

TAX & EXCHANGE CONTROL ALERT

9 FEBRUARY 2023



CLIFFE DEKKER HOFMEYR

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Tax highlights from the Draft 2023 Budget Policy Statement

On 18 January 2023, the Kenya National Treasury and Economic Planning (Treasury) published the Draft 2023 Budget Policy Statement (BPS). The BPS focuses on economic turnaround and inclusive growth. Specifically, it aims to increase investments by prioritising these sectors - agriculture; micro, small, and medium enterprises; housing; healthcare; the digital superhighway and the creative industry.

SOUTH AFRICA

Tax evasion: So nice SARS can punish you twice?

In the recent judgment of *Motloung and Another v Commissioner for the South African Revenue Service and Others* (5492/2021) [2022] ZAFSHC 327 the Free State High Court was tasked with determining whether or not a taxpayer found to have committed tax evasion can be charged an understatement penalty by the South African Revenue Service (SARS) and be held criminally liable in terms of the provisions of the Tax Administration Act 28 of 2011 (TAA).

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To finance the economic turnaround plan, the Government projects Kenya's real gross domestic product (GDP) will rebound from 5,5% in 2022 to 6,1%. The Government expects to raise revenue of KES 3 trillion in the financial year 2023/24 and KES 4 trillion over the medium term.

The BPS has proposed a cocktail of tax policy and administrative reforms. With respect to administrative reforms, it seeks to reduce the valued-added tax gap from 38,9% to 19,8% by rolling out the Electronic Tax Invoice Management System (eTIMS). It also aims to reduce the Corporate Income Tax gap from 32,2% to 30% of the potential, as envisaged in the Kenya Revenue Authority's (KRA) Corporate Plan.

In addition, the BPS contemplates integrating the KRA's tax system with telecommunication companies, expanding the tax base in the informal sector, and implementing rental income tax measures by mapping rental properties. It also aims to roll out measures at customs and border control leveraging technology and enhanced data analytics to enhance revenue per unit.

Strategic aims

Regarding policy reforms, finalisation of the National Tax Policy and the Medium-Term Revenue Strategy (MTRS) for the period FY 2023/24 – 2026/27 is captured as necessary to boost tax revenues and improve the tax system in the country. The National Tax Policy is expected to provide consistency and certainty in tax legislation and management of tax expenditure, as well as to enhance the administrative efficiency of the tax system.

On the other hand, the MTRS aims for a comprehensive approach of undertaking effective tax system reforms. Notably, the objectives of the MTRS include raising ordinary revenue to GDP from 15% in 2021/22 to 25% by 2030 and increasing the tax compliance rate from 70% in 2021/22 to 90% by 2030. It also seeks to enhance the ease of doing business and promote collaboration between government entities for domestic revenue mobilisation.

Webinar
Invitation

Developments
and changes in
the Kenyan tax
landscape:

Tax outlook for 2023



Wednesday,
15 February 2023



14h30 – 15h30
(EAT)

[Register Here](#)

KENYA

Tax highlights from the Draft 2023 Budget Policy Statement

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Tax incentives

The BPS has also introduced multiple tax incentives in disparate sectors in a bid to promote local manufacturing and production. The BPS asserts that domestic pharmaceutical manufacturers have the capacity to compete favourably but are inhibited by punitive taxes and the high cost of production. To address this situation, the Government aims to review the tax regime and high cost of doing business in a bid to scale up domestic manufacturing of pharmaceutical products and other essential supplies. Last year, the Government introduced various tax incentives for manufacturers of human vaccines.

The Government also intends to incentivise commercial transporters and public service vehicle operators to adopt electric vehicles by offering tax incentives. In this regard, the Government is keen to develop the electric vehicle and motorcycle assembly industry. Currently, motor vehicle assemblers enjoy a reduced

corporation income tax rate and can import completely knocked down kits for assembly free of duty subject to getting approval from the Government.

Additionally, the BPS articulates tax incentives to harness the potential of the sports and art industries in the country. The Government aims to provide a ring-fenced or dedicated tax and public-private partnership framework for infrastructure development as well as tax incentives for corporate sponsorship.

Other initiatives in the BPS include training of KRA staff, leveraging data that the various government agencies have, automation of systems for all key government entities, monitoring excisable goods factories and monitoring payments from Government to ensure taxes are paid.

Conclusion

To sum it up, the BPS seeks to roll out various tax policies and administrative reforms in an attempt to transform the nation's economy and spur growth. It highlights various measures and incentives in various sectors aimed at increasing revenue collection, promoting local manufacturing and production, and reducing reliance on foreign debts.

In terms of next steps, The Public Finance Management Act requires Treasury to prepare and submit the BPS to Cabinet for approval. The Treasury then submits the approved BPS to Parliament by 15 February every year. Within 14 days, Parliament tables and discusses a report containing its recommendations and passes a resolution to adopt it with or without amendments. The Cabinet Secretary is then obliged to take into account resolutions passed by Parliament in finalising the budget for the relevant year.

**Alex Kanyi, Joseph Macharia, and
Ndinda Munyaka.**

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The applicants challenged sections 222 and 235 of the TAA as being inconsistent with the Constitution of the Republic of South Africa, 1996 (Constitution) and therefore invalid, as both sections provide for two different punishments for the same offence – intentional tax evasion.

Facts

The second applicant (Reatlehise Development CC) submitted zero returns for value-added tax (VAT) to SARS for the period from March 2014 to July 2018 and submitted zero returns for corporate income tax (CIT) for the 2015, 2016 and 2017 years of assessment. By submitting zero returns, the second applicant purported to have generated no income and incurred no expenses for these periods. SARS included the second applicant in a full scope audit.

SARS sent an audit findings letter to the second applicant indicating that it had understated its tax liability and that it would be levying understatement penalties for the relevant periods, which was not disputed by the applicants. The applicants did not respond to SARS with reasons as to why the understatement penalties should not be levied.

SARS imposed a 150% understatement penalty in respect of the understated CIT and VAT, for intentional tax evasion. The applicants admitted that SARS suffered prejudice of R819,607.09 in relation to VAT and R493,600 in relation to CIT. The applicants were subsequently criminally charged for intentional tax evasion.

The applicants complained that they cannot tender a plea contrary to SARS' finding, that is, that they were guilty of intentional tax evasion and liable for an understatement penalty on the basis of intentional tax evasion.

Webinar Invitation

Virtual 2023 Budget Speech Overview

Join us for an insightful and practical overview of the 2023 Budget Speech.

Date

Wednesday, 22 February 2023

Time

17h00 to 18h30 (CAT)

Speakers:

Emil Brincker

CDH | Director and Practice Head
Tax & Exchange Control

Gerhard Badenhoarst

CDH | Director | Tax & Exchange Control

Annabel Bishop

Investec | Chief Economist

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For more information contact
cdhevents@cdhlegal.com

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According to the applicants, their right to a fair trial had been infringed due to their inability to plead to the contrary, which meant that they had fallen victim to the concept of double jeopardy.

Double jeopardy

Understatement penalty

The court explained that the concept of double jeopardy is simple and trite – nobody may be punished for the same offence twice. Double jeopardy has been included in section 106(1)(c) of the Criminal Procedure Act 51 of 1977. The concept of double jeopardy is also prohibited as per section 35(3)(m) of the Constitution, where it is provided that an accused has the right “*not to be tried for an offence in respect of an act or omission for which that person has previously been either acquitted or convicted*”, a fundamental right of the accused to a fair trial.

Section 221 of the TAA defines an “*understatement*” as:

“Any prejudice to SARS or the fiscus as a result of:

- *a default in rendering a return;*
- *an omission from a return;*
- *an incorrect statement in a return or;*
- *if no return is required, the failure to pay the correct amount of ‘tax’.”*

Section 222 of the TAA details the penalty which will be levied in relation to an understatement made by a taxpayer, providing that an understatement penalty will be payable by the taxpayer, over and above the outstanding tax payable.

The applicants argued that the understatement penalty in terms of section 222 of the TAA constitutes a criminal punishment, which is why it is distinguishable from the administrative penalties in section 208 of the TAA, that are automated and mechanical in nature. Essentially, their argument was that understatement penalties could only be imposed pursuant to an enquiry and therefore, the process followed in levying understatement penalties is the same as the process in the criminal court.

The applicants relied on the foreign case of *United States v Halper* 490 US [1989] in submitting that:

“Under the double jeopardy defence, a person who has already been punished in a criminal prosecution may not be subjected to an additional civil remedy based upon the same conduct where the civil remedy constitutes punishment.”

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However, the High Court noted that the decision in *Halper* was overturned by the foreign decision in *Hudson v United States* 522 US 93 [1997], where the court decided that the concept of double jeopardy is not a bar to criminal prosecution, as administrative proceedings are not criminal in nature.

Criminal prosecution

The High Court referred to the decision in *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission and Another* [2005] (6) BCLR 613 (CAC) where the Competition Appeal Court opined that in order to determine whether or not double jeopardy will apply, there must be a consideration as to whether there is a distinction between the proceedings. In other words, if the one proceeding is criminal in nature, and the other is non-criminal or administrative in nature, then the issue of double jeopardy will not arise.

The court also quoted paragraph 22 of *Pather and Another v Financial Services Board And Others* [2018] (1) SA 161 (SCA) as follows:

"'Criminal law', observed Lord Atkin, 'connotes only the quality of such acts or omissions as are prohibited under appropriate penal provisions by authority of the state. The criminal quality of an act cannot be discerned by intuition; nor can it be discovered by reference to any standard but one: is the act prohibited with penal consequences?' And, criminal proceedings, according to Lord Bingham of Cornhill CJ, 'involve a formal accusation made on behalf of the state or by a private prosecutor that a defendant has committed a breach of the criminal law, and the state or the private prosecutor has instituted proceedings which may culminate in the conviction and condemnation of the defendant'." (our emphasis).

At paragraph 28 of its judgment the High Court remarked as follows about the authorities quoted above:

"The above authorities demonstrate that nothing precludes civil administrative proceedings and criminal proceedings from the single act. Administrative penalties and criminal proceedings do not serve the same purpose. The other [sic] is aimed at strengthening internal controls of the administrative authority and to promote compliance while the other is aimed at correcting a behaviour that caused harm to the society." (our emphasis).

The court stated that the main purpose of a penalty is "to deter impermissible conduct that results in violation of the TAA and to enforce compliance", and of course, to address the shortfall owed to SARS. An understatement penalty is not imposed to punish criminal conduct

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in the form of tax evasion, but rather serves as a regulatory function to assist SARS in respect of its obligations prescribed by the enabling legislation.

The High Court's conclusion

The purpose of section 222 of the TAA addresses the shortfall flowing from an understatement by a taxpayer, deters impermissible conduct that violates the provisions of the TAA, and enforces compliance with the provisions of the TAA; while section 235 of the TAA criminalises intentional tax evasion and deals with the criminal state of mind of the taxpayer.

With reference to *Pather*, the High Court acknowledged that just because a penalty is designed to have a deterrent effect, does not make it non-administrative, and a decision to consider any regulation

with a deterrent purpose as criminal in nature for double jeopardy purposes, "would severely undermine the Government's ability to effectively regulate institutions". In order to maintain a stable relationship between citizens and the Government, SARS has a duty to maintain effective tax administration.

Furthermore, in relation to section 35(3)(m) of the Constitution, the court indicated that the section relates specifically to accused persons and the protection of their right to freedom, whose right to a fair trial could be threatened by repeated (criminal) charges for the same act. The court stated that the fact that a single act may give rise to more than one consequence is not tantamount to double jeopardy.

The court consequently held that sections 222 and 235 of the TAA do not offend an accused's right to a fair trial, and do not amount to double jeopardy, therefore, the sections are neither invalid nor unconstitutional.

Comment

The significance of *Motloung* is that intentional tax evasion can give rise to more than one consequence, and the double jeopardy defence will not be coming to your rescue. What is curious about the case, is that the applicants seemingly made no attempt to justify why they had submitted nil returns and why understatement penalties should not be imposed for intentional tax evasion. In terms of section 42 of the TAA, once SARS has issued a letter of audit findings, the taxpayer must

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be given at least 21 business days to respond to SARS' audit findings. From a tax perspective, section 102 of the TAA states that SARS bears the burden to prove the facts on which the understatement penalty are based. This is one of only a few issues in respect of which SARS bears the burden of proof as opposed to the taxpayer, but one should appreciate that this is in the context of tax disputes regulated by the TAA. In a criminal trial, the burden of proof will be different and the state would be required to prove that the offence was committed beyond a reasonable doubt.

Of course, the case should serve as a lesson that taxpayers should comply with their tax obligations diligently, but also that an opportunity to respond to findings made by SARS in the context of an audit, should be utilised. This is especially where SARS makes allegations pertaining to understatement penalties, where it bears the burden of proving the facts on which the understatement penalty is imposed.

Sasha Schermers and Louis Botha

2022 RESULTS

CHAMBERS GLOBAL 2018 - 2021 ranked our Tax & Exchange Control practice in Band 1: Tax.

Emil Brincker ranked by **CHAMBERS GLOBAL 2003 - 2022** in Band 1: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **CHAMBERS GLOBAL 2022** for tax: indirect tax. **CHAMBERS GLOBAL 2009-2021** ranked him in Band 1 for tax: indirect tax.

Mark Linington ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 1: Tax: Consultants.

Ludwig Smith ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 3: Tax.

Stephan Spamer ranked by **Chambers Global 2019-2022** in Band 3: Tax.



Cliffe Dekker Hofmeyr

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

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