TAX & EXCHANGE CONTROL
ALERT

6 OCTOBER 2022

INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

KENYA

National Treasury cannot lawfully approve abandonment of taxes without recommendation from the revenue authority

Is the revenue authority obliged to comply with unlawful instructions from National Treasury? Recently, the High Court had to answer this question in *Republic v Commissioner of Domestic Taxes & Ex-Parte London Distillers (K) Limited [2022] eKLR*.

SOUTH AFRICA

Welcome clarity on the taxation of farmers in South Africa?

Farming and agriculture form the lifeblood of any economy. It is no wonder that the Income Tax Act 58 of 1962 (Act) provides for a special set of beneficial rules applicable to farmers in South Africa. This special taxation regime is by and large set out in the First Schedule to the Act.

KENYA

National Treasury cannot lawfully approve abandonment of taxes without recommendation from the revenue authority

Is the revenue authority obliged to comply with unlawful instructions from National Treasury? Recently, the High Court had to answer this question in *Republic v Commissioner of Domestic Taxes & Ex-Parte London Distillers (K) Limited [2022] eKLR*.

BRIEF FACTS

In a letter dated 15 September 2021, LDK applied to the Cabinet Secretary for National Treasury and Planning for the abandonment of KES 517,118,680 which LDK had collected as excise duty in the course of its business. National Treasury allowed the application and approved the abandonment of 80% of the outstanding principal excise duty and waived 100% of the penalties and interest.

Subsequently, the KRA wrote to LDK acknowledging the outcome of the abandonment and demanding a sum of KES 80 million, being the 20% outstanding tax arrears. The KRA and LDK agreed on the settlement of the said amount in weekly instalments of KES 7,500,000 beginning on 2 February 2022. At the time of lodging the case at the High Court, LDK had paid the instalments that were due.

On 2 March 2022, the KRA advised LDK that after consultation the approval given by National Treasury had been rescinded and the entire sum of KES 517,118,680 ought to be paid within seven days, failing which the KRA would institute enforcement measures. LDK, in rebuttal, asserted that it had not received any communication from National Treasury rescinding its approval nor was there an application or hearing for the rescission.

The KRA replied stating that LDK did a self-assessment return for January 2020 to August 2021 for taxes amounting to KES 529,278,680 but failed to remit the same. It applied for abandonment of the taxes to National Treasury, which in turn wrote to KRA seeking its advice on the application. The KRA advised National Treasury that the application was not tenable and did not meet the threshold under section 37 (1) of the Tax Procedures Act. Nevertheless, National Treasury partially allowed the abandonment.

Later, the KRA sought advice from the Attorney General. While seeking this advice, the KRA informed the Attorney General that National Treasury could not on its own abandon tax. In addition, it explained that the excise duty had already been collected by LDK on behalf of other taxpayers and abandoning the tax would amount to financing LDK. The Attorney General agreed with the KRA and advised National Treasury. Accordingly, the Cabinet Secretary for National Treasury rescinded the approval for abandonment of the taxes.

ISSUE FOR DETERMINATION BY HIGH COURT

The High Court found that the main issue for determination was whether the KRA's decision to demand full taxes, despite National Treasury's decision to abandon part of the taxes, was irrational, illegal, unreasonable, and untenable.

KENYA

National Treasury cannot lawfully approve abandonment of taxes without recommendation from the revenue authority

CONTINUED

The High Court observed that under section 37 of the Tax Procedures Act the Commissioner (KRA) may determine if:

- it may be impossible to recover an unpaid tax;
- there is undue difficulty or expense in the recovery of an unpaid tax;
- there is hardship or inequity in relation to the recovery of an unpaid tax; or
- there is any other reason occasioning inability to recover the unpaid tax.

Upon making a determination on these grounds and with the prior written approval of the Cabinet Secretary, the KRA can refrain from assessing or recovering unpaid tax and the tax liability shall be deemed to be extinguished, abandoned, or remitted.

The High Court found that only the Commissioner can initiate an application to abandon taxes. In this case, National Treasury did not have the power to allow an application to abandon taxes without recommendation from the KRA. The purported abandonment was illegal and void ab initio. Accordingly, National Treasury's decision to abandon the taxes did not confer any right to LDK and no legitimate expectation could arise from an illegality. Moreover, National Treasury had rescinded its decision to abandon the taxes upon receiving advice from the Attorney General.

Overall, the KRA's decision to demand the payment of KES 517,118,680 was not illegal, irrational, or un-procedural as contended by LDK.

COMMENT

Indeed, the Tax Procedures Act provides that the Commissioner may, with the prior written approval of the Cabinet Secretary, refrain from assessing or recovering an unpaid tax and the tax liability shall be considered extinguished, abandoned, or remitted.

In *Communications Commission of Kenya and 5 Others v Royal Media Services and 5 Others* [2014] eKLR, the Supreme Court noted that:

> *"Legitimate expectation would arise when a body, by representation or by past practice, has aroused an expectation that is within its power to fulfil. Therefore, for an expectation to be legitimate, it must be founded upon a promise or practice by public authority that is expected to fulfil the expectation."*

LDK argued that there was a legitimate expectation that the KRA would not demand the full principal tax when:

- National Treasury allowed the application and approved the abandonment of 80% of the outstanding principal excise duty and waived 100% of penalties and interest;

KENYA

National Treasury cannot lawfully approve abandonment of taxes without recommendation from the revenue authority

CONTINUED

- the KRA had acknowledged the approval for the abandonment and demanded the sum of KES 80 million instead, being 20% of the outstanding tax arrears; and
- the KRA had agreed to the settlement of the said amount in weekly instalments of KES 7,500,000 from 2 February 2022.

The High Court rightly asserted that the decision to abandon taxes by National Treasury was illegal. National Treasury does not possess the requisite authority to abandon taxes. Only the KRA can invoke the provisions of section 37 of the Tax Procedures Act on abandonment of taxes.

The decision is a testament to the independence of the KRA, the Attorney General and the courts.

The independence of Government agencies should be guarded so that the executive exercises its powers within the law.

The taxpayer in this case was caught in a disagreement between National Treasury and the KRA. The relief that National Treasury had accorded LDK quickly melted like thin ice. Perhaps, the court could have directed the KRA to re-consider the application from LDK to National Treasury and check if there were any valid grounds to abandon the taxes. Going forward, taxpayers should follow the right channel to seek abandonment of taxes, that is, through KRA. Taxpayers can still go to court for judicial review if the KRA abuses its discretion to review and recommend approval for the abandonment of taxes.

ALEX KANYI, JOAN KAMAU AND JOSEPH MACHARIA

SOUTH AFRICA

Welcome clarity on the taxation of farmers in South Africa?

Farming and agriculture form the lifeblood of any economy. It is no wonder that the Income Tax Act 58 of 1962 (Act) provides for a special set of beneficial rules applicable to farmers in South Africa. This special taxation regime is by and large set out in the First Schedule to the Act.

Even though the South African Revenue Service (SARS) has already issued an interpretation note on "*Game Farming*", namely Interpretation Note 69, SARS has previously not provided an extensive explanatory note or guide on the First Schedule. Farmers would therefore have welcomed the publishing of the SARS Draft Guide on the Taxation of Farming Operations on 22 September 2022 (Draft Guide). This article discusses some of the key guidance notes contained in the Draft Guide.

MEANING OF FARMING OPERATIONS

In order for the special tax regime in the First Schedule to apply there are a number of requirements that need to be met. Arguably, the most important is the requirement that the person is "*carrying on pastoral, agricultural or other farming operations*". This is because only taxable income derived from the carrying on of such operations will fall within the special taxation regime.

Even though ultimately, it is a factual question whether a person is carrying on pastoral, agricultural or other farming operations, SARS' Draft Guide indicates that the term "*other farming activities*" generally includes activities such as horse breeding, fish farming and bee keeping.

SARS' Draft Guide discusses various case law on the meaning of "*carrying on pastoral, agricultural or other farming operations*" including *ITC 1324* 42 SATC 288 where a grower who merely intended to sell crops that were surplus to his needs was judged to not be carrying on farming operations. The Draft Guide thus confirms that one must be conducting a trade in farming and there must be an overall profit-making intention.

Another important issue that the Draft Guide considers is the position of two persons, where one person owns the land on which the farming operations are conducted, and another person physically conducts the farming operations. Ultimately, it is also a question of fact as to which person will be considered to be "*farming*" and thus benefit from the special taxation regime. Example 1 on page 8 of the Draft Guide provides that if a person leases land from another entity where the first person physically conducts the farming operations (in this case wine farming), it is the first person that will generally be considered to be farming.

According to the SARS Draft Guide, the owner of the land will not be involved in the farming operations as the rental income is derived from the ownership of the land and not farming operations. Interestingly, the Draft Guide states that if the rental payments were not fixed amounts but determined as a percentage of the turnover from the activities conducted on the vineyard, the owner of the land might apply the First Schedule to determine its taxable income derived from farming.

SOUTH AFRICA

Welcome clarity on the taxation of farmers in South Africa?

CONTINUED

Notably, it is only income "*derived from farming*" that falls within the special tax regime in the First Schedule. This means that not all income from farming will necessarily fall within the First Schedule as there must be a connection between the income earned and the farming operations. Some examples the Draft Guide provides of "*supplementary farming operations*" include the sale of manure; the sale of firewood; the letting of grazing rights if the rental amount is derived from farming proceeds; the sale of plantation and forest produce; prize money received, for example, best wool or biggest pumpkin; or compensation received from the Government for the compulsory destruction of livestock due to disease.

Conversely, the Draft Guide states that, amongst other things, packing of fruit for other farmers; stakes won by a farmer as a result of racing horses which were bred by the farmer; and accommodation and catering activities for people spending holidays on the farm do not constitute farming activities. In those circumstances, the normal tax principles apply to such income.

VALUATION OF CLOSING AND OPENING STOCK

Another important aspect which the Draft Guide discusses is the calculation of opening and closing trading stock of a farmer including livestock and produce. Notably, the Draft Guide confirms that a farmer's consumable stores, for example fuel and spares used for farming equipment, and non-livestock or non-produce items do not have to be taken into account as closing stock for purposes of the First Schedule.

In addition, the Draft Guide discusses the use of standard values of livestock fixed by regulation, apart from game livestock. Farmers can also adopt a different value (other than the standard value) provided that it is not more than 20% higher or lower than the standard value fixed by the regulations. If a farmer adopts a different value, it is bound by that value, and it cannot be altered or varied. Valuation of stock and produce is therefore an important taxation concept for farmers.

DEDUCTION OF CAPITAL EXPENDITURE

Generally, unless one of the special capital allowances in the Act apply, one cannot deduct capital expenses from income. However, one of the most beneficial aspects of the First Schedule to the Act pertaining to farming operations is that paragraph 12 provides for a special dispensation for farmers which allows for a deduction in respect of specified capital expenses.

Paragraph 3.6.1(b) of the Draft Guide discusses some of the capital development expenditure that can be claimed under paragraph 12 of the First Schedule, including expenditure

SOUTH AFRICA

Welcome clarity on the taxation of farmers in South Africa?

CONTINUED

incurred in relation to the eradication of noxious plants and alien invasive vegetation; the prevention of soil erosion; dipping tanks; dams, irrigation schemes, boreholes and pumping plants; fences; and the erection of, or extensions, additions or improvements (other than repairs) to, buildings used in connection with farming operations, other than those used for domestic purposes.

Notably, the Draft Guide also discusses the deduction of costs incurred in relation to the building of roads and bridges as well as electrical infrastructure. Importantly, however, not all expenses incurred in respect of infrastructure will potentially fall within paragraph 12 of the First Schedule as one must be able to show that the relevant roads and bridges are used in connection with the farming operations (which the Draft Guide interprets to mean "*in respect of*" farming operations). In addition, electrical infrastructure costs must be wholly or mainly used for farming purposes, which SARS interprets to mean more than 50%. Electrical infrastructure that also services the farmer's domestic premises will therefore also need to be factored in when considering this provision.

DEDUCTION OF COSTS INCURRED IN RELATION TO RENEWABLE ENERGY

Given the ongoing electricity crisis in South Africa, farmers would be well advised to also study the provisions in the Act regarding he deduction of plant and machinery used in the course of providing renewable energy. Some key provisions mentioned in the Draft Guide include section 12B(h) which states that should a farmer use the plant or machinery in the production of renewable energy which is used in farming operations, then they will be entitled to an accelerated capital depreciation allowance on the plant and machinery.

EXPROPRIATION OF LAND

The Draft Guide also discusses aspects of taxation relevant to where a farmer's land is expropriated. It specifically refers to the reduced tax rate applicable to the "*excess farming profits*" derived on land that is expropriated as well as the capital gains tax consequences on the disposal of the land. Notably, the Draft Guide indicates that paragraph 65 of the Eighth Schedule to the Act may apply to defer the capital gain on the disposal of the land on the basis that it was disposed of involuntarily.

CONCLUDING REMARKS

SARS' Draft Guide provides welcome clarity regarding several aspects of the special taxation regime applicable to a vital industry of South Africa's economy. Farmers would be well advised to study the Draft Guide and submit comments to the SARS Legal & Policy Division to the extent that further clarification is required regarding any aspects of the Draft Guide. The due date for submission of public comments is 25 November 2022.

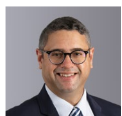
JEROME BRINK

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:

Emil Brincker
Practice Head & Director:
Tax & Exchange Control
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

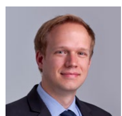
Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com



Lance Collop
Director:
Tax & Exchange Control
T +27 (0)21 481 6343
E lance.collop@cdhlegal.com

Mark Linington
Director:
Tax & Exchange Control
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

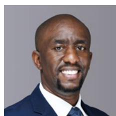
Gerhard Badenhorst
Director:
Tax & Exchange Control
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com



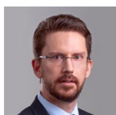
Jerome Brink
Director:
Tax & Exchange Control
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com

Petr Erasmus
Director:
Tax & Exchange Control
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

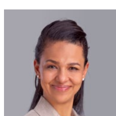
Dries Hoek
Director:
Tax & Exchange Control
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com



Alex Kanyi
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E alex.kanyi@cdhlegal.com

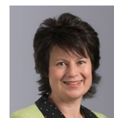


Heinrich Louw
Director:
Tax & Exchange Control
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com



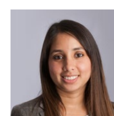
Howmera Parak
Director:
Tax & Exchange Control
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com

Stephan Spamer
Director:
Tax & Exchange Control
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com

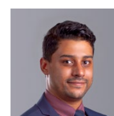


Tersia van Schalkwyk
Tax Consultant:
Tax & Exchange Control
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com

Louis Botha
Senior Associate:
Tax & Exchange Control
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com



Varusha Moodaley
Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com



Tsanga Mukumba
Associate:
Tax & Exchange Control
T +27 (0)11 562 1136
E tsanga.mukumba@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

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.

PLEASE NOTE

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

©2022 11567/OCT

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA