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Recently, the High Court in Commissioner of Domestic Taxes v Pevans Africa Ltd Income Tax Appeal Nos. E079 of 2020 & E048 of 2021, delivered its judgment on 12 August 2022 allowing the Kenya Revenue Authority (KRA) to collect betting tax of KES. 1.6 billion from Pevans EA Limited t/a Sportspesa.

In overruling the Tax Appeals Tribunal's judgment, the High Court observed that betting tax is an income subject to the Income Tax Act (ITA). Its collection is by way of Withholding Tax (WHT), and KRA could issue agency notices under the Tax Procedures Act, 2015 (TPA) to collect betting tax.

The taxman's issuance of agency notices to Sportspesa to collect betting tax was held to be within the law.

BRIEF BACKGROUND

In a letter dated 28 June 2019, Sportspesa, made a voluntary self-disclosure of betting tax for the year 2018, of KES. 1,2 billion and made a settlement proposal with the Commissioner of Domestic Taxes (the commissioner). The taxman issued Sportspesa with withholding tax demands and agency notices for withholding tax arrears for April and May 2019 amounting to KES. 3,29 billion and 2,57 billion, respectively.

Aggrieved, Sportspesa filed Tax Appeal Nos. 304 and 305 of 2019 before the Tax Appeals Tribunal (the Tribunal) on 28 June 2019. It sought interpretation of the term winnings and for the agency notices to be set aside. In the meantime, the taxman wrote to the Betting Control and Licensing Board citing Sportpesa's tax non-compliance and requesting non-renewal of its license. Consequently, Sportspesa paid KES. 1,9 billion pending determinations by the Tribunal of the said appeals hoping for an amicable settlement of the dispute.

On 6 November 2019, the Tribunal held that winnings did not include the stake of punters and hence set aside the taxman's demands for withholding tax of KES. 3,29 billion and KES. 2,57 billion. Subsequently, KRA enquired on the payment status of the voluntary self-declaration for betting tax for 2018, and Sportspesa responded to KRA by requesting that it offset the KES. 1,2 billion betting tax from the KES. 1,9 billion that Sportspesa had paid earlier.

KRA declined to offset the betting tax as requested on the ground that the KES. 1,9 billion that was paid by Sportpesa was withholding tax which related to punters and not Sportspesa. Moreover, it demanded immediate payment of the betting tax of KES. 1,66 billion (i.e. the KES. 1,2 billion plus penalties and interest) by issuing agency notices. This action prompted Sportspesa to file Tax Appeal No. 402 of 2020 before the Tribunal.

The Tribunal, in its judgment dated 16 April 2021, partly allowed the appeal, and set aside KRA's agency notices. Nonetheless, it upheld KRA's decision to disallow set-off of betting tax against the 1,9 billion paid by Sportpesa. Both parties were aggrieved by the Tribunal's decision causing Sportspesa to file ITA No. E079 of 2021 and Commissioner for Domestic Taxes ITA E048 of 2021 in the High Court. The appeals were consolidated by the High Court and heard concurrently.

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ISSUE FOR DETERMINATION BY HIGH COURT

The High Court collapsed the issues for determination as follows:

- whether KRA's issuance of agency notices over betting tax, interests, and penalties was *ultra vires*; and
- whether betting tax of KES. 1,661,350,351/= could be offset from the KES. 1,900,000,000/= paid by Sportspesa to KRA.

Whether KRA's issuance of agency notices over betting tax, interests, and penalties was *ultra vires*

In reference to Article 209 of the Constitution of Kenya and section 5 of KRA Act, the High Court (the court) noted that KRA has the mandate to administer and enforce assessment, collection, and account for all government revenue. The court noted the provisions of the TPA apply to all taxes unless a specified procedure unique to administration of a tax is established under a tax law.

Accordingly, the court found that no specific procedure for enforcement of betting tax had been established under the Betting Act. Judge Mabeya asserted that section 68 of the Betting Act did not provide an enforcement mechanism for collection of betting tax.

The court found that betting tax qualifies as a withholding tax and the absence of an enforcement procedure under the Betting Act means that its collection is subject to TPA. Overall, the taxman's decision to issue agency notices to collect betting tax by issuing agency notices was, thus not *ultra vires* (i.e. it was within its powers).

Whether betting tax of KES. 1,661,350,351/= could be offset from the KES. 1,900,000,000/= paid by Sportspesa to KRA

On the second issue, the High Court found that the KES. 1,900,000,000/= paid by Sportspesa to KRA was not paid as withholding tax but as security for any taxes. It was paid to avoid non-renewal of Sportspesa's betting license and to secure lifting of the agency notices pending determination of the tax dispute. Furthermore, it was undeniable that betting tax of KES. 1,661,350,351 was due from the Sportspesa's tax declaration.

The High Court ordered KRA to set-off the KES. 1,661,350,351/= from KES. 1,900,000,000/= paid by Sportspesa as security for taxes. The court also found that Sportspesa should follow the process of applying for refund of overpaid tax under Section 47 of the TPA.

COMMENTARY AND CONCLUSION

On the first issue, courts have stated clearly over time that the rules of interpretation of tax statutes requires that a tax statute is read and interpreted strictly. This position was captured in *Republic v Kenya Revenue Authority Exparte Bata Shoe Company* (*Kenya*) *Limited* [2014] eKLR where the court asserted the literal rule of interpretation to decipher the

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actual intention of legislature when enacting the statute. The Supreme Court in *Gatirau Peter Munya v Dickson Mwenda Kithinji and 2 others* [2014] eKLR pronounced that a purposive interpretation should be given to statutes to reveal the statute's intention.

The discourse herein reveals an ambiguity in the enforcement procedure of betting tax under the Betting Act. Furthermore, it is unclear whether the Betting Act falls within the meaning of a "*tax law*" in the Tax Procedures Act. In *Mount Kenya Bottlers v AG and 3 others* [2019], the Court of Appeal stated that if there is ambiguity in a tax statute, such ambiguity must be resolved in favour of the taxpayer or as is sometimes stated; the *contra fiscum rule*.

On the second issue, in the case of *Kenya Revenue Authority v Maluki Kitili Mwendwa* [2021] eKLR, the court stated that "*burden of proof*" is a legal term used to assign evidentiary responsibilities to parties in litigation. Tax laws provide that in any tax proceedings the burden of proof to show that the tax decision should not have been made or should have been made differently, falls on the taxpayer as there exists a presumption of correctness which attaches to KRA's assessments or determinations of deficiency.

This presumption remains until the taxpayer produces competent and relevant evidence to support his position, afterwards the case must be decided upon the evidence presented, with the burden of proof still on the taxpayer. Once the taxpayer has made out a solid case to prove the facts, the burden then shifts to KRA to rebut the case. If it cannot provide any evidence to prove its position, the taxpayer will succeed. Therefore, the decision by the High Court to allow the set-off, was well within the law.

Indeed, collection of WHT from Sportspesa has been a bone of contention in recent years. For instance, the High Court in *Commissioner of Domestic Taxes v Pevans East Africa Limited & 6 others* (Tax Appeal E003 of 2019) [2022] KEHC 10392 (KLR), upheld that the Commissioner could not collect WHT from Sportspesa, and all it could was to seek the same from punters directly. The decision in that case was based on some ambiguity in the law applicable to the dispute. The same benefit of ambiguity of the law was not accorded to Sportpesa in the current case.

Albeit binding, the decision of the High Court can be challenged for failing to uphold the *contra fiscum rule*. Nonetheless, the 13th Parliament should legislate to make it clear whether betting tax under the Betting Lotteries and Gaming Act falls within the ambit of the TPA and the ITA.

ALEX MWAURA KANYI, JOSEPH MACHARIA AND JOAN KAMAU

SOUTH AFRICA

Interpretation Note 75 (Issue 4): Exclusions from the Definition of Group of Companies in Section 41(1)

The ability for corporate groups to acquire businesses that fit their proposed models, divest in order to right-size or realise returns, and introduce capital from various sources is of increasing importance in today's economic climate.

The corporate roll-over relief provisions contained in Part III of Chapter 2 of the Income Tax Act 58 of 1962 (Act) provide corporate groups with the agility to reorganise to meet the exigencies of the prevailing economic realities. These provisions achieve this by allowing corporate groups to reorganise by deferring the otherwise immediate income tax and capital gains consequences associated with certain transactions.

The application of aspects of the corporate roll-over relief and several other provisions in the Act, in many instances turns on whether the companies in question form part of the same "*group of companies*" as defined in the Act. In the context of these provisions, there are two sets of rules to be considered in determining whether a "*group of companies*" indeed exists. The first consideration is the general definition of "*group of companies*" contained in section 1(1) and the second consideration is the exclusions of certain companies and shares from the determination as provided for in the more limited definition of "*group of companies*" in section 41(1).

The South African Revenue Service (SARS), on 18 August 2022 issued an update to Interpretation Note 75: Exclusion of Certain Companies and Shares From a "*Group of Companies*" as Defined in Section 41(1) (IN75). This interpretation note provides updated guidance on how to determine whether a set of companies indeed form part of the same "*group of companies*". No significant changes have been made to the guidance provided, but IN75 now caters for amendments which were made to the Act following promulgation of amendments introduced under the 2021 tax laws and tax administration laws amendment process.

"GROUP OF COMPANIES" DEFINITIONS IN THE ACT

Section 1(1) provides that a Group of Companies exists where one company (the controlling group company) directly or indirectly holds shares in at least one other company (the controlled group company), where:

- at least 70% of the equity shares in each controlled group company are held by the controlling group company directly, one or more other controlled group company or any combination of the preceding; and
- the controlling group company holds at least 70% of the equity shares in at least one controlled group company.

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This definition in sum provides that a "*group of companies*" exists where there is a top holding company that holds at least 70% of the equity shares in one or more second level subsidiaries. It further includes in that group any other subsidiary company down the ownership chain, where either a group subsidiary or the top holding company, alone or together, hold at least 70% of the equity shares.

It is important to note for the purposes of this definition, that equity shares are defined in section 1(1) as *"any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution"*.

Section 41 in turn defines a "*group of companies*" with reference to the definition in section 1(1) noted above, but contains a proviso excluding certain categories of companies from the determination whether such company forms part of such group and that deems equity shares held in certain circumstances to not be equity shares and therefore excluded from consideration in whether the 70% threshold is met.

The categories of companies to be excluded are:

- all co-operatives;
- associations formed in South Africa for a specific purpose, beneficial to the public or a section of the public;
- the portfolio of an investment scheme carried on outside of South Africa, comparable to a collective investment scheme, where members of the public are able to contribute and hold a participatory interest in such portfolio through shares, units or another form of participatory interest;
- non-profit companies as defined in the Companies Act 71 of 2008;
- companies where any amount constituting gross income of whatever nature would be exempt from tax under the provisions of section 10; this would include government entities, and pension funds pension preservation funds, provident funds, provident preservation funds or retirement annuity funds;
- public benefit organisations or recreational clubs approved by SARS under the provisions of section 30 or 30A;
- foreign incorporated companies, unless effectively managed in South Africa; and
- locally incorporated companies that are effectively managed outside of South Africa.

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- the circumstances in which shares will be deemed to not constitute equity shares are:
  - where the shares are held as trading stock; and
  - where any person is under a contractual obligation to sell or purchase the relevant share, or has an option to sell or purchase the relevant share, unless that obligation or option provides for the sale or purchase to take place at the market value of such share at the time of the sale or purchase.

HIGHLIGHTS OF THE IN75 GUIDANCE

IN75 emphasises that the exclusions contained in the proviso to the definition of "*group of companies*" in section 41(1) must be read together with the preceding wording which refers to the definition in section 1(1). Meaning that for the purposes of the section 41(1) definition, the exclusions must be read as applying to the definition of "*group of companies*" is section 1(1).

For example, where a company that is an approved public benefit organisation or a foreign incorporated company constitutes the controlling group company under the definition in section 1(1), such company must be excluded for the purposes of the section 41(1) definition. The exclusion of the controlling group company from the consideration could therefore possibly result in the group not constituting a "*group of companies*" as defined in section 41(1).

IN75 also considers the applicability of Article 24(5) of the Organisation for Economic Cooperation and Development's Model Tax Convention on Income and Capital, which prohibits more burdensome tax treatment applying to resident subsidiaries held by non-resident holding companies, than resident subsidiaries not held by a non-resident holding company, where the circumstances are similar.

The conclusion drawn by IN75 is that the proviso to the definition in section 41(1) does not treat foreign held subsidiaries in a more burdensome manner, because the policy basis for the exclusion is that the exclusions target companies that do not fall within the South African tax net. The exclusions therefore also target resident companies which are not subject to tax in South Africa, such as approved public benefit organisations and pension funds pension preservation funds, provident funds, provident preservation funds or retirement annuity funds.

COMMENT

The policy rationale for the exclusion of certain categories of companies and shares from the definition of "*group of companies*" in section 41(1) is that the companies and shares

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targeted would erode the South African tax base in a manner not aligned to the policy imperatives of National Treasury.

It is therefore possible that in future further amendments may be made to the Act, seeking for the section 41(1) definition of a "*group of companies*" to be applied in more circumstances than at present. Aiming to prevent the provisions of the Act applying in circumstances where base erosion is a policy consideration.

Overall, an appreciation of the scope of the definition of "*group of companies*" in section 41(1) is critical to a proper understanding of the availability of corporate roll-over relief for a given set of companies. It is also important for the correct application of several other provisions within the Act, for example the debt concession or compromise provisions contained in section 19 and paragraph 12A of the Eighth Schedule to the Act.

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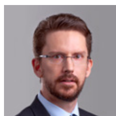

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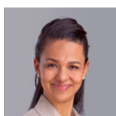

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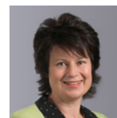

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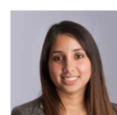

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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