



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT MOMBASA

CIVIL SUIT NO. 60 OF 2013 (INCOME TAX APPEAL)

MOTAKU SHIPPING AGENCIES LIMITED.....APPELLANT

-VERSUS-

THE COMMISSIONER OF INCOME TAX.....RESPONDENT

JUDGMENT

Introduction

1. **MOTAKU SHIPPING AGENCIES LIMITED** (hereinafter “**the Appellant**”) is a limited liability company incorporated in Kenya. It is also a shipping agent registered under the Merchant Shipping Act (No. 4 of 2009).
2. At varying dates ranging from 1st January 1996 to 1st January 2007, the Appellant entered into various **Ship Management Agreements** (hereinafter “**the Agreements**”) with owners of four different vessels under which the Appellant was appointed as manager of the respective vessels. The four vessels were **M.V. TORGELOW**, **M.V. SEMLOW** and **M.V. ROZEN**, all registered in the names of different companies incorporated in the Republic of Liberia and **M.V. MILTZOW**, registered in the name of a company incorporated in the Republic of Panama.
3. Pursuant to the Agreements, the Appellant opened, in its name, a US Dollar **Account Number 8702047506600** with Standard Chartered Bank Kenya Limited, Treasury Square Branch, Mombasa which account was referred to as “**Shipping Resident Account**”. The owners of the vessels remitted various amounts to the Appellant directly into the Shipping Resident Account.
4. In accordance with the Agreements, the Appellant procured for the provision of various services to the vessels whenever they visited the Kenyan Port which services included repairs, service, crew, supplies, surveys and investigations. The services were procured by the Appellant from various suppliers who were based in Kenya and who were paid by the Appellant from the Shipping Resident Account.
5. The Respondent carried out a tax audit of the Appellant's business and on 9th April 2009, issued assessment notices for payment of taxes under various heads which included **Kshs. 1,594,089.00** as withholding tax. The Appellant objected to the assessment of the taxes and appealed to the **Income Tax Local Committee- Mombasa** (“**the Local Committee**”) on the ground that the Respondent had no basis to raise the withholding tax assessments on payments effected by the ship owners who were non-resident persons.

6. The Local Committee on 8th April 2013, informed the Appellant that its appeal on withholding tax had failed. The Appellant then filed this appeal to challenge the decision of the Local Committee.

The Grounds of Appeal

7. The Memorandum of Appeal filed on 22nd May 2013 contained 12 grounds of Appeal. Many of the grounds overlapped. The common thread running through the submissions of the parties and which can be deciphered from the pleadings and the documentation before court is that the grounds of appeal can be condensed into two main grounds:
 - i. **The Local Committee erred in fact and law in failing to find that the Appellant was acting as an agent of and under the express authority of its various principals and the payments in respect of which additional assessment of withholding tax is made were made by the Appellant's principals.**
 - ii. **The Local Committee erred in fact and law in failing to find that the Appellant's principals for purposes of the Income Tax Act, were non-residents and did not have a permanent establishment in Kenya and as such withholding tax was not chargeable on the principals.**

The Appellant's Arguments

8. The Appellant's argument is that pursuant to Section 3 (1) of the Income Tax Act (Cap. 470) of the Laws of Kenya, income tax is charged upon all the income of a person that accrued in or was derived in Kenya.
9. The Appellant therefore argues that it does not matter whether the person who makes the income is, at the relevant time, a resident or non-resident. That the basis of the tax is that the income must accrue in or be derived from Kenya.
10. The Appellant argues that according to Section 10 of the Income Tax Act, any person, whether resident or non-resident, who receives a management or professional fee or training fee from a resident person or a person having permanent establishment in Kenya, is deemed to have received an income which accrued in or derived from Kenya and which is subject to income tax imposed by Section 3 (1) of the Act.
11. The Appellant submits that pursuant to Section 10 of the Act, only payments made by a resident person or a person having a permanent establishment in Kenya are subject to income tax; and not payments made by a non-resident person. The Appellant contends that since it made the payments, the subject of the disputed withholding tax, merely as an agent of the ship owners who were non-residents, the payments were not chargeable to tax. The Appellant therefore concludes that since the payments were made by non-residents, it (the Appellant) was not under obligation as imposed by Section 35 (3) (f) of the Act to deduct the withholding tax.

The Respondent's Arguments

12. The Respondent started by challenging the competence of this appeal.

According to the Respondent, the main ground of this appeal which is that the payments in respect of which the Respondent is demanding withholding tax were not made by the Appellant but by its principals, was neither pleaded nor canvassed at the Tribunal. That since the said ground was not raised before the Tribunal, the same cannot be raised in this appeal. The Respondent submits that Rule 14 of the **Income Tax (Appeals to the High Court) Rules** is clear that the appellant shall not, on appeal, raise an issue which was not raised at the Tribunal level. The Respondent therefore urges that the appeal be disallowed for raising new issues that were not before the Local Committee.

13. On merit, the Respondent submits that Section 10 of the Income Tax Act deems as income payment by every resident person, or a person having permanent establishment in Kenya in respect of the items specified thereunder. That the subject payments were made by the Appellant who is a resident for purposes of the Income Tax Act and therefore the payments are deemed to be income which accrued in or was derived in Kenya and the Appellant was under obligation, pursuant to Section 35 of the Income Tax Act, to withhold and remit to the Respondent a percentage of such payments.
14. The Respondent argues that withholding tax is not tax of the payer but a tax of the person to whom it is paid and the payer merely acts as an agent of the Commissioner for purposes of collection and accounting.

The Issues for Determination

15. The main grounds of appeal have been summarised hereinbefore. In my view, the main issue for the court's determination is whether the subject payments, made by the Appellant to various suppliers who were based in Kenya, should be deemed as income for purposes of Income Tax Act and subjected to withholding tax.

Analysis and Findings

16. I wish to start by addressing the issue raised by the Respondent touching on the competence of this appeal. The Respondent argued that the main and only issue in this appeal is whether the payments in issue were made by the Appellant or by the Appellant's principals, the vessel owners who are non-residents for purposes of income tax hence no withholding tax is payable. The Respondent submits that in accordance with Rule 14 of the Income Tax (Appeals to the High Court) Rules, an issue that was not raised before the Local Committee cannot be raised in an appeal in the High Court.
17. Rule 14 of the Income Tax (Appeals to the High Court) Rule, 1974 provides as follows:

“The appellant shall not, except by leave of the Court and upon such terms as the Court may determine, rely on a ground other than a ground stated in the memorandum of appeal.”

Rule 2 of the Rules defines “memorandum” to mean “a memorandum of appeal presented under rule 3.” Rule 3 provides for form and time of filing an appeal under section 86 (2) of the Income Tax Act which is clearly an appeal to the High Court. Thus, Rule 14 only bars an appellant from relying on a ground that is not contained in the memorandum of appeal to the High Court and not to the Tribunal.

18. Even assuming that the said Rule 14 barred a party from raising an issue that was not canvassed before the Local Committee in the appeal before the High Court, the Memorandum of Appeal filed by the Appellant before the Local Committee clearly contains as grounds the issue of payments by non-resident persons being charged on the company (Appellant) and the question of the withholding tax charged not being in accordance with the Income Tax Act, issues that are very identical to the issues raised in this appeal. The Respondent's attack on the competence of this appeal therefore fails. It is important to also consider the duty of the High Court when considering an appeal against a decision of the Income Tax Local Committee. This was considered by Justice Musinga (as he then was) in the case **COMMISSIONER OF INCOME TAX –Vs- MABATI ROLLING MILLS LTD [2012]eKLR** as follows-

“An appeal to this Court is by way of a retrial and that implies that the appellate Court has jurisdiction to consider whether the decision of the Local Committee was arrived at appropriately or not. The appellate Court can confirm, reduce, increase or annul the assessment concerned or make any other order as it deems fit.”

19. I now move to the main issue for determination. The Appellant's case is that the subject payments were made by the ship owners and that the Appellant was only acting as an agent of the ship owners in making the payments. That the payments should not be subjected to income tax because they were made by the ship owners who are non-residents. The Appellant relied on Section 10 of the Income Tax Act to posit that only payments made by a resident or a person having a permanent establishment in Kenya to any other person are deemed as income which accrued in or was derived in Kenya and should be subjected to income tax. That since the subject payments were made by the ship owners who were non-residents, the same cannot be deemed to be income which accrued or was derived in Kenya to warrant the subsection of the same to withholding tax.

20. The argument put forth by the Appellant seems to me to be two- thronged. One, the Appellant is arguing that the subject payments were made by persons who are non-residents and who are therefore not subject to income tax as imposed by Section 3 (1) of the Income Tax Act. That income tax is only chargeable, for purposes of the Income Tax Act, on payments made by a resident or a person having permanent establishment in Kenya to any other person, and not payments made by non-resident or a person who has no permanent establishment in Kenya. Two, the Appellant seems to be saying that even if the subject payments were chargeable to income tax, the Appellant was not the right person to withhold the tax and remit the same to the Respondent because it was only acting as an agent of disclosed principals.

21. Section 3 (1) of the Income Tax Act provides as follows:

“Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.” (emphasis mine)

22. From section 3 (1) of the Income Tax Act, it is clear that subject to the provisions of the Act, income of a person, whether resident or non-resident, is chargeable to income tax provided the income accrued in or was derived from Kenya. Therefore, income of a person cannot be subject to income tax unless it is income “which accrued in or was derived from Kenya”.

23. The Income Tax Act provides for taxation of various categories of income. For instance, the Act provides for the taxation of income from businesses (Section 4), income from employment (Section 5), income from the use of property (Section 6) and income from management or professional fees, royalties, interest and rents (Section 10).

24. Both parties herein agree that the payments in question were made by the Appellant to various suppliers based in Kenya. They were made in respect of various services to the vessels such as repairs, service, surveys and investigations. The subject payments therefore relate to professional fees and fall under the income described in section 10 of the Income Tax Act. In deed, in its Statement of Fact filed in court on 28th June 2013, the Respondent states that “the payments were deemed to fall under the definition of management and professional fees... The payments were therefore subjected to tax in accordance with Section 10 (a) of the Income Tax Act as read with Section 35 (3) (f) of the Income Tax Act.”

25. Section 10 of the Act provides as follows:

“For the purposes of this Act, where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of -

(a) a management or professional fee or training fee;

(b) a royalty;

(c) interest and deemed interest;

(d) the use of property;

(e) an appearance at, or performance in, a public or private place for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience; or

(f) an activity by way of supporting , assisting or arranging an appearance or performance referred to in paragraph

(e) of this section;

(g) winnings from betting and gaming, the amount thereof shall be deemed to be income which accrued in or was derived from Kenya:

Provided that—

- 1. this section shall not apply unless the payment is incurred in the production of income accrued in or derived from Kenya or in connexion with a business carried on or to be carried on, in whole or in part, in Kenya;**
- 2. this section shall not apply to any such payment made, or purported to be made, by the permanent establishment in Kenya of a non-resident person to that non-resident person.”**
(emphasis mine)

26. In accordance with Section 10 of the Income Tax Act, for a payment for management or professional fee to be deemed to be income which accrued in or was derived from Kenya, that payment must be made by a resident person or a person having a permanent establishment in Kenya and the payment must be incurred in the production of income accrued in or derived from Kenya or in connection with a business carried on or to be carried on, in whole or in part, in Kenya. Only then will such payment be chargeable to income tax as provided for in Section 3 of the Income Tax Act. It appears that if a payment does not satisfy the requirements of section 10 as to accrual in or being derived from Kenya, such income is not chargeable to income tax under Section 3 (1) of the Income Tax Act.

27. **Black's Law Dictionary**, 8th Edition, defines “withholding tax” as **“a portion of income tax that is subtracted from salary, wages, dividends, or other income before the earner receives payment.”**

28. Section 35 of the Income Tax Act provides for deduction of tax from certain income. Of relevance is Section 35 (1) (a) and (3) (f) which provides for subtraction or deduction of income tax from payment in respect of management or professional fee as follows:

“35 (1) Every person shall, upon payment of any amount to any non-resident person not having a permanent establishment in Kenya in respect of—

a. a management or professional fee or training fee except—

- i. a commission paid to a non-resident agent in respect of flowers, fruits or vegetables exported from Kenya and auctioned in any market outside Kenya and audit fees for analysis of maximum residue limits paid to a non-resident laboratory or auditor; or**
- ii. a commission paid by a resident air transport operator to a non-resident agent in order to secure tickets for international travel;**

b)...

c)...

d)...

e)...

f)...

g)...

h)...

which is chargeable to tax deduct therefrom tax at the appropriate non-resident rate.”

“35 (3) A person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya in respect of—

a)...

b)...

c)...

d)...

e)...

ee)...

f) management or professional fee or training fee, the aggregate value of which is twenty-four thousand shillings or more in a month:

Provided that for the purposes of this paragraph, contractual fee within the meaning of “management or Professional fee” shall mean payment for work done in respect of building, civil or engineering works;

g)...

h)...

which is chargeable to tax, deduct therefrom tax at the appropriate resident withholding tax.”

29. Based on the definition in the Black's Law Dictionary, it appears that the Section of the Income Tax Act that makes provision for deduction of withholding tax in respect of payment for management or professional fee is Section 35 (1) (a) and (3) (f) of the Act. It is the said section that provides for deduction or subtraction of a portion of a person's income for management or professional fee before the earner receives payment. The said section provides for withholding tax in respect of payment to both non-resident person not having permanent establishment in Kenya as well as in respect of payment to a person resident or having permanent establishment in Kenya.

30. A cursory reading of Section 35 (1) (a) and (3) (f) cited above shows that all payments in respect of management or professional fee is subject to withholding tax. However, the key phrase in the said provisions is **“which is chargeable to tax”**. That Section stipulates that the deduction is to be made only in instances where the payment is chargeable to tax. In order to establish whether payment for management or professional fee is chargeable to tax, one must fall back to the provisions of Sections 3 (1) and 10 of the Income Tax Act.

31. Section 3 (1) of the Act provides that income tax is only charged upon income which accrued in or was derived from Kenya. Section 10 provides that payment in respect of a management or professional fee is deemed to accrue in or to be derived from Kenya only when the payment is made by a resident person or a person having a permanent establishment in Kenya. There is no provision in the Income Tax Act for taxation of payment in respect of management or professional fee made by a non-resident person not having a permanent establishment in Kenya, even if such payment is made to a person resident or having permanent establishment in Kenya.

32. The Respondent submits that the subject payments should be chargeable to income tax because the same were made to resident persons or persons having permanent establishment in Kenya (the respective Kenyan based suppliers) and were made by the Appellant who is resident person. The Appellant on the other hand submits that it made the payments as an agent of its principals (the respective vessel owners) who are non-resident persons not having permanent establishment in Kenya. That it is the principals who were making the payments and not the Appellant and hence the payments should not be subject to income tax.

33. I have considered the Statements of Fact filed by both the Appellant and the Respondent. From the Statements the following facts are not in dispute:

- **The Appellant had entered into Ship Management Agreements with certain principals who were ship owners pursuant to which the Appellant managed vessels on behalf of the principals and earned monthly management fee and an agency fee each time the vessels docked at the Kenyan Port.**
- **The Appellant maintained account number 8702047506600 with Standard Chartered Bank Kenya Limited referred to as “Shipping Resident Account” which the Appellant used to receive funds from its various principals. The funds in the said account remained the property of the Appellant's principals.**
- **The Appellant made payments to various providers based in Kenya for services incurred in the management of the vessels which payments were made through the Shipping Resident Account.**

34. From the undisputed facts above, it is clear to me that in making the subject payments, the Appellant acted as an agent of the vessel owners. The Appellant sourced for the ship management services on behalf of the vessel owners and paid for the same from an account that was

opened solely to hold funds belonging to the vessel owners.

35. I have looked at the four Ship Management Agreements in issue and they all contain identical Clauses 1 and 2 which are couched in the following terms:

“1.1 The Owners hereby appoint the Manager and the Manager hereby agrees to act as Manager of the Vessel and in that capacity and subject as hereinafter provided the Manager shall have and be entrusted with the management of the Vessel.

2. The services to be performed or rendered by the Manager in its above-mentioned capacity in connection with the Vessel are those usually and customarily performed or rendered by a Manager of a Vessel and shall be carried out as agent for the account and on behalf of the Owners.” (emphasis mine)

36. Clearly, the relationship between the Appellant and the vessel owners was one of an agent and principal. The Respondent, in its Statement of Fact concedes to this agency relationship by recounting the above undisputed facts which demonstrate the existence of the agency relationship. The Respondent states that the said facts disclosing the agency relationship were discovered by its

officers during an audit conducted on the Appellant's documents. The fact that the Appellant made the subject payments on behalf of its principals was clearly documented and cannot therefore be disputed. Since the Appellant made the payments only as an agent, legally, it is the principals (the vessel owners) who made the payments. The question is, should the Appellant have been exempted from deducting income tax from the subject payments simply because the Appellant was an agent of the vessel owners?

37. Rule 2 of the Income Tax (Withholding Tax) Rules, 2001 defines a payer as a **“person who deducts withholding tax for the purposes of these Rules”**.

38. Rule 4 of the same Rules provides as follows:

“A person who makes a payment of, or on account of, any income which is subject to withholding tax shall deduct tax therefrom in the amount specified—

(a) under paragraphs 3 and 5 of Head B of the Third Schedule; and

(b) where the Government of Kenya has double taxation agreement with the Government of another country, in the terms of that agreement:

Provided that the rates of tax under this subrule shall not exceed the rates specified under paragraph (a).

(2) A person who fails to comply with the requirement of subrule (1) commits an offence.”

39. The Income Tax (Withholding Tax) Rules, 2001 mandate a person who makes payment of, or on account of, any income which is subject to withholding tax to deduct tax from the payment at the provided rate. The said Rules do not create a distinction between instances where the payer is an agent and where the payer is the principal himself. In my view, even an agent is under obligation to retain a portion of any payment made to any person on behalf of the principal and to remit the same to Kenya Revenue Authority on account of withholding tax, if the payment is chargeable to income tax. It is worth the emphasis that the obligation is only created where the payment is chargeable to income tax.

40. The Respondent states that the payments in issue were deemed to fall under the definition of management and professional fees and were therefore subject to tax in accordance with section 10 (a) of the Income Tax Act as read with section 35 (3) (f) of the Act. These Sections have been discussed above. They create the obligation to deduct tax from payment for management and professional fee only where the payment is chargeable to tax.

41. As already discussed above, payment for management and professional fee is only chargeable to tax if the same accrued in or was derived from Kenya (Section 3 of the Income Tax Act). A payment in respect of a management or professional fee is deemed to accrue in or to be derived from Kenya only when the payment is made by a resident person or a person having a permanent establishment in Kenya (Section 10 of the Income Tax Act). In my view, since the payments in issue were made by the vessel owners who were non-resident persons not having a permanent establishment in Kenya, the same were not chargeable to income tax even if the payments were made to persons based in Kenya.

42. The Respondent has raised the point that withholding tax under the Income Tax Act is tax of the payee (the person who receives the payment in issue) and that the payer only acts as an agent of the Respondent for purposes of collection and accounting for the tax collected. That the Appellant should have deducted income tax from the payments which were received by resident persons. While I find that argument to be cogent and quite convincing, it appears that the Income Tax Act

does not just impose income tax by reference to the person receiving the payment but also by reference to the person making such payment and the place where the income is deemed to have accrued in or was derived from. All the three reference points- the payer, the payee and the place of accrual or derivation- must be borne in mind in determining whether payment is subject to withholding tax. Thus, in the instant case, although the persons receiving the payments were resident persons for purposes of income tax, the persons making the payments were non-resident persons not having permanent establishment in Kenya who the Income Tax Act does not mandate to retain portions of the payments for purposes of withholding tax.

CONCLUSION

43.It is therefore the judgment of this Court that the Appellant was, therefore, under no obligation to retain portion(s) of the subject payments and to remit the same to the Respondent on account of withholding tax since the Appellant was not the payee for purposes of withholding tax and the payments in question were not subject to income tax under the Income Tax Act.

44.It is also the judgment of this Court that the decision of the Income Tax Committee-Mombasa delivered vide the letter dated 8th April 2013 be and is hereby set aside and is substituted with an order that the Respondent's additional assessment of Withholding Tax due from the Appellant as particularized in the Form 11H.O dated 9th April 2009 be and is hereby annulled.

45.The costs hereof are awarded to the Appellant.

DATED and DELIVERED at MOMBASA this 19TH day of JUNE, 2014.

MARY KASANGO

JUDGE