

TRADE BASE MONEY LAUNDERING and SALES SUPPRESSION

Sometimes the figures just do not add up, there is no escaping the accounting world of debits and credits.



Investigative Techniques for the Cash
Economy (Specialty)
Country Presentation
-South Africa-
12 October 2021

Trade base Money-Laundering and taxation

Trade-based money laundering is defined as the process of **disguising** the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins. In practice, this can be achieved through the **misrepresentation of the price, quantity or quality of imports or exports**. Moreover, trade-based money laundering techniques vary in complexity and are frequently used in combination with other money laundering techniques to further **obscure the money trail**.

There are **three main methods** by which criminal organisations and terrorist financiers move money for the purpose of **disguising its origins and integrating** it into the **formal economy**.

- The first is through the **use of the financial system**;
- the second involves the **physical movement of money** (e.g. through the use of **cash couriers**); and
- the third is through the physical movement of **goods through the trade system**

Tax evasion as a predicate offence for money laundering

Money Laundering is a three-stage process

1. which starts with the money coming from the crime first being placed somewhere to hide its link to the crime (**placement**).
2. After it has been placed it is layered, which means its connection to the crime and the criminal is further disguised. This can be done, for example, by a series of transactions, a process which often involves the **money being transferred through several banks abroad** or being used to set **up shell companies in tax havens** (**layering**).
3. After it has been layered successfully, the money (which can also be in the form **of property**) is then integrated into the lawful economy (**integration**).

It is a good habit now and then to question things that one has taken for granted for years. - German proverb



SARS risk selection rules frequently flagged large cash based businesses with annual turnovers in excess of R1 Billion per annum (US \$ 100 Million) based on 3 main criteria :

- VAT Refunds being claimed monthly
- Income Tax returns outstanding for 3 years or more
- Negative Gross Profit Margins



Record of previous tax evasion : Jumbo Cash and Carry

- Primarily a cash business which generates significant amount of revenue
- SARS engaged Jumbo Cash and Carry for integrated tax audit after the company was already sold in 2001
- Due to the lack of co-operation and the lack of documentation a section 74C inquiry was instituted from 2006 - 2009 into the affairs of the various Jumbo Cash and Carry businesses and its shareholders / members
- It was established during the tax inquiry that the company purchased a stand-alone point of sales system which contained an optional feature to have sales suppressed and removed from all accounting records
- SARS then proceeded against the four directors with regards to unpaid taxes of £30 million (approx. R585 Million) expatriated to Swiss bank accounts - SARS proceeded with raising tax assessments against the four directors
- SARS filed tax evasion compliant with HMRC Serious Tax Offence office, SARS received confirmation that the matter was investigated however the outcome is unknown.
- No criminal charges were brought by SARS to Jumbo directors
- Following litigation 3 of the 4 directors entered into settlement agreements with SARS
- SARS then directed its subsequent focus to the customers of **React Software solutions** which offered tailor paid Point of Sales systems (POS) specifically designed and marketed to the Cash and carry industry.



Africa Cash and Carry : New company

- Rainbow Cash and Carry was name changed to ACC in March 2003, transferring Rainbow Cash and Carry assets and liabilities to Africa Cash and Carry



SHORT BACKGROUND TO CASE (CONTINUED)

Initial VAT audits (various) during 2006 : Ghost Exports & Input VAT focus

- Following 2009 Jumbo Inquiry and evidence to REACT POS utilised = all tax audits centralised and **scope of audit extended 2003 - 2009**
- Request for Information issued s74A & s74B(IT Act) and S54A (VAT Act) on 16 Feb 2009
 - Request access to REACT and PASTEL accounting systems
 - SARS was denied permission to image systems on **19 Mar 2009**
 - **Search and seizure on 20 and 21 Mar 2009** - SARS seized certain hard drives, storage devices and some documentation which were believed to contain backup data of the point of sales and accounting systems.
 - **Only 7 Month data available on REACT Windows version** (remainder has been deleted)
- SARS subsequently issued the Letter of audit findings and the **Letter of assessment on 15 June 2011**, based on the under declaration of income.
 - **Gross profit margin** - 7 months data, extrapolated to 2003-2009 (84 months)
 - **Estimated Assessment raised** - IT & VAT under-declared sales
 - **Prescription not applicable** - fraud, misrepresentation and non disclosure
 - **Additional tax - 200% imposed**, tax fraud and Ooplang practices



Divesting of assets during tax audit and Preservation order

Divesting of Assets of ACC to ACC Crown Mines October 2013 : SARS raised Income Tax and VAT assessment years of assessment 2003 - 2009 during 2011 in the amount of R1.2 Billion (US\$ 100Million)

Following extensive negotiations ACC agreed to hold minimum R300 Million in stock as security for taxes AND to be fully tax compliant from 2010

However ACC allegedly sold business as going concern to a new company ACC Crown Mines in October 2013

SARS Preservation Order - 10 July 2014, leave to appeal 1 Oct 2014 dismissed, SCA petition dismissed (25 June 2015)

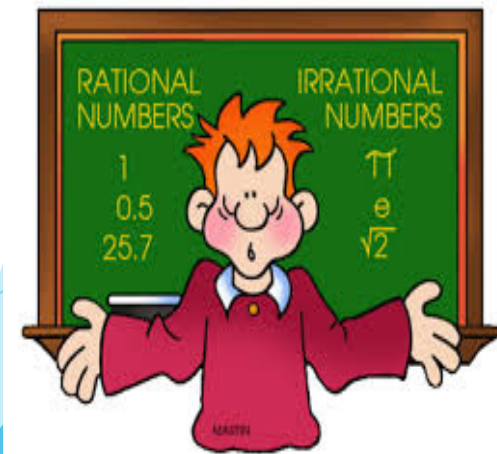
- Breach of suspension of payment of taxes pending Appeal
- Curator bonis appointed as director and required to preserve the assets in lieu of tax debts
- Information secured by SARS indicated the **increased use of Ooplang transactions from 2011 amounted to approx. R300Million per year** as well as the expatriation of **funds to foreign entities**.



SALES SUPPRESSION, ADDITIONAL SCHEMES AND TBML

The Point of Sales (POS) system and Accounting system

- In certain POS software versions a sales suppression functionality existed which could be activated by the taxpayer to omit sales from POS Reports.
- These transactions will not appear in the POS system generated report nor the Accounting System report.
- Separate “cash till/s” existed, operated by a trusted employee which is not linked (logged on) to the POS system daily and these sales are thus excluded from POS reports.
- Electronic POS and Pastel back up’s are not retained on site or for more than one tax year.
- Software program REACT (widely used in Cash and Carry industry) has a “sales suppression” functionality **build into the DOS version** of the software.
- **Electronic interface between systems**
 - No electronic interface between POS and Pastel existed - manual exportation and capturing via Excel
- **Chart of accounts**
 - The deployment of ZZZZ or other accounts with **alphabetical pre-fix** which will **not be detected in event of the Chart of Accounts** is generated or printed from 001/001 to 999/999.
- **Reported Negative Gross Profit Margin** - Rebate and discount structures : volumes and special arrangements
- **Ooplang Schemes: (Keeps 2 sets of financial accounts - Evade Tax)**
 - Quotation System
 - Fictitious Creditors
 - Cross invoicing and Profit Shifting via VAT
 - Negative invoicing
 - Cell phone cards
 - “Banking facility” for illegal foreigners and traders



“Ooplang”

the practice of keeping a portion of vat, collected on behalf of the tax man, instead of declaring the full amount then hiding it from the government.

IMPORTANCE OF PROPER RECORD OF FORENSIC PROCESS

Essential cornerstones of introducing data as evidence :

1. A **proper documented seizure of back end data** (raw data unaltered) – “**mirror image**” not a “copy”
2. Protecting the **chain of evidence** in a forensically sound manner (this is usually the first legal challenge)
3. The obtaining the **exact same version** of the software program used (with a sale suppression functionality, usually custom designed) stored on a stand-alone hard drive/computer in the forensic lab
4. All functional access and passwords – **especially user, manager and super user functionalities** must present in uploaded SAME version as that of taxpayer
5. **Internal CAAT EFS experts** to upload data into software program and test (initially SARS were presented with two software versions by designer, the one incomplete and another one without passwords)
6. **External computer forensic experts** to assist in court and testify as **expert witnesses**
7. **Numbering of data lines** from outset to ensure data version by taxpayer presented is not manipulated
8. **Background Stock tables and data : ALL the Standard React reports** are written in a manner to **exclude the manipulated data** – which is not included in any of the existing reports
9. **Demonstrating the functionality in live court** – In this case SARS was able to obtain **7 months data only** (the rest was wiped) for 60 terminals, the adjustments were identified as **so called P-adjustments** (positive and negative, it was then isolated to two terminals numbers.
 - Following loading of the back end data and version of software **SARS was able to re-create the front end function** i.e. the actual terminal point.
 - SARS experts then tested each transaction on the **58 terminals and compared results with 2 terminals with Sales Suppression functionality** - It was found that the Stock table (not any of reports) codes these transactions as “P” adjustments which is then removed from stock but at same time the SALE is reversed i.e. 1.) the SALE is reversed 2.) Stock is removed 3.) however the initial purchased cost in cost of sales (100%) and VAT (14%) is claimed as expenses and Input Tax respectively
10. **Employing external Legal counsel upfront** to meet challenges from seizure to court



ESSENTIAL CORNERSTONES OF PROVING INTRODUCING DATA AS EVIDENCE :

11. **Admission of the initial Tax Inquiry transcripts as evidence** - enablers and beneficiaries conceded to the use of sales suppression software and explained the working
12. SARS also required the **software designer** and distributor to testify in Tax Inquiry - he then provided much needed detail to how the system software is designed - SARS however then still needed to prove such “functionality” was actually utilised by the taxpayer
13. Then the most important step : **The actual tax prejudice needed to be determined**, it takes time but if steps above is followed this can be proven beyond a reasonable doubt (even if just for a period) - **it must be matched to a tax return** which was **misrepresented** (this proved challenging)

Indicators of Sales Suppression software :

- ❖ The first indicator of Sale suppression : Stock was captured on a **stand alone, separate software** system then exported into Excel whereafter (post further manipulation) it is recorded in Accounting system
- ❖ A second very good indicator is that stock is brought in once a year as “**closing stock**” **VIA JOURNAL** only i.e. 364 days to manipulate - the stock and accounting system is not integrated - Inevitably the closing stock will reconcile with the stock take on that single day
- ❖ The first flag being **low or negative Gross Profit margins (below 6%) after discounts and rebates** and the consisted VAT refunds due to all expenses being claimed but not all sales being recorded

SARS process :

- Departure point **use Annual Financial Statements and Tax returns** (CIT and VAT) filed - reflecting Negative Gross Profit Margins
- SARS then added difference between closing stock in Accounting records (Pastel) vs. Point of Sale Software (POS) called REACT which equaled R 17 Million - which could not be explained by taxpayer
- **Script to extract back data for 7 months** - all other data and reports were deleted by taxpayer
- **Rebates, settlement discounts** and advertising allowances, which related to specific stock purchases should, according to the accounting standards, have been **allocated to reducing the cost of sales**, and should have been accounted for as income
- ACC has also admitted that there was a variance in sales in an amount of approximately R28 million, brought about by “*P-type adjustments*”
- **Extrapolate 7 months to 7 years - initial GP margin used 6% however subsequently reduced to 3.6% and then to 2.04%**

FURTHER TRADE BASE MONEY-LAUNDERING SCHEMES

SCHEME 1 : QUOTATION SYSTEM

The Cash and Carry generates “Quotations” to selected Ooplang (“OP) customers whereby VAT is charged at a discount of 7% (later 9%) however neither the full cash received amount nor VAT amount is declared or paid over to SARS.

“Selected customers” participating in this scheme are usually “trusted” business partners whom are family members, linked to family members or conduct operations in their personal name or via other registered entities outside the tax net.

SCHEME 2 : FICTITIOUS CREDITORS

Fraudulent invoices were processed and Input Tax claimed specific linked vendors/taxpayers, the net amount of “7% VAT discount” would be balanced by a cash Cheque which is cashed and OP is used for personal purposes.

SCHEME 3 : DISCOUNT ON VAT (Profit shifting)

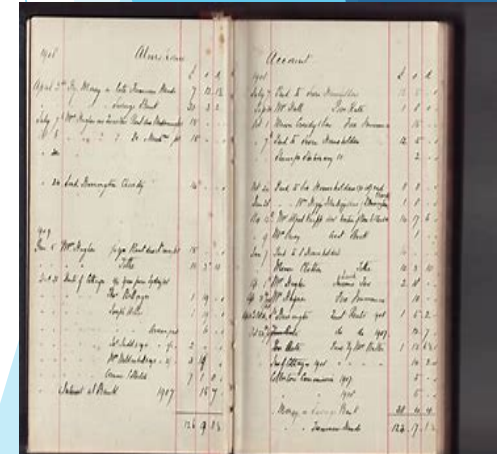
A scheme is in practice whereby on sale transaction a discount on VAT (at 7%) on invoice generated to an ultimately linked company via an intermediary company. The Cash and Carry will invoice the intermediary company (B) at 114% for “stock”, same time B will issue an invoice to the Cash and Carry linked company at 107% with same stock items thus creating a 7% “profit” in B.

SCHEME 4: BUYING ON ANOTHER VAT VENDOR’S ACCOUNT

This process entails facilitates **foreigners located in South Africa without bank accounts** or facilities to purchase stock in cash via facilitation of a registered VAT vendor and client of the Cash and Carry. The foreigner pays for his purchase **in full however the invoice is in the name of the SA registered VAT vendor**. The SA vendor on production of Cash and Carry invoice charged at 14% pays the foreigner 7% back of the VAT amount reflected as a “commission”.

SCHEME 5: ZERO RATING OF NON-EXPORTS / GHOST EXPORTS/ CAROUSEL FRAUD

Due to the continued cash syphoning of the business cash flow was required to acquire stock, Cash and Carry claims per VAT201 returns that large totals of Sales represent “exports” which is submitted as zero-rated supplies in order to “generate” cash flow in its operations.



FURTHER TRADE BASE MONEY-LAUNDERING SCHEMES

SCHEME 6: NEGATIVE SALES INVOICES AND CREDIT NOTES

“Selected stock” was sold to “selected customers” in cash however **credit notes were subsequently passed to another debtors account** : “Hawkers” to which no debtor’s invoices or statements were issued. These sales of stock items were then deleted of REACT stock system. The credit note (credit) on this account was subsequently cleared by a cash Cheque. Once Cheque was cashed this cash received was used for personal purposes and expatriation.

SCHEME 7 : INPUT TAX CLAIMED ON ACCOUNTING ENTRIES

Input tax was claimed to transactions with no commercial substance **via journal between various loan accounts** in order to substantiate expense and subsequently Input Tax, but more importantly to limit the gross profit margin. (various methods are used, this requires scrutiny of each and every line item contained in the loan account)

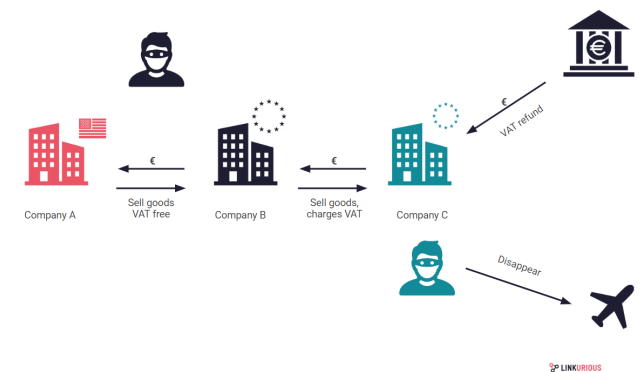
SCHEME 8: “REGULARISING” OOPLANG PURCHASES OF CELLPHONE AIRTIME

Although the purchase and sale of Cell phone airtime from Ooplang cash transactions in itself offers an convenient alternative source of laundering cash.

The sale of Cell phone air time however was later regularised by use of **company loan accounts** thereby now allowing for **claiming of the full invoice (expense purposes Income Tax) and 14% Input Tax on air time suppliers** invoices purchased with Ooplang cash.



The carousel scheme for VAT fraud



CSARS VS AFRICA CASH AND CARRY – ITC 13251 AND VAT 1077

TAXPAYER'S LEGAL DEFENCES RAISED IN TAX COURT

- **White collar argument** : The Incorrect assessments before court, 5 attempts to assessments, prescription applied and SARS materially “altered” the basis of its assessments and such therefore must be set aside
- **Blue collar argument** : **Unreasonable methodology** used by SARS to calculate remised turnover and tax 12/7 and then over 7 years
- **Grey collar argument** : evidence by the former CFO, Cassim Aysen to fraud is not admissible as he was the real architect of the tax fraud
- **ONLY Two expert witnesses on behalf of taxpayer** : focussed on reasonability and reliability of ACC's Annual Financial Statements and presented three potential alternative calculations of GP Margin and taxable income. Directors and/or employees did not testify
- SARS employees expertise and qualification challenged

Initial main thrust of taxpayer defence :

1. Claiming that SARS case was **only to sales suppression** and **not to manipulation of gross profit or cost of sales** or general accounting records
2. There was an **alternative (reasonable) calculation** to take 7 months to 12 months and thereafter to 7 years
3. There is **availability of alternative information** in taxpayer records
4. The assessments before Tax Court was based on SARS original estimated of GP Margin of **3.6%** and have **not been revised to 2.04%** in Sept 2015

Triumph card - attempted used by taxpayer to restart assessment and dispute process afresh

- If SARS relies on sec.95 of the TAA then SARS **MUST FIRST adjust their assessments** from 3.6% and the assessments before court is the **incorrect assessments**.
- SARS then corrected ACC that the applicable **substantive legislation at time of assessment was the sec.78 of the Income tax act and VAT** act not sec.95 of TAA.
- SARS also in record set out from Oct 2015 that it will request the **Tax Court to confirm the lower assessments** in terms of **sec.129 (2)(b) read with sec. 107 of TAA**. SARS further noted that the **assessments are not to be WITHDRAWN or REFFERED back for re-assessment** but SARS request the Tax Court to make an order on the amount should the Tax Court find SARS assessments to be reasonable

Tax Court Judgement : <https://www.sars.gov.za/lapd-drj-tc-2018-04-tcit-13251-and-vat-1077-jhb-16-may-2018/>

Supreme Court of Appeals Judgment : <http://www.saflii.org/za/cases/ZASCA/2019/148.html>

- ❑ **Preservation order was obtained on 11 July 2014**
- ❑ **Only Sales Suppression Case ever proceeding to Tax Court in South Africa and first ever civil tax judgements in SA history**
- ❑ **Repeated tax evasion stopped dating back to 1982 – Assessment capital but more importantly 200% additional tax and interest was confirmed US\$ 100 Million (2003 – 2009) whilst US\$ 109.7 Million (2010 - 2014) was conceded**
- ❑ **Fraudulent VAT refunds stopped – US\$ 8 Million and further US\$ 2.9 Million and US\$ 1.5 Million in fraudulent refunds**
- ❑ **Linked Carousel fraud uncovered - US\$ 77.2 Million and arrest of internal employees**
- ❑ **Uncovered a further 2 Carousel VAT fraud rings – collectively SARS managed to claw back US\$ 4.2 Million + US\$ 9.33 Million + US\$ 21.24 Million = US\$ 34.77 Million however US\$ 134.28 Million was paid out**
- ❑ **With regards to 23 taxpayers under audit : 65 Annual Financial Statements (2013 – 2020) were submitted, 53 Income tax returns and taxes paid**
- ❑ **Punitive Costs orders against taxpayer - Payment of SARS Legal Costs – US\$ 2.35 Million**
- ❑ **Uncovered and identified undisclosed offshore assets amounting to at least : US\$ 106 Million in Guernsey, Jersey, BVI registered companies, UK properties at least US\$ 90 Million, Dubai at least US\$ 20 Million, Switzerland US\$ 6 Million and India**

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SARS wins R1bn tax evasion case against Africa Cash & Carry

Nov 28 2019 19:22

The South African Revenue Service welcomed the judgement of the Supreme Court of Appeal that brought to an end a protracted dispute with Africa Cash & Carry, it said in a statement on Thursday.

The judgment – issued on November 21 – followed an investigation by SARS into the use of sale suppression systems and the manual manipulation of accounting books, the revenue agency said. The Tax Court altered its assessments to include some 200% additional tax, according to the statement.

Africa Cash & Carry disputed the results of the investigation and ultimately approached the Supreme Court of Appeal.

The Supreme Court, however, upheld the Tax Court order.

"SARS is committed to combat intentional tax evasion. SARS is concerned with the compliance levels within the Cash & Carry industry with a particular focus on 'Doplang' schemes involving 'Ghost Exports', non-recording of the sale of cell-phone airtime, manipulation of loan accounts, claiming fraudulent invoices for VAT and Income Tax purposes, utilisation of intermediary shell companies to create invoices and sales suppression systems," SARS said.

Business Times

Bribe tycoon Hathurani hit with R1.2bn tax bill

by Loni Prinsloo 13 July 2014, 08:27



THE SA Revenue Service (SARS) has swooped on Edreess Hathurani, the controversial cash-and-carry tycoon at the centre of a bribery scandal involving the regulator, the Financial Services Board (FSB).

On Friday morning, SARS officials served a court order on Hathurani's Africa Cash 'n Carry, a warehouse-style business in southern Johannesburg which sells 15 000 products from cosmetics to electronics, effectively freezing its assets. The court order confirms that SARS believes Hathurani and his companies owe a tax debt of R1.23-billion.

This comes weeks after the 63-year-old Hathurani claimed sensationally that he had paid R12-million in bribes to former FSB finance boss Dawood Seedat to make his tax problems "vanish". Hathurani's admissions cast a cloud over both the FSB and SARS, suggesting officials at both state institutions could be bribed.

In affidavits submitted to the court, SARS investigators said it was necessary to freeze Africa Cash 'n Carry's assets to stop it "divesting its business and assets to a connected entity, Africa Cash & Carry Crema".

The SARS affidavit paints a damning picture of how Hathurani went out of his way over many years to cheat on tax, even going so far as to have a system designed to hide sales from the authorities.

For example, under one company he used to own called Jumbo Cash & Carry, SARS says Hathurani under-declared sales by "manipulating the point-of-sale system".

Jumbo did this by issuing a quote to a customer, rather than an invoice – which made it appear that no sale had taken place. It found similar accounting problems at Africa Cash 'n Carry. The court order was served on the company on Friday morning.

City Press

How cash & carry roundtripped tax goods

MOYAGABO MAAKE@City_Press
13 July 2014 15:00
Tweet11



Africa Cash and Carry in Crown Mines, Joburg.

Despite allegedly paying millions to former Financial Services Board finance boss Dawood Seedat to quash a tax audit, Edreess Ahmed Hathurani's assets have been provisionally placed under curatorship until his debt to the taxman has been repaid.

At the North Gauteng High Court on Thursday, Judge Eberhard Berlesemann appointed Cletia Murray of Seehaba Trust as curator of the Africa Cash and Carry boss' companies, family trust, property and vehicles.

Hathurani was joined by two of his family members – who are also co-owners of Africa Cash and Carry – and a business partner.

Together, they owe the SA Revenue Service (Sars) just more than R1.2 billion in income tax and VAT, which the taxman says they evaded over the seven years to 2009.

"The order was sought to prevent the possible dissipation of assets held by Africa Cash and Carry and 18 other respondents," said Marka Muller, the deputy spokesperson for the tax collector.

"It was served on all the respondents on Friday morning."

Muller said the respondents were disputing the R1.2 billion tax assessment before the tax court.

"Sars sought the order to preserve to prevent a dissipation of assets whilst the outstanding tax debt is in dispute. Importantly, under the authority of the curator, the business entities will be allowed to continue with commercial trade."