REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

MILIMANI COMMERCIAL & ADMIRALTY DIVISION

INCOME TAX APPEAL NO. 2 OF 2007

THE COMMISSIONER OF INCOME TAX................APPELANT

VERSUS

MOUNT KENYA SAFARI CLUB LIMITED...........RESPONDENT

JUDGEMENT

1. The Decision by the Local Committee of Nairobi South made on 19th April 2000 in which it held that additional Capital Expenditure made by Mt. Kenya Safari Club on the construction of 16 additional Rooms qualifies for Investment Deduction and Industrial Building Allowance is the subject of this Appeal.

2. In the Appeal filed on 7th June 2000 by KRA raises the following Grounds:-

> **1. The Local Committee has wrongly upheld the Respondent's appeal that the additional Capital Expenditure on the Construction of 16 additional rooms qualifies for Investment Deduction and Industrial Building Allowance.**
>
> **2. The Local Committee erred in law and fact in deciding that the renovations or modifications which were carried out by the Respondent as indicated in the architects plans were extensions and therefore separate buildings as per Second Schedule Part V Paragraph 24(3)(a) and as such should qualify for investment deduction.**
>
> **3. In the alternative, the Local Committee failed to consider that Part I and V of the Second Schedule of the Income Tax Act do apply to the Respondent as the constructions was not "new" as it was carried out utilizing existing Respondent's premises and which had already been considered for investment deduction when the structures were initially constructed.**
>
> **4. The Local Committee erred in law in failing to uphold the Appellants decision of not considering the Constructions by the Respondent for Investment Deduction as the said constructions do not fall under that category of "separate building".**
>
> **5. The Local Committee erred in law and fact by not considering the Appellants inspection Report of the premises.**
>
> **6. The Local Committee erred in law in construing the meaning of construction in accordance with the Respondent's perspective and failing to consider the Appellant's view.**
>
> **7. The Local Committee erred in law and fact by upholding the Respondent's appeal and to certify that the Respondent qualified for Investment Deduction and Industrial building allowance which is irrational and unjustifiable.**
>
> **8. That the Amended Assessment No.04/2056/93 issued by the Appellant on 7th May 1996 to the Respondent which was subject of the dispute between the Appellant and the Respondent should be upheld.**

3. The facts constituting the Dispute are not involved. Mount Kenya Safari Club Limited (**Mount Kenya**) has run a Hotel business in Nanyuki since 1959. There was an upsurge in demand for hotel rooms and a decision was made to convert certain buildings into 16 additional rooms.

4. On 30th June 1989 and 27th June 1990, Mount Kenya submitted its Tax Returns for the financial years of 1988 and 1989 respectively. In those Returns it claimed an investment deduction and an industrial Building Allowance for the renovations carried out on its premises. On 9th

September 1992, KRA made a Tax assessment in which it decided that Mount Kenya was not entitled to the deduction and allowance sought. A decision that was reversed by the Local Committee.

5. Before probing into the substance of the Appeal, the Court must decide on the propriety of the Notice of Appeal lodged by KRA as Mt. Kenya contends that it was lodged out of time. The argument by Mount Kenya is that parties were notified of the Local Committees decision on 26th April 2000 and KRA was required to notify Mount Kenya of its decision to appeal by 11th May 2000. Instead KRA notified it via a letter written on 12th May 2000 and received by the Respondent on 22nd May 2000. This in the estimation of the Mount Kenya is 10 days late.

6. This objection to the propriety of the Appeal is founded on the provisions of Section 86(2) of the Income Tax Act as it then stood:-

> **"A party to an appeal under subsection (1) of this section or under section 89(1) who is dissatisfied with the decision thereon may appeal to the Court against that decision upon giving notice of appeal to the other party or parties to the original appeal within fifteen days after the date on which a notice of that decision has been served upon him; but an appeal to the Court under this subsection may be made only on a question of law or of mixed law and fact".** *(my emphasis*)

7. KRA makes a simple response to this. It argues that the Respondent have made no submission as to when the decision was issued, that is when the Notice of the Decision of The Local Committee was served upon it (KRA).

8. I would think KRA has a point. The 15 days in Section 86(2) within which an Appellant may give a Notice of Appeal to the Respondent begins to run **after** the date on which a Notice of the impugned decision has been served upon the Appellant. So as to reckon time, the starting point must be the date on which the Notice is served upon a party. There is evidence as to when the Local Committee made its decision (19th April, 2000) and the date of its Notice of the Decision to the parties (26th April, 2000). This is also evidence that KRA issued a Notice of Appeal dated 12th May 2000. This would be within 15 days of 26th April 2000. Whilst Mount Kenya says it was served this Notice on 22nd May 2000, it provides no proof as to when the Notification of the Decision by The Local Committee was served upon KRA. Without that evidence Mount Kenya cannot successfully plead that the Notice of Appeal has been lodged out of time. That does if for that satellite issue.

9. At the core of this Appeal is the interpretation to be ascribed to the provisions of Paragraphs 24(1)(c) and 24 (3)(b) of the 2nd Schedule of the Income Tax Act that was in force as at 1986. These provisions read:-

> **"24.(1)(c) Subject to this schedule, where Capital expenditure is incurred:-**
>
> **a. ……..**
>
> **b. …….**
>
> **c. On construction of a hotel building which is certified as an Industrial Building under paragraph 5(1)(c), there shall be deducted, in computing the gains or profits of the person incurring that expenditure for the year of income in which they were first used (hereafter referred to as 'the year of first use"), either both the building and machinery referred to in subparagraph (a), or both the machinery and, for the purposes of manufacture the part of the building in which that machinery has been installed referred to in subparagraph (b), or the building referred to in subparagraph (c), as the case may be, a deduction referred to as an investment deduction.**
>
> While, **24. (3)(b) for the purposes of this paragraph-**
>
> > **a.,,,,,,,**
> >
> > **b. where an existing building is extended by further construction, the extension shall be treated as a separate building.**
> >
> > **c. ,,,,,,,,,".**

10. It is contended by KRA that for purposes of Income Tax, when a structure of a Hotel is constructed ready for occupation, the owner is allowed Investment Deduction and an Industrial Building Allowance. In addition, that an extension to an existing Hotel Building qualifies for Deduction. However, KRA invited the Court to find that while an extension to a Hotel structure would qualify for investment Deduction, an alteration or modification would not. In this regard the Court was asked to look at the Drawings submitted by Mount Kenya for approval of the construction that was undertaken and find that the construction which involved modification and alterations did not qualify.

11. KRA asserts that the effect of the claim by Mount Kenya was to seek Deductions twice without first seeking the approval of KRA as contemplated by paragraph 5(1)(c).

12. The Respondents submit that the criteria for Deduction on investment should be whether there was a construction done and whether pursuant thereto capital expenditure was incurred. It was submitted that the works carried out involved new materials and new designs. The Court was urged to find that there was nothing to link paragraph 24(3)(b) and paragraph 24(1) (c), and if the Court was to find an ambiguity in the law then it should resolve it in favour of the Tax payer (Commissioner of Income Tax vs. Westmont Power (k) Ltd [2006] eKLR.

13. It was also proposed on behalf of the Respondent, that the meaning of the word construction may be derived from paragraph 1(3) of the 2nd Schedule to the Act. Counsel for the Respondent suggested that the provision read, inter alia, that:-

> **"for the purposes of this paragraph, construction of an industrial building includes the expansion or substantial Renovation or rehabilitation of an Industrial building, but does not include routine maintenance or repair".**

Although I must right away observe that no such provision existed at the time when the assessment was made. These provisions were introduced by an amendment that came later (post 1992).

14. Part v of the 2nd Schedule to the Income Tax is dedicated to Investment Deductions. Paragraph 24 falls under this part. It is under paragraph 24(1)(c) that Mount Kenya benefitted from the Deduction. It then read,

> **"24. (1) Subject to this schedule, where Capital expenditure is incurred:-**
>
> **a. ……..**
>
> **b. …….**
>
> **c. On construction of a hotel building which is certified as an Industrial Building under paragraph 5(1)(c), there shall be deducted, in computing the gains or profits of the person incurring that expenditure for the year of income in which they were first used (hereafter referred to as 'the year of first use"), either both the building and machinery referred to in subparagraph (a), or both the machinery and, for the purposes of manufacture the part of the building in which that machinery has been installed referred to in subparagraph (b), or the building referred to in subparagraph (c), as the case may be, a deduction referred to as an investment deduction".**

15. Paragraph 24(3)(b) then provides that:-

> **"for the purposes of this paragraph-**
>
> **a.,,,,,,,**
>
> **b. where an existing building is extended by further construction, the extension shall be treated as a separate building.**
>
> **c. ,,,,,,,,,**
>
> **d. 'Building' includes any building structure** *(my emphasis)*

KRA asks the Court to find, that in respect to an existing building, only an extension by further construction can be treated as a separate building. Mount Kenya on the other hand asks Court to give regard to paragraph 24(3)(d) which defines building to include any structure.

16. The Law as it stood enabled an Investor to enjoy an Investment Deduction on the construction of a hotel building (which was certified as an Industrial building) in the year of first use of that building. And it does not seem in dispute that the Building that was modified or renovated had been certified as an Industrial Building under the provisions of paragraph 5(1) which reads,

> **"subject to this paragraph, in this schedule, "Industrial building means",**
>
> **a. ……**
>
> **b. …….**
>
> **c. a building which is in use as an hotel or part of an hotel and which the Commissioner has certified to be an industrial building".**

The Rule (paragraph 24) however, recognizes that other than construction of a new hotel, construction can be made to an existing Building which invariably involves incurring capital expenditure. In my view Sub paragraph (3) clarifies the type of construction, other than a new building, which is to benefit from an Investment deduction.

17. The wording of subparagraph (3) which is,

> **"where an existing building is extended by further construction, the extension shall be treated as a separate building", delimits the type of construction, other than a new Construction, which should enjoy from the Deduction.**

18. It has been suggested by Mount Kenya that, if the intention of Parliament is to encourage Investment in the Hotel and Tourism Industry, then this Rule is ambiguous and it should be interpreted in favour of the Tax Payer (Commissioner of Income Tax Supra). It is postulated that there is ambiguity when one gives regard to the meaning of the word construction of an Industrial Building assigned to that word by

paragraph (1) (3) of the 2nd Schedule, (which I have nevertheless observed was none existent then).

19. A plain reading of paragraph 24(2)(b) brooks of no ambiguity, in my view. By expressly setting out what type of Construction is to be treated as a separate building for purposes of Investment Deduction under part v, it restricts the application of the Rule to what is specifically set out. If the intention of the legislation was that extension was just but one category then it would have used such a word as 'include'. In reaching this decision the Court takes a cue from the Court of Appeal in **Mjengo Limited vs. Commissioner of Domestic Tax** [2016] eKLR which approved the following passage in **Dilworth vs. Commissioner of Stamps [1989] A.C 99.**

> **"The word "include" is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is used these words or Phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. But the word "include" is susceptible of another construction, which may become imperative, if the context of the Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words or expressions. It may be equivalent to "mean and include," and in that case it may afford an exhaustive explanation of the meaning which, for the purposes of the Act, must invariably be attached to these words or expressions".**

20. The meaning given by subparagraph 3(b) is complete in respect to what type of construction to an existing building can benefit from the Investment deduction. It is not helpful to import a definition from another part of the statute when subparagraph 3 is the definition section of paragraph 24 on Investment deductions. The Court does not accept the argument by Counsel for Mount Kenya that there is nothing that links paragraph 24(3)(b) to the definition in paragraph 24(1)(c). There is clear nexus because the former clarifies what type of further construction to an existing Building is to benefit from the Deduction granted by the Rule.

21. There will be instances where capital expenditure on substantial renovation or modification may be more (sometimes much more) than capital expenditure on extension of a building and it may seem illogical that such renovation and modification should not benefit in the same way as the extension. However, the language in the provision is unequivocal and this Court need not second guess the intention of the Legislature which expressed itself in clear words. The task of the Local Committee was to apply the law as set out in the statute and not to apply what, in their view, was logical or rational.

22. I revisit an issue, for a moment. In asking the Court to find that the decision of Local Committee as correct, Mount Kenya had sought refuge in what it saw as paragraph 1(3) of Part 1 of The Second Schedule to the Act. At the time the disputed Tax was assessed (years 1988 and 1989), there was no subparagraph 3 to paragraph 1. This was introduced by a subsequent amendment which provided:-

> **"for the purposes of this paragraph, construction of an Industrial Buildings includes the expansion or substantial renovation or rehabilitation of an industrial building, but does not include routine maintenance or repair".**

The meaning ascribed to the word construction was intended to expand the category of construction that would benefit from Deduction on Capital Expenditure. It can be argued that, after the amendment, modification or renovations such as those undertaken by Mount Kenya would fall in the expanded bracket. But this, as submitted by Mr. Ontweka for KRA, reflected a shift in policy rather than the need to clarify an existing Rule.

23. In reaching its Decision, the Local Committee did not give regard to an Inspection carried out by KRA on the renovated premises 11 years after the renovations had been carried out. KRA had criticized this. I think the Local Committee would be entitled to disregard an inspection done so many years after the modification or renovations had been carried out unless there was clear evidence that the modifications or renovations were as they were and unchanged from the time they were carried out. Their evidential value would otherwise be diminished.

24. However, the plans used to carry out the modification were available to both the Local Committee and this Court. The Construction that was carried out was on the basis of the plan. The Construction carried out was modifications and renovations. There is no controversy about that. The Construction did not involve Extension of the existing Building or Buildings. Clearly, then the Local Committee erred in holding that the modifications or renovations were entitled to benefit from the Deductions when they did not fit the definition of Separate Building as provided by paragraph 24(3)(b).

25. The Appeal is for allowing and is hereby allowed with costs. The Decision of The Local Committee made on 19th April, 2000 is hereby quashed.

Dated, Signed and Delivered in Court at Nairobi this 21st day of March, 2018.

F. TUIYOTT

JUDGE

PRESENT;

Chabala h/b Ontweka for Appellant

Odaga for Respondent