Commissioner Of Domestic Taxes v Stima Cooperative Savings & Credit Society Limited (Tax Appeal E090 of 2021) [2022] KEHC 12993 (KLR) (Commercial and Tax) (26 August 2022) (Judgment)

Neutral citation: [2022] KEHC 12993 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E090 OF 2021

A MABEYA, J

AUGUST 26, 2022

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

STIMA COOPERATIVE SAVINGS & CREDIT SOCIETY LIMITED ..... RESPONDENT

(Being an appeal from the judgment of the Tax Appeals Tribunal No. 372 of 2019 delivered at Nairobi on 23rd April, 2021: Stima Cooperative Savings & Credit Society Limited vs The Commissioner of Domestic Taxes)

JUDGMENT

1. The appellant is a principal officer of the Kenya Revenue Authority which is a body established under section 3 of the*KRA Act.* Its primary duty is, *inter alia*, assessment, accounting and general administration of tax revenue on behalf of the government. The respondent is a savings and credit co-operative society registered under the *Cooperative Societies Act, 2012*.

2. The appellant carried out a tax audit for the respondent with regard to corporation tax for the years of income 2015-2016 and excise duty for the years of income 2013 to 2016. He subsequently assessed tax due thereon and demanded the same.

3. The respondent objected to the same but the appellant proceeded to give an objection decision thereon. The respondent appealed to the Tax Appeals Tribunal ("the tribunal") and by a judgment delivered on April 23, 2021, the tribunal partially upheld the said appeal.

4. Aggrieved by part of that decision, the appellant preferred the present appeal. This being a first appeal, this court is enjoined to review the evidence adduced before the tribunal and come to its own independent conclusion and findings. See *Selle & another v Associated Motor Boat Co Ltd & others* (1968) EA 123.

5. The respondent's case before the tribunal was that, following an audit on the respondent, the appellant issued it with a notice of assessment on excise duty and corporation tax on April 1, 2019. He demanded outstanding tax of Kshs 195,852,112/16 for the period 2013-2016 and Kshs 34,484,976/80 for corporate income tax for 2015-2016.

6. On objecting, the appellant amended the assessment and gave an objection decision on June 27, 2019 demanding a sum of Kshs 182,852,818/- for excise duty and Kshs 22,029,934/- for corporate income tax. As already stated, the tribunal partially allowed the respondent's appeal.

7. In his memorandum of appeal dated June 16, 2021, which was against part of that decision, the appellant raised 8 grounds which were collapsed into 4 as follows; that the tribunal erred in;

    a. finding that charges relating to bridging loans, loan appraisal, boosting deposits and deferred on appraisal are not subject to excise duty;

    b. finding that insurance premiums collected by the respondent on behalf of insurance companies between July, 2013 and November, 2015 are not subject to excise duty;

    c. failing to make a determination that corporate income tax from surplus of insurance premiums remitted to insurance companies by the respondent for the year of income 2016 was payable by the respondent; and

    d. misinterpreting the terms of the ADR agreement dated December 1, 2016 and thereby holding that the appellant was estopped from demanding excise duty for the period June, 2013 and October, 2014.

8. In opposition to the appeal, the respondent filed a statement of facts dated July 21, 2021. It contended that upon filing the appeal before the tribunal, the dispute was referred to ADR process and the corporate income tax demand of Kshs 22,029,934/- was vacated on without prejudice. An ADR agreement was executed on May 11, 2020 and a partial consent filed with the tribunal on October 5, 2020.

9. That paragraph 7 of part III of the fifth schedule of the *Customs and Excise Act* (repealed) and paragraph 4 part II of the *Excise Duty Act*, which were applicable at the time, specified the fees that was exempt from taxation. Amongst those exempted was interest on loans. In the premises, interest on bridging loan, loan appraisal, deferred loan appraisal and boosting deposits were exempt from excise duty.

10. That though the definition of the term 'interest' was not provided for either in the repealed *Customs and Excise Act* nor the amendment introduced by the *Finance Act 2013*, a reading of the *Customs and Excise Act* (repealed) showed that; (i) interest was classified as a fee within the definition of other fees, (ii) is a fee that was excluded from excise duty, and (iii) was not defined in the said Act. That the intention of the legislature was to exempt interest from excise duty.

11. That the fifth schedule of the *Customs and Excise Act* that was applicable prior to November 2015 defined other fees to include 'any fees, charges or commissions charged by financial institutions, but does not include interest.' That the *Finance Act 2013* introduced paragraph 9 of the fifth schedule which replicated the same definition of 'other fees.' That in the absence of an express definition of the

term interest, the tribunal correctly relied on the definition of interest in section 2 of the *Income Tax Act*.

12. That in the absence of a definition of 'interest' in the repealed *Customs and Excise Act*, the general cannons of statute interpretation were applicable including the 'plain meaning rule' which called for ordinary interpretation of the language used, and '*pari materia rule*' whereby if a statute is not clear or is ambiguous, the court can seek recourse in provisions of other statutes forming or relating to the same subject matter as was the case between the *Income Tax Act*, *Excise Duty Act* and *Customs and Excise Act* (repealed) as they all deal with tax matters in general and taxation of interest.

13. On insurance premiums collected on behalf of insurance companies for the period 2013 to November 2015, it was contended that the respondent was collecting premiums from its members to secure their loans. That the same was not income as the respondent only acted as a collecting agent for insurance companies. That paragraph 4 of part ii as read with part iii to the first schedule of the *Excise Duty Act* exempts insurance premiums from excise duty.

14. On the ADR agreement dated December 1, 2016, it was contended that the alleged misrepresentation alluded to by the appellant was not specifically particularized. That the scope of the formula under the ADR agreement covered computation of corporation tax for the years 2011 and 2012, PAYE and withholding tax for the period January 2012 and October 2014, and excise duty for the period June 2013 to October 2014. The respondent therefore urged that the appeal be dismissed.

15. On the first ground, the appellant submitted that though interest on loans were exempt from excise duty, other fees attracted a charge of 10% excise duty. That the Act did not provide the definition of interest and the tribunal erroneously adopted the definition provided for under the *Income Tax Act*.

16. On its part, the respondent submitted that interest was exempted from excise duty as earlier pleaded. That the items under this ground were all interest and not fees. The respondent described these items as follows;

    i. Interest on bridging loan

       A bridging loan is the amount advanced to members of the respondent to help them clear their existing loans so as to be able to apply for a new loan facility. Interest on bridging loan refers to interest earned from a loan given to a member to clear an existing loan and is at the rate of 3% of the bridging loan.

    ii. Interest on loan appraisal

       Loan appraisal is applied on all loans to cater for the appraisal process especially to cater for the risks associated with lending. It was submitted that the interest is charged at 0.75% of the loan.

    iii. Interest on deferred loan appraisal

       Interest on deferred loan appraisal is a balance sheet liability account that holds interest on appraisal that is yet to be earned. If any tax were payable, it would be due and payable as and when the amount is earned as explained under interest on loan appraisal.

    iv. Interest on boosting deposits

       This is interest charged on loans advanced to members to top up their deposits to enable them qualify for a higher loan. Interest on boosting deposits is charged on the credit extended to the member at the rate of 3%.

17. In making its decision, the tribunal examined the meaning of the term interest and relied on the definition in section 2 of the *Income Tax Act*. It made a finding that the above items fell under the definition of interest and were not subject to excise duty.

18. Paragraph 4 of part ii of the first schedule to the *Excise Duty Act* provides that: -

> "excise duty on other fees charged by financial institutions shall be twenty percent of their excisable value."

19. 'Other fees' were defined in the operative section of part iii of the first schedule to the *Excise Duty Act* as follows: -

> " other fees" includes any fees, charged or commissions charged by financial institutions relating to their licenced activities, but does not include interest on loan or return on loan, or an insurance premium or premium based on related commissions."

20. It was not in contention that interest was exempted from excise duty. All that the parties did not agree on is whether the subject items should be classified as interest or as other fees.

21. The general rule is that tax statutes are to be construed strictly. There is completely no room for intendment or presumption. In construing a tax statute, the court is called upon to ascertain the clear intention of parliament. It should avoid a construction that will lead to an injustice or absurdity. See *Cape Brandy Syndicate v IR Commissioners* [1921] 1 KB and *Republic v Kenya Revenue Authority exparte Bata Shoe Company (Kenya) Ltd* [2014]. Further, the construction should use the plain and literal meaning of the words used in the statute to discern the intention of parliament.

22. The *Finance Act, 2012* is the one that introduced an amendment relating to excise duty on other fees. It provided thus: -

> " excise duty on other fees charged by financial institutions shall be ten percent.'

23. The same applied to the *Customs and Excise Duty Act* (repealed). The terms 'financial institutions' and 'other fees' were not defined until clarification came in by way of the *Finance Act, 2013*.

24. The question is whether, the items set out above are interest or fees. These items are; charges on bridging loans, loan appraisal, boosting deposits and deferred on appraisal. The appellant submitted that these were fees while the respondent contended them to be interest.

25. As already stated, in construing a tax statute, plain and literal meaning should be used. *Black's Law Dictionary*, 10th Edn 2014 pg 935 defines interest as: -

> " The compensation fixed by agreement or allowed by law for the use or detention of money, or for the loss of money by one who is entitled to its use; esp., the amount owed to a lender in return for the use of borrowed money."

26. On the other hand, the *Oxford Dictionary*, 8th Edn define interest as: -

> " the extra money that you pay back when you borrow money or that you receive when you invest money; to pay interest on a loan."

27. Further. the *Halsbury's Laws of England*, defines interest as: -

> " the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another"

28. While dealing with a similar issue in *Commissioner of Domestic Taxes v National Bank of Kenya* [2022] Eklr, the court held: -

> " From the foregoing, it is crystal clear that interest is the compensation paid in consideration of using someone else's money. Or put differently, it is the consideration that is paid for keeping someone out of the use of his money. It is payable both when a lender lends money to a borrower or a lender takes a deposit from a depositor."

29. Section 7 of the *Finance Act, 2013* defined 'other fees' to include any fees, charges or commissions charged by financial institutions, but does not include interest. From this provision, it is clear that parliament recognized that apart from the compensation that is paid for the borrowed money, there were other expenses or charges that are to be incurred.

30. From the definition of interest above, there is the fact of the owner of the monies being kept away from that money for a certain duration. It is that duration that the compensation applies to and that is the interest charged. That includes deposits by a depositor in a bank or a lending by a financial institution. The depositor or lender is paid interest, which is the cost of being out of his/its money for the duration the bank/borrower is in use of the money deposited or lent.

31. Despite the use of the term 'loan' by the respondent on the subject items, those are basically charges. There is no money that is passed on to the members. These are mere book entries that are made to enable the respondent's members either borrow more from the respondent or are mere administrative expenses such as appraising the members loans.

32. They are but expenses or charges exerted by the respondent on its members and not interest per se. The respondent is not kept away from its money for a period to justify those charges to qualify to be interest.

33. In its judgment, the tribunal relied on the definition of interest under the *Income Tax Act* on the ground that it was not defined under the *Excise Duty Act*.

34. The view I take is that, the tribunal need not have looked for the definition of interest in the *Income Tax Act*. Before going out of the *Excise Duty Act* to look for the definition of interest, there should have been difficulty first as to what parliament's intention was. The term 'interest' should have been given its plain and literal meaning before seeking its legal meaning or definition in statutes. The cases relied on by the tribunal are inapplicable in the present case.

35. I have already found that the literal meaning of the term interest is the consideration payable for keeping one away from his money or for using someone else's money. The definition of interest in the *Income Tax Act* should not have been resorted to in ascertaining the intention of parliament in *Excise Duty Act*. The term interest is used in the *Income Tax Act* for the purposes of charge, assessment and collection of income tax; for the ascertainment of the income to be charged; for the administrative and general provisions relating thereto and for matters incidental to and connected therewith. Not for excise duty.

36. In *Cape Brandy Syndicate v I R Commissioners* [1921] 1KB the court held: -

> "... in a taxing Act one has to look at what was clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

37. Accordingly, the tribunal erred when it held that the charges for bridging loans, appraisal, boosting deposits and deferred on appraisal are interest and exempt from excise duty. Obviously, these charges are just but fees that is christened 'interest' and are not interest *strictu sensu*. They are not exempt from excise duty.

38. The second ground was whether the tribunal erred in finding that insurance premiums collected by the respondent on behalf of insurance companies between July 2013 to November 2015 are not subject to excise duty.

39. The appellant submitted that the genesis on imposition of excise duty on insurance premium was traceable to the *Finance Act 2012* and 2013 which amended the repealed *Customs and Excise Act* cap 472. That the Finance Act 2012 amended part iii of the fifth schedule to the *Customs and Excise Act* which imposed excise duty at the rate of 10% on other fees charged by financial institutions. That as of November 2015 when the *Excise Duty Act* came into force, the insurance premium was specifically exempted from excise duty.

40. That prior to that date, the appellant was lawfully charging excise duty on insurance premium between the periods July 2013 to November 2015 when the same was not exempt from excise duty. That the Tribunal thus erred in holding that from the period between July 2013 to November 2015 insurance premium was exempt from excise duty. That the tribunal wrongfully applied the provisions of the *Excise Duty Act* to assessments raised prior to its coming into force in contravention to section 46(4) of that Act. That the relevant applicable law for the period between June 2013 to November 2015 was the repealed *Customs and Excise Act* which did not exempt insurance premiums from excise duty. That the *Excise Duty Act* could not apply retrospectively.

41. The respondent on its part submitted that all loans advanced to the respondent's members were insured. That the respondent makes payment for the premium to the insurance companies and an expense transaction is recorded. That the premiums were subsequently recovered from the members from the monthly remittances at the rate of 0.75%. The respondent thus maintained that the insurance premiums were not an income and the obligation lay with the insurance companies to remit necessary taxes accruing from their income on insurance business.

42. At paragraph 53 of the judgment, the tribunal found that insurance premiums were exempt from excise tax for insurance companies. It therefore acknowledged that the issue for determination was whether the exemption included sacco's collecting premiums on behalf of insurance companies, and whether the exemption included fees, charges and commissions earned from transactions relating to insurance premiums. The tribunal found that the premiums amounts as remitted to the insurance companies were not subject to excise duty, however, the remaining amounts which were not remitted were subject to excise duty as other fees, charges and commissions. The tribunal thus found that the appellant erred in charging excise duty on insurance premiums collected on behalf of insurance companies for the period 2013 to November 2015.

43. The issue for determination is whether the insurance premiums collected by the respondent was an income, and if so, whether it was subject to excise duty for the period before the coming into force of the *Excise Duty Act*.

44. The respondent admitted that it was collecting premiums from its members to secure their 3loans. That the insurance covers were in relation to offsetting loans due from members as well as safeguarding their non-withdrawable deposits in the event of the demise of a member. That the premiums were paid upfront by the respondent at the beginning of each year and subsequently is collected from members as reimbursement at the rate of 0.75%. The remittance advices were reflected on pages 284-295.

45. From the foregoing, it clear that the insurance premiums was never an income on the part of the respondent. The respondent only made a one off payment of the premium to the insurer then made recovery thereof from its members monthly remittances. What is key is that the insurance premiums themselves are not an income, but the 0.75% which is a commission that is earned by the respondent is what is income thus taxable.

46. In as much as this court agrees with the appellant's submission that excise duty was applicable to insurance premiums before the *Excise Duty Act* came into force, the same ought to have been imposed on the insurance companies who were making an income therefrom. The appellant could only have taxed the 0.75% commission by the respondent for the period July 2013 to November 2015.

47. The upshot is that the tribunal did not err in finding that the insurance premiums collected by the respondent on behalf of insurance companies between July 2013 to November 2015 were not subject to excise duty.

48. The third ground is whether the tribunal erred in failing to determine that corporate income tax from surplus of insurance premiums remitted to insurance companies by the respondent for the year of income 2016 was payable to the respondent.

49. It was submitted that despite the tribunal finding that surplus of insurance premium was an income, it failed to make final orders that the surplus for insurance premium for year 2016 was taxable income and ought to be subjected to income tax. That failure to make final orders on that finding was an error which ought to be remedied.

50. The respondent submitted that the burden was on the appellant to prove the reconciling differences but that burden had not been discharged.

51. In paragraphs 57-65 of the judgment, the tribunal found that the respondent did not explain why there was a surplus of Kshs 11,752,967/- and Kshs 24,406,102/- for the years 2015 and 2016, respectively. It further held that the appellant would be correct to treat the surplus as income within the meaning of section 3 of the *ITA* and subject to taxation under section 19A (d) of the *ITA*.

52. In as much as the tribunal found that the appellant erred in charging corporate income tax on insurance premiums remitted to insurance companies for 2015, it ought to have issued orders to enforce its findings on the surplus of insurance premiums which was found to be an income. The court finds that that ground is merited.

53. The final ground was whether the tribunal misinterpreted the terms of the ADR agreement dated December 1, 2016. It was submitted that the tribunal relied on the ADR agreement to estop the appellant from demanding excise duty taxes for the period June 2013 to October 2014. That the settlement terms of the agreement only covered the corporation tax element. The respondent submitted otherwise.

54. The court has seen the ADR agreement dated December 1, 2016. Paragraph 2 thereof indicated that the audit covered corporation tax for the years 2011 and 2012, PAYE and withholding tax for January 2012 to October 2011, and excise duty for June 2013 to October 2014. Paragraph 5 thereof bound the parties to the agreement.

55. The appellant cannot turn around and re-litigate the issue of excise duty for the years June 2013 to October 2014. In *Pius Kimaiyo Langat v Co-operative Bank of Kenya Ltd* [2017] eKLR, it was held that: -

> "We are alive to the hallowed legal maxim that it is not the business of courts to rewrite contracts between parties. They are bound by the terms of their contracts, unless coercion, fraud or undue influence are pleaded and proved."

56. The appellant has not challenged the agreement on any of the above grounds. The appellant's attempt to invite this court to review the contract cannot succeed. Both parties are bound to the terms they agreed upon in the ADR agreement. That ground fails.

57. Accordingly, the appeal partially succeeds as follows: -

    a. That part of the judgment of the tribunal holding that the charges on bridging loans, loan appraisal, boosting deposits and deferred on appraisal are interest is hereby set aside.

    b. Corporate income tax from surplus of insurance premiums for the year of income 2016 is taxable. The same be assessed and be paid accordingly.

    c. Costs of the appeal are awarded to the appellant in any event.

It is so decreed.

DATED AND DELIVERED AT NAIROBI THIS 26TH DAY OF AUGUST, 2022.

A. MABEYA, FCIArb

JUDGE