IN THE HIGH COURT OF KENYA

AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL AND TAX DIVISION

CORAM: D.S. MAJANJA J.

TAX APPEAL NO. E042 OF 2020

BETWEEN

COMMISSIONER OF DOMESTIC TAXES.....APPELLANT

AND

SONY HOLDINGS LIMITED.....RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 27th March 2020 in Tax Appeal No. 506 of 2019)

JUDGMENT

Introduction and Background

1. The Appellant ("the Commissioner") is challenging the decision of the Tax Appeals Tribunal ("the Tribunal") dated 27th March 2020 allowing the Respondent's appeal. The substance of its appeal is set out in the Amended Memorandum of Appeal dated 9th October 2020. The Respondent opposes the appeal. It has filed its Statement of Facts dated 15th June 2020. Both parties have filed written submissions which their Advocates highlighted orally.

2. The facts giving rise to this appeal are apparent from the record and are as follows. The Respondent is a Company engaged in the business of development, owning and letting real estate and its flagship project is the Westgate Shopping Mall ("the Mall") from which it received rental income. On 21st September 2013, the Mall the subject of a terrorist attack leading to loss of lives and property which ultimately affected the operations of the Mall.

3. The Respondent held a terrorism and political violence insurance cover for property damage (buildings and outbuildings) and loss of rent receivable in the sum of KES. 6,000,000,000.00 and KES. 1,200,000,000.00 respectively with Kenindia Assurance Company Limited ("Kenindia"). After the attack, the Respondent claimed and was granted the insurance compensation and accordingly received a total compensation for loss of rent receivable of KES. 1,200,000,000.00 and an amount of KES. 3,100,000,000.00 for loss/ damage of buildings and outbuildings. Further, the Respondent sought exemption from withholding tax on rental income in a letter dated 7th March 2017 addressed to the

Cabinet Secretary, National Treasury. In response, the Commissioner by the letter dated 16th March 2017 requested for supporting documents purportedly in consideration of the Respondent's application. On 19th December 2017, the Commissioner gave notice of its intention to make an additional assessment and by the letter dated 18th May 2018, proceeded to issue an additional assessment for Income Tax, VAT and Withholding Tax. The Commissioner assessed the Respondent's tax liability as KES. 380,388,596.00 being principal corporation tax, penalty and interest thereon.

4. Aggrieved by the Commissioner's decision, the Respondent formally objected by filing its Notice of Objection dated 14th June 2018. The Commissioner affirmed its decision by its letter dated 10th August 2018. The Respondent, being dissatisfied with the Commissioner's objection decision, filed an appeal at the Tribunal.

5. In its consideration, the Tribunal raised four issues for determination. First, whether the insurance compensation of KES 6,000,000.00 paid to the Respondent for loss of building and outbuildings is taxable under **section 4(c)** of the ***Income Tax Act*** ("the ***ITA***"). Second, whether the Respondent is entitled to Commercial Building Allowance under **Paragraph 6A** of the **Second Schedule** of ***ITA***. Third, whether the Appellant is entitled to deduction for unrecovered service charge incurred in the years 2015 and 2016 and lastly, whether the Commissioner should reverse the incorrect entries on the Respondent's *iTax* portal.

6. At the conclusion of the hearing, the Tribunal held that the insurance compensation paid to the Respondent was not chargeable to corporation tax as there was evidence that the said sum was used for re-construction of the damaged Mall thus it could neither qualify as gains or profit in terms of **section 3(2) (a) (i)** of ***ITA*** nor compensation for loss of profit under **section 4(c)** of ***ITA***. The Tribunal further held that the Respondent, having fulfilled the requirements of **Paragraph 6A** of the **Second Schedule** of ***ITA***, was qualified for the Commercial Building Allowance. The Tribunal also held that the Respondent was entitled to deduction of the unrecovered service charge expenses incurred in the years 2015 and 2016 in accordance with **sections 15(1)** and **16(1)** of ***ITA***. The Tribunal directed the Commissioner to correct the entries in the Respondent's *iTax* portal.

7. It is these determinations that led the Commissioner to lodge its appeal. Although the Commissioner has raised 10 grounds of appeal, considering the determination of the Tribunal, the facts and submissions by the parties, the issues for resolution can be condensed into the following grounds:

(a) Whether the Tribunal erred in determining a dispute pending before the Court of Appeal.

(b) Whether the Tribunal erred holding that the insurance compensation sum of KES. 600,000,000.00 was not revenue and therefore not chargeable to tax.

(c) Whether the Tribunal erred in holding that the Respondent was entitled to Commercial Building Allowance.

(d) Whether the Tribunal erred in holding that the Respondent was entitled to a deduction from its income for the unrecovered service charge incurred in the years 2015 and 2016.

8. I will now proceed to determine each of the issues framed for determination bearing in mind that the jurisdiction of this court, exercising appellate jurisdiction is circumscribed by the law. Under **section 56(2)** of the ***Tax Procedures Act, 2015*** ("***TPA***"), *"An appeal to the High Court or to the Court of Appeal shall be on a question of law only"*. An appeal limited to a question issue of law does not permit the appellate court to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts. The Court of Appeal in ***John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others*** **[2018] eKLR** summarised what amounts to "*matters of law*" as follows:

[38] [T]he interpretation or construction of the Constitution, statute or regulations made thereunder or their application to the sets of facts established by the trial Court. As far as facts are

concerned, our engagement with them is limited to background and context and to satisfy ourselves, when the issue is raised, whether the conclusions of the trial judge are based on the evidence on record or whether they are so perverse that no reasonable tribunal would have arrived at them. We cannot be drawn into considerations of the credibility of witnesses or which witnesses are more believable than others; by law that is the province of the trial court. [Emphasis mine]

Existence of pending dispute over the same subject matter

9. The first issue raised by the Commissioner is a procedural issue relating to proceedings pending in the Court of Appeal. It is not in dispute that there is pending litigation regarding the subject of this appeal in the Court of Appeal; ***Nairobi CA Civil Appeal No. 11 of 2020, Sony Holdings Ltd v Commissioner of Domestic Taxes*** arising from the judgment in ***Sony Holdings v Commissioner of Domestic Taxes*** **NRB Judicial Review No. 363 OF 2018 [2019] eKLR**.

10. In that case, the Respondent applied for several orders including an order that the Commissioner's Tax Assessment made on 18th May 2018 which is the same assessment that was the subject of the appeal to the Tribunal. At any rate, the court dismissed the application and concluded that, *"In this case, the applicant ought to have subjected itself dispute resolution mechanism provided under the TAT and the TPA instead of invoking the Judicial Review jurisdiction of this Court."*

11. The Commissioner complains that the Tribunal erred by adjudicating on this case contrary to **section 6** of the ***Civil Procedure Act (Chapter 21 of the Laws of Kenya)*** which provides that no court shall proceed with a matter between the same parties involving the same subject matter before a court of competent jurisdiction. The Commissioner contends that despite the pending proceedings being brought to the Tribunal's attention, it failed to stay the proceedings. The Commissioner submitted that it filed a Notice of Motion dated 2nd March 2020 seeking to stay the proceedings but the Tribunal failed to rule on the application instead proceeded to hear the appeal and render its judgment.

12. In response, Counsel for the Respondent, submits that the principle of res sub-judice invoked by the Commissioner does not arise as the appeal on the judicial review deals with the process while the proceedings before the Tribunal deal with the merits of the matter and substantively determines the dispute. Counsel adds that the Commissioner had applied for stay of proceedings on 3rd December 2019 which the Tribunal declined by a ruling made on 19th February 2020 and the matter proceeded for hearing on 2nd March 2020.

13. The record of proceedings before the Tribunal indicates that the Commissioner filed two interlocutory applications. In the Notice of Motion dated 3rd December 2019, the Commissioner sought to strike out the memorandum of appeal on the ground that it was filed out of time and that the appeal raised the same issues as those in **JR No. 363 of 2018**. The second application was a Notice of Motion dated 2nd March 2020 seeking to stay the appeal before the Tribunal.

14. The Tribunal heard submissions on the Notice of Motion dated 3rd December 2019 and delivered its ruling on 19th February 2020 dismissing the application. As regards **JR No. 363 of 2018**, it held that the proceedings before it dealt with the merits of the dispute whereas what was before the court was on the legality of the process. As regards the application of the Notice of Motion dated 2nd March 2020, when the appeal came up for hearing on 10th March 2020, Counsel for the Commissioner drew the Tribunal's attention to its application seeking the stay of proceedings. The Tribunal heard submissions from both counsel and ordered the parties to proceed with the appeal.

15. It is true that the that Tribunal did not render any decision on the Commissioner's application dated 2nd March 2020 but I think the question for determination is whether the Commissioner suffered any prejudice given that the Tribunal had already expressed its view on the issue of proceedings pending before the High Court when it ruled on the earlier application.

16. Further, I hold that the Tribunal is a creation of statute with limited jurisdiction and I do not find

any provision where the Tribunal can stay its own proceedings on account of other proceedings pending before a Superior Court (see ***Commissioner of Investigations and Enforcement v Estama Investments Limited*** **Tax Appeal No. E039 of 2020 [2020] eKLR**). Since the Commissioner is a party to the proceedings before the Superior Courts, it retained the option of applying for stay of the Tribunal's proceedings pending the determination of the proceedings before the Superior Courts. I therefore hold that while the Tribunal erred in not rendering a ruling on the Commissioner's application dated 2nd March 2020, this error did not prejudice the Commissioner in any way.

Whether income tax chargeable on KES 600,000.000.00 insurance compensation

17. The Commissioner contends that it acted within the law by charging income tax on the sum of KES. 600,000,000.00 received by the Respondent for insurance compensation in accordance with **section 4 (c)** of the ***ITA***. It also submits that the Respondent bears the onus to support its case that the KES. 600,000,000.00 received was compensation for loss of buildings and outbuildings which it did not discharge.

18. The Commissioner further submits that the Respondent did not provide the bank account statements which would indicate the particularization of the case received as insurance compensation as these would show the precise amounts received and the purpose of the same. It complains that the Respondent also failed to avail the assessors report which would contain details of the loss or damage which was covered by the insurance and would assist in confirming that the payments were in relation to which losses. The Commissioner also points out that the discharge voucher did not support the fact that the payment was in respect of loss of buildings and outbuildings.

19. The Commissioner invites the court to find that in absence of sufficient evidence, the Respondent did not demonstrate that a different tax decision could have been reached as the preponderance of evidence suggests that the Respondent has not availed sufficient evidence as required to controvert the Commissioner's assessment. In its view, it is not the amount of information availed but the accuracy of the information availed that would result to the discharge on the burden placed on the taxpayers by the tax law.

20. The Commissioner submits that the Tribunal erred in shifting the burden of proof to it to prove that the insurance money was income contrary to **section 56(1)** of the ***TPA*** which provides that:

> *In a proceeding before the Tribunal, the Appellant has the burden of proving:*
>
> *(a) Where an appeal relates to an assessment that the assessment is excessive; or*
>
> *(b) In any other case that the tax decision should not have been made or should have been made differently.*

21. In the Commissioner's view, the Respondent did not discharge the burden of showing that the amount received was not taxable and in the circumstances, the Commissioner submits that it acted within **section 4(c)** of the ***ITA***. The Commissioner contends that the Respondent did not demonstrate that the insurance compensation was for loss of building and outbuildings.

22. In response to the Commissioner, the Respondent submits that it was not in dispute that it received this sum on 18th October 2013 and it related to the income tax year of 2013. It states that it provided the Commissioner with documents requested including, the Policy document, the discharge voucher for the sum of KES. 600 million for loss and damage, payment advice and bank account statements. It states that it also furnished the Commissioner with a Discharge Voucher for an amount which was paid for loss of rental income dated 18th April 2016 and a letter from Kenindia confirming that this payment was for compensation for loss of building.

23. Counsel submits that the Respondent presented all evidence required to support its position and thereafter the Commissioner carried out two audits, in relation to the income tax years 2012 and 2014

where in a letter dated 11th April 2016, the Commissioner confirmed that the way the sum had been treated was correct. This was followed by a refund audit where the Commissioner confirmed that the Respondent was entitled to a refund or income tax both for the years 2013 and 2014. The Respondent therefore contends that the Commissioner cannot now claim that it did not have the evidence. Counsel submits that there was no assessor's report on the Mall as the building was valued by a quantity surveyor and a report submitted to the Commissioner during the refund audit.

24. The question whether the Commissioner acted within the law by charging income tax on KES 600,000,000.00 received by the Respondent for insurance compensation is determined under **section 4(c)** of ***ITA***. Under **section 3(2)(a)(i)** of the ***ITA***, income tax is chargeable on *"gains and profits from any business, for whatever period of time carried on."* **Section 4** then goes on to expand the meaning of, *"gains and profits from any business"* as follows:

> ***4. Income from businesses***
>
> *For purposes of section 3(2)(1)(a) -*
>
> *(c) any sum received under any insurance against loss of profits, or received by way of damages or compensation for loss of profits, shall be deemed to be gains or profits of the year of income in which it is received;* [Emphasis mine]

25. In discerning the meaning of the statute, the court is guided established principles on the approach to interpretation of tax statutes. In this regard, the Court of Appeal in ***Commissioner of Domestic Taxes (Large Taxpayers Officers) v Barclays Bank of Kenya Ltd*** **NRB CA Civil Appeal No. 195 of 2017 [2020] eKLR** observed as follows:

> *There is no doubt in our minds that the decisions in* ***Adamson v Attorney General [1933] AC 247, Cape Brandy Syndicate v. Inland Revenue Commissioners [1920] 1 KB 64, T. M. Bell v. Commissioner of Income Tax [1960] EA 224, Republic v. Commissioner of Income Tax ex parte SDV Transami [2005] eKLR*** *and the first judgment represent a correct statement of the law, namely strict construction of tax legislation, so that the tax demand must fall within the terms of the statute without ambiguity. If there's any ambiguity in the legislation, it is not to be rectified by considerations of intendment, but by amending the legislation. However, determination of whether there is clarity or ambiguity in the legislation or whether a tax demand is precise and within the terms of the legislation, is not an abstract or pedantic exercise. It must be based on the evidence and the circumstances of each case. We agree with the majority of this Court in* ***Stanbic Bank Ltd v. Kenya Revenue Authority [2009] eKLR*** *that meaning of words should not be strained so as to find ambiguity.*

26. The meaning of **section 4(c)** of ***ITA*** is plain and obvious and does not admit any ambiguity. The compensation subjected to taxation, is insurance compensation received by the taxpayer in respect of compensation for "*loss of profits*" for it is the profits that are subject to taxation in line with **section 3(2)(a)(i)** of the ***ITA***. The Tribunal thus correctly observed that **section 4(c)** of the ***ITA*** does not deal with or affect insurance sums paid as compensation for destruction of buildings and outbuildings. Such payment does not constitute income as it is intended to replace the destroyed or lost asset.

27. The next level inquiry is whether on the facts, the Respondent demonstrated that the Commissioner was incorrect in concluding that the KES. 600,000,000.00 received by it was compensation for profits within the meaning of **section 4(c)** of the ***ITA***. This is a question of fact and in its consideration, the Tribunal concluded that the evidence before it indicated that KES 600,000,000.00 was received by the Respondent as compensation of buildings and outbuildings.

28. As I stated earlier, the duty of this court is limited to satisfying itself that Tribunal acted within the law on the basis of the evidence available to it. It is not to review the evidence and reach and independent decision. I have reviewed the evidence available to the Tribunal. There is no dispute about the Policy Document referenced as P/104/043/0443/2013/1/01 and issued by Kenindia indemnifying the Respondent

from losses and damages arising out of acts of terrorism and the losses covered by the policy included Buildings and Outbuildings and 24 Months' Rent Receivables. There is also a Discharge Voucher dated 18th October 2013 confirming that the Respondent accepted the KES. 600,000,000.00 as an interim payment in respect of the aforementioned Policy and '*in respect of loss or damage by Terrorism'*. Though this statement is ambiguous and general and does not really specify whether the amount is for loss in respect of the 24 Months' rent receivable or for the damage to the Buildings and Outgoings, the ambiguity was put to rest by Kenindia's letter dated 4th December 2013 addressed to the Respondent and which states, in part, "*We would like to clarify that the first on Account payment of Kshs. 600M made to you is for the expenses related to repairs and reinstatement of the damaged building"*. That the amount was for compensation for the building and outgoings is further fortified by the Discharge Voucher dated 7th April 2015 in which the Respondent acknowledges receipt of the said KES. 600,000,000.00 in respect of '*loss of Buildings and Outgoings by Terrorism'*.

29. In my view, no one was better placed to clarify the basis of the KES. 600,000,000.00 payment other than Kenindia. I do not see any reason why the Commissioner rejected this clarification if at all it was initially in doubt as to the purpose of the payment. Further, there is no other reason for Kenindia to pay the Respondent other than in accordance with the policy as indemnity for the loss of buildings and outbuildings as a result of terrorism.

30. The Commissioner complained that the Respondent did not provide an assessor's report and an approved compensation report hence it did not establish the purpose of the compensation. The Respondent's response was that Kenindia did not make such a report hence it was not available. It argued that it provided all the necessary documentation to support its case.

31. I hold that there was sufficient evidence for the Tribunal to find that the payment of KES. 600,000,000.00 was in respect of damages to the Mall and was to be used in repairs and reinstatement of the Mall and was therefore not subject to corporation tax. The evidence also shows that the Respondent was subjected to two audits by the Commissioner who raised the issue of insurance compensation. In both instances, the Respondent provided documents and a satisfactory explanation accepted by the Commissioner.

32. From the totality of the facts and evidence, I cannot say that the decision was without any legal or factual basis to support the Respondent's case that the Commissioner's assessment was incorrect. I therefore affirm the Tribunal's decision on this issue.

Whether Respondent was entitled to Commercial Building Allowance

33. After the terrorist incident, the Respondent commenced reconstruction of the Mall on 1st September 2014. It was partially re-opened for business in July 2015 and then fully in 2017 upon completion of construction works. During the period, the Respondent had accumulated tax losses by the end of 2015 whereupon it sought an opinion on whether it was entitled to the Commercial Building Allowance. The Commissioner, by the letter dated 6th May 2015 reviewed the matter and informed the Respondent, in part, as follows:

> *(i) The reconstruction expenditure must be capital in nature.*
>
> *(ii) Sony can claim commercial building deduction in the relevant return of Income (ITC2) after completion of construction and after the building is put to use but subject to (iii) below.*
>
> *(iii) The claim for the deduction is allowable if the commissioner is satisfied that it meets the conditions set out in paragraph 6A of the second schedule to the Income Tax Act: that besides the capital expenditure on commercial building, Sony must have provided roads, water, sewers and other social infrastructure.*

34. The Respondent complained that despite complying with the conditions set out in the private ruling

contained in the letter dated 6th May 2015, the Commissioner wrongfully rejected its claim for the Allowance on the ground that, *"the construction does not meet the conditions of paragraph 6A."*

35. It is common ground that **Paragraph 6A of the Second Schedule** of ***ITA*** allows deductions on income based on capital expenditure incurred in respect of a commercial building. It provides as follows:

> ***6A. Expenditure in respect of commercial building***
>
> *(1) Where a person incurs capital expenditure on the construction of a commercial building to be used in a business carried on by him or his lessee on or after the 1st January, 2013, and the person has provided roads, power, water, sewers and other social infrastructure, there shall be deducted, in computing the gains or profits of that person for any year of income in which the building is so used, a deduction equal to twenty-five percent per annum.*
>
> *(2) For the purpose of this paragraph "commercial building" includes a building for use as an office, shop or showroom but shall not include a building which qualifies for deduction under any other paragraph or a building excluded for industrial building under paragraph 5(3) of this Schedule.* [Emphasis mine]

36. In disallowing this expense, the Commissioner submits that Westlands area, where the Respondent's Mall is located, is an urban area within the Capital where the Nairobi County has provided a sewer system, that the area is already connected with power and a good network of roads. It contends that the Respondent cannot argue that it provided those facilities as they existed before the reconstruction of the Mall. The Commissioner further argues that facilities were not for the sole use of the Respondent's business as they were also being used by members of the public.

37. On the fact that this expense had already been allowed by the Commissioner in its private ruling dated 6th May 2015, the Commissioner submits that this allowance was conditional upon the satisfaction of the Commissioner and compliance with the aforementioned provisions which the Respondent did not satisfy.

38. The Respondent case is that it is entitled the Commercial Building Allowance. It submits that it provided for roads, water, sewer, electricity and other social infrastructure supported by documents provided to the Commissioner including the construction contracts, bill of quantities, payments, construction ledgers, photographs and other evidence demonstrating that it incurred capital expenditure.

39. Resolution of this issue is once again a matter of law and fact. The interpretation of **Paragraph 6A of the Second Schedule** of ***ITA*** is that all a tax payer needs to do is put up, *"roads, power, water, sewers and other social infrastructure"* while incurring capital expenditure on construction of a commercial building. It does not matter that roads, power and other social infrastructure is already in place or that the same is not being utilized solely by the tax payer as argued by the Commissioner. The use of the word "social" is deliberate and implies that infrastructure is not only for use by the taxpayer but also for members of the public. Giving **Paragraph 6A** the interpretation proposed by the Commissioner would be inserting additional words in the statute and or giving it a different and broader interpretation not supported by the words of the statute contrary to the strict rules of construction of tax laws espoused in several decisions among them ***Cape Brandy Syndicate v Inland Revenue Commissioners*** **[1920] 1 KB 64** and ***T.M. Bell v Commissioner of Income Tax*** **[1960] EALR 224**.

40. To prove that it had provided for roads, water, sewer, electricity and other social infrastructure, the Respondent produced a Quantity Surveyor's Bills of Quantities dated 31st May 2018 in respect of the Mall's reconstruction. The Bill provided for, among others, construction of roads, light poles and light boxes. The Respondent also furnished the Tribunal and this court the ledger showing how amounts were expended for the infrastructure. The Respondent produced a letter by Nairobi City County dated 25th February 2015 and an agreement dated 23rd December 2015 between the it and County approving the Respondent's construction of '*Mwanzi Road between Peponi Road and Lower Kabete Road'* together with street lighting infrastructure and drainage improvement along the road. It produced photographs of

the said amenities. The Respondent placed all this evidence before the Commissioner and Tribunal to demonstrate that it incurred capital expenditure and satisfied the conditions for granting of the Commercial Building Allowance.

41. I do not see any reason why the Commissioner would claim that the Respondent had not fulfilled these conditions in light of the evidence on record, for it to disallow the Respondent's application for the Commercial Building Allowance. The Tribunal's decision in that regard cannot be said to be perverse to the extent of inviting interference. I reject this ground of appeal.

42. Related to this issue, is the question of the private ruling by the Commissioner contained in the letter dated 6th May 2015, whose contents I have set out at para. 33 above. The Commissioner complained that the Tribunal erred by adjudicating on a private ruling contrary to **section 67(5)** of the ***TPA*** which provides that:

> *A private ruling shall set out the commissioner's opinion on the question raised in the ruling and is not a decision of the Commissioner for purposes of this Act or the Tax Appeals Tribunal Act 2013.*

43. In relation to the private ruling, the Tribunal, after reviewing the documentary evidence showing that the Respondent complied with **Paragraph 6A of the Second Schedule** of the ***ITA***, it concluded as follows:

> *We find the evidence satisfactory in support of the claim for Commercial Building Allowance, just as buttressed by the Respondent in its Private Ruling dated 6th May 2015. As such we find that the private ruling still stands and bind the Respondent. This Ruling created a legitimate expectation in the Appellant and the Tribunal is bound to hold the Respondent to it.*

44. The Tribunal cited and relied on the decision in ***R v Kenya Revenue Authority ex-parte M-Kopa Kenya Limited*** **NRB JR No. 599 of 2017 [2018] eKLR** where the court held as follows:

> *[99] It is therefore clear that a private ruling has a binding effect on the parties thereto and remains in force until it is withdrawn. From the record it is clear that the said ruling was not expressly withdrawn. In fact while not disputing the presence of the private ruling, the Respondent averred that the same was issued contra statute, hence the reason the Respondent did not adhere thereto. Again while appreciating the legal effect of such a private ruling under section 67 of the TPA, the Respondent averred that pursuant to section 67(4) of the TPA, such a ruling remains in force until it is withdrawn which according to the Respondent was discernible from the Respondent's conduct in relation to the letters it issued post the private ruling in which the Respondent advised the Applicant that its items did not qualify for exemption.*

45. I find that the Tribunal was not adjudicating on the private ruling. It only cited the private ruling as a basis for fortifying its decision that the Respondent has made out a case for the Commercial Building Allowance. In any case, the Commissioner, in the private ruling, merely restated the legal position. When the Respondent made the application for the Commercial Building Allowance and the Commissioner rejected the same, the Respondent was entitled to appeal to the Tribunal. The Tribunal appraised itself of the facts and law and came to the conclusion that the Respondent's claim was justified even in the absence of the private ruling.

Whether the Respondent was entitled to a deduction from its income for the service charge incurred in the years 2015 - 2016

46. The Respondent's case for the consideration of the unrecoverable service charge amounting to KES 49,332,837.00 and KES 112,857,750.00 for years 2015 and 2016 respectively is grounded on the fact that any property that is leased out to tenants requires certain services to be supplied for the smooth running of the property. These services include cleaning, advertising, security, land rent, rates, insurance amongst others. According to the Respondent, these services are incurred whether the property is leased out or not and while the same may be recovered from tenants as service charge in proportion to the areas of the

property occupied by tenants, where the area is unoccupied the landlord has absorbed the cost of those services. The Respondent urges that these are necessary expenses for the production of the income earned from the property and are therefore deductible under **section 15(1)** and **16(1)(a)** of the ***ITA*** which provide as follows:

> ***15. Deductions allowed***
>
> *15 (1) For the purpose of ascertaining the total income of any person for a year of income there shall, subject to section 16 of this Act, be deducted all expenditure incurred in such year of income which is expenditure wholly and exclusively incurred by him in the production of that income, and where under section 27 of this Act any income of an accounting period ending on some day other than the last day of such year of income is, for the purpose of ascertaining total income for any year of income, taken to be income for any year of income, then such expenditure incurred during such period shall be treated as having been incurred during such year of income.*
>
> *16.(1) Save as otherwise expressly provided, for purposes of ascertaining the total income of a person for a year of income, no deduction shall be allowed in respect of –*
>
> *(a) Expenditure or loss which is not wholly or exclusively incurred by him in the production of the income;* [Emphasis mine]

47. In the additional assessment dated 18th May 2018, the Commissioner took the view that it had sought proof and support for unrecoverable service charge, *"which was a cost in the accounts but was not seen as revenue."* It accordingly subjected the amount to tax under **section 16** of the ***ITA***. The Commissioner therefore submits that it acted reasonably and within the law in disallowing the Service Charge expense as the unoccupied areas were in respect of new building extension that was ongoing. It is expected that these expenses to be capitalized in respect to the new building rather than claimed as revenue expenses.

48. The Commissioner further argues that the Respondent was not able to provide clear evidence of the expenses incurred to cover the areas under construction and the occupied areas owing to the fact that the mall was partially re-opened in 2015 and construction went on including the year 2016, therefore it is obvious that some of the expenses.

49. On its part, the Respondent submitted it provided an account of the expenses which indicated that there was part of the building which had been completed but had no tenant and therefore the Respondent was bound to pay the service charge in respect of that area and not charge the tenant who had only occupied a portion of the premises.

50. I am satisfied that unrecovered service charge, being the expenses necessary for the maintenance of the taxpayer's property, are expenses wholly and exclusively incurred in the production of income and therefore deductible under **sections 15** and **16** of the ***ITA***.

51. Turning to the facts of the case, I have gone through the said statement referenced by the Respondent and it indicates that the Respondent incurred service charge expenses which ought to have been deducted from the Respondent's income for the subject years 2015 and 2016. In any case, I am in agreement with the Tribunal that by the Commissioner's own letter dated 18th May 2018 which states that, *"We sought proof and support for unrecoverable service charge which was a cost in the account but was not seen as revenue"* is an admission by the Commissioner because it related to the unoccupied area whose service charge was met by the Respondent and fortifies the Respondent's claim that this was an expense and ought to be deducted as such from its income as per **section 15(1)** of ***ITA***. I therefore affirm the Tribunal's decision that there was no basis for the Commissioner to subject the unrecoverable service charge to corporation tax.

Conclusion

52. In conclusion, I propose to deal with the common thread running through the Commissioner's appeal. The Commissioner contended that the Respondent had not provided sufficient evidence to support its case before the Tribunal and that the Tribunal erred in law and in fact by shifting the burden of proof to the Commissioner contrary to express provisions of **section 56 (1)** of the ***TPA*** and **section 30** of the ***Tax Appeals Tribunal Act.***

53. The record shows that prior to the appeal, the Commissioner subjected the Respondent to two audits; for the period January 2012 to December 2014 and for the period May 2016 to January 2017. During both audits, the Respondent provided the documentation requested and the same issues now raised in this appeal were considered. The same documents were furnished to the Tribunal and reviewed. On the whole, based on the law and evidence, the Commissioner failed to demonstrate any error, factual or otherwise, in the Tribunal's decision that would warrant intervention by this court. On the other hand, the Respondent was able to demonstrate before this court that the Tribunal came to the correct conclusion based on the facts and law.

Disposition

54. For the reasons I have set out above, I affirm the decision of the Tax Appeal Tribunal dated 27th March 2020. I dismiss the appeal with costs to the Respondent.

DATED and **DELIVERED** at **NAIROBI** this **30TH day of APRIL 2021.**

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Ms P. Leparashao, Advocate instructed by Kenya Revenue Authority for the Commissioner of Domestic Taxes.

Mr G. Oraro, SC with him Ms R. Omondi instructed by Oraro and Company Advocates for the Respondent.