



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
COMMERCIAL AND ADMIRALTY DIVISION
INCOME TAX APPEAL NO. 3 OF 2016

BIDCO OIL REFINERIES LIMITED.....APPELLANT

-VERSUS -

THE COMMISSIONER OF INCOME TAX.....RESPONDENT

JUDGEMENT

1. The appeal before me emanates from the decision of the Local Committee dated 18th December 2004.
2. The whole appeal turns on the interpretation of the provisions of Section 4 A of the Income Tax Act, which reads as follows;

“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”.

3. It is the appellant’s position that;

“...all the foreign exchange losses arising out of the foreign exchange differences applicable on the transaction value between the date of the transaction and the date of settlement that it realized during the period covered by the audit were tax deductible?.

4. The respondent agreed with the appellant concerning the need for realization.
5. However, whilst the appellant holds the view that realization may occur through the process in which the tax payer applies the formula provided in Section 4 A of the Income Tax Act, the respondent insists that realization denotes a change in the taxpayer’s economic position.
6. The parties agreed that the following issues fell for determination before me;

“(a) When is an exchange gain or loss realized for tax purposes?

(b) Is conversion the only criteria to be used in determining whether realization has occurred?

(c) Were the losses claimed by the Appellant as deductions realized within the meaning of

Section 4 A and thus rendering the Respondent's case without basis?

(d) Are the provisions of Section 4 A ambiguous, and if so, what is the effect”?

7. It is common ground that the appellant maintains both Foreign Currency Bank Accounts as well as Kenya Shillings Bank Accounts.
8. The appellant confirmed that it has a facility to settle the US Dollars liabilities, using the US Dollar Bank Account. Therefore, when it was necessary to settle the transactions denominated in US Dollars, the appellant did not require to purchase such foreign currency specifically to settle such transactions.
9. However, notwithstanding the absence of actual conversion of the funds from one currency to another, the appellant submitted that provided that a foreign denominated transaction had taken place, and had been affected by currency fluctuations, a gain or loss would have been realized.
10. The parties are in agreement that conversion of foreign exchange is definitely one way through which the gain or loss of foreign exchange may be determined.
11. However, the appellant insisted that conversion was not the only basis of determining the loss or gain of foreign exchange.
12. On the other hand, the respondent insists that it was only when actual conversion of foreign currency happened, that the taxpayer would realize either a loss or a gain.
13. It is correct to point out that the word “*realization*” is not defined in the Income Tax Act. But as the parties, correctly note, a statute cannot be expected to give the definition of all the terms in it.
14. I do share the view of the appellant, that the word “*realize*” is the bedrock of Section 4 A of the Income Tax Act. Therefore, in an ideal situation the said word ought to have been defined.
15. It is the appellant's position the absence of a definition implies that there is a lack of a clear definition, and that therefore results in great ambiguity of the whole of Section 4 A of the Income Tax Act.
16. In principle, the mere fact that an important word or phrase is not defined in the statute does not necessarily render the word or phrase ambiguous.
17. Secondly, the fact that 2 or more parties to a case make submissions which suggest different meanings to a word or a phrase, does not imply that the same was ambiguous.
18. It is an everyday occurrence in the adversarial system of our courts, to have 2 or more parties give their respective submissions, which were calculated to persuade the court about the correctness of their respective interpretations.
19. In this case, the parties are agreed that conversion of foreign currency is definitely one way through which a taxpayer can either make gain or suffer losses. To that extent therefore, there is common ground, which therefore implies that there was no ambiguity.
20. However, the appellant added that translation can also give rise to the realization of losses or gains.
21. Translation is the process undertaken when a company which has foreign activities is incorporating, into its Financial Statements, the foreign currency transactions, which must be expressed in the Reporting Currency. In Kenya, the Reporting Currency is Kenya Shillings.
22. It was the submission of the appellant that even though translation constituted the restatement of the foreign currency transactions into Kenya Shillings, the said process did not involve the actual conversion

of foreign exchange into Kenya Shillings.

23. In a literal sense, translation, if done correctly, should not alter the substance. Therefore if it is a sentence being translated from one language to another, the substance should be relayed; it should not change.

24. Similarly, if a report of a financial transaction is being translated from one Currency into another Currency, the substance ought to be reflected even in the other currency. What I mean is that if there was a profit in Dollars, a proper translation of the transaction should reflect a profit, even if the Reporting Currency was in Kenya Shillings.

25. Therefore, in a literal sense, the “*translation*” from foreign currency to the Kenya Shillings ought not to result in a gain or a loss. However, that is assuming that the entire transactions which are being reported, take place almost simultaneously. In other words, the placing of the orders; the delivery of the goods; and the remittance of payment for the said goods, would need to have taken place almost simultaneously.

26. In the case before me I understand the parties to have acknowledged that the transactions are completed over a period of time.

27. By a letter dated 24th February 1976, the respondent addressed the issue of realization, in a manner which suggests an appreciation that was comparable to translation. This is what it said;

“...you cannot measure with certainty the loss or profit on exchange until the day the payment is made. It follows that the loss can only arise at that point and thus become allowable for tax purposes on that point, and not before. If the order is placed, say in December of year 1 but not paid for until May of year 2, the loss if any, will be allowable in year 2”.

28. In my understanding, that statement does not necessarily imply that if the date of payment was different from the date when the order was made, there would be either a loss or a gain.

29. As expressly stated, it is only when the payment was being made that it could be ascertained whether or not there was a loss or a gain.

30. In the Australian case of **TAXATION RULING No. 93/8**, it was held as follows;

- **“The general principles are as follows: If a foreign exchange gain or loss arises from a liability in a foreign currency, the taxpayer realizes the gain or loss when the liability is discharged by actual or constructive payment. Conversely, if a foreign exchange gain or loss arises from a right to receive foreign currency, the taxpayer realizes the gain or loss on the actual or constructive receipt of payment;**
- **If a taxpayer has a liability in a foreign currency and pays part of that liability, the taxpayer realizes any foreign exchange gain or loss on the amount repaid at the time of the part payment. Similarly, if a taxpayer entitled to receive an amount of foreign currency receives part of that amount, the taxpayer realizes any foreign exchange gain or loss on the amount received at the time the taxpayer receives part payment;**
- **A taxpayer can realize a foreign exchange gain or loss arising from a liability in a foreign currency without outlaying Australian dollars to acquire the relevant currency to satisfy the liability. Similarly, a taxpayer can realize a foreign exchange gain or loss arising from a right to receive foreign currency without converting the amount received to Australian dollars”.**

31. Clearly, therefore, in the Australian experience, a foreign exchange gain or loss may be realized without the taxpayer outlaying Australian dollars to acquire the relevant currency to satisfy the liability in foreign currency. Secondly, the foreign exchange gain or loss may be realized without converting the foreign currency which the taxpayer received.

32. Of course, the Australian decision is not binding on me, however, it does offer a useful guide.

33. I am persuaded that the word “*realization*” is not synonymous with “*conversion*”.

34. I find that Section 4 A does not make it a requirement that the taxpayer should have purchased foreign currency from the local market to meet the foreign currency requirement, as suggested by the respondent.

35. By providing a formula for the calculation of the amount of foreign exchange loss or gain, the statute must be deemed to have intended that taxpayers be guided by the formula. It cannot be correct to assert that;

“the formula of calculating the amount of foreign exchange gain or loss prescribed in Section 4 A of the Act presupposes that a foreign exchange loss or gain or loss has already been realized in the transaction”.

36. I hold the considered view that the application of the prescribed formula is what would lead to the conclusion as to whether or not a gain or a loss had been realized.

37. Through its technical ruling, under the Technical Bulletin for the months of July – September 2006, the respondent provided its explanation and interpretation of Section 4 A, in the following words;

“For an exchange gain or loss to be considered as realized, and therefore allowable, there must be a foreign exchange conversion and not mere translation. It is not just enough that there is a payment. The payment must have actual conversion of the local currency to a foreign currency”.

38. It is noteworthy that the matters in issue in this case, took place between the years 1996 and 1999. Therefore, the respondent’s explanation and interpretation was being made long after the event.

39. Even assuming that the said explanation and interpretation was accurate, it could not be applied retrospectively.

40. In any event, as the explanation and interpretation was provided by one of the 2 parties who were in dispute, it is arguable that it may have been self-serving.

41. Thirdly, the very fact that the respondent deemed it necessary to provide the explanation and interpretation, suggests that the respondent was well aware that there was a need for such explanation and interpretation. If the position was absolutely crystal clear, the respondent would not have needed to offer its technical ruling.

42. By its conduct, the respondent was implying that there was an ambiguity which needed to be cleared up.

43. However, I hold the view that Section 4 A makes it clear that “*realization*”, is not limited to “*conversion*”. I so hold because the said provision provides that;

“The amount of foreign exchange gain or loss shall be calculated in accordance with the difference between (a times r 1) and (a rims r 2) where;

a. is the amount of foreign currency *received, paid or otherwise computed* with respect to a foreign currency asset or liability in the transaction in which the foreign exchange gain or loss is realized;

b.?

- The emphasis is mine.

44. 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.

45. Secondly, the said foreign exchange gain or loss is the amount of foreign currency received, paid or otherwise computed, with regard to a foreign currency asset or liability in the transaction in which the foreign exchange gain or loss is realized.

46. By distinguishing between the acts of payment, receipt and computation, the statute must be deemed to have intended Section 4 A to encompass situations beyond those in which foreign currency was paid or was received.

47. Of course, conversion is a process of computation. But I hold the considered view that there is no legal basis for arguing that conversion is the only process of computation.

48. Therefore, to the extent that the Local Committee held that realization was synonymous with conversion, it erred. I hold that provided the appellant utilized the formula provided by the statute, it cannot be faulted.

49. Accordingly, I allow the appeal, and set aside the decision of the Local Committee.

50. The costs of the appeal are awarded to the appellant.

DATED, SIGNED and DELIVERED at NAIROBI this 16th day of May 2017.

FRED A. OCHIENG

JUDGE

Ruling read in open court in the presence of

Mrs. Kabagi for Mrs. Onchwari for the Appellant

Mrs. Almadi for Ochieng for the Respondent

Collins Odhiambo – Court clerk.