Commissioner of Domestic Taxes v Oceanfreight East Africa Limited (Income Tax Appeal E166 of 2023) [2024] KEHC 7851 (KLR) (Commercial and Tax) (24 June 2024) (Judgment)

Neutral citation: [2024] KEHC 7851 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

INCOME TAX APPEAL E166 OF 2023

JWW MONG'ARE, J

JUNE 24, 2024

BETWEEN

COMMISSIONER OF DOMESTIC TAXES .... APPELLANT

AND

OCEANFREIGHT EAST AFRICA LIMITED .... RESPONDENT

(An appeal from the Judgment of the Tax Appeals Tribunal dated 1st September, 2023 in Tax Appeals Tribunal Appeal Number 841 of 2022)

JUDGMENT

1. The Appellant, the Commissioner of Domestic Taxes (the Commissioner) filed a Memorandum of Appeal dated 1st October 2023, against the judgment of the Tax Appeals Tribunal delivered on 1st September, 2023 in Tax Appeals Tribunal Appeal Number 841 of 2022, raising the following grounds: -

   a. That the Honourable Tribunal erred in fact and in law in failing to appreciate that the dispute before it had a guiding principles which was binding as provide in the High Court Case No. 13/2017 Ocean freight E.A Ltd Vs. Commissioner Domestic Taxes delivered on 7th February, 2020 that demurrage should be treated as income derived from and that the shipping line agents were liable to withholding tax.

   b. That the Honourable Tribunal failed to appreciate and/or give due regard to the filed submissions of the Appellant herein which clearly highlighted its previous decision of TAT No. 101/2015 Ocean Freight E.A Ltd Vs. Commissioner Domestic taxes delivered on 8th December 2016 and Tax Appeal No. 89 of 2015 CMA CGM (K) Limited vs. Commissioner DTD which held that as per Rule 2 of Income tax (withholding tax) rules 2001 the Appellant

should have deducted withholding tax from demurrages collected is rent for use of container after the free period has lapsed hence income derived from Kenya.

c. That the Honourable Tribunal failed to appreciate and/or give due regard to the provisions of *Income Tax Act* Sections 3 (2) (a) (iii), Section 6 (1), section 10 and 35 (1) (c) Income Tax Rules 2001 that demurrage charges collected from the consignee by a company acting as agent of a disclosed Principal who is based outside Kenya is subject to Withholding Tax hence arrived at the wrong conclusion on the demand for taxes by the Commissioner.

d. That the Honourable Tribunal erred in both law and fact in failing to take into account and/or disregarding evidence provided by the Appellant in its Statement of Facts and submissions as the nature of demurrages and the guiding principles.

e. That the Tribunal erred in law in misapplying the provisions of *Income Tax Act* that Sections 3 (2) (a) (iii) as read together with Section 6 (1), Section 10 and 35 (1) (c) of the *Income Tax Act*/ which Demurrage charges which are in the nature of rent for the use of property of the international carrier hence an income derived from Kenya and withholding tax chargeable.

f. That the Tribunal erred in misapplying the facts and law and arrived at a misguided conclusion that demurrage is not in nature rent for use of property in the International Courier and hence the obligation to withhold tax was not on the Respondent herein who was an agent and recipient of the payments from the shipping line.

2. The Commissioner also filed written submissions dated 20th February 2024 urging this Court to allow the appeal with costs and to set aside the impugned judgment and the consequential orders and uphold its objection decision and assessments.

Response:-

3. In opposing the appeal, the Respondent filed a Statement of Facts and written submissions dated 15th November 2023 and 22nd February 2024 respectively.

Background:

4. The Commissioner carried out investigations to confirm the Respondent's compliance with Rule 4 of Income Tax (Withholding Tax) Rules, 2001 for the period February to December 2017. It established that there existed an agency relationship between the Respondent and Mediterranean Shipping Company (MSC) SA which is registered and located in Geneva Switzerland, a non-resident Principal. The Respondent collected demurrage charges and detention charges made by various importers/consignees on behalf of MSC and thereafter remitted the same. In consideration of the agency services offered, the Respondent earned a 20% commission fee for all demurrage and detention amount credited to the MSC.

5. The Commissioner found that the Respondent failed to withhold taxes on demurrage and detention charges for containers. Hence, it raised additional assessments on 21st April, 2022 for WTH for the period February 2017 to December 2017 totalling to Kshs.49,845,438.07/= excluding interest and penalty.

6. On 17th May, 2022, the Respondent filed an objection against the whole assessment. The Commissioner then issued a demand for supporting documents. The Respondent provided financial statements for 2017, the agency agreement and a schedule of demurrage received.

7. Upon review, the Commissioner found that the documents supplied were insufficient. It therefore issued an Objection decision dated 13th July 2022 confirming the earlier assessments together with interest and penalties totalling to Kshs.80,537,204.76/=.

8. Dissatisfied, on 5th August, 2022 the Respondent filed an appeal before the Tax Appeals Tribunal against the Commissioner's decision. Through its judgment of 1st September 2023, the Tribunal set aside the Commissioner's objection decision, leading to the filing of the present appeal.

Analysis and Determination:

9. I have considered the record of appeal, the statement of facts and the parties' respective submissions and authorities. To my mind, the issues that fall for determination in this appeal are:-

   (1) "whether the Tribunal erred by finding that the Respondent was not obligated to pay WHT on demurrage in that the obligation lies with the payer and not the recipient" and

   (2) whether the Tribunal erred by finding that there was no proper basis for WHT as there was no mention of demurrage in the ITA prior to the enactment of the Finance Act 2018.

10. Before going into the issues, I am mindful of this Court's obligation in such an appeal, set out under Section 56 of the *Tax Procedures Act*, as follows:-

> " 56.
>
> (1) In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect.
>
> (2) An appeal to the High Court or to the Court of Appeal shall be on a question of law only.
>
> (3) In an appeal by a taxpayer to the Tribunal, High Court or Court of Appeal in relation to an appealable decision, the taxpayer shall rely on the grounds stated in the objection to which the decision relates unless the Tribunal or Court allows the person to add new grounds." (Emphasis added).

11. The Court has elaborated that the determination of questions of law relates to the interpretation or construction of *the Constitution*, statute or regulations or their application to the facts. As to questions of fact, the Court is limited to background or context and can only interfere where it finds that the Tribunal's findings were perverse or unreasonable. See John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others NRB CA EPA NO. 5 OF 2018 [2018] eKLR

12. The first issue is whether the Tribunal erred by finding that the Respondent was not obligated to pay WHT on demurrage in that the obligation lies with the payer and not the recipient. The Commissioner based its assessments for withholding tax on Rule 4 of Income Tax (Withholding Tax) Rules, 2001 for the period February to December 2017. The Commissioner asserted that the demurrage is an income derived from Kenya and is therefore subject to WHT. The Commissioner relied on Section 56(1) of the *Tax Procedures Act* to argue that it is the taxpayer's burden to prove that a tax decision is incorrect, which the Respondent failed to do. The Commissioner submitted that the Respondent was liable to remit the WHT because it collected the full payments from the importer for remittance to its principal, MSC. This is because the importers were under obligation to make full payment of demurrage to

ensure release of their goods. However, this did not absolve the Respondent from deducting WHT while remitting the funds to its principle.

13. On the other hand, the Respondent submitted that the Tribunal correctly determined that it was not obligated to pay WHT on demurrage and detention payments as it was not the payer. The Respondent contended that the obligation to pay WHT fell on the various importers and consignees who made the payments.

14. As highlighted by the Commissioner, this Court has considered this issue before in *Ocean Freight (E.A) Limited v Commissioner of Domestic Taxes (Income Tax Appeal No. 13 of 2017*) [2020] eKLR where the Court observed as follows:-

"

" 34. On whom the obligation to withhold the tax falls, section 4(1) of the Income Tax (withholding tax) Rules 2001 reads:

(1) A person who makes a payment of, or on account of, any income which is subject to withholding tax shall deduct tax therefrom in the amount specified —

(a) under paragraphs 3 and 5 of Head B of the Third Schedule; and

(b) where the Government of Kenya has double taxation agreement with the Government of another country, in the terms of that agreement:

Provided that the rates of tax under this subrule shall not exceed the rates specified under paragraph (a).

35. Taking the judgment in Appeal No. 101 of 2015 ocean freight (E.A) Limited –vs- The Commissioner of Domestic Taxes as an example, this is how the Tribunal dealt with the issue:

"35. It is important now to note that the Income Tax (Withholding Tax) Rules, 2001 mandates a person who makes payment of, or on account of, any income, which is subject to Withholding tax to deduct tax from the payment at the provided rate. The said Rules do not create a distinction between instances where the payer is an agent and where the payer is the principal himself. It is the Tribunal's view that even an agent is under obligation to retain a portion of any payment made to any person on behalf of the principal and to remit the same to the Respondent because of withholding tax, if the payment is chargeable to income tax. It is worth the emphasis that the obligation is only created where the payment is chargeable to Income Tax Civil Suit 60 of 2013 (Income Tax Appeal) Motaku Shipping Agencies limited The upshot therefore is that the Respondent's confirmed Additional Assessment relating to Withholding tax 'and relating to demurrage charges mounting to KES.142,308,538/= is hereby confirmed and this Appeal is accordingly dismissed".

36. If it is accepted, as this Court has held, that payment on post-port demurrage on containers is a charge to Income Tax then the withholding tax ought to have been dealt with Under Section 35(1) (c) of the *Income Tax Act* which reads:-

"A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of:-

a) .....

b) .....

c) A rent, premium or similar consideration for the use or occupation of property, except aircraft, aircraft engines, locomotives or rolling block;

Which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate."

37. When Section 35(1) and Rules (2) and 4(1) of the Income Tax (withholding tax) Rules 2007 are read together then it becomes clear that the person who bears the responsibility to withhold tax is the one who makes the payment of the income. This is apparent from the definition of who a payer and payee are under Rule (2) of the Withholding Tax Rules which reads:-

"'Payee' A person who receives income from a payer for the purpose of these rules".

"'Payer' A Person who deducts Withholding Tax for the purposes of these Rules".

38. There is now a divergence between the parties as to who the payer is in respect to the charges on demurrage on containers. The Appellants think that it is obviously the consignee while the Respondent argue that it is the Appellants who should do so before remitting the income to its principals.

39. One would have thought this to be rather straightforward because the entire case of the Respondent is that demurrage in containers is an income accrued or derived in Kenya by the shipping lines which are non-resident of the country. In these circumstances the person paying the charges would be the consignee or importer and the payee would by the shipping lines, although they would receive the money through the Appellants who were their local agents.

40. The Respondent does not think that the matter is that uncomplicated. It is argued that the consignee paid the demurrage based on local invoices raised by the Appellants and so Section 35(1) (c) would not apply to the consignee and the obligation to withhold tax would be on the Appellants before repatriating the money to the parent company.

41. The Court is not certain that the evidence on the invoices placed before the Tribunal is as stated by the Respondent. I flag out two examples. The invoice of 3rd June 2016 bespeaking African Cotton Industries Ltd to pay demurrage fees of USD 780.00 is in the name of W.E.C Lines (the Shipping Line) ,although the corresponding address on the invoice is of W.E.C Lines Kenya Limited (the Agent) (TAT 13/2016). The payment order of 31st December 2012 for demurrage of USD 182 to be paid by Super First Forwarding Ltd is raised by Gulf Badr Group (Kenya) Ltd (The Agent) but clearly states that it does so as agent for Evergreen Line (the shipping line). It is therefore evident that the monies though payable through the agents are monies to the shipping lines. This, in fact, is in tandem with the Respondent's own case that demurrage charges on the container are charges paid to the shipping line, non-residents of Kenya.

42. Even if the Court was to accept that the invoices for the Demurrage charges were raised solely in the name of the Agents, the position ought not to be any different. The law recognises the Appellants as shipping Agents under Section 8 of the *Merchant Shipping Act* and are licenced as such. Demurrage on containers is a charge payable to the principals and so the shipping Agents can only be an agent for these payments. That is the statutory arrangement. So the payment made by the consignee is a payment made to the shipping lines who are non-resident. The shipping lines is a non-resident payee receiving money through their agencies while the consignee is the payer. Ordinarily, under the provisions of Section 35(1) (c) the onus is on the consignee to withhold the tax. But that, in my view, is not the end of the matter!

43. Not the end because, as pointed out by the Respondent in its further submissions, the arrangement is that, although the payment is eventually to a non-resident shipping line, the payment is made to resident agents. The Respondent then calls in aid the provisions of Rule 4(1) of the Income Tax (withholding Tax) Rules 2001;

4(1) A person who makes a payment of, or on account of, any income which is subject to withholding tax shall deduct tax therefrom in the amount specified—

(a) under paragraphs 3 and 5 of Head B of the Third Schedule; and

(b) where the Government of Kenya has double taxation agreement with the Government of another country, in the terms of that agreement:

Provided that the rates of tax under this subrule shall not exceed the rates specified under paragraph (a).

44. It is argued that the words "on account of" are not idle as they bring to charge any remittances by a person on behalf of another provided the transaction falls within the ambit of section 35(1) (c).Mr Kiragu for the Appellants does not agree with that characterisation of the words and prefers that "on account of " means "in respect of".

45. In resolving these competing positions, it helps to bear in mind the purpose and object of withholding tax on a non-resident. I think it is to ensure that taxes are paid on income accrued in or derived from Kenya by the non-resident as a first, and perhaps, final tax. If that Tax is not withheld then it will by all likelihood be lost. If the penalties on post-port demurrage are an income that attract a charge on tax, then the agent who collects the income and then remits it to the non-resident has an obligation to ensure that the tax that ought to be withheld is indeed withheld before making the remittance to its non-resident principal. If there is no such obligation, then there would be a leak on tax. It is for the reason that I hold that in the circumstances obtaining here the Appellants are the persons paying for purposes of section 35(1) of the Income Tax and I am unable to fault the Tribunal's decision in that respect. That conclusion should not be illogical or oppressive to the shipping agents because even if the shipping agents were to so withhold the tax they would not be withholding part of their income but the income of their principals." (Emphasis added)

15. From the foregoing, it is clear that it is the agent's obligation to remit WHT on demurrage. Accordingly, I find that the Tribunal erred by finding that the Respondent was not obligated to pay WHT on demurrage in that the obligation lies with the payer and not the recipient.

16. I now move to the issue of whether WHT on demurrage was applicable in the ITA prior to the enactment of the Finance Act 2018. I note that through the Finance Act, 2018, under Section 2 of the ITA, demurrage charges was defined as "the penalty paid for exceeding the period allowed for taking

delivery of goods, or returning of any equipment used for transportation of goods". Section 10 of the ITA was amended to include demurrage charges in the category of income which accrued in or is derived from Kenya. Section 35 was amended to expressly provide for withholding tax on demurrage and paragraph 3 of the third schedule was amended to provide the withholding tax rate on demurrage to be at 20%.

17. The Respondent asserted that prior to these amendments, WHT was not applicable on demurrage and that the Tribunal was correct to so find.

18. Again, on this issue, the Court already pronounced itself in the Ocean Freight case [supra], that demurrage on containers was chargeable to income tax pursuant to Section 35(1) and Rules (2) and 4(1) of the Income Tax (withholding tax) Rules 2007 even before amendments that were made to reinforce legislation. As such, the principle of consistency favours the Commissioner. Thus, I find that the Tribunal erred in law by finding that there was no proper basis for WHT as there was no mention of demurrage in the ITA prior to the enactment of the Finance Act 2018.

19. For the foregoing reasons, I allow the appeal with costs to the Appellant.

It is so Ordered!

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 24TH DAY OF JUNE, 2024.

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J.W.W. MONG'ARE

JUDGE

In the Presence of:

1. Ms. Megan Muthoni for the Appellant.

2. Ms. Njue holding brief for Ms. Chepkemoi for the Respondent.

3. Amos - Court Assistant