not to breach constitutional provisions.

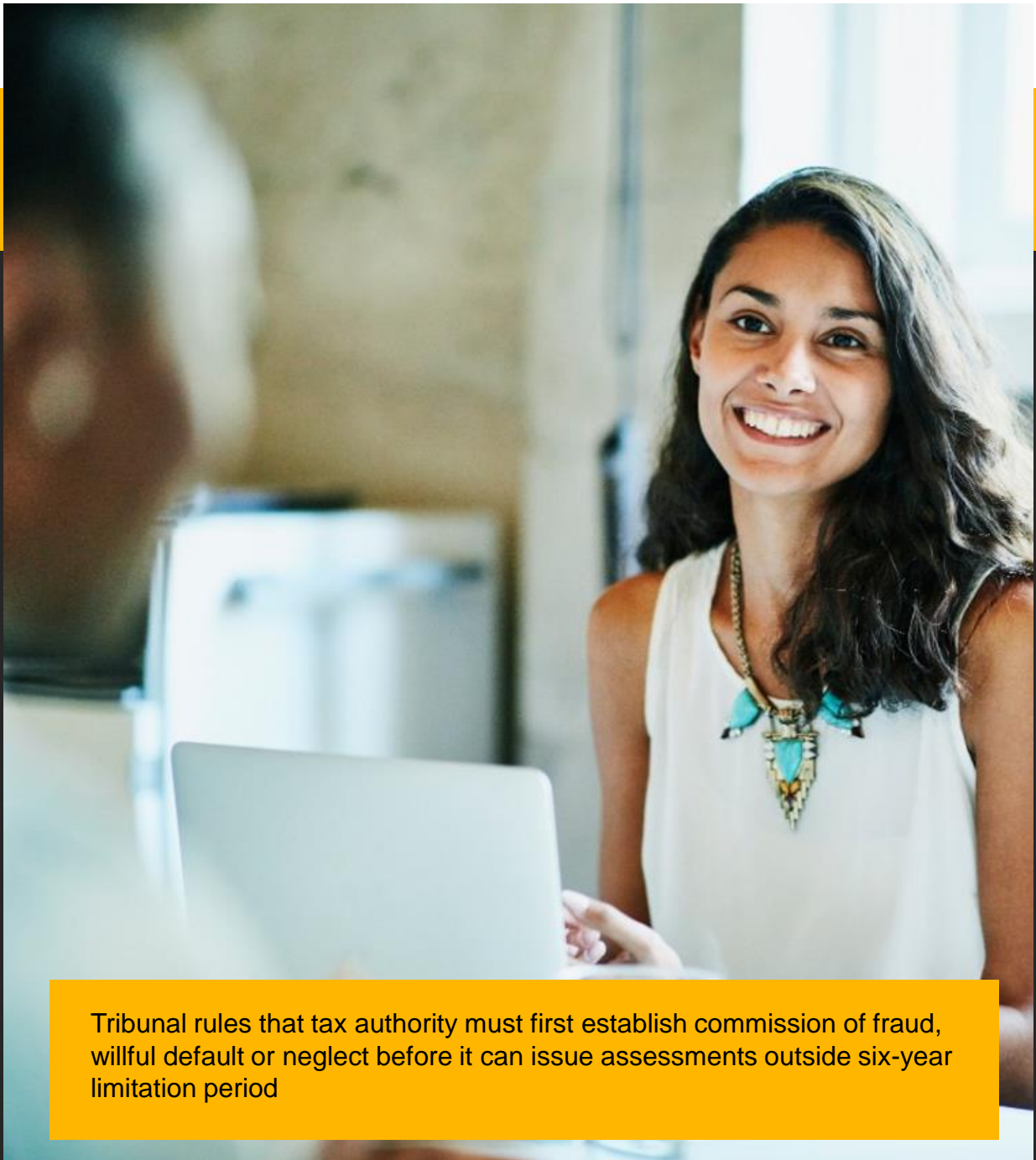
While it is unlikely that the tax authority will challenge the reliefs granted to taxpayers by virtue of a delegated power exercised by the Minister, taxpayers who are currently enjoying such benefits or incentives brought about by Orders made pursuant to the highlighted sections may wish to consider available options to ensure that they do not suffer losses in the event of a challenge, these include advocating for an amendment by the Legislature.

Finally, it is noteworthy to draw a distinction between the powers discussed above and powers to make delegated legislation. The Minister as a member of the executive arm of government has powers to make subsidiary legislation provided the legislation is consistent with and within the confines of an enabling Act of the legislature.

1. for purposes of checks and balances e.g. the requirement for executive assent to legislative bills, legislative ratification of treaties entered into by the executive and executive budgets etc, for oversight purposes e.g. supervisory jurisdiction of the courts over legislative and executive powers, or out of necessity e.g. subsidiary/delegated legislation

Citibank v. FIRS

TAT/SSZ/017/2018



Tribunal rules that tax authority must first establish commission of fraud, willful default or neglect before it can issue assessments outside six-year limitation period

Background

Section 55 of the Personal Income Tax Act (PITA) sets a six-year limitation period within which a tax authority must assess a taxpayer to additional assessments. However, section 55(2) provides an exception to the limitation period – where the taxpayer has committed fraud, willful default or neglect the tax authority can assess the taxpayer outside the six-year period and as many times as possible.

Facts

In *Citibank Nigeria Limited vs Rivers State Board of Internal Revenue*, the tax authority raised additional assessments against the bank covering a period of 19 years. The bank objected and subsequently appealed on the basis that the assessments were unlawful given that the tax authority had not proved fraud, willful default and/or neglect.

Taxpayer's arguments

The taxpayer's arguments are summarised in the following paragraphs:

- a) the tax authority failed to prove or establish fraud, willful default or neglect
- b) section 332 of the Companies and Allied Matters Act (CAMA) do not require records to be kept longer than six years as such it did not provide the documents in respect of those years
- c) the demand notice was premature given that it had, with respect to the assessments within the six-year period, provided relevant documents to a Special Tax Audit Reconciliation Committee (STARC) and had requested for meetings to resolve the audit.

Tax authority's arguments

- a) Section 55(2) does not put a burden on tax authorities to establish the guilt of a taxpayer but only required a tax authority to show that any of fraud, willful default or neglect had been committed by the taxpayer.
- b) The bank's objection was not valid in law.

The decision

The Tribunal found as a fact that the tax authority did not establish the existence of fraud, willful default and/or neglect before the demand notice and during trial.

Following which the Tribunal held that:

- the assessments relating to the years outside the limitation period were unlawful
- the bank's objection was valid in law as it met the requirements of the law – it was in writing, contained the grounds of objection and was filed within 30 days of the demand notice,
- with respect to the assessments with the six-year period, the tax authority was too hasty and it "didn't properly exhibit its duty of fairness and due diligence in carrying out its statutory responsibility" especially since it could have exhausted the opportunities for settlement offered by the STARC meetings.

Analysis and takeaway

The ruling sets a high bar for tax authorities as they are required to establish taxpayer guilt or commission of fraud, willful default or neglect before they can issue assessments outside a six-year period. Therefore, authorities would have to, during trial, lead evidence of the existence of any of these exceptions. In addition, where fraud is alleged, a tax authority would need to plead the details of fraud specifically in its Reply as required by civil procedure rules. One point, however, requires some clarification – given that, by its enabling law², the Tribunal does not have jurisdiction over criminal matters as it "shall be obliged pass" information / any evidence of criminality to the relevant authorities, it appears that fraud in section 55(2) may not be "criminal fraud" since, by law, the Tribunal cannot entertain criminal matters. Rather section 55(2) would refer to "civil fraud" as defined by the same Tribunal in *Delta Afrik Engineering Nig v. Akwa Ibom State Board of Internal Revenue*.³ In this appeal, the Tribunal, relying on the Black's Law Dictionary, 9th Edition defined "fraud" as:

A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. Fraud is usually a tort, but in some cases (especially when the conduct is willful) it may be a crime.

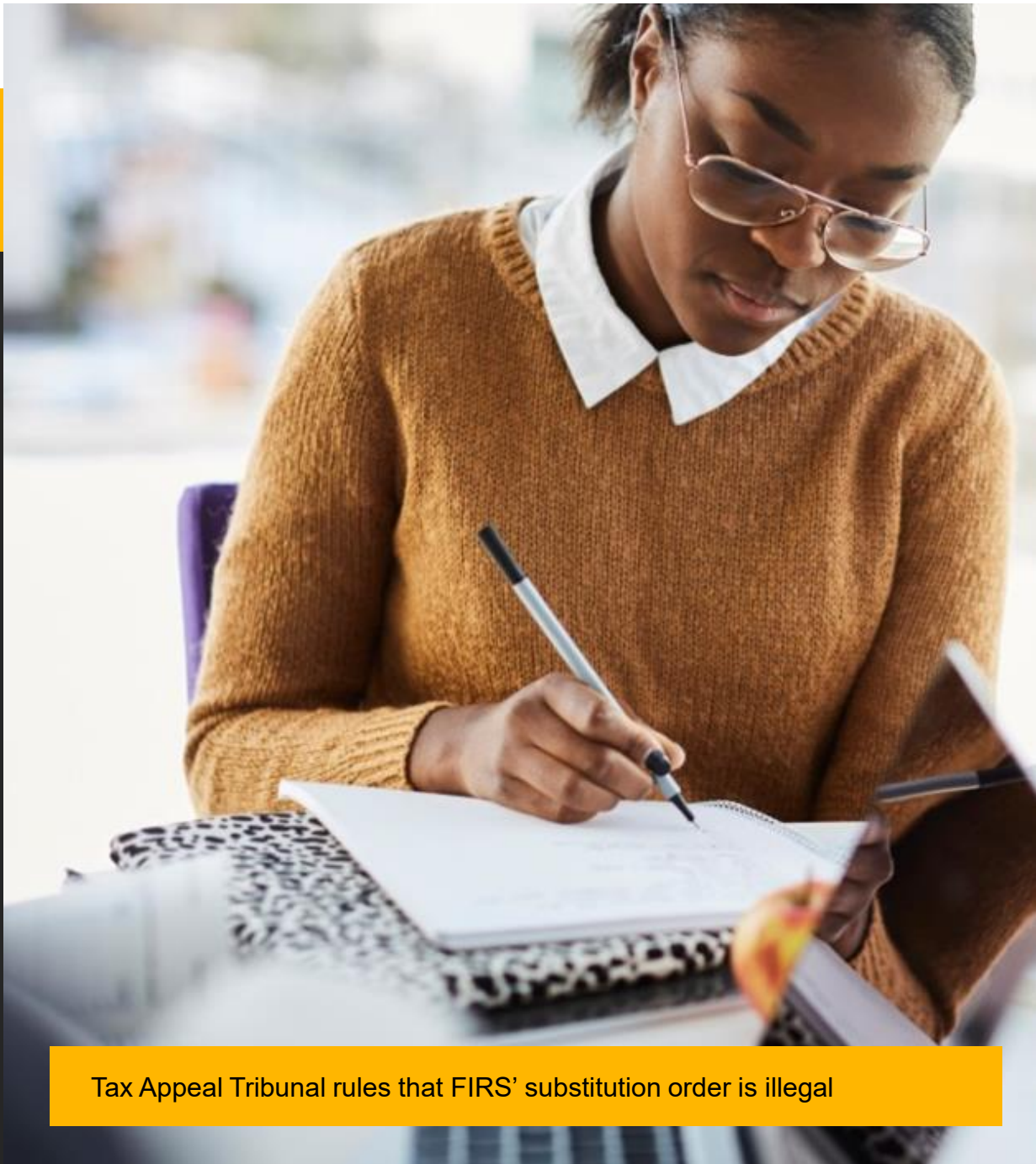
All other definitions relied on in the *Delta Afrik* case suggest that fraud is a civil offence. Given the definitions, all that the tax authority needs to establish is that a taxpayer "knowingly misrepresented the truth or concealed a material fact with the intention to induce the tax authority to act to the tax authority's detriment". Therefore, taxpayers would need to take extra care to be sure that all information communicated to tax authorities is correct and true.

However, to avoid all these rules, tax authorities need to conclude audits and issue assessments within the six-year period.

². See paragraph 12 of the 5th Schedule to the Federal Inland Revenue Service (Establishment) Act 2007
³. TAT/SSZ/001/2017, delivered on 20th January 2020. In this appeal, the Tribunal, relying on the Black's Law Dictionary, 9th Edition

Michael Oluwole Oladotun (Liquidator, Nu Metro Retail Nigeria Ltd.) v. Executive Chairman, FIRS

TAT/LZWHT/020/2019



Tax Appeal Tribunal rules that FIRS' substitution order is illegal

Background

Sections 49 and 32 of the Companies Income Tax Act and Federal Inland Revenue Service (Establishment) Act respectively give FIRS powers to appoint an agent on behalf of a taxpayer for the purpose of collecting any tax payable to FIRS. To be valid, the appointment must meet the following cumulative criteria:

- must be in writing,
- the tax has or will become payable and
- the agent must have in his custody funds belonging to the taxpayer.

To increase tax collection, FIRS appointed banks as agents of taxpayers (usually referred to as Substitution Orders). In addition to the appointment, FIRS ordered banks to freeze or put a lien on the account of alleged tax defaulters. In most instances the banks complied but many taxpayers complained that FIRS abused its powers of appointment.

Facts of the Case

In *Oladotun v. Executive Chairman, FIRS*, the FIRS instructed the taxpayer's bank to put a lien on the taxpayer's accounts with the intention of recovering the taxpayer's alleged tax debt. The bank complied without recourse to the taxpayer who was in the process of a Creditors Voluntary Winding Up. The taxpayer sued.

Taxpayer's argument

The taxpayer raised a number of arguments relating to the validity of the appeal, however, the crux of the taxpayer's case was that FIRS' appointment of the bank as the taxpayer's agent was wrong in law because FIRS did not fulfil the conditions precedent before appointing the bank. Specifically, FIRS did not issue any notice of assessment on the taxpayer therefore no tax could have been payable to FIRS.

The taxpayer also argued that by failing to give it the opportunity to defend itself, its constitutional right to fair hearing was infringed.

FIRS' argument

FIRS did not have any valid arguments because the Tribunal barred FIRS for failing to file its Reply to the appeal despite multiple orders of the Tribunal to do so and failing to pay costs awarded to the taxpayer on account of FIRS' consistent failure to file its Reply.

The decision

The Tribunal held that:

- FIRS did not meet all the conjunctive conditions precedent to the power of appointment,
- the taxpayer was not given the opportunity of being heard either by FIRS or the bank before a lien was placed on its account,

- relying on a previous decision of the Federal High Court⁴, placing a lien on the taxpayer's account without a court order and without establishing tax fraud or evasion was unlawful and
- it had no powers to award damages in favour of the taxpayer.

Analysis and takeaway

The decision further clarifies and limits the extent of FIRS' power of appointment. Where all conditions are not met, taxpayers can successfully challenge a Substitution Order. In addition, FIRS does not have the powers to order banks to freeze accounts in the absence of a court order. Such orders are also restricted to instances where tax fraud or evasion has been established.

The decision has far reaching implications as it will be binding on all tax authorities across the 36 states in Nigeria including the Federal Capital Territory. Tax authorities may also be exposed to litigation before the High Courts for damages. Taxpayers may decide to file actions before the Tribunal to challenge any abuse of the powers and the High Courts for damages. Tax authorities may also be liable for procuring breach of the banker / customer contract especially if it is established that FIRS abused its power of appointment.

It is interesting to note that both sections 49 and 32 give the agents the right to object against such appointment. However, the provisions do not give any guidance on the grounds of objection.

Reasonable grounds of objection by the agents could be:

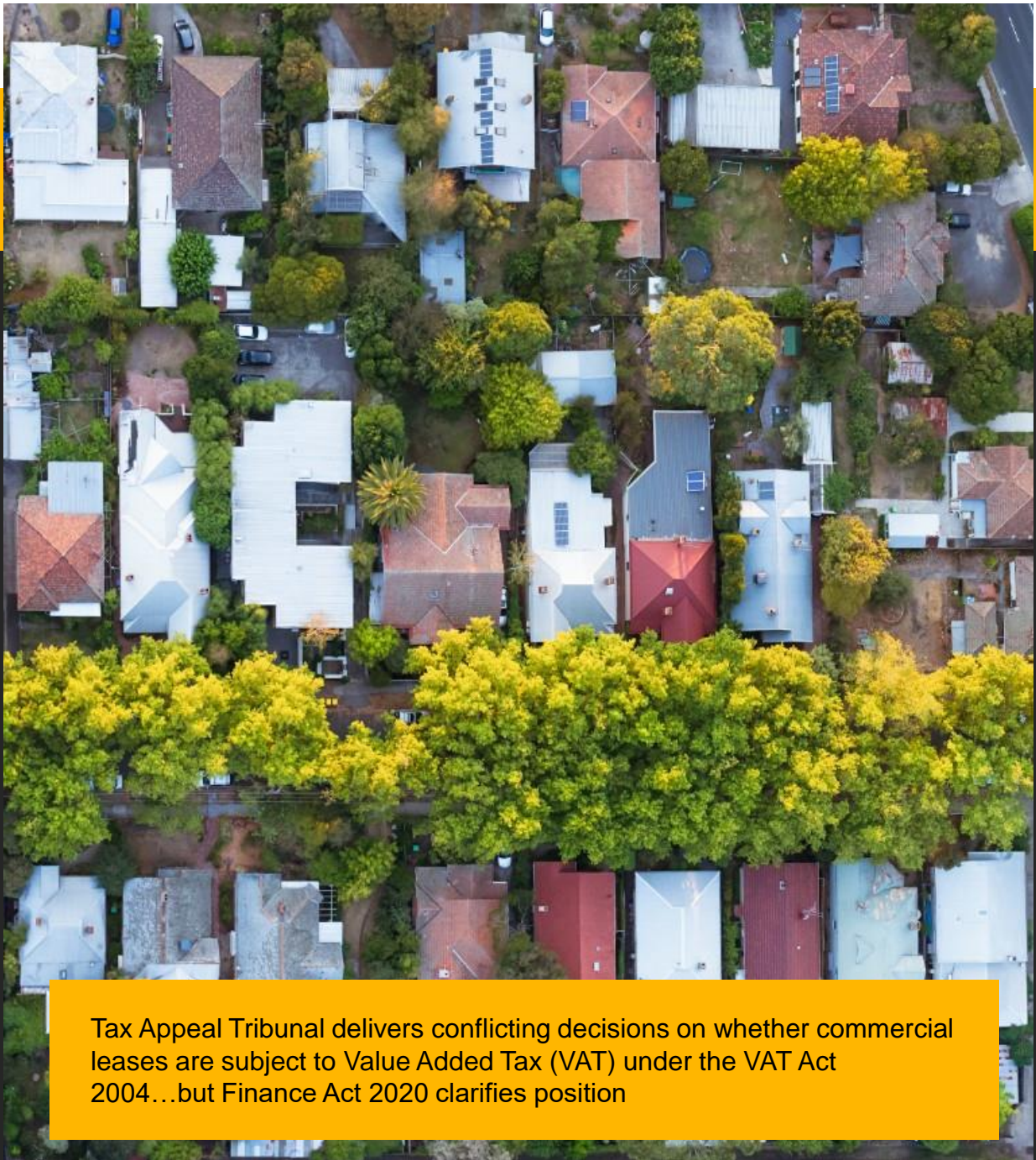
- failure by FIRS to provide proof that the tax has or will become payable,
- the existence of a lien over the account sought to be frozen,
- FIRS carrying out acts ultra vires or abuse of its power.

Therefore, to protect themselves from damages, banks and other agents must examine any contractual or fiduciary duties owed to the taxpayer before accepting the agency appointment.

4. *Ama Etuwewe Esq v. FIRS & Anor* (Suit No. FHC/WR/CS/17/2019)

Chief J.W. Ellah & Sons Company Ltd v. FIRS & Essay Holdings Ltd v. FIRS

TAT/SSZ/001/2019
TAT/LZ/VAT/029/2019



Tax Appeal Tribunal delivers conflicting decisions on whether commercial leases are subject to Value Added Tax (VAT) under the VAT Act 2004...but Finance Act 2020 clarifies position

Background

According to the VAT Act, 2004 [Act], VAT is imposed on goods and services but “goods” and “services” were not defined under that Act. The First Schedule to the Act contains a list of exempt goods and services. “Lease” is not included on either list.

To clarify certain provisions of the Act particularly relating to exemptions, FIRS issued Information Circular 9701 in 1997. While the Circular exempted residential accommodation from VAT, commercial leases was not exempted.

Facts of the appeal

In *Chief J.W. Ellah & Sons Company Ltd v FIRS and Essay Holdings Ltd v. FIRS* decided by the Tax Appeal Tribunal (TAT) in Benin and Lagos Zones respectfully, the TAT delivered conflicting decisions on whether commercial leases are subject to VAT. Both zones also adopted different approaches to the role of Information Circulars in interpreting statute.

The appeals were contested under the VAT Act, 2004.

The appeals

The facts of both appeals are similar. In both appeals, the FIRS assessed the taxpayers to VAT which, according to FIRS, should have been collected by the taxpayers and remitted to FIRS on rents received on commercial leases.

FIRS' position is that commercial leases are not contained as an exempt item in the First Schedule to the VAT Act. In addition, commercial leases / accommodation are not exempt under Information Circular 9701.

The taxpayers' views were that leases are neither goods nor services so should not be subject to VAT. In *Essay*, the taxpayer argued that leases are an incorporeal right and do not amount to goods or services. The taxpayer relied on *CNOOC v AGF* where the Federal High Court decided that an interest in an oil mining lease was not subject to VAT.

The decisions

In *Ellah*, delivered 9 September 2020, the TAT held that commercial leases were subject to VAT. In arriving at its decision, the TAT relied on the definition of “Supply of Goods” in the VAT Act particularly on the phrase the letting out of taxable goods on hire or leasing. The TAT also relied on the Information Circular 9701 holding that it would be inconsistent of the taxpayer to accept the exemption on residential accommodation under the Circular but not accept that commercial leases were not exempt.

However, in *Ess-ay* delivered a day after, the TAT held that leases are not goods. They are incorporeal rights which are not subject to VAT. In arriving at its decision, the TAT relied on the definition of goods in the UK Sales of Goods Acts and Lagos State Sales of Goods Law that goods are severable from land. The TAT also relied on the decisions in *CNOOC v. AGF*⁵ and *Momotato v UACN*⁶ to hold that interest in land were neither goods nor services.

In *Ess-ay*, the TAT also pronounced on the effect of Information Circular 9701. The TAT held that the Circular does

not amount to subsidiary legislation so it cannot amend the VAT Act.

However, such circulars are useful tools for determining the mind of tax authorities which help taxpayers plan their affairs.

Analysis and takeaway

It does not help that the TAT gave conflicting decisions. However, since the TAT is not bound by the decisions of another Zone, parties can rely on a decision that supports their positions or seek resolution from a higher court. Alternatively, it could be said that the decision in *Ess-ay*, coming after the *Ellah* case should take precedent being the later in time and on the basis that the Tribunal in Lagos must have considered the judgement yet chose to depart from it.

The decisions also raise the question of refunds. Can taxpayers rely on *Ess-ay* to apply for refunds? The answer to this question would depend on another question – whether the law pre-FA 2019 has always been that commercial leases were not subject to VAT or whether the decision in *Ess-ay* only just determined the position of the law. In the former, taxpayers would have a right to request for refunds of VAT previously paid.

To remove the uncertainties under the Act, “goods” and “services” were defined under the Finance Act 2019 (FA 2019). From the definitions, it appeared that interests in land were outside the scope of VAT. The definition of “goods” in FA 2019 includes:

“any intangible product, asset, or property over which a person has ownership rights, or from which he derives benefits, and which can be transferred from one person to another excluding interest in land”

On the other hand, “services” were defined as:

“anything other than goods, money or securities which is supplied excluding services provided under a contract of employment”

Though the popular view was that “interests in land” (which includes leases) are a specie of exempt goods and because they do not fall under the definition of “services” they are exempt from VAT, some commentators argued that the phrase “anything other than goods” in the definition of “services” could be interpreted to mean that interests in land falls under services and therefore subject to VAT. To put the uncertainty to rest the FA 2020 further clarified the definition of “goods” and “services”. While the new definition of “goods” excludes “land and building”, “services” also exclude “interest in land and building”. With the new definitions, land and all interest in land are outside the scope of VAT.

Another interesting point to note in *Ess-ay* is the extent of Ministerial power to amend laws. In *Ess-ay*, the TAT relying on the decision in *HOMAL v. FIRS*⁷ raised the question of the validity of Ministerial power in section 38 of the VAT Act to amend the VAT Act. Given that such powers are inconsistent with Nigeria's Constitution, they may be declared null and void in subsequent cases. Therefore, relevant government authorities exercising such powers should take care to determine that such powers are consistent with the Constitution.

5. 2011 4 TRLN 186
6. 6 All NTC 37
7. See page 11 above



Our Contacts



Chijioke Uwaegbute
Partner
+234 706 401 9039
chijioke.uwaegbute@pwc.com



Folajimi O. Akinla
Senior Manager/Lead, TCDR
+234 802 846 3369
folajimi.akinla@pwc.com



Adeoluwa Akintobi
Senior Associate
+234 816 111 9888
adeoluwa.akintobi@pwc.com



Adetutu Olowu
Senior Associate
+234 703 105 1099
adetutu.olowu@pwc.com



Oluwatoyin Obateru
Senior Associate
+234 812 727 1079
oluwatoyin.obateru@pwc.com



Nnamdi Echegwisi
Associate
+234 703 887 9466
nnamdi.echegwisi@pwc.com



Chidera Igweagu
Associate
+234 813 216 7323
chidera.igweagu@pwc.com



Eniola Olanipekun
Associate
+234 703 614 8627
eniola.olanipekun@pwc.com



Tax Controversy & Dispute Resolution



South Africa



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Medtronic International Trading SARL v. CSARS

(33400/2019)



An interesting development for VDP applicants as well as for the South African Revenue Service on VDP interest

Of late, the Voluntary Disclosure Programme (“VDP”) legislation in Chapter 16 of the Tax Administration Act, No. 28 of 2011 (“TAA”) seems to be causing confusion in practice. This is brought about by a combination of the inconsistent application of the VDP provisions by SARS’ VDP Unit as well as certain loosely worded provisions contained in Chapter 16 of the TAA.

An example of such provision is, section 229 of the TAA which provides for the relief that an applicant could qualify for, should they participate in the VDP i.e. SARS must not pursue criminal prosecution for a tax offence arising from the default, SARS must grant relief in respect of understatement penalties and SARS must grant 100% relief in respect of administrative non-compliance penalties. The section, however, remains silent on relief from interest levied in terms of a VDP application. Additionally, Chapter 16 of the TAA, as a whole, is silent on the interest component of a VDP application.

This stance differs from the “old” VDP process as under section 6 of the Voluntary Disclosure Programme and Taxation Laws Second Amendment Act, No. 8 of 2010, the Commissioner was empowered to grant 50% or 100% relief in respect of interest otherwise payable by the VDP applicant.

This begs the question of whether a VDP applicant can request the remission of interest outside the VDP process, via the normal channels, for example section 187 of the TAA (which has been partially promulgated) read with section 89*quat*(3) of the Income Tax Act, No. 58 of 1962 or section 39(7) of the Value-Added Tax Act, 89 of 1991 (“VAT Act”).

In the recent case of *Medtronic International Trading S.A.R.L v The Commissioner for SARS*¹ (“Medtronic case”), SARS had refused to consider the Applicant’s request for the remission of interest in terms of section 39(7)(a) of the VAT Act following the conclusion of two VDP agreements between SARS and the Applicant. The Applicant sought a review of, *inter alia*, this decision.

The facts of this case are that an employee of the Applicant had embezzled an amount of R537,236,176 from the Applicant. This was attained by the employee submitting false VAT201 returns to SARS and then seeking reimbursements from SARS in order to conceal her embezzlement.

The Applicant thus sought to regularise its affairs via the VDP. On 14 and 18 June 2018 two VDP agreements were concluded between SARS and the Applicant. According to these VDP agreements the Applicant was liable for the payment of the capital VAT amount of R286,464,756.62 and interest of R171,205,356.12. SARS’ VDP Unit had waived all understatement and administrative non-compliance penalties amounting to R172million and also agreed to refrain from pursuing any criminal action against the applicant. The Applicant proceeded to sign the VDP agreement as well as pay over the capital and interest amounts to SARS.

The Applicant then sought to have the interest in the amount of R171,205,356.12 remitted in terms of section 39(7) of the VAT Act, which states:

‘Where the Commissioner is satisfied that the failure on the part of the person concerned or any other person under the control or acting on behalf of that person to make payment of the tax within the period for payment contemplated in subsection (1)(a), (2), (3), (4), (6), (6A) or (8) or on the date referred to in subsection (5), as the case may be-

a) was due to circumstances beyond the control of the said person, he or she may remit, in whole or in part, the interest payable in terms of section’

Further, the Applicant relied on the explanation of what constitutes “circumstances beyond a person’s control” per interpretation note 61:

“‘circumstances beyond a person’ control are generally those that are external, unforeseeable, unavoidable or in the nature of an emergency, such as an accident, disaster or illness which resulted in the person being unable to make payment of VAT due.”

According to the Applicant, the embezzlement of funds by an employee of the Applicant was beyond the control of the Applicant.

However, SARS argued that the application of section 187(6) of the TAA Act and likewise section 39(7)(a) of the VAT Act are not applicable to a situation where the VDP agreement is in play. In addition, SARS alleged that the Applicant’s request for remission of interest effectively constituted an attempt to renege on the VDP agreements.

The Gauteng High Court held that *“it is evident that the interest and penalties were added to the eventual amount attained in the VDP agreement by virtue of the application of section 39(1) of the VAT Act.”*

Hughes J took the view that *“if remission requests of interest were not intended to be sought in situations where there was a VDP agreement, either by way of section 187 of the [TAA] or section 39(7) of the VAT Act, the legislature would have set this out succinctly in the provisions regulating the VDP agreement and procedure.”*

On this basis, the Court held that *“the notion adopted by [SARS] that the Applicant seeks to vary the VDP agreement through the back door by seeking the remission cannot stand muster. This is so because it is common cause that the applicant has already complied with the VDP agreement as it has paid the interest sought”* and went on to state that *“The entire purpose of the VDP process pertains to taxes and is regulated by Acts which are tax related with the Tax Act being the default position if there is conflict or confusion. How then does one exclude that which is a self-prevailing Act when dealing with a process borne out in that same Act. Hence, the analogy being that if section 187(6) can be applied then the equivalent that being section 39(7) of the VAT Act, most certainly is applicable.”*

Accordingly, the Court held that the VDP provisions contained in the TAA do not prohibit a request for remission of interest in terms of section 39(7) of the VAT Act, notwithstanding a VDP agreement being entered into. The impugned decisions taken by SARS were pertinently swayed by errors in law, were not authorized by any empowering legislation and were made without important and relevant considerations being considered.

Ultimately, the decision made by SARS (i.e. the refusal to consider the Applicant's request for the remission of interest in terms of section 39(7)(a) of the VAT Act) was referred to SARS for consideration.

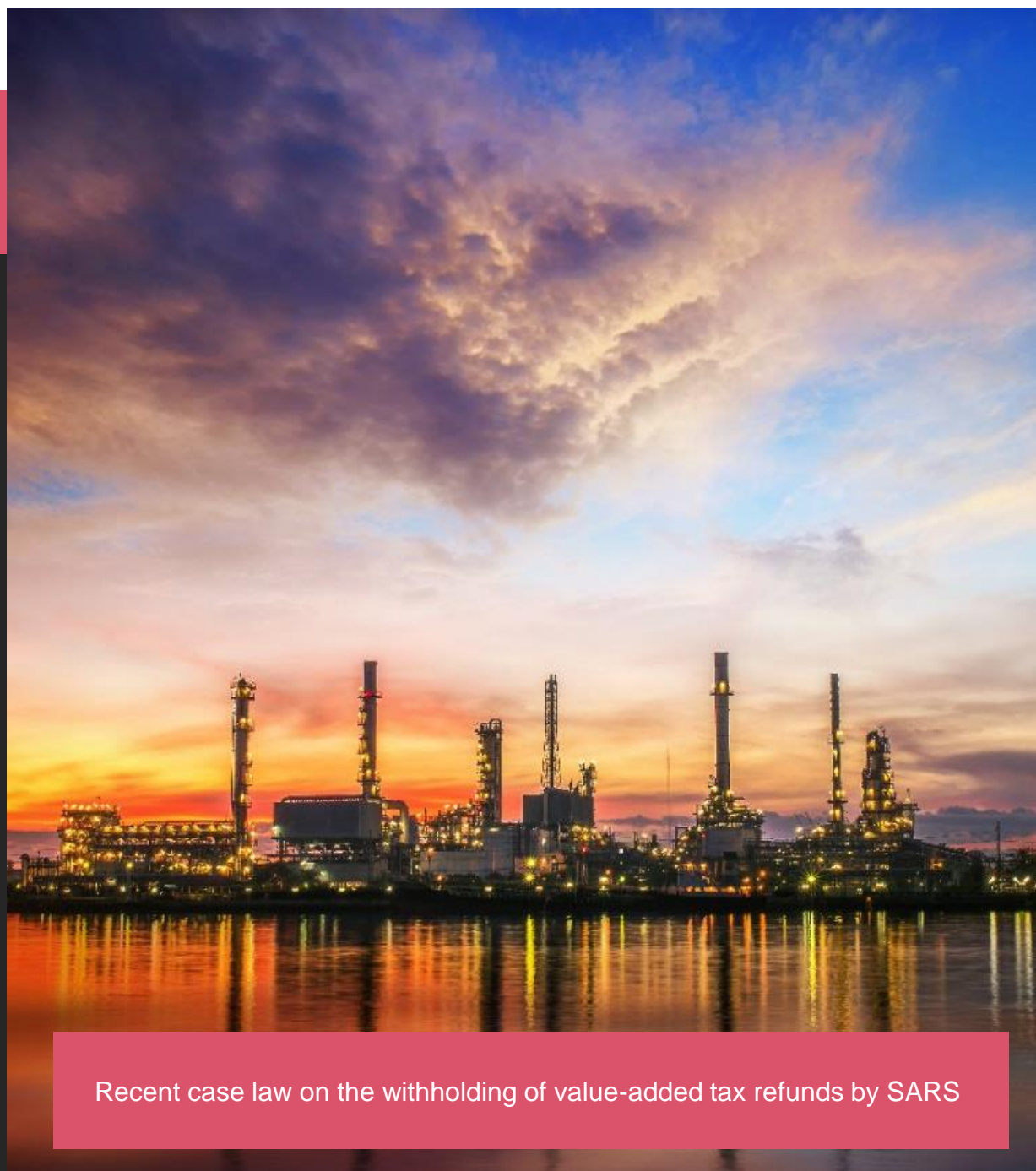
Key takeaways

- The Medtronic case provides welcome clarity for taxpayers who are undertaking the VDP process and who seek to request the remission of interest (in appropriate circumstances) borne out of the VDP process.
- Although the SARS VDP unit is not empowered to remit interest, this does not prohibit the taxpayer from seeking remission of interest via the standard procedures separately from or subsequent to its VDP application.
- It remains to be seen whether the Medtronic case is the final push for some of the VDP provisions in Chapter 16 of the TAA to be amended.



Rappa Resources (Pty) Ltd v. Commissioner for SARS

20/18875



Recent case law on the withholding of value-added tax refunds by SARS

A recent case which demonstrates the contentious nature of section 190 of the Tax Administration Act, 2011 (“TAA”) is that of *Rappa Resources (Pty) Ltd v Commissioner for SARS 20/18875* which was heard in the Johannesburg division of the Gauteng High Court. As an exporter of gold bearing bars and other precious metals, Rappa Resources (Pty) Ltd (“Rappa”) pays Value-Added Tax (“VAT”) on its purchases whilst its exports are zero-rated for VAT purposes. Therefore, Rappa claims VAT refunds for the VAT paid to suppliers and the timeous payment of such refunds are essential for its commercial survival.

SARS notified Rappa that it was being audited and stopped the payment of the Rappa’s VAT refunds whilst the audit was in progress. SARS asserted that the basis of the audit was that there was reason to believe that Rappa was either directly or indirectly involved in unlawful activities including the possible disposal of illegally mined gold or smelted down Krugerrands. As a result, VAT refunds amounting to R1.6 billion had been withheld by SARS from Rappa since February 2020. Due to Rappa’s contention that it would not be able to operate its business without the refunds, it approached the Court for relief on an urgent basis. To add fuel to the fire, Rappa’s bank had also terminated its overdraft facility on which it had been reliant. This was based on a combination of the withholding of the VAT refunds by SARS and a period of five weeks during March and April 2020 when it was unable to operate due to the hard lockdown imposed as a result of the COVID-19 pandemic.

At paragraph 33, the Court commented that:

“While the prejudice to Rappa in the withholding of the refunds (and future refunds while the audit is proceeding) is astronomical, the prejudice to the fiscus if the audit or inquiry discloses that Rappa is in fact colluding with others in the supply chain is also astronomical. The TAA seems to seek to balance the interests of the taxpayer and the fiscus by allowing SARS to retain the refunds pending the outcome of the audit. If this is not done the taxpayer who claims refunds based on the self-assessment system that is used would always have an advantage and SARS would be able to do nothing until it has clear evidence that there is something untoward at play.”

The court then turned to section 190 of the TAA which deals with refunds of excess payments and states, most relevantly, that:

*“(1) SARS must pay a refund if a person is entitled to a refund, including interest thereon under section 188 (3) (a), of—
(a) an amount properly refundable under a tax Act and if so reflected in an assessment....
(2) SARS need not authorise a refund as referred to in subsection (1) until such time that a verification, inspection, audit or criminal investigation of the refund in accordance with Chapter 5 has been finalised.
(3) SARS must authorise the payment of a refund before the finalisation of the verification, inspection, audit or criminal investigation if security in a form acceptable to a senior SARS official is provided by the taxpayer.”*

Section 190(1) of the TAA requires SARS to pay a refund if a taxpayer is entitled to it. However, section 190(2) provides that if the taxpayer is under audit, SARS need not pay a refund until such time as the audit is finalised. Section 190(3) goes on to

state that SARS must pay the refund – even if the taxpayer is under audit – provided that the taxpayer provides acceptable security to a senior SARS official. This palisade of caveats has clearly been designed in light of the reality that the payment of a refund is effectively final in nature and not an interim decision, as without security, SARS has no guarantee that the funds will be preserved following finalisation of the audit.

In considering the facts at hand, the Court found that Rappa had not demonstrated a clear right to the relief sought. However, SARS’ refusal to accept security for anything less than the full amount of the refunds was found to be unreasonable. In this regard, the Court held that Rappa was immediately entitled to a refund for as much as it has been able to provide acceptable security. In addition, SARS was not permitted to withhold refunds in respect of any periods which were not under audit.

Interestingly, at paragraph 51, the court said that:

“Taking the scheme of the TAA as a whole, where SARS has withheld a refund, particularly where the refund is as integral to the business model of the taxpayer as in this matter, it cannot be allowed to take an indefinite time to complete an audit. This would mean that the TAA is inherently unfair towards the taxpayer. The audit has to be completed in a reasonable time, taking into account the circumstances.”

The Court rejected both SARS’ contention that it required six months to complete the audit (since SARS could not provide an explanation of why it needed six months), as well as the Taxpayer’s request for a *mandamus* that SARS complete the audit within a period of just 15 days (as the court acknowledged that SARS must be afforded sufficient time to carry out the audit).

Instead, the Court permitted SARS a period of four months from the date on which it received the requested information to finalise its audit. This was just over a month from the date of handing down judgment.

Key takeaways:

- Many tax compliant Taxpayers rely on refunds from SARS for business continuity purposes. The withholding of refunds by SARS can directly affect the taxpayer’s liquidity. In some cases, in order to obtain the timeous release of a refund from SARS, the Taxpayer may have no other option but to provide SARS with acceptable security.
- The purpose of the provision requiring payment of the refund on the provision of acceptable security, is to preserve the funds until it is clear as to who is entitled to it (i.e. SARS or the Taxpayer).
- On the basis of this judgment, the positive news is that a partial provision of security should be sufficient to secure a partial release of the refund.
- SARS is not entitled to conduct audits in a manner and at a pace that is entirely at SARS’ discretion. Rather, SARS is obliged to adopt an approach which gives due consideration of fairness to the Taxpayer. In the absence thereof, Taxpayers do have grounds to seek a *mandamus* order from the Court compelling SARS to finalise its audit within a period of time that is reasonable and fair to the Taxpayer.

**Purveyors South Africa Mine Services (Pty) Ltd v.
The Commissioner for the South African Revenue Service**

(61689/2019) [2020] ZAGPPHC
409 (25 August 2020)



Introduction

The Voluntary Disclosure Programme (VDP) was introduced into the Tax Administration Act, No. 28 of 2011 (TAA), with effect from 1 October 2012, for purposes of enhancing voluntary compliance in the interest of the good management of the tax system and the best use of SARS' resources. The VDP is a mechanism for taxpayers to regularise their tax affairs without incurring potentially significant penalties or criminal charges. It is also an important tool for revenue collection for SARS. According to the Annual Report 2018–2019, SARS reported that an amount of R3.2 billion was collected for the period 1 April 2018 until 31 March 2019 under the VDP. Under section 227 of the TAA, six key requirements must be met for an application to be considered to be a valid voluntary disclosure. Such disclosure must:

1. be voluntary;
2. involve a 'default' which has not occurred within five years of the disclosure of a similar 'default' by the applicant;
3. be full and complete in all material respects;
4. Involve a behaviour referred to in column 2 of the understatement penalty percentage table in section 223 of the TAA;
5. not result in a refund due by SARS; and
6. be made in the prescribed form and manner.

Tying in to the requirement that a VDP application must be voluntary, section 226(2) of the TAA states that if the person seeking relief has been given notice of the commencement of an audit or criminal investigation into the affairs of the person, which has not been concluded and is related to the disclosed 'default', the disclosure of the 'default' is regarded as not being voluntary for purposes of section 227, unless a senior SARS official is of the view, having regard to the circumstances and ambit of the audit or investigation, that:

1. the 'default' in respect of which the person has sought relief would not otherwise have been detected during the audit or investigation; and
2. the application would be in the interest of good management of the tax system and the best use of SARS' resources.

Facts

In the recent judgment of *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service* (61689/2019) [2020] ZAGPPHC 409 (25 August 2020), the court stated that the concepts of 'default', 'voluntary' and 'disclosure' make up the three essential components of section 227 of the TAA.

The court noted that section 225 of the TAA defines the term 'default' to mean the submission of inaccurate or incomplete information to SARS. In the *Purveyors* case, the concept of 'default' was not in contention, as it was common cause that it had failed to pay import VAT in 2015 when it should have done so. The inquiry in the case was thus focused on the concepts of 'voluntary' and 'disclosure', which are not defined in the TAA.

By way of a background, Purveyors had imported an aircraft into South Africa during 2015 which it then used to transport goods and personnel to other countries in Africa. Purveyors became liable for the payment of import VAT to SARS in respect of the importation of the aircraft in 2015, which it failed to pay to SARS during the latter part of 2016. Purveyors was advised by SARS on 1 February 2017 that the aircraft should have been declared in South Africa and VAT thereon paid, but, more importantly, it was advised by SARS that penalties were applicable as a result of the failure to have paid the VAT. This prompted Purveyors to avail itself of the voluntary disclosure relief under the TAA. SARS declined to grant relief on the basis that Purveyors had not met the requirements of section 227 of the TAA on the basis that there was no 'disclosure' nor was it made 'voluntarily'. Purveyors brought an application to the High Court to have SARS' decision set aside.

The crux of the *Purveyors* case was that as at the date of submission of its VDP application it had not been given notice by SARS of the commencement of an audit or criminal investigation into the affairs of Purveyors, which had not been concluded as contemplated by the provisions of s 226(2) of the TAA, and that the effect thereof was that this application was indeed 'voluntary' as contemplated in s 227(a) of the TAA, despite the said prior knowledge on the part of SARS. With regard to the 'disclosure', Purveyors contended that prior knowledge on the part of SARS was not a disqualifying factor, that SARS' interpretation was too wide and it went on to refer to the ordinary meaning of the word 'voluntary' as defined in the Merriam-Webster Dictionary.

SARS, however, contended that section 227 of the TAA envisages a disclosure of information or facts of which SARS had been unaware. With regard to whether the VDP application was 'voluntary', SARS contended that the term is not defined, but its ordinary meaning is 'an act in accordance with the exercise of free will'. If there is an element of compulsion underpinning a particular act, it is no longer done voluntarily. In the context of Part B of Chapter 16 of the TAA (i.e. the VDP part of the TAA), a disclosure is not made voluntarily where an application has been made after the taxpayer had been warned that it would be liable for penalties and interest owing from its mentioned default. It was thus submitted that the application was brought in fear of, *inter alia*, being penalised.

Ultimately, the court was of the view that:

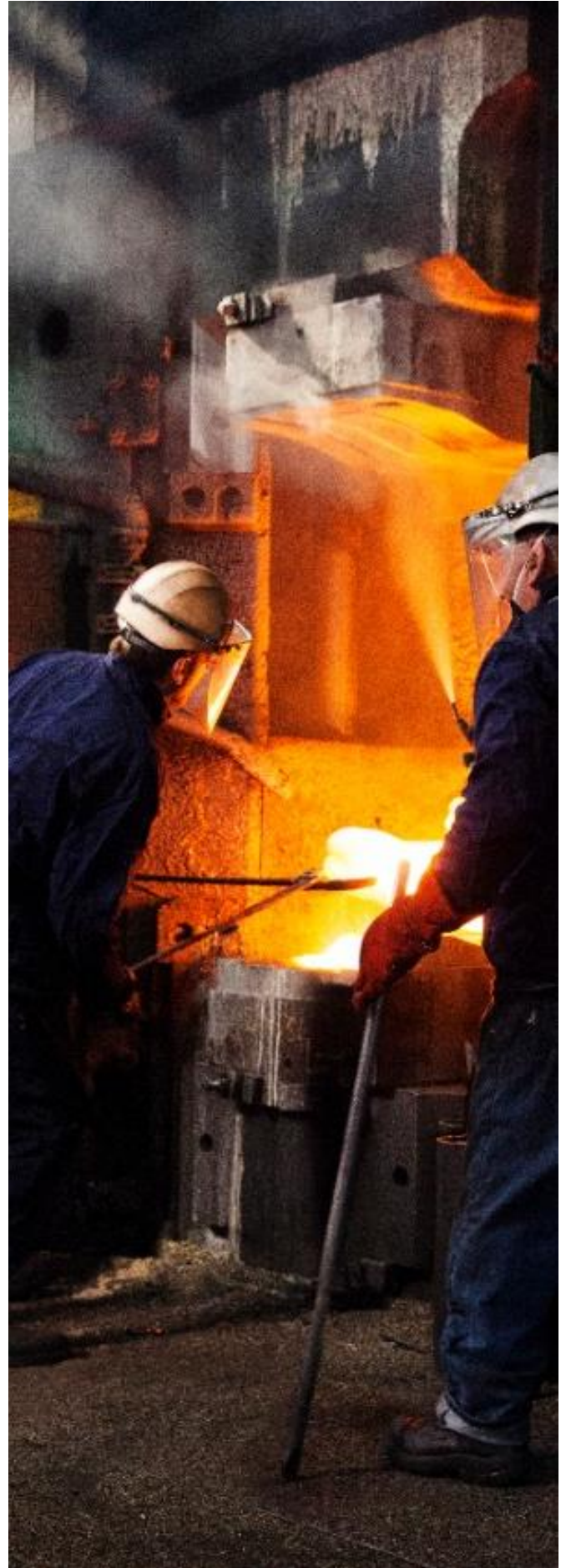
- a) the interpretation and argument put forward by Purveyors was too narrow and did not accord with the purpose of the said sections or what they sought to achieve,
- b) the VDP application was not 'voluntary' for the reasons referred to by SARS; and
- c) there was no disclosure to SARS of information which it was not already aware of.

Purveyors' application was therefore dismissed.

Key takeaways:

With the current state of our economy post Covid-19 and considering the Government's deteriorating fiscal position, it may be time for SARS to refocus on the VDP regime (legislation and practical implementation) to make it more accommodating for taxpayers and to fulfil the objective that it was envisioned to achieve. Furthermore, for SARS, this could mean more revenue collected without conducting long, drawn-out audits. Therefore, it is suggested that SARS refocuses on:

- Restoring taxpayers' faith in the effectiveness of the VDP regime as well as improving operations within the VDP Unit.
- This may include continuing to request amendments to the TAA in respect of certain sections contained in the VDP part of the TAA, for instance to define terms such as 'disclosure' and 'voluntary', what constitutes an 'audit' and furthermore the meaning of 'full and complete' – as there seems to be different interpretations on whether this part is not limited by section 99 of the TAA (i.e. prescription). As can be seen in the Purveyors case, there is a difference in the interpretation of fundamental key concepts relating to what constitutes a valid VDP application.
- Employing more skilled staff to the VDP Unit to assist with managing the processing of applications, thereby improving the turnaround time of applications.
- Issuing an Interpretation Note which contains guidance on drafting and submitting a VDP application (which Note must align with SARS' own internal policies on how the VDP Unit deals with VDP applications), as it would seem from the Taxing Times 2020 Survey and the Purveyors case that there is disparity between the interpretation of key concepts between SARS and taxpayers.



Joseph Nyalunga v CSARS

(90307/2018) [2020] ZAGPPHC (6 May 2020)



Introduction

Section 33 (1) of the Constitution of South Africa provides a right to just administrative action, which includes the right to administrative action that is lawful, reasonable and procedurally fair. The Promotion of Administrative Justice Act, No. 3 of 2000, is an act which has been promulgated to give effect to section 33 of the Constitution. In terms of PAJA, if a taxpayer feels that a decision by SARS is unlawful, unreasonable or that fair procedures were not followed, the taxpayer can approach a court for judicial review of the decision.

The facts

The taxpayer, a former member of the South African Police Service was arrested in connection with Money laundering and rhino poaching.

In March 2012, the taxpayer was imprisoned. Whilst in prison, SARS hand delivered a notification of its intention to audit the taxpayer based on the 'possible under-declaration of taxable income' for the tax years between 2009 and 2012.

A letter of audit findings, dated 3 September 2013, was delivered to the taxpayer on 4 September 2013. The letter contained the following caution:

"Please note that this letter does not constitute an assessment as contemplated in the tax Administration Act, No. 28 of 2011 (the "Act"). This letter merely notifies you of our intention to raise an assessment, and our reasons therefore. It also offers you a further opportunity to provide us with any relevant material that may not have been available during the audit which could negate the necessity of issuing an assessment.

However, if no further documentation is forwarded to this office within 21 business days from the date of delivery of this letter, we would proceed in raising the estimate assessment in terms of section 91 and 92, read with section 95 of the TA Act."

The taxpayer failed to respond to this letter or provide any relevant material to SARS.

On 24 February 2014, SARS delivered a finalisation of audit letter to the Taxpayer. When the taxpayer received such letter, he confirmed receipt of the letter as follows:

"I won't be able to respond to SARS on the stated time because I am unable to get any documents because I am still at prison with no bail since March 2012. I will submit some receipts immediately when I am out from prison. Objection of 30 days won't be made due to the reason I mentioned."

The taxpayer was released from prison on 24 March 2014 and his objection was due to SARS by 8 April 2014. SARS submitted that the 30-day time period for the taxpayer to submit an objection commenced from the taxpayer's release. Thus, the taxpayer had until 7 May 2014 to file an objection, but failed to do so.

After several attempts to attach the taxpayer's goods, on 18 September 2018, the sheriff successfully attached the goods belonging to the taxpayer and proceeded to advertise a sale by public auction of this goods. This prompted the taxpayer to bring an urgent application to stay the auction. Hence, this review application was launched.

The taxpayer's case

The taxpayer challenged SARS audit findings on 4 grounds:

- a) The crux of the taxpayer's assertions was that he was not able to actively participate as a normal taxpayer would, as he was incarcerated when the assessment was conducted, thus he was not able to comply;
- b) The taxpayer attacked the procedure and the process followed by SARS as being unfair. He highlighted the procedural irregularities, some of which included him not receiving the lifestyle questionnaire from SARS and the fact that the scope of the assessment was extended to include 2013, without him being notified;
- c) The taxpayer further attacked the audit and calculations conducted by SARS, stating that no explanation was advanced as to the origin of specific amounts; and
- d) Finally, the decision of SARS was unconstitutional and infringed on his constitutional rights and the rule of law.

SARS' case

SARS contended the following:

- a) The review application was brought 4 years out of time;
- b) The court did not have jurisdiction to hear this matter as only the tax court had jurisdiction in these circumstances;
- c) The allocated timeframes to object, of which the taxpayer was notified of and made aware of, to the assessments have prescribed; and
- d) The relief sought had no practical effect.

The judgment

The court stated that in terms of section 7(1) of PAJA, the taxpayer had 180 days to seek the review of the decision, alternatively within a reasonable time.

The court found that the taxpayer was ignorant to the letter of audit findings as well as the finalisation of audit letter. The taxpayer stated that he was not aware of the judgement taken against him by SARS – as he was not notified nor was the judgment served and he only came to know of it on 18 September 2018. As he had not heard from SARS nor had he received further notices or assessments from SARS for the period February 2014 up until September 2018, he thought that the matter had "become stagnant".

The court agreed with SARS, that the taxpayer could not have been under any misapprehension – the taxpayer was advised in the finalisation of audit letter, that SARS had assessed him, and he was aware of the amount due by him. Further, if he was aggrieved, he could have objected. The court referred to the note which the taxpayer had penned on receipting the finalisation of audit letter personally. The taxpayer was well aware that he had to object within 30 days, which he failed to do so.

With regards to the application being out of time, the court agreed with SARS that the taxpayer failed to address the requirements of the legality challenge. The court found that the delay was unreasonable and did not warrant being overlooked.

The issue of the court's lack of jurisdiction raised by SARS was in fact that the taxpayer had acknowledged that in terms of the TA Act, he ought to have first exhausted all internal processes before he proceeded with this review application. The taxpayer contended that he was time barred to engage these internal processes and only had the option of review. The court stated that this explanation was not plausible as in terms of PAJA the review was also time barred, being 180 days. In the result, the court did not have jurisdiction to entertain this matter.

The taxpayer failed to submit tax returns to SARS and failed to lodge an objection in respect of the assessments, thus finality of the assessment, was reached in terms of section 100(1)(a) and (b). The time period to raise an objection in terms of section 104(5) had come and gone, especially so in terms of section 104(5)(b) which curtails one seeking an extended objection period if three years has lapsed after the assessment. In this case four years had passed; thus, the assessment had prescribed.

The court, per W Hughes, ordered that the review application was dismissed with costs, such costs to include the employment of 2 counsel where so employed.

Key takeaways

- Compliance with time frames contemplated under the TA Act and PAJA is important. The failure to adhere to timeframes can leave a taxpayer with little or no recourse.
- The taxpayer must exhaust all internal processes and remedies before bringing a PAJA review application in the high court.
- The finality of an assessment is reached if no return is submitted or no objection is lodged, and the timeframe has lapsed.



**SIP Project Managers (Pty) Ltd v The Commissioner
for the South African Revenue Service**

(11521/2020) [2020] ZAGPPHC (29 April 2020)



Introduction

Section 179 of the Tax Administration Act, No. 28 of 2011 (“TAA”) deals with the liability of a third party appointed to satisfy tax debts. The section states (most relevantly) that:

- ‘(1) A senior SARS official may authorise the issue of a notice to a person who holds or owes or will hold or owe any money...for or to a taxpayer, requiring the person to pay the money to SARS in satisfaction of the taxpayer’s outstanding tax debt.*
- (2) ...*
- (3) A person receiving the notice must pay the money in accordance with the notice and, if the person parts with the money contrary to the notice, the person is personally liable for the money.*
- (4) ...*
- (5) SARS may only issue the notice referred to in subsection (1) after delivery to the tax debtor of a final demand for payment which must be delivered at the latest 10 business days before the issue of the notice, which demand must set out the recovery steps that SARS may take if the tax debt is not paid and the available debt relief mechanisms under this Act, including, in respect of recovery steps that may be taken under this section—*

- (a) ...*
- (b) if the tax debtor is not a natural person, that the tax debtor may within five business days of receiving the demand apply to SARS for a reduction of the amount to be paid to SARS under subsection (1), based on serious financial hardship...’*

Briefly, from the section set out above, it is observed that the TAA gives the South African Revenue Service (“SARS”) the power to issue a notice to a third party i.e. a Bank who holds money on behalf of a taxpayer. This third-party notice will require the Bank to pay over to SARS such money in satisfaction of a taxpayer’s tax debt. Where the Bank can comply with the requirements of the third-party notice, the Bank must pay such money to SARS in accordance with the third-party notice. If the Bank parts with the money contrary to the third-party notice, then the Bank will be held personally liable for the taxpayer’s tax debt. However, before SARS can issue this notice, there is a provision in section 179 which limits SARS’ collection powers and safeguards taxpayers’ rights i.e. the third-party notice may only be issued by SARS, after it delivers a letter of demand to the taxpayer. This letter of demand must be delivered at least 10 business days before the issue of the third-party notice by SARS. The letter of demand provides the taxpayer with an opportunity to make arrangements with SARS to pay the outstanding tax debt/ a portion thereof, before SARS can rely on the appointment of a third-party to make payment of the taxpayer’s tax debt.

The recent case of *SIP Project Managers (Pty) Ltd v The Commissioner for the South African Revenue Service* (11521/2020) [2020] ZAGPPHC, highlighted the importance of due process being followed by SARS, when issuing a third-party notice contemplated in section 179 of the TAA above.

Facts

The Taxpayer’s case was as follows:

- In October 2019, SARS issued an additional assessment to the Taxpayer, via the SARS e-filing system.
- According to the additional assessment, the Taxpayer was assessed to owe SARS an amount of approximately R1,2 million and the date for the payment of this amount, was 30 November 2019.
- The additional assessment did not come to the attention of the Taxpayer. According to the Taxpayer’s accountant, he was alerted to the additional assessment, for the first time on 6 February 2020, when the Taxpayer informed him that Standard Bank South Africa (“SBSA”) had received a notification to pay an amount of approximately R1,2 million to SARS, from the Taxpayers’ bank account.
- Upon scrutinizing the Taxpayer’s e-filing profile, the Taxpayer’s accountant located the additional assessment, however, there was no letter of demand as contemplated in section 179(5) of the TAA, to be found on the e-filing profile of the Taxpayer, pursuant to the non-payment of the assessed amount.
- The Taxpayer’s accountant contacted the SARS official whose name was reflected on the third-party appointment notice issued to SBSA on 7 February 2020, who informed him that 3 letters of demand had been sent to the Taxpayer before the third-party appointment notice was issued to SBSA, namely on 7 November 2019, on 11 November 2019 and on 22 January 2020.
- The SARS official forwarded copies of these 3 letters to the Taxpayer’s accountant. The Taxpayer’s accountant maintained that none of these letters were sent to him or the Taxpayer, nor had they been uploaded on the Taxpayer’s e-filing profile.
- Upon contacting the SARS call centre to ascertain where he could locate the letters of demand on the Taxpayer’s e-filing profile, the Taxpayer’s accountant was informed that there were no letters of demand uploaded on the Taxpayer’s e-filing profile.
- The Taxpayer then approached its legal advisors and a letter of demand for repayment of the amount paid over by SBSA in terms of the third-party notice, was sent to SARS on 10 February 2020.
- SARS did not respond to this letter of demand, which led to the application for declaratory relief being brought in the Pretoria High Court, by the Taxpayer against SARS. The Taxpayer contended that no letter of demand was delivered prior to the issue of the third-party notice as required by section 179 of the TAA. Further, in the event that the court found that such a letter or letters were delivered, the Taxpayer contended that the letters were either pre-mature as the tax debt was not yet payable at the time, or the 10-business day period prior to the issue of the third party-notice had not yet expired by the time that the notice was in fact delivered.

SARS’ case was as follows:

- SARS abandoned relying on the letters dated 11 November 2019 and 22 January 2020 and only relied on the letter dated 7 November 2019, as being the demand letter referred to in section 179(5). The letter of 11 November 2019 was merely a reminder and did not comply with the requirements as set out in section 179(5).

- Further, the letter of 22 January 2020 was not issued at least 10 business days before the notice to SBSA was issued on 3 February 2020 and therefore did not meet the requirements for a letter of demand as required by section 179(5) of the TAA.
- SARS' explanation of the issue of the letter of demand dated 7 November 2019 was contradictory in respect of who actually sent the letters.
- SARS did not put forth adequate proof that the letter of demand was uploaded on the SARS e-filing system.
- In addition, SARS did not address the telephonic conversation held between the Taxpayer's accountant and the SARS call centre personnel, wherein it was confirmed that the letters of demand were not uploaded on the Taxpayer's e-filing profile.

In respect of whether a letter of demand was in fact delivered to the Taxpayer, the judge referred to the case of *Wightman t/a JW Construction v Headfour (Pty) Ltd and another* 2008 (3) 371 (SCA) which states that:

"When the facts averred are such that the disputing party must necessarily possess knowledge of them and be able to provide an answer (or countervailing evidence) if they be not true or accurate but instead of doing so: rests his case on a bare or ambiguous denial, the court will generally have difficulty in finding that the test is satisfied."

In this regard, the judge found that no letter of demand was delivered to the Taxpayer by SARS.

In respect of whether the letter of demand dated 7 November 2019 was premature, the court reasoned that it was clear that section 179 deals with a scenario where there is an outstanding tax debt due by the Taxpayer. In this instance, this was not the position as at 7 November 2019 as the Taxpayer would only have an outstanding debt after the due date for payment, namely 30 November 2019. SARS conceded that on this date there was not yet an outstanding tax debt owed by the Taxpayer. The letter of demand dated 7 November 2019 was accordingly premature and therefore not lawful.

In respect of the third-party notice, the court stated that:

"[22] Subsection (5) to section 179 was introduced by an amendment to the Act in 2015. Prior to this amendment, there was no obligation on SARS to deliver a demand for an outstanding debt before issuing a third-party notice. The context of this amendment is that SARS may only use the method in sec 179 to obtain payment through a third party if it complies with the provisions of the requirements of the section. The wording of section 179(5) is unambiguous and clear – the notice to a third party "may only be issued after delivery of a final demand for payment which must be delivered at least 10 business days before the issue of the notice....". This is a peremptory requirement before the step can be taken to issue a third-party notice for recovery of an outstanding tax debt.

[23] The notice issued to the third party in terms of section 179(1) does not comply with the peremptory qualification as set out in subsection 5, in that the notice was issued in the absence of a letter of demand delivered to the applicant is required. The notice issued is therefore unlawful and declared null and void.

[24] A finding that a legislative provision is peremptory is not the end of the matter. The Court must further enquire whether it was fatal that it had not been complied with. The Appellate Division as it then was laid down the test as "In deciding whether there has been compliance with the object sought to be achieved by the injunction and the question of whether this object has been achieved, are of importance".²

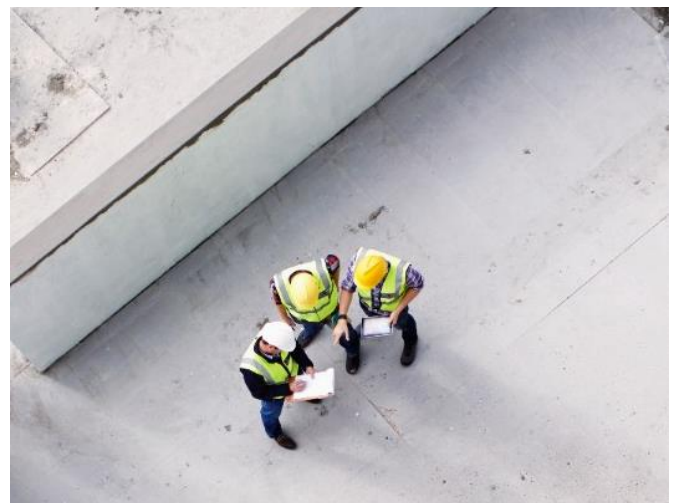
[25] Once it is established that a legislative provision is peremptory and the question arises whether exact compliance therewith is required, the answer is sought in the purpose of the statutory requirement which is to be found ascertained from its language read in the context of the status as a whole".³ (Our emphasis)

The court ultimately ordered that the third-party notice issued to SBSA be declared null and void.

In addition, not only was SARS ordered to repay the amount of approximately R1,2 million to SBSA (together with interest), SARS was also ordered to pay the Taxpayer's costs of the application.

Key takeaways

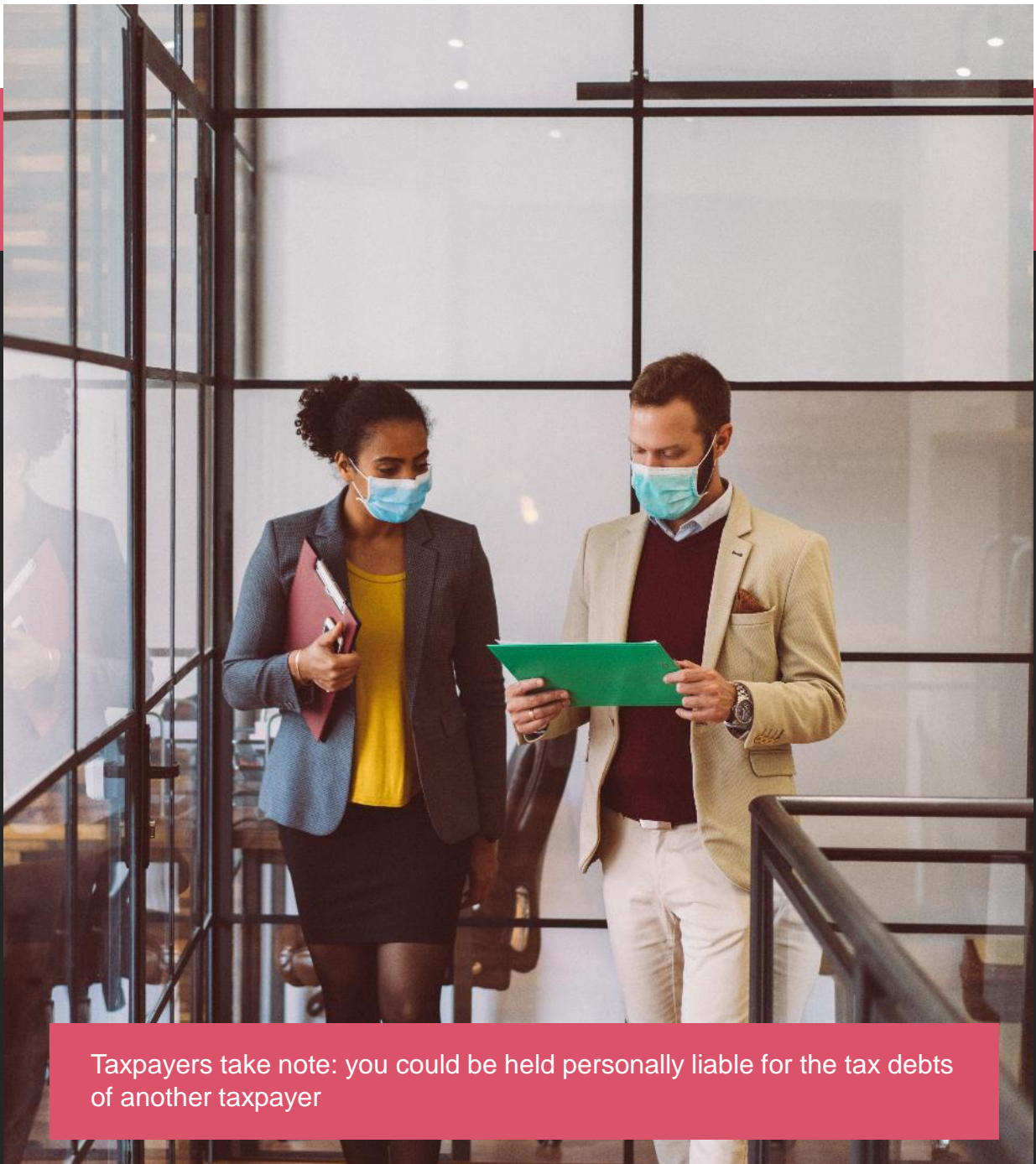
- SARS has the power to issue a notice to a third-party in satisfaction of a taxpayer's tax debt, however, SARS must ensure that it exercises its powers in accordance with the law.
 - As a starting point, the taxpayers' tax debt must be outstanding.
 - Thereafter, SARS is permitted to deliver a letter of demand to the taxpayer in accordance with the relevant rules for electronic communication.
 - Finally, SARS may issue a third-party notice, at least 10 business days after the letter of demand was issued to the taxpayer.
 - Until then, SARS may not commence with mechanisms for the recovery of the taxpayer's tax debts from a third-party.
- Taxpayers must closely monitor their e-filing profiles and check whether assessments, notices and letters have been issued by SARS. This is important as not only does it dictate what action is required on the part of taxpayers, but it also impacts on the lawfulness of SARS' subsequent actions.



2. Maharaj and others v Rampersad 1964 (4) SA 638 (a) at 646C.
3. Ex parte Mothulho 1996 (4) SA 1131 (T) at 1137H – 11378F.

**Siphayi and Another v.
Commissioner for SARS and Others**

(34975/2019) [2019] ZAGPJHC 455 (25 October 2019)



Taxpayers take note: you could be held personally liable for the tax debts of another taxpayer

Introduction

Considering the rapidly deteriorating economic climate that taxpayers find themselves in, it is important to note that, in certain circumstances, the South African Revenue Service (SARS) has the right to hold taxpayers personally liable for the tax debts of other taxpayers.

Section 184 of the Tax Administration Act, No. 28 of 2011 (TAA), gives SARS the power to recover tax debts from, *inter alia*, a representative taxpayer as well as from a withholding agent, as if they themselves were the taxpayer. In turn, the representative taxpayer / withholding agent has the same rights and remedies as the taxpayer would have had against SARS. However, SARS is obliged to first provide notice to the representative taxpayer / withholding agent which it intends to hold personally liable for the taxpayer's tax debt.

Facts

The recent High Court case of *K Siphayi v SARS* (case number 34975/2019) dealt with circumstances where Mr Siphayi was held personally liable for a tax debt of about R14 million owed by Kenny Bricks CC, in which Mr Siphayi was the sole member.

SARS attempted to deduct funds from Mr Siphayi's bank account in respect of the tax debt owing by Kenny Bricks CC.

The applicants, Mr Siphayi and Kenny Bricks CC, approached the High Court in order to obtain an urgent interdict preventing SARS from deducting the tax debt from the bank account of Mr Siphayi.

Mr Siphayi alleged that the urgency of the matter lay in the fact that if the tax debt of Kenny Bricks CC was deducted from the bank account of Mr Siphayi, then he would be severely affected in his ability to conduct his business.

Being satisfied that the matter was in fact urgent, the court went on to consider the merits of the matter.

SARS contended that the required notices in terms of the TAA were sent to Mr Siphayi via email and they were also posted to a physical address via registered mail. The emails were sent on 7 June 2019 and 6 August 2019 respectively, but nothing further was said as to whether these emails were delivered or not. In respect of the registered mail, the tracking notes reflected that they were returned because the registered letters were not collected at the post office.

Mr Siphayi contended that he did not receive the notices on 7 June 2019 and 6 August 2019. Had he received them he would have acted upon them and made the relevant representations as requested in the notices. It was contended further for the applicant that:

[9] ... Section 253 (1) [of the TAA] provides that a notice, document or other communication issued, given, sent or served in the manner referred to in section 251 or 252, is regarded as received by the person to whom it was delivered or left, or if posted it is regarded as having been received by the person to whom it was addressed at the time when it would, in the ordinary course of post, have arrived at the a addressed place. Subsection (1) does not apply if— (a) SARS is satisfied that the notice, document or other communication was not received or was received at some other time; or - (b) a court decides that the notice, document or other communication was not received or was received at some other time.

[10] ... if SARS is satisfied that a notice, document or other communication (other than a notice of assessment) issued, given, sent or served in a manner referred to in section 251 or 252 (excluding paragraphs (a) and (b) thereof) – (i) has not been received by the addressee; or – (ii) has been received by that person considerably later than it should have been received; and the person has in consequence been placed at a material disadvantage, the notice, document or other communication must be withdrawn and be issued, given, sent or served anew.

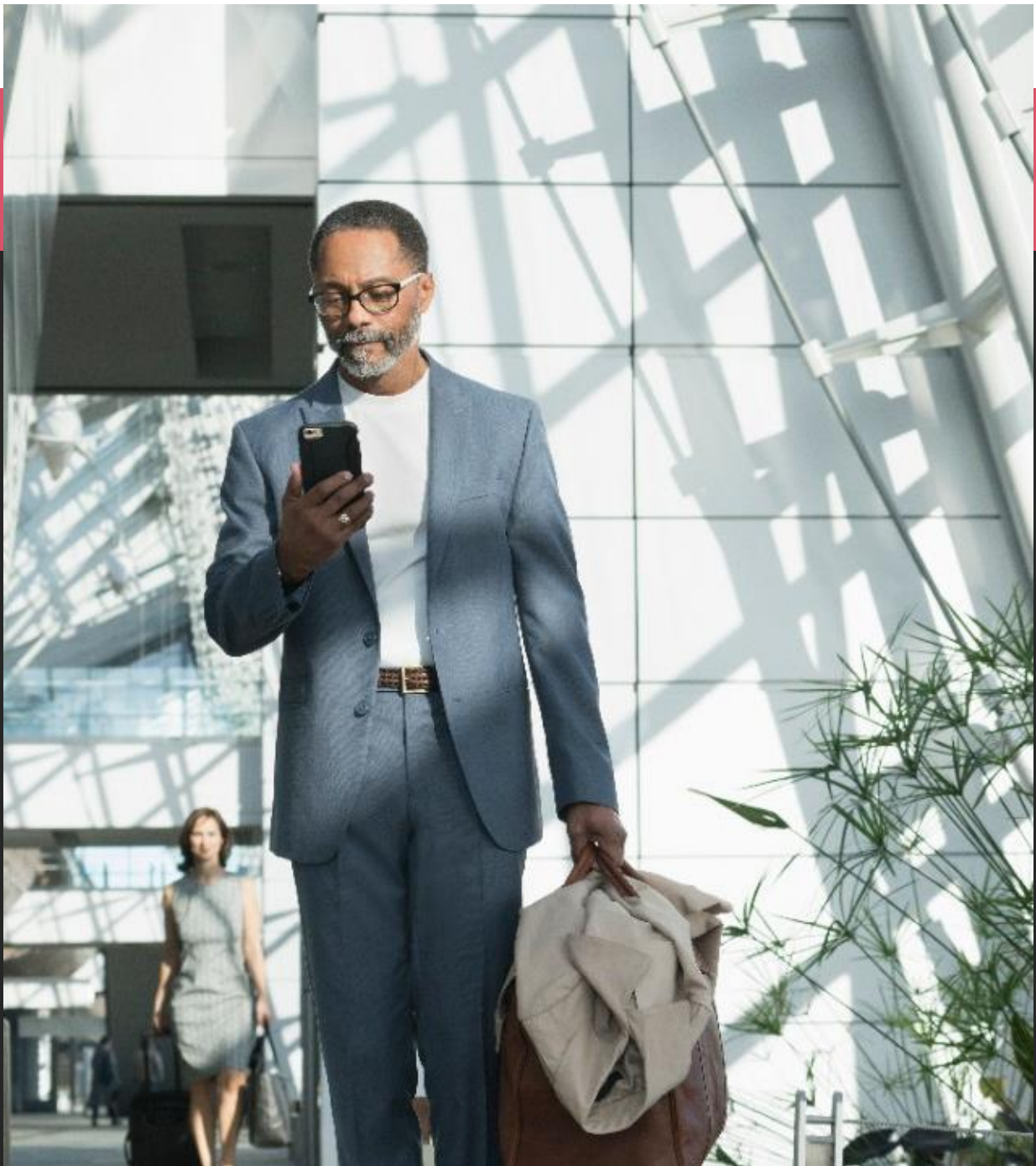
The court ordered that SARS and the Commissioner for SARS were interdicted from deducting monies from the Mr Siphayi's bank account in terms of section 184 of the TAA. In addition, SARS was ordered to resend the notices of intention to hold Mr Siphayi liable for the tax debts of Kenny Bricks CC.

Key takeaways:

- Taxpayers can be held liable for the tax debts of another person.
- If SARS seeks to hold another person liable for the tax debts of the taxpayer, due process must be followed. In particular, the correct methods of service of notices as envisaged in the TAA must be followed and taxpayers must be afforded the opportunity to make representations before they are held liable for the tax debt of another taxpayer.

Peter v CSARS

(3158-2018) ZAGPJHC (31 May 2019)



Introduction

This case also dealt with the review of a decision taken by SARS, i.e. the 'Tier Three Debt Committee' (Committee) in particular to decline the request by the taxpayer, brought in terms of section 164(2) of the TAA to suspend the payment of his tax liability in respect of additional assessments for years of assessment 2005 to 2011 pending the finalisation of his appeal which was currently pending before the Tax Court.

Facts

On 13 February 2013, SARS issued the taxpayer with additional assessments for the years of assessment 2005 to 2011 for various incidences of non-compliance and alleged under-declaration of his income. On 25 June 2013, the taxpayer objected against these assessments. A few days later, he made the first request for suspension of payment of his tax liability pending the finalisation of his objection and further appeal.

On 17 October 2013, SARS informed the taxpayer of its decision to refuse his request for suspension. The taxpayer took the decision on review. On 20 June 2014, Weiner J handed down an order reviewing and setting aside the decision and remitting it to SARS for reconsideration. Subsequent to the order being handed down, SARS invited the taxpayer to make a new request for suspension of payment given that the information contained in the first request had become outdated. On 24 January 2017, the taxpayer filed a new request for suspension of payment. This request was considered by SARS' Tier Two Committee who recommended that the request be denied. The request and this recommendation served before the Tier Three Committee which ultimately adopted the recommendation and refused the taxpayer's request to suspend payment.

The taxpayer's case

The taxpayer's case was as follows:

- a) The failure by SARS to comply with a previous court order of Weiner J handed down on 20 June 2014 by requiring a new application for suspension of tax liability was influenced by an error of law;
- b) The Committee that took the decision was not authorized to do so in that it was not empowered by section 164(3) of the TAA to do so, it was not properly delegated by the SARS Commissioner to do so in that there was no written delegation of authority that complies with section 10 of the TAA;
- c) The Committee acted irrationally in finding that the taxpayer's tax appeal was frivolous and vexatious. It failed to consider the taxpayer's prospects of success in the tax appeal. It also incorrectly found that the taxpayer was employing dilatory tactics;
- d) It was irrational for the Committee to indicate that the taxpayer's disclosure of its assets and liabilities was incomplete given that the taxpayer had repeatedly submitted the financial information required which included lists of assets and liabilities; and
- e) In taking into account that the taxpayer failed to offer payment of security, the Committee acted irregularly in that the taxpayer is demonstrably unable to provide security.

SARS' case

The more notable contentions made by SARS was that:

- a) The Committee had the relevant authority to act; and
- b) The taxpayer's appeal was frivolous and vexatious.

The judgment

With regards to the lack of authority, SARS contended that the argument that the decision of the Committee taken in terms of section 164(3) was unauthorised, is without merit. SARS contended that it was competent for the Committee to take the decision in view of the fact that each of the individual members of the Committee was empowered (by virtue of the designation of the posts they occupied) to take the decision. The court stated that such a submission is inconsistent with our constitutional order and the doctrine of legality. The Committee sat as a committee to consider and decide on the request to suspend payment under section 164(3) of the TAA. The Committee is a complex structure which includes a number of members, permanent invitees and specialist advisors. It even has its own secretariat. It is described by SARS as "the highest decision-making body within SARS concerning, *inter alia*, taxpayers' requests for suspension of payment". Given that the Committee not only performs an advisory function but also a decision making one, it stands to reason that the Committee (being distinct from its individual members) must be properly empowered to do so. This is precisely what the doctrine of legality requires. The court found that SARS had not put up any information to support the contention that the Committee was empowered to take the decision. Accordingly, the court found that the Committee lacked the authority to do so. This ground of review thus succeeded.

With regards to the request from SARS that the taxpayer lodges a new application to suspend payment of the disputed tax debt, the court found that the taxpayer had fallen short of demonstrating that the request by SARS that he brings a fresh application for suspension tainted the decision taken by SARS in respect of the application which forms the subject-matter of this review. This ground of review thus failed.

With regards to the taxpayers contention that SARS failed to have regard to the assertion made in his application for suspension that he could not afford to provide security for the tax debt, the court found that the taxpayer did not provide a full and accurate reflection of his financial position to SARS. In the circumstances, SARS could not be faulted for taking this into account in deciding whether or not to grant the application to suspend payment. Given the taxpayer's incomplete (and inaccurate) financial statements, the court found that SARS was entitled to view this assertion with scepticism. This ground of review thus failed.

The Committee took into account that the taxpayer was employing dilatory tactics in conducting the appeal. The taxpayer contended that these reasons were irrational in that there were good prospects of success on appeal. In this regard, the taxpayer argued that three of the seven years may have become prescribed. Furthermore, even if the prescription argument did not succeed the taxpayer had not engaged in dilatory conduct. In sharp contrast, the conduct of the taxpayer and its legal representatives has resulted in a delay in the finalization of the tax appeal.

While section 164(5)(a) of the TAA empowers a senior SARS official to deny an application to suspend payment if the objection or appeal is “frivolous or vexatious”, the TAA does not provide any guidance in lending meaning to the term “frivolous or vexatious”. The court referred to the following case law in this regard:

“[44] However, our courts have equated this term with an abuse of process. In Price Waterhouse Coopers Inc,⁴ the SCA held that: “Frivolous or vexatious litigation has been held to be an abuse of process (per Innes CJ in Western Assurance v Caldwell’s Trustee (supra) at 271 and in Corderoy v Union Government (Minister of Finance) (supra) at 517) and it has been said that ‘an attempt made to use far ulterior purposes machinery devised for the better administration of justice’ would constitute an abuse of the process (Hudson v Hudson and Another (supra) at 268).”⁵

[45] In CCII Systems⁶ the Court considered the interpretation of the term ‘frivolous and vexatious’ as used in the Promotion of Access to Information Act 1 of 2000 and held that: “The Act provides no guidelines for when a request is frivolous or vexatious. The ordinary meaning of frivolous (SOED) is ‘lacking seriousness or sense: silly’ which suggests no serious purpose. The ordinary meanings of vexatious (SOED) are ‘1. causing or tending to cause vexation, annoyance or distress: annoying, troublesome. 2. spec in LAW, of an action: instituted without sufficient grounds or winning purely to cause trouble or annoyance to the defendant’.”

The court found that SARS fell short of demonstrating that the appeal instituted by the taxpayer was frivolous and vexatious. SARS was required to demonstrate that the appeal constituted an abuse of process or that it was purely intended to cause annoyance to SARS. This it had failed to do. Accordingly, there was no rational connection between the conclusion reached by the Committee that the tax appeal is frivolous and vexatious, and the material placed before. This ground of review thus succeeded.

The court ordered, *inter alia*, that:

1. The decision by SARS to refuse the taxpayer’s request to suspend payment of his tax liability for years of assessment 2005, 2006, 2007, 2008, 2009, 2010 and 2011 pending the finalisation of his tax appeal pending before the Tax Court is reviewed and set aside;
2. The taxpayer’s request to suspend payment of his tax liability for years of assessment 2005, 2006, 2007, 2008, 2009, 2010 and 2011 pending the finalisation of his tax appeal pending before the Tax Court is remitted to SARS for reconsideration;

Key takeaways:

- Section 164(5)(a) of the TAA empowers a senior SARS official to deny an application to suspend payment if the objection or appeal is ‘frivolous or vexatious’, however the TAA does not provide any guidance in lending meaning to the term “frivolous or vexatious”.
- According to case law, our courts have equated this term with an abuse of process.
- The ordinary meaning of frivolous is ‘lacking seriousness or sense: silly’ which suggests no serious purpose.
- The ordinary meanings of vexatious are ‘1. causing or tending to cause vexation, annoyance or distress: annoying, troublesome. 2. spec in LAW, of an action: instituted without sufficient grounds or winning purely to cause trouble or annoyance to the defendant’.

4. Price Waterhouse Coopers Inc v National Potato Co-Op Ltd 2004 (6) SA 66 (SCA).
5. P81A.

6. CCII Systems (Pty) Limited v Lekota NO (23554/02) [2005] ZAGPHC 45 (15 April 2005).



Our Contacts



Elle-Sarah Rossato
Lead, Tax Controversy and
Dispute Resolution
+27 (0) 11 797 4938



Jadyne Devnarain
Senior Manager, Tax Controversy
and Dispute Reslution
+27 (0) 11 797 4282

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We would like to acknowledge the contribution made by Lihle Qasha to this article.



Lihle Qasha
Associate
+27 (0) 11 059 7627



Tax Controversy & Dispute Resolution



Kenya



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Coca-Cola Central East and West Africa Limited v Commissioner of Domestic Taxes High Court Tax Appeal 19 of 2013

Background – Legal Basis & Practice

Services exported out Kenya are subject to value added tax (“VAT”) at the rate of zero in Kenya. The Value Added Tax Act, 2013 (“VAT Act”) defines services exported out of Kenya to mean services provided for use or consumption outside Kenya. Identifying the consumer and the place of consumption is critical in determining if a service qualifies as an exported service or not. The VAT Act neither defines who qualifies as a consumer nor lays out the imperatives in determining the place of consumption.

This has left room for divergent views between taxpayers and the Kenya Revenue Authority (“KRA”) and necessitated interpretation by the Courts of law and the Tribunal which are faced with numerous disputes regarding export of services.

Facts of the Appeal

This was an appeal of the Tribunal’s decision to the High Court (“the Court”).

Coca-Cola Central East and West Africa Limited (“Coca-Cola Kenya”) was contracted by Coca-Cola Export Corporation (“Coca-Cola Export”), a company incorporated in the United States of America (“USA”) to provide marketing and advertising services in Kenya. Coca-Cola Export and its subsidiaries manufacture concentrate in various parts of the world. The concentrate is then sold to various authorized Bottlers, some of which are in Kenya, who import and use it in preparing and packaging Coca-Cola beverage products.

The KRA conducted an audit into the affairs of the Coca-Cola Kenya for the period 2007-2010. Following the audit, KRA raised an assessment against Coca-Cola Kenya on the basis that it had not accounted for VAT on the marketing and advertising services supplied to Coca-Cola Export. In particular, KRA sought to charge VAT at the standard rate on the services on the premise that the services were consumed locally. On the other hand, the Coca-Cola Kenya held the view that the services it supplied qualified as exported services and were therefore zero rated.

Taxpayer’s Position

Coca-Cola Kenya argued that whereas the performance of the service was done in Kenya, the consumer of its services was Coca-Cola Export based in the USA. In support of its case, it relied on the OECD’s destination principle (*Guideline 3.1 of the OECD International VAT/GST Guidelines*) which provides that internationally traded services and intangibles should be subject to VAT in their jurisdiction of consumption.

Coca-Cola Kenya also placed reliance on Guideline 3.3 of the OECD *International VAT/GST Guidelines* which provides that the identity of the customer should be determined by reference to the business agreements in place. The Service Agreement between Coca-Cola Kenya and Coca-Cola Export shows the customer/consumer as Coca-Cola Export, an entity based abroad. As such, the Kenyan consumers were third parties in so far as the Service Agreement was concerned.

The Taxpayer also argued that although the marketing and advertising services were performed in Kenya, the test was not where the services were performed or provided but rather

where the consumer was located. Consequently, the services it rendered to Coca-Cola Export’s services qualified as exported services.

Kenya Revenue Authority’s Position

The KRA argued that the marketing and advertising services rendered by Coca-Cola Kenya were done in the local market with the ultimate aim of increasing the uptake of Coca-Cola products in Kenya by the Kenyan population.

Further, that the OECD Guidelines are inapplicable where Kenya’s tax statutes have an express provision which are not in consonance with the Guidelines. In that event the provisions of our statutes prevail.

The Decision

In determining the matter, the High Court was guided by OECD Guidelines. One of the Guidelines (3.1) is the *destination principle* which provides that internationally traded services and intangibles should be subject to VAT in their jurisdiction of consumption. The Guidelines (3.2) also provide that in so far as business to business supplies are concerned, the jurisdiction in which the customer is located has taxing rights over the internationally traded services or intangibles. The subsequent Guideline (3.3) provides that the identity of the customer should be determined by reference to the business agreements in place.

According to the Court, the marketing and advertising services supplied by the Appellant to Coca-Cola Export constituted a business to business supply. The Court further observed that in order to ascertain the customer, reference must be made to the Service Agreement between the two which depicts the customer/consumer as Coca-Cola Export, an entity based abroad.

However, the Court took note of correspondence between the Appellant and KRA which depicted the Bottlers as direct beneficiaries of the marketing activities by the Appellant through increased sales. In its analysis, the Court held that the destination principle which gives rise to the conclusion that Coca-Cola Export was the consumer may be deviated from if it is shown that the arrangement is merely a device to avoid or artificially minimize VAT. This is in tandem with Guideline 3.3 which provides instances in which the destination principle can be deviated from.

Coca-Cola Export paid Coca-Cola Kenya for the marketing and advertising activities rendered. Coca-Cola Export then built in the expenses borne in marketing and advertising activities into the cost of the concentrate it sold to the Bottlers in Kenya. The Bottlers paid VAT on the purchase and importation of the concentrate.

In light of the foregoing analysis, the Court held that the said marketing and advertising services do not escape the VAT charge given that the VAT paid on importation of the concentrate constitutes VAT on inbuilt marketing and advertising services cost. Therefore, there was no reason to deviate from the destination principle.

Consequently, the Court took the view that the services rendered by Coca-Cola Kenya qualified as exported services and as such set aside the Tribunal’s decision

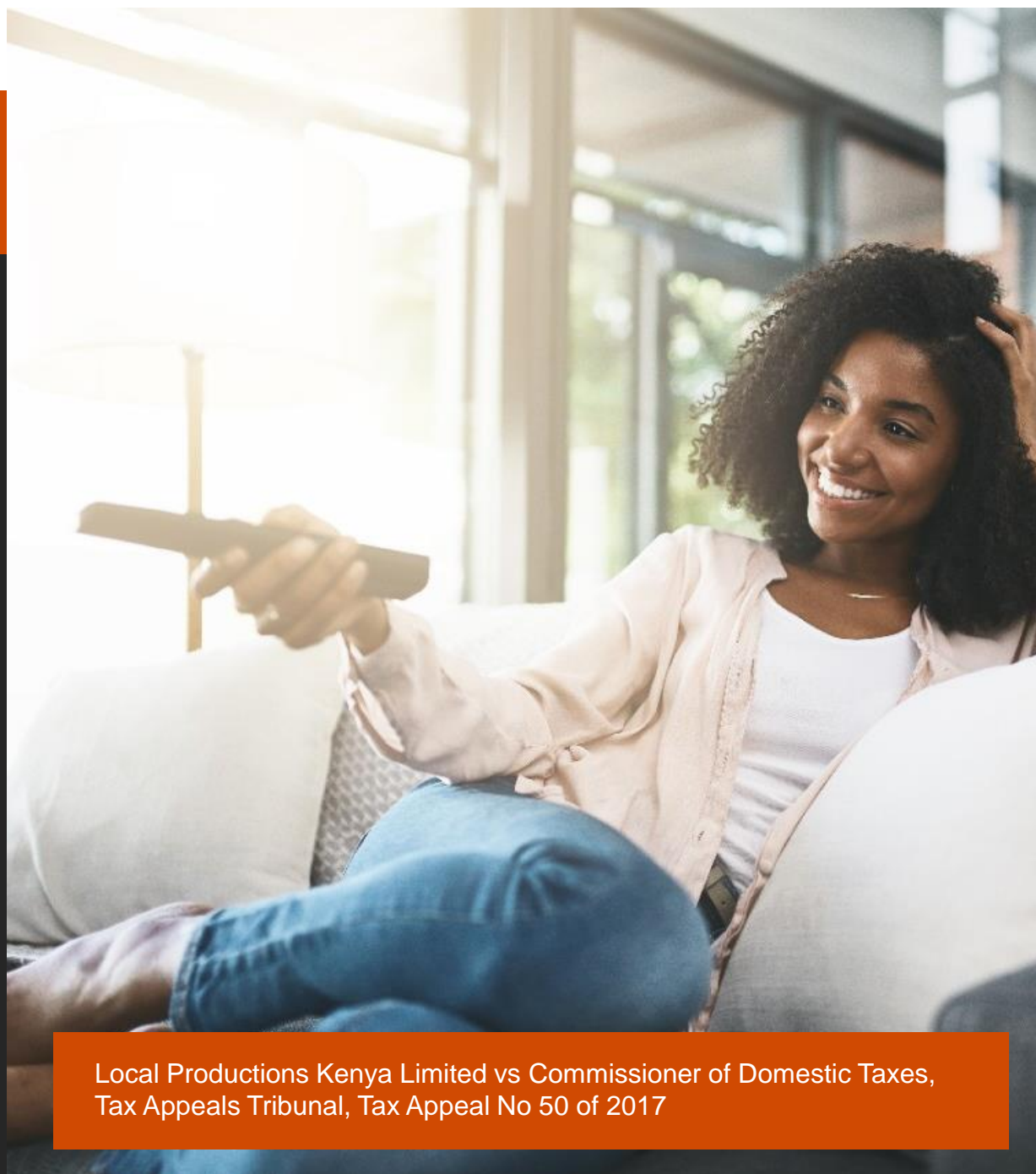
Key takeaways:

In our view, the foregoing decision is a welcome reprieve for many taxpayers in the export service industry. Further, it being a decision of the High Court, it goes a long way to avail more clarity on the issue of exported services following several conflicting decisions on the subject from the Tribunal.

Over and above the foregoing decision, we note that recent decisions of the Tribunal being *LG Electronics Africa Logistics FZE Kenya Branch v Commissioner of Domestic Taxes (Tax Appeal No 359 of 2018)* and others have adopted the same approach.

It is also worth noting that the Coca-Cola decision above is a High Court decision, unless it is set aside it is a binding precedent going forward in so far as VAT on exported marketing and advertising services is concerned.





Local Productions Kenya Limited vs Commissioner of Domestic Taxes,
Tax Appeals Tribunal, Tax Appeal No 50 of 2017

Background- Legal Basis & Practice

Section 13(5) of Kenya's VAT Act provides that in calculating the taxable value of a supply of services, any incidental costs incurred by the supplier of the services while making the supply to the client shall be included. However, where the supplier has merely made a disbursement to a third party as an agent of his client, then such disbursement shall be excluded from the taxable value.

KRA is increasingly relying on the foregoing provision to deny VAT refunds claimed by exporters of services, claiming that the costs were incurred as an agent and that the costs were or should be disbursed to the principal.

Facts of the Appeal

Local Products Kenya Limited's ("LPKL") principal business activity is producing and/or commissioning production of television content. LPKL's customers included SuperSport and M-NET. Both entities are tax resident in South Africa.

LPKL produced the content and sent it to Supersport or M-NET in South Africa. Their relationship was governed by a Service Level Agreement which provided that the customers, M-NET and Supersport, were the owners of the content created and that they had discretion to do whatever they wanted with it.

LPKL applied for VAT refunds on the basis that the services it provided qualified as zero-rated exported services under the VAT Act. KRA rejected the claim. One of the grounds that KRA cited for its decision, was that the Appellant, LPKL, incurred the costs as an agent to the principal (being M-NET and Supersport) and that the costs were being reimbursed by the principal. Therefore, it was KRA's view that LPKL could not claim VAT refunds on costs that it did not incur.

Taxpayers Position

LPKL argued that the KRA did not follow due process in its decision to reject its refund claims. Further, that there was no principal agency relationship between it and its customers. In proving this ground, LPKL relied on several legal authorities which defined the agency relationship as the authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties.

LPKL argued that the Service Level Agreement it had in place with its customers was categorical that no party can bind the other in so far as third-party engagements are concerned. As such there is no agency relationship between it and its customers and that their VAT refunds were due and payable by the KRA.

KRA's Position

KRA argued that there were no procedural lapses in rejecting LPKL's VAT refund claim. Further, that the reason the same was rejected was because LPKL failed to separate its own exported services from the services performed on behalf of others in its capacity as an agent. KRA argued that LPKL was an agent of its customers and as such cannot claim VAT refund on costs which were or should have been disbursed to the Customers.

The Decision

The Tribunal amongst other grounds, analysed at length the issue regarding whether there existed an agency relationship.

Relying on several authorities, the Tribunal noted that the relationship of principal and agent could only be established by consent of the principal and agent. In particular, a principal-agent relationship arises between two persons where one expressly or impliedly consents that the other should act on his behalf.

Following analysis of the Service Level Agreement (Agreement) between LPKL and Supersport, the Tribunal noted that one of the conditions in the Agreement was that no party shall be liable for any damages or claims of the other party in respect of such party's failure to perform its obligations under the Agreement or any default or omissions to third parties. The Tribunal noted that one of the characteristics of existence of an agency relationship is the ability of the principal to be bound by the actions of its agent.

The Tribunal in its wisdom found that all factors considered, the relationship between LPKL and Supersport did not amount to a principal agent relationship and as such LPKL was entitled to its VAT refund claim.

Key Takeaways

Considering the stipulations of Section 13(5) of the VAT Act, it is highly advisable that exporters review their Service Agreements to make sure they do not give rise to a principal-agent relationship where none is intended.

One way in which taxpayers may protect themselves from implied agency relationships is to have express provisions within their agreements to the effect that neither of the parties is to be bound by the other's actions or omissions to third parties. This position is in tandem with the Tribunal's findings in Local Production Kenya Limited decision.



Co-operative Bank of Kenya Limited versus Commissioner of Domestic Taxes, Tax Appeals Tribunal, Tax Appeal No. 45 of 2017

Background – Legal basis and Practice

One of the other contentious subjects in the financial services sector has been the issue of what constitutes ‘other fees’ and hence subject to excise duty. Paragraph 4 of Part II of the First Schedule of the Excise Duty Act, 2015 charged excise duty on “other fees” charged by financial institutions. However, the said Section specifically exempts interest charge from Excise duty

KRA took a very strict interpretation of the word “interest” excluding all other aspects appurtenant to interest on loans e.g. early loan repayment fees/charges and return on loans from the definition of interest and as such subjecting the same to excise duty. The taxpayers on the other hand relied on the definition of interest under the Income Tax Act which is quite broader. This led to numerous disputes between the taxman and various taxpayers in the financial sector.

Facts of the Case

KRA assessed the Cooperative Bank of Kenya Limited for excise duty on fees and commissions appearing in the Bank’s financial statements. These fees entailed loan moratorium fees and flexi interest fees which the Bank never accounted excise duty on the basis that the said fees were exempt from excise duty.

Taxpayer’s Position

In its defense, Cooperative Bank argued that moratorium fee relates to interest charged on loans during the grace period before the borrower starts paying interest. The Bank also argued that flexi interest is earned from short-term loans and no other charge is applicable for advancing such loans. The Bank also went ahead to clarify that the other income item being interchange fee as received had already been subjected to excise duty in the hands of the acquirer bank. Accordingly, subjecting the same to excise duty in the hands of the Appellant would amount to double taxation.

Kenya Revenue Authority Position

The Revenue Authority argued that in its view the moratorium and flexi fees lacked the features of ‘interest’ e.g. by virtue of the rate applicable not being pre-defined and separate disclosures from the interest line in the financial statements. Therefore, as per the taxman these income streams ought to have been subjected to excise duty.

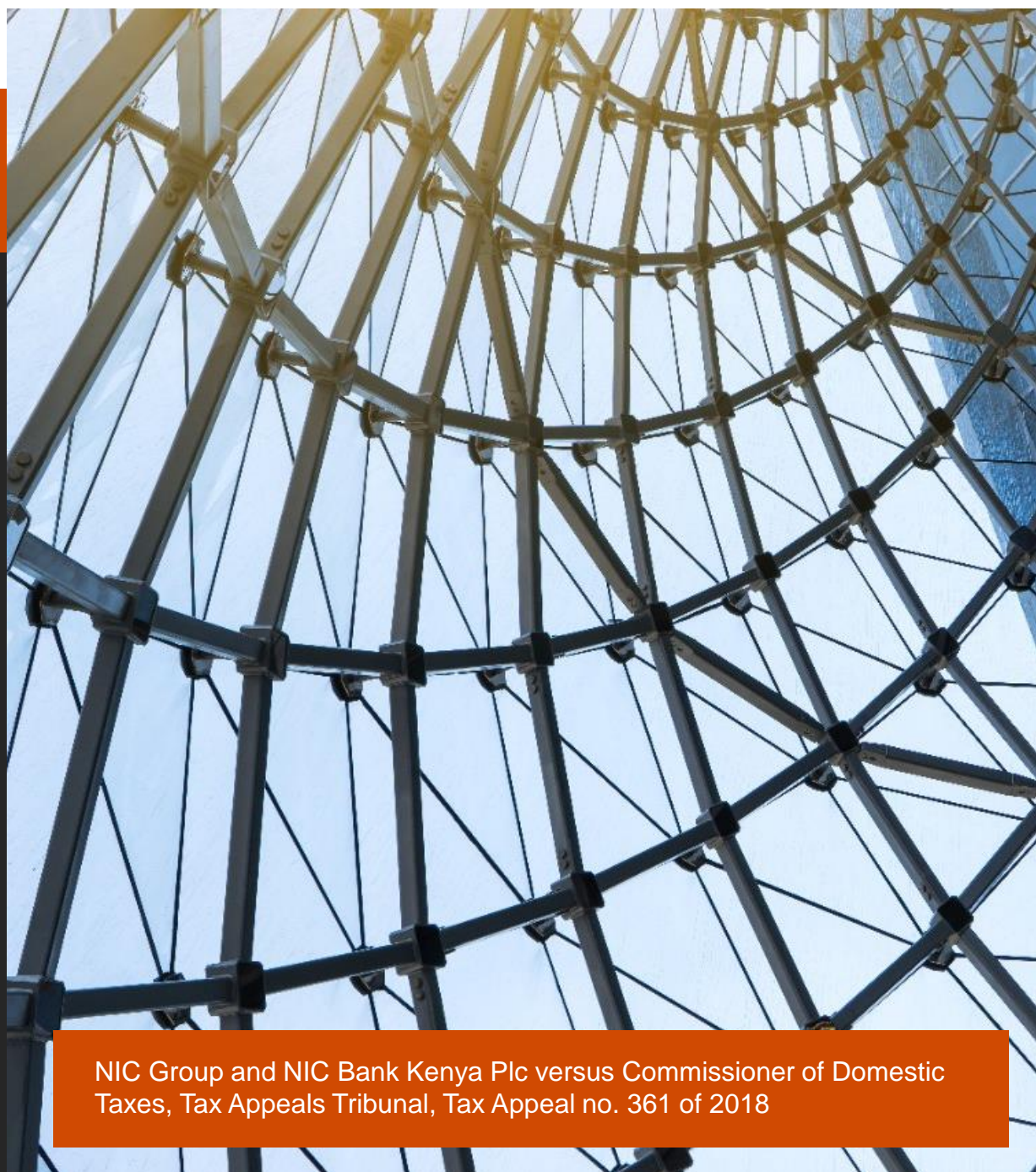
The Decision

The Tribunal held that in the absence of a definition of the term ‘interest’ under the Excise Duty Act, inference of an operational definition is found in the Income Tax Act, which defines interest to mean “interest payable in any manner in respect of a loan, deposit, debt, claim, or other right or obligation, and includes premium or discount by way of interest and any commitment or service fee paid in respect of any loan or credit.” Accordingly, based on this definition, the Tribunal found that moratorium fee and flexi interest were in the nature of interest and thus outside of the purview of excise duty. The Tribunal went ahead to find that subjecting interchange commissions, which had already been taxed in the hands of the acquirer bank would amount to double taxation.

With regards to agency income, the Tribunal held that this was derived income not charged to customers by the Appellant and it could thus not be considered as being excisable service chargeable to Excise duty.

Key Takeaways

We note that this decision of the Tribunal comes on the back of a recent change to the Excise Duty Act, 2015 aimed at clearing ambiguity in the law. The Finance Act 2019 amended the Excise Duty Act, 2015 effective November 2019 and provided clarity on what constitutes ‘other fees’ subject to excise duty. Prior to this amendment, various players in the financial services sector were embattled in disputes with the taxman for almost a decade regarding whether certain fees, charges and commissions earned by those financial institutions ought to attract excise duty at the rate of 20% (10% before July 2018).



NIC Group and NIC Bank Kenya Plc versus Commissioner of Domestic Taxes, Tax Appeals Tribunal, Tax Appeal no. 361 of 2018

Background- Legal basis and Practice

Various banks in Kenya act as issuing banks in that they issue either debit or credit cards to their customers. The customers use these cards to purchase goods and services from suppliers such as supermarkets or eateries. It is these stores that are referred to as 'merchants' in card transactions. For every purchase done by use of card, a commission known as 'merchant service commission' is charged and shared based on pre-agreed ratios. This commission is then shared amongst the issuing bank; the bank that owns the point of sale terminal used to swipe the cards (referred to as 'acquiring bank'); and the card companies such as Visa and Mastercard who enable settlement of the funds between the parties involved.

It is the share of commission earned by the issuing bank that is referred to as 'interchange fee'. The issue in contention has been whether the share of revenue allocated to the issuing bank should be subject to VAT. On the one hand, the KRA have taken a position that the interchange fee is subject to VAT while taxpayers have adopted a contrary view.

Facts of the Case

The Kenya Revenue Authority assessed NIC Bank Kenya Plc ("the Bank") for VAT on interchange fees. The KRA took the view that the interchange fees received and retained by the Bank is for a taxable service and as such should have been subject to VAT at the appropriate rate.

Taxpayer's Position

The Bank argued that it was simply effecting transfer of money from its customer's accounts. Further, that Paragraph 1(b) of Part II of the First Schedule to the VAT Act, 2013 specifically exempts the transfer or other dealings with money from VAT. The Bank also argued that in accordance with Section 2 of the VAT Act 2013 money is defined to include any amount provided by way of payment using debit and credit cards.

The Bank also argued that interchange fees was obtained from operation of customer's accounts and that operation of accounts is specifically exempted from VAT under Paragraph 1(c) of Part II of the First Schedule to the VAT Act, 2013 and paragraph 1(a) of the Third Schedule to the VAT Act CAP 476 (now repealed).

Kenya Revenue's Position

KRA argued that the service NIC Bank supplied to the acquiring bank is a composite service in the nature of authorization and capture and settlement. In KRA's view the service is subject to VAT pursuant to Section 5(1)(a) and 5(2)(b) of the VAT Act, 2013. The Bank should therefore have accounted for VAT in relation to the same which it failed to do. Further, that the services supplied by the Bank did not qualify for exemption under the VAT Act, 2013.

The Decision

The Tax Appeals Tribunal has held inter alia that interchange fees received by an issuing bank is not subject to VAT as the same is exempt under the VAT Act, 2013. In the Tribunal's view, the cardholder verification process undertaken by the issuing bank is not a distinct service but rather ancillary to the supply of transfer of money services by the issuing bank, which is VAT exempt.

Key Takeaways

The above decision came as reprieve to the Banking Sector following a sector wide assessment(s) by the KRA. This decision is in tandem with the High Court decision in Barclays Bank of Kenya Limited versus Commissioner of Domestic Taxes on the same subject matter which was ruled in favor of the taxpayer.

The determination that VAT was not applicable on the income sought to be taxed by the revenue authority goes a long way in reducing the cost of accessing financial services and by extension deepening financial inclusion in Kenya.



Shreeji Entreprises (K) Limited v Commissioner of Investigations & Enforcement, Tax Appeals Tribunal, Tax Appeals No. 58 and 186 of 2019

Background - Legal basis and Practice

In 2019, the Kenya Revenue Authority discovered a scheme involving traders who would use fictitious invoices to illustrate business transactions where there was no actual supply or movement of goods and services. In the scheme (commonly referred as “the missing traders scheme”), business entities would mimic the actual trading process by trying to meet all the legal requirements of a 'supply' for tax purposes and in the process claim input VAT where there was none.

This led to the KRA disallowing all input VAT claims that had no corresponding entries from the suppliers including cases where actual supplies have been made and payments effected.

Facts of the Case

Shreeji Entreprises (K) Limited (“Shreeji”) in the course of business had paid out VAT on its sales and claimed input VAT as provided under the VAT Act, 2013. However, KRA disallowed Shreeji’s input VAT claim and further demanded that it pays input VAT it had claimed on previous occasions. The KRA’s reason for disallowing the input VAT claim by Shreeji being that the input VAT disallowed related to four missing traders who were working in connivance with Shreeji to implement the missing trader’s scheme.

Taxpayer’s position

Shreeji argued that it was not participating in the any missing trader scheme and that it had in fact provided substantial documentation to the KRA to prove that it had made actual purchases.

Shreeji also argued that it had adduced evidence that the traders it dealt with were registered with KRA and had PIN numbers which they used in the normal course of business and that Shreeji used the said PIN numbers and ETR receipts given in the normal course of business to input VAT which was accepted by KRA’s iTax system. However, the KRA refused to take the same into consideration in its assessment.

It further argued that KRA had not tabled any evidence in support of its fraud assertion.

KRA’s Position

KRA argued that the basis for its decision was that claimant was a beneficiary of the missing traders’ fraud. In particular that the 17 transactions conducted by Shreeji were connected with the fraudulent scheme and the Company knew these facts.

KRA further argued that there was no actual supply made to warrant the input VAT claim and that Shreeji acquired documentation from four companies implicated in the missing traders’ scheme. Further, that the said traders had no known place of business and only printed and sold invoices to various companies at a commission to reduce their tax liabilities. Based on its findings, KRA disallowed the cost of sales which in turn increased the income of the business and charged income tax on it.

The Decision

The Tribunal held that whereas the onus of proof lies with the taxpayer to prove that tax was paid or that KRA’s assessment was wrong, it cannot be that the intention of the legislature was to put the taxpayer in a position where he would be required to produce any document that the taxman may require. Further, that in demanding the production of documents which are not prescribed by legislation, the KRA should be guided by reasonableness and accept reasonable explanations given by the taxpayer.

In the instant case, the Tribunal noted that Shreeji had discharged its duty of paying output VAT and supplying corresponding information to the effect that it had purchased goods from registered persons prior to claiming input tax. Further, that the only obligation placed on taxpayers by the legislation in so far as investigating the status of its counterparty is concerned was to confirm that it purchased its supplies from a VAT registered trader and that the trader had a registered ETR register. Shreeji had discharged this obligation.

The Tribunal further found that whereas the burden of proof rests with the taxpayer in tax law, the burden shifted to the KRA at the point issues of VAT fraud were raised. The Tribunal, while relying on several authorities, held that the burden of proof where fraud is alleged is beyond a balance of probability which the KRA failed to discharge. Moreover, nothing was placed before the Tribunal proving that Shreeji knowingly took part in transactions connected with the fraudulent evasion of VAT.

Taking the foregoing into consideration, the Tribunal ruled in favor of Shreeji hence vacating the assessment and its attendant penalties and interest.

Key Takeaways

The above decision from the Tribunal is a welcome reprieve to taxpayers. The KRA has on previous occasions invoked fraud and willful neglect to exceed the five-year limit on the period it can raise assessments. In the foregoing decision, the Tribunal has raised the threshold for KRA to invoke such powers granting taxpayers more protection.



Our Contacts



Titus Mukora
Partner
+254 (20) 285 5000
titus.mukora@pwc.com



Janet Lavuna
Senior Manager
+254 (20) 285 5000
janet.lavuna@pwc.com



Imelda Mutiso
Manager
+254 (20) 285 5000
imelda.mutiso@pwc.com



Edward Paranta
Senior Associate
+254 (20) 285 5000
edward.paranta@pwc.com





Key Contacts

Nigeria



Chijioke Uwaegbute
Partner
+234 706 401 9039
chijioke.uwaegbute@pwc.com



Folajimi O. Akinla
Senior Manager/Lead, TCDR
+234 802 846 3369
folajimi.akinla@pwc.com

South Africa



Elle-Sarah Rossato
Lead, Tax Controversy and
Dispute Resolution
+27 (0) 11 797 4938



Jadyne Devnarain
Senior Manager, Tax Controversy
and Dispute Reslution
+27 (0) 11 797 4282

Kenya



Titus Mukora
Partner
+254 (20) 285 5000
titus.mukora@pwc.com



Janet Lavuna
Senior Manager / Lead TCDR
+254 (20) 285 5000
janet.lavuna@pwc.com

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Notes

A series of horizontal dashed lines for taking notes.



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