CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

2 Febraury 2023

Tax & Exchange Control
ALERT

IN THIS ISSUE

SOUTH AFRICA

Referral back to SARS – An interesting point *in limine* considered by the Tax Court

The rules (Rules) promulgated in terms of section 103 of the Tax Administration Act 28 of 2011 (TAA) provide for parties to raise points in limine, prior to the merits of the matter being heard.

KENYA

High Court nods to VAT's imposition on exported services despite lack of clarification on the term '*business process outsourcing*'

On 31 January 2023, the High Court in Nairobi (court) rendered its judgment in the renowned petition challenging the constitutionality of the Finance Act of 2022 (Act). Among the impugned taxes in the case, was Value Added Tax (VAT) on exportation of services introduced by the Act's amendment to the VAT Act, 2013.

FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

SOUTH AFRICA

Referral back to SARS – An interesting point *in limine* considered by the Tax Court

The rules (Rules) promulgated in terms of section 103 of the Tax Administration Act 28 of 2011 (TAA) provide for parties to raise points *in limine*, prior to the merits of the matter being heard.

The Tax Court has dealt with different types of preliminary points raised, such as which party has the duty to begin, whether portions of a party's pleadings should be struck out, or whether a party has raised new grounds of assessment or new grounds of appeal that are inconsistent with the Rules (see for example our Tax and Exchange Control Alert of 26 January 2023).

However, a preliminary point the Tax Court had not yet been asked to consider, is whether a matter can be referred back to the South African Revenue Service (SARS) for consideration and assessment, prior to the hearing on the merits proceeding. This was the question to be considered in *AB v The Commissioner for the South African Revenue Service* (35746) [2022] ZATC 9, which was heard by the Tax Court on 23 August 2022 and which we discuss here.

Facts

The taxpayer is a shareholder in several companies that loan money to one another and a central issue in the tax dispute was the loan account in one of the taxpayer's companies. In an unaudited financial statement for 2014 (one of the tax periods to which the dispute relates), the taxpayer's loan account was recorded as amounting to R30,179,163. The taxpayer contended that this amount was incorrect, that the financial statements were rewritten to correct this and that the correct value was R10,390,949.

SARS questioned the taxpayer's submission and how the error went undetected for more than five years. It alleged that the taxpayer gave three different versions during the objection and appeal process and that a fourth version was put forward after the appeal was lodged, during the alternative dispute resolution process. As such, SARS said that it was unable to investigate and consider the second version of the revised financial statements and requested that the matter be referred back to it for

SOUTH AFRICA

Referral back to SARS – An interesting point *in limine* considered by the Tax Court

CONTINUED

further examination and assessment. This practically meant that SARS would conduct a further audit of the companies in the group and other related companies to determine the taxpayer's liability.

SARS argued that the Tax Court had the power to refer the matter back to SARS for examination and assessment in terms of section 129(2)(c) of the TAA, which the taxpayer disputed.

Judgment

The Tax Court considered the relevant sections. Section 129(2)(c) of the TAA states that in the case of an assessment or "*decision*" under appeal or an application in a procedural matter referred to in section 117(3), the Tax Court may refer the assessment back to SARS for further examination and assessment. Section 117(3) of the TAA states that the court may hear and decide an interlocutory application or an application in a procedural matter relating to a dispute under Chapter 9 of the TAA as provided for in the Rules.

The Tax Court accepted the taxpayer's argument that the referral contemplated in section 129(2)(c) could only be granted after the hearing of the taxpayer's appeal. It rejected SARS' argument that the referral could be granted as SARS was not seeking final relief and it was merely an interim order that could be appealed against. The court further accepted the taxpayer's argument that the order would be final as when SARS makes a new assessment, that decision is final in nature. The court based its decision in this regard on the judgment in *Metlika Trading Ltd and Others v Commissioner for SARS* [2004] 4 All SA 410 (SCA) which held that where an interim order is intended to have an immediate effect and will not be reconsidered on the same facts in the main proceedings, it will generally be final in effect.

The court thus found that it could not grant the order requested by SARS and dismissed the preliminary point. However, it indicated that SARS would not be without remedy as the court ultimately hearing the tax dispute on the merits could refer the matter back, in terms of section 129(2)(c), after the hearing contemplated in that section.

Comment

While not mentioned expressly in the judgment, it reaffirms the principle that the Tax Court is a creature of statute and that its jurisdiction and powers are limited to what is provided for in the TAA and the Rules. The finding in this case is potentially very significant, as a finding in favour of SARS, could have created a situation whereby SARS' power to audit is broadened, such that it could essentially restart or revisit a completed audit if it wished to do so, in an attempt to ensure an ultimate outcome in its favour. Furthermore, such a finding could have potentially resulted in a situation where tax disputes take even longer to resolve, which would not be in the interests of SARS, taxpayers or the administration of justice, given the amount of tax disputes already ongoing and being heard by the Tax Court.

Louis Botha

KENYA

High Court nods to VAT's imposition on exported services despite lack of clarification on the term '*business process outsourcing*'

On 31 January 2023, the High Court in Nairobi (court) rendered its judgment in the renowned petition challenging the constitutionality of the Finance Act of 2022 (Act). Among the impugned taxes in the case, was Value Added Tax (VAT) on exportation of services introduced by the Act's amendment to the VAT Act, 2013.

Ultimately, the court held that the imposition of taxes is Parliament's constitutional mandate and dabbling in its affairs would be an error and untenable in light of the purposes of the Constitution of Kenya 2010 (Constitution), unless otherwise shown that due process was not followed.

Exportation of services has previously been exempted from VAT up until the Act's enactment which moved VAT on exported services to being zero-rated but only in respect to "*business process outsourcing*" without defining this term. The implication of this was to subject all other exported services not sufficing as "*business process outsourcing*" to the 16% VAT chargeable to taxable supplies.

In the case before it, the court condensed the issues advanced by the petitioners as whether the imposition of the impugned taxes by the National Government was unconstitutional for being onerous and unconscionable. This, they alleged, was not in line with the principles of public finance such as public participation as envisaged under Article 201 of the Constitution.

The petitioners further contended that the Act would subject them to double taxation. They alleged that the zero-rate for exported services in respect to business process outsourcing meant that other exported services were subjected to VAT. Being a tax levied on final consumption in the taxing jurisdiction, the Finance Act defied this position by imposing VAT at the point of origin.

The court noted that it was undisputed that one of the constitutional functions of the National Government is the power to impose taxes and charges as envisaged under Article 209 of the Constitution. Notably, the interpretation of the court was that the provision did not articulate a floor or ceiling of how it can execute its mandate to impose taxes.

KENYA

High Court nods to VAT's imposition on exported services despite lack of clarification on the term '*business process outsourcing*'

CONTINUED

Overall, the court found the petitioner's averments on lack of public participation and double taxation to be merely speculative and a product of apprehensions as no evidence was tabled to ascertain the claim. According to the court's judgment, the petitioners neither showed how the impugned amendments contravened the constitutional mandate of Parliament in the enactment of laws nor proved violation of laid down principles of legislative process.

The judgment bears profound tax implications for businesses all over the nation engaged in exportation of services. It is a nod to the Government's intention to increase revenue collection by expanding the tax base of businesses involved in the exportation of services.

It follows, then, that businesses will increase the cost of exporting services to cater for the VAT imposition. It also follows that businesses that were not charging 16% VAT on exported services from 1 July 2022 may be exposed to VAT assessments until when it is clear whether their services fall within the undefined term of "*business process outsourcing*". Such businesses should carry out a review of the potential exposure and come up with strategies to counter any claims from the revenue authority.

An appeal to the Court of Appeal with a stay on the High Court decision would offer relief to affected businesses. Further the businesses offering exported services should come together to push for VAT on exported services to be zero-rated through an amendment in the VAT Act. The soonest this can be done appears to be through Finance Act 2023 with the effective date being 1 July 2023.

The decision by the High Court, unless reversed, may cause capital and revenue flight to neighboring nations who do not impose 16% VAT on exported services. Overall, service providers in Kenya may lose business which is ultimately detrimental to the taxman's revenue collection objective.

Alex Kanyi and Joseph Macharia

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

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

Puleng Mothabeng
Associate:
Tax & Exchange Control
T +27 (0)11 562 1355
E puleng.mothabeng@cdhlegal.com

Nicholas Carroll
Associate Designate:
Tax & Exchange Control
T +27 (0)21 481 6433
E nicholas.carroll@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

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA