REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI COMMERCIAL & TAX DIVISION

INCOME TAX APPEAL NO. 357 & 358 OF 2015

BETWEEN

TWIGA STATIONERS & PRINTERS LTD.....APPELLANT

-VERSUS-

THE COMMISSIONER OF INCOME TAX.....RESPONDENT

J U D G M E N T

1. **TWIGA STATIONERS & PRINTERS LIMITED**, the Appellant hereof, has filed the two above mentioned appeals which rely on the same facts and the same grounds. Consequently this one judgment will be delivered in respect of both those matters.

BACKGROUND

2. The Appellant is in the business of converting paper into various products which it sells locally and abroad. The Appellant also procures raw materials both locally and from foreign countries. Some of those foreign purchases are on credit basis which gives rise to foreign creditors.

3. The Appellant maintains a foreign currency account (hereinafter the account) where the proceeds of its foreign sales are deposited and its payments for purchases are made. The Appellant, during the tax period of the years 2000 and 2001, secured a loan in foreign currency, which loan it repaid through the account.

4. The Respondent, **COMMISSIONER OF INCOME TAX** (hereinafter the Commissioner) undertook a tax audit of the Appellant for the years 2000 and 2001. the Commissioner after that audit found the Appellant wrongly claimed for foreign exchange losses/gains under Section 4A of the Income Tax Act (hereinafter the Act). The Commissioner communicated its finding by letter dated 21st May 2003 and in that regard stated thus:

> ***"The company (the Appellant) maintains a retention account which caters for the dollar transactions and as such this renders the forex loss or gain to be unrealized. For a forex loss/gain to be realized there must be an actual conversion of currencies such that fluctuations of exchange rates are actually experienced. The forex loss in this case was just a perceived loss and hence not realized because there was no actual conversion of currencies. The company was also translating the closing balance at the year end which is not realized also."***

5. The Commissioner therefore proceeded to add back the loss the Appellant had claimed. the Appellant served on the Commissioner a Notice of Objection and a Notice of Intention to Appeal against the income year of 2000 being assessment No. 09852000-000-634; and income year 2001 being assessment No. 09852000-000174. The appeal was heard before the Local Committee for Nairobi North. That Local Committee dismissed the Appellant's appeal in respect to both of the assessments. The two appeals before me, that is in Income Tax Appeals Nos 357 and 358 of 2015 relate to that dismissal by Local Committee.

THIS APPEAL

6. The main issue raised by the Appellant in the four grounds of appeal, before me, is whether the Local Committee erred in Law and in fact in not recognizing that the Appellant's gains and/or losses in the foreign currency account (the account) were realized for the purpose of Section 4A of the Act and were therefore deductable.

ANALYSIS

7. The Appellant's case is that the foreign currencies it earned were from foreign sales. Those foreign sale proceeds were converted/or are reflected by the Appellant into Local currencies, at the rate existing at the time the sale took place, for the purpose of the Appellant's reporting/accounting. The Appellant in its accounting reflected gain/loss on exchange rate when the foreign currency is used to settle its foreign expenditure. The Appellant had recognized in its account different rate of exchange from which it used when the same currency was first acquired.

8. The Appellant's argument is that it applied the exchange rate because the Commissioner required accounts to be in local currency which led the Appellant to translate the foreign sales/expenditure with the fluctuating exchange rates which then led to increase/decrease or gain/loss. Essentially the Appellant's argument is that since it was required to include the dollar cash sales equivalent in local currency, in profit determination, at the rate of exchange rate existing at the time the foreign sale was made, it was justified in including the same sale dollar equivalent at the value when the same dollar cash was first acquired at the time it utilizes the same to settle a liability or expenditure. It is that which led to gains or losses.

9. The Commissioner's response to the Appellant's argument was captured by the letter dated 12th August 2003 addressed to the Appellant. This is how the Commissioner responded:

> ***"Translation of foreign currency assets and liabilities for purpose of statutory reporting would only give rise to unrealized foreign exchange gains/losses. Gains or loss in respect to foreign currency would only be realized on the settlement of a foreign currency liability, which would necessitate conversion of the local currency (Kshs) into foreign currency as in the case at hand, then there is no realization as all the transactions are done in foreign currency. Translation into the local currency is done for comparison purposes only."***

10. The Appellant relied on the provision of Section 4A of the Act in providing for gain/loss in the different exchange rate to the proceeds and expenditure on its foreign currency account. Section 4A(1) of the Act provides:

> ***"A foreign exchange gain or loss realized on or after the 1st January, 1989 in a business carried on in Kenya shall be taken into account as a trading receipt or deductible expenses in computing the gains and profits of that business for the year of income in which that gain or loss was realized:"***

11. As correctly stated by the Appellant the Act does not define what the word "realized" means. The understanding of what the legislature meant by that word – realized – will assist to determine whether the Appellant erred in its claim for gains/losses on its foreign currency.

12. The Commissioner through its written submissions referred to the definition of the word – realize as stated in the Black's Law Dictionary, that is to mean "to convert any kind of property into money." The Commissioner also relied on the Canadian case **MNR VS CONSOLIDATED GLASS LTD (1957) S.C.R. 167** date 1957-01-22 and submitted that currency loss or gain prior to conversion was not a taxable expense as provided in Section 4A of the Act.

13. I have considered the parties documents and submissions in support or opposition in both appeals. The Appellant, as stated before, operated a foreign currency account. In that account it received payment from the buyers of its product and it made payment to supplier of raw material. It is in those transactions the Appellant claimed gains and losses. The issue to determine is whether those transactions fell within what Section 4A of the Act called 'realized'.

14. The **Black's Law Dictionary Tenth Edition** defines realization as:

> ***"Conversion of noncash assets into cash asset.***
>
> *Tax.* ***An even or transaction, such as the sale exchange of property, that substantially changes a taxpayer's economic position so that income tax may be imposed or a tax allowance granted."***

15. The same dictionary proceeds to define realized loss as:

> ***"****Tax.* ***The excess of a property's adjusted value over the amount realized from its sale or other disposition."***

16. The dictionary further defines realized gain as:

> ***"****Tax.* ***The excess of the amount realized from the sale or other disposition of the property over the property's adjusted value."***

17. The consideration of the above definition make it clear that for a trade receipt or deductible expense to be allowed there must be realization which results in gain or loss. Realization in my view, and bearing in mind the above definition must involve conversion of the foreign currency into local currency which conversion either results in gain or loss. In this case there was no such conversion. The Appellant's foreign currency remained as foreign currency both when the Appellant received payment for sale of its goods, to overseas clients, and when it paid its suppliers for raw material. The Appellant's foreign currency remained in the form of foreign currency throughout those transactions. It therefore failed the test of realization under Section 4A of the Act.

18. I am aware of the High Court decision, namely **BIDCO OIL REFINERIES LIMITED V COMMISSIONER OF INCOME TAX [2017] eKLR** where it was held that the word 'realize" as used in Section 4A of the Act was not limited to conversion of the foreign currency. The Learned Judge in that case expressed himself thus:

"I find that S4A does not make it a requirement that the taxpayer should have purchased foreign currency from the local market to meet the foreign currency requirement…

However, I hold the view that Section 4A makes it clear that "realization," is not limited to conversion…

In my understanding, the foreign exchange gain or loss is not a simple direct matter. It is determined through calculations, which are to be carried out using the formula provided."

19. I am not persuaded by the above finding. In my view S4A makes it clear that there must be foreign exchange gain/loss which is realized. In this case there was no realized gain/loss by the Appellant because the Appellant's foreign currency at all times remained in foreign currency form when all its foreign transactions were undertaken. It follows that Section 4A was inapplicable in claiming a gain/loss by the Appellant. It is because of that finding that I accept as correct the Commissioner's determination, in the letter dated 12th August 2003. By that determination the Commissioner stated that for the Appellant to benefit from the provisions of Section 4A there needed, of necessity, to be conversion of the local currency (Kshs) into foreign currency. I find and hold that Section 4A of the Act is directed at such conversion and not otherwise. Anything else would be artificial realization.

CONCLUSION

20. The Appeals No. 257 of 2015 and No. 258 of 2015 for the reasons set out above both fail and are dismissed. Having been dismissed the Appellant is hereby ordered to bear the costs of the Income Tax Appeals No. 257 of 2015 and No. 258 of 2015.

DATED, SIGNED and DELIVERED at NAIROBI this 24TH day of JULY, 2019.

MARY KASANGO

JUDGE

***Judgment Read** and **Delivered** in **Open Court** in the presence of:*

Sophie..... **COURT ASSISTANT**

..... **FOR THE APPELLANT**

…… **FOR THE RESPONDENT**