



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
MILIMANI COMMERCIAL COURTS
COMMERCIAL & ADMIRALTY DIVISION
INCOME TAX APPEAL NO 584 OF 2009

THE COMMISSIONER OF INCOME TAX.....APPELLANT

VERSUS

EQUATOR BOTTLERS LIMITED.....RESPONDENT

JUDGMENT

(Being a judgment against the decision of the Local Committee

for Nairobi North that was delivered on 10th March 2005)

INTRODUCTION

1. It was the Respondent's case that in June 2001, the Respondent who was in the process of manufacturing bottled soda and purchased empty bottles and crates in the sum of Kshs 22/= and Kshs 307/= respectively. When the Appellant audited the Respondent for the year 2000-2001, it emerged that the Respondent had allocated Kshs 12/= out of Kshs 22/= and Kshs 207/= out of Kshs 307/= as expenses for the bottles and crates respectively. It then treated the sum of Kshs 10/= and Kshs 100/= on the bottles and crates respectively as capital expenditure.

2. The effect of this was that the Appellant treated the sum of Kshs 102,788,660/= consisting of Kshs 55,254,837/= and Kshs 49,533,823/= for the bottles and crates respectively as a recurring expense item and not as capital expenditure. The Respondent therefore disallowed this amount and issued a tax assessment No 098520010005 of Kshs 30,884,514/= on 26th May 2003.

3. On 23rd July 2003, the Respondent objected to this assessment. However, the Appellant confirmed the same on 25th June 2004. Whereupon the Respondent issued a notice of intention to appeal against the said assessment on 22nd July 2004. The matter was heard by the Local Committee for Nairobi North (hereinafter referred to as "the Local Committee") and on 9th March 2005, the said Local Committee accepted the Respondent's appeal.

4. Being dissatisfied with the said decision, on 18th April 2005, the Appellant appealed against the same as is provided in Section 86 of the Income Tax Act which provides as follows:-

“ 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 in 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.”

5. The grounds of appeal in the Appellant’s Memorandum of Appeal dated 15th April 2005 and filed on 18th April 2005 were set out as follows:-

a. The Local Committee for Nairobi North erred in law and in fact in failing to take into account that bottles and crates were assets and not stock-in-trade.

b. That the Local Committee erred in law and in fact in failing to take into account that expenditure incurred by the Respondent on bottles and crates was a capital expenditure and not deductible under Section 16 (1) (b) (sic).

c. That the Local Committee erred in law and fact in not examining all the material and evidence presented before it.

6. It therefore sought the following reliefs:-

a. The decision of the Local Committee for Nairobi North made on 10th March 2005 be set aside.

b. The Additional Assessment No 09852001005/4 be set aside.

c. The Respondent was not entitled to the deduction claimed. This appeared to be more of a submission rather than a relief.

d. Costs of and incidental to the Appeal and costs to the Appeal to the Local Committee be awarded to the Appellant.

e. This Honourable Court give other or further relief as it may deem fit to grant.

7. The Respondent filed its Statement dated 16th May 2005 on 18th May 2005. Its written submissions and List of Authorities were both dated 17th September 2012 and filed on 18th September 2012 while its Supplementary List of Documents was dated 30th September 2013 and filed on 1st October 2013.

8. It sought to have the Appellant’s appeal struck out in the first instance for having been served on 29th April 2005 instead of 19th April 2005 as was provided for under the law. Further, it contended that the Local Committee had arrived at a correct finding when it upheld its arguments that the figures of Kshs 10/= and Kshs 100/= on the bottles and crates represented the value of the deposit. It submitted that the bottles and crates were current assets whose value was the lower cost or net realisable value which was consistent with the International Accounting Standards No 2 (hereinafter referred to as “IAS No 2”).

LEGAL ANALYSIS

9. The Respondent attacked the validity and competence of the Appeal herein on three (3) grounds, namely:-

a. THAT the Appellant had filed two (2) appeals.

b. THAT the present appeal related to one (1) assessment which was dated 26th May 2003 for the years of income 2000-2001 but the Appellant had only preferred the appeal with respect to the year of income 2001.

c. THAT the Appellant served it with the Memorandum of Appeal outside the time that was stipulated in Rule 3 of the Income (Appeals to the High Court) Rules.

10. As the question of the competence and validity of the Appellant's appeal went to the very root of the appeal herein, the court found it prudent to determine the issue in the first instance.

11. The Respondent abandoned its submission regarding the filing of two (2) appeals by the Appellant to wit Appeal No 243 of 2005 and Appeal No 244 of 2005 in respect of the years 2000 and 2001 as the latter filed a Notice of Withdrawal on 12th October 2005 in respect of Income Tax Appeal No 243 of 2005. The court will therefore not deal with issue No (a) hereinabove as the same was no longer an issue for determination.

12. Regarding issue No (b) hereinabove, the Respondent had argued that the present appeal was in respect to the year 2001 yet the assessment that was dated 26th May 2003 related to the financial year of income 2000 and 2001. It was its submission that this was an intention to sever the years of income to which the said assessment related. It said that as no application was made to amend pleadings to remedy the error and include the second year of the appeal, this was fatal to the appeal.

13. The Appellant did not submit on this issue in its written submissions. However, in her oral submissions, counsel for the Appellant clarified that the audit covered the years 2000 and 2001, that the assessment was issued in respect of the year of income 2001 and that the appeal was in respect of the year of income 2001.

14. In Paragraph 2.9 of the Statement of Facts, the Appellant was clear that the Respondent was audited for the years 2000-2001. A perusal of the Company Additional Assessment Notice (IT2C) showing the total tax payable in the sum of Kshs 30,884,514/= and Notice of Assessment No 09852001000056 that was issued under Section 85 of the Income Tax Act that were marked "C.I.T. 3" and "C.I.T 4" respectively indicated that the period in question related to year of income 2001.

15. There was no other Company Additional Assessment Notice (IT2C) or Notice of Assessment relating to the year 2000. Indeed, the Respondent did not adduce the same as evidence to persuade this court to find that the present appeal only dealt with the year of income 2001 which was to commence in January 2001 to December 2001.

16. Whilst it was not clear to the court why the Appellant withdrew Appeal No 243 of 2005, and whether or not the same related to the year 2000 as had been alluded to by the Respondent as it did not submit on this issue, the Report and Financial Statements annexed to the Respondent's Statement showed that the assessment was for the year ending 30th June 2001. This meant that the accounting financial year ran from 31st July 2000 – 30th June 2001.

17. It was thus evident that the audit that was conducted by the Appellant was for the years of income 2000-2001. In the absence of any evidence to the contrary, the court finds that the Appellant was correct in referring to the accounting period of year of income as 2001. The court was thus not inclined to strike out the Appeal herein on this ground.

18. As regards issue No (c) above, the Respondent argued that there were two (2) prerequisites of a valid appeal, being filing and service of the same. It argued that the Appellant ought to have sought extension of time to serve the Memorandum of Appeal and because it did not do so, such an Appeal that had been served out of time could not be entertained by the court. They relied on the case of **The Commissioner of Income Tax vs A.Q. East African Tax Cases Case No 43. Kenya – Civil Appeal (Mombasa) No 3 of 1957** in this regard.

19. To buttress its case, the Appellant referred the court to Rule 3 of the Income Tax (Appeals to the High Court) Rules which provides as follows:-

“No appeal shall be filed unless a memorandum of appeal is presented to the Registrar during office hours, and a copy served upon the respondent, within 30 days after the date of service upon the respondent of a notice of appeal under section 86(2) (emphasis court); but where the Court is satisfied that, owing to absence from Kenya, sickness, or other reasonable cause, the appellant was prevented from presenting the memorandum of appeal within that period and that there has been no unreasonable delay on his part, the Court may extend that period.”

20. The Appellant filed its Memorandum of Appeal on 18th April 2005 having issued its Notice of Intention to sue on 18th March 2005. This was within the stipulated period of the thirty (30) days issuance of the said Notice of Intention to appeal under Section 86 (2) of the Income Tax Act. There was therefore no need for the Appellant to have sought extension of lodging the said Memorandum of Appeal. The case of **The Commissioner of Income Tax vs A.Q.** (Supra) was indeed distinguishable from the facts of this case as the bone of contention herein was the period of service.

21. The Appellant averred that it received the Memorandum of Appeal on 29th April 2005 instead of 19th April 2005 as was envisaged in Rule 3 of the Income Tax (Appeals to the High Court) Rules. It said that this was clearly out of the thirty (30) days period that was envisaged therein.

22. Notably, Rule 20 of the Income Tax (Appeals to the High Courts) Rules provides that rules applying to civil suit shall be applicable in Income Tax Appeals in so far as they are not inconsistent with the Income Tax Act service. The said Rule stipulates as follows:-

“The rules determining procedure in civil suits before the Court in so far as those rules relate to recognized agents and advocates, to service, to consolidation, to admissions, to the production, impounding and return of documents, to the summoning and attendance of witnesses, to adjournments, to the examination of witnesses, to affidavits, to judgement and decree, to the execution of decrees, to the attachment of debts, to the death, bankruptcy and marriage of parties, to withdrawal, discontinuance and adjustment, to security for costs, to commissions, to corporations, to trustees, executors and administrators, and to the enlargement of time shall, to the extent to which those rules are not inconsistent with the Act or these Rules, apply to an appeal as if it were a civil suit but, save as provided in these Rules, the procedure relating to civil suits before the Court shall not apply to an appeal.”

23. Under the Order 5 Rule 3 of the Civil Procedure Rules, 2010 it is provided as follows:-

“ Subject to any other written law, where the suit is against a corporation the summons may be served-

- a. on the secretary, director or other principal officer of the corporation; or**
- b. if the process server is unable to find any of the officers of the corporation mentioned in rule 3 (a)-**
 - i. by leaving it at the registered office of the corporation;**
 - ii. by sending it by prepaid registered post**
 - iii. if there is no registered office and no registered postal address of the corporation, by leaving it at the place where the corporation carries on business; or**
 - iv. by sending it by registered post to the last known postal address of the corporation.**

24. The Appellant did not submit on the issue of how it effected service upon by the Respondent. It did

not explain why it did not serve the Respondent at its registered office. However, bearing in mind the provisions of Rule 20 of the Income Tax (Appeals to High Court) Rules on service against the backdrop of the provisions of Order 5 Rule 3 of the Civil Procedure Rules, the court was of the view that there was nothing in the said Rules that prevented the Appellant from serving the Respondent with the Memorandum of Appeal by way of registered mail.

25. Going further, the Respondent did not attach a copy of the envelope in which it received the Memorandum of Appeal in its Statement. It had, however, annexed an illegible copy of an envelope in its Chamber Summons application that was dated 16th May 2005 and filed on 18th May 2005 in which a determination was to be made by Mutungi J (as he then was) on 10th May 2006. The ruling of the said application was never rendered and the parties appeared to have abandoned the same when they opted to proceed with the hearing of the Appeal herein. The court is therefore unable to attach any weight to the contents on the face of the said envelope.

26. Be that as it may, the time of service is ordinarily calculated from the date when court process is posted by registered mail and not from the date when a recipient received the same. Indeed, the lawmakers would not have intended that service was to be the date a recipient received the court process for the reason that a recipient could deliberately refuse to collect of court process and then turn around and alleged that he had received the same out of time.

27. Accordingly, in the absence of any tangible evidence detailing when the said Memorandum of Appeal was served, it was difficult for the court to authoritatively determine that the same was served out of time. The court was thus not persuaded by the Respondent's submissions that the Appeal herein should be struck out on the ground that the Memorandum of Appeal had been served out of time.

28. In any event, the court would have found it difficult to have dismissed an appeal which had been validly lodged just because service was late. Indeed, if the court has power to extend time for lodging an appeal, nothing would have prevented this court from extending the period of service. The courts are now enjoined by Article 159 (2) (d) to determine matters without undue regard to technicalities.

29. Turning to the substantive issues, the court noted that in its Memorandum of Appeal, the Appellant had sought to have Additional Assessment No 09852001005/4 confirmed. This was erroneous as the Assessment No was in fact 098520010005/4. As the Appellant did not amend its pleadings, the court would not confirm an Assessment that was non-existent. The court therefore restricted itself to Prayer Nos (1), (3), (4) and (5) of the Appellant's Memorandum of Appeal.

30. The court found the decision of the Local Committee to have been in substance wanting. The reasons which formed the basis of its decision were not given making it difficult for the court to analyse the same. In its decision of 10th March 2005, the Clerk to the Local Committee merely stated as follows:-

“At a meeting held on 9th March 2005, the Local Committee made the following decision in your case.

Appeal case accepted.”

31. The court found itself groping in the dark as failure by the Local Committee to give the reasons, put it in a situation where it was being forced to hear and determine the case afresh with no material before it. Doing the best that it could, the court established that the issue for determination was whether the sum of Kshs 12/= and Kshs 207/= for bottles and crates respectively were an expenditure of a recurrent nature or assets that were held by the Respondent as capital.

32. In this regard, the Appellant submitted that by deducting the aforesaid amounts, the Respondent was purporting to have sold the containers, with the soda in it, which it did not. It relied on the cases of **Sun Newspapers Limited vs Federal Commissioner of Taxation (938) IT CA 73; (1938) 61 CLR 337** , **New Precision (India) PVT Limited vs Commissioner of Income Tax** and **Assam Bengal Cement Co**

Limited vs The Commissioner of Income Tax West Bengal 1955 AIR 89, 1955 SCR (1) 876 in support of its case.

33. On its part, the Respondent contended that the aforesaid deductions were allowable as they were wholly and exclusively incurred in the production of income as was stipulated in Section 16 as read with Section 15 of the Income Tax Act and were not capital expenditure. It argued that the bottles and crates were revenue expenditure.

34. It referred the court to the case of The Commissioner of Income Tax vs B.G. Limited [East African Tax Case] Case No 74 in which the court therein found that expenses incurred in payment of rates and rent during the construction of a building was revenue expenditure.

35. They also placed reliance on the definition of capital expenditure in the Halsbury's Laws of England (the citation was not given) which was that:-

“ A payment which is the price of acquisition of a fixed capital asset of the business if a capital payment and is not deductible in ascertaining the profits.”

36. The said bottles and crates could not be deemed to be capital expenditure as is demonstrated in Black's Law Dictionary Free Legal Online Legal Dictionary 2nd Edition in which capital expenditure has been defined as follows:-

“A capital expenditure is incurred when a business spends money either to buy fixed assets or to add value of an existing fixed asset with a useful life beyond the taxable year.”

37. As was stated by Lush J at page 37 in the case of Hancock vs General Reversionary and Investment Company (1919) I K.B. 25 :-

“... the proper test to apply is this; was the expenditure incurred in order to meet a continuing business demand, in which case it should be treated as an ordinary business expense and an admissible deduction or was it an expenditure incurred once and for all in which case it should be treated as capital outlay...”

38. Indeed, in the case of Assam Bengal Cement Co Limited vs The Commissioner of Income Tax West Bengal (Supra), the court was clear on what an outlay was when it stated as follows:-

“Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for substantial replacement of equipment...”

39. In the same case, the court observed as follows:-

“...Expenditure may be treated as properly attributable to capital when it is made only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade... the expression of once and for all... is used to denote an expenditure which is made once and for all for procuring an enduring benefit to the business as distinguished from a recurring expenditure in the nature of operational expenses... The expressions “enduring benefit” or of a permanent character” were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset...”

40. The court has carefully considered the arguments by the parties and agrees with the Respondent that as bottles and crates were interchangeable between bottlers, they could not be referred to as capital expenditure as the Respondent did not acquire the same. The said bottles and crates were neither fixed assets nor did belong to the Respondent.

41. Once the said bottles and crates left the Respondent's hands, there was no guarantee that they would come back to it possession for the reason that they could break or be retained by customers. Additionally,

it would be impossible to identify which bottles and crates belonged to the Respondent and not to other bottlers as they had no peculiar marks. In the unlikely event a bottle or crate came back to the Respondent's possession, it would lead to taxation over and above the first taxation creating an absurd situation. In other words, it could lead to double or more than double taxation of the same item to the detriment of the Respondent's business, which would be unjust and unlawful.

42. Clearly, the Appellant did not demonstrate that the bottles and crates were made for initiation of business, for extension of business or were a substantial replacement of equipment. The court thus rejected the Appellant's submission that the sums of Kshs 10/= and Kshs 207/= for bottles and crates were an outlay but that they were instead recurring operational expenses for purposes of making an income.

43. Indeed, it was necessary for the Respondent to incur a cost for the bottle to make an income as sodas would have to be bottled. The deduction of the sum of Kshs 10/= and Kshs 100/= thus fell squarely under the provisions of Section 16 (1)(b) of the Income Tax Act.

44. Accordingly, having considered the parties' pleadings and oral and written submissions, the court was not satisfied that the Appellant had demonstrated that the Local Committee had come to an incorrect finding regarding the bottles and crates in question. The court finds that the Respondent was entitled to the deduction that had been claimed by the Appellant in their Company Additional Assessment Notice (IT2C) showing the total tax payable in the sum of Kshs 30,884,514/= as was set out in the Notice of Assessment No 09852001000056.

DISPOSITION

45. The upshot of this court's judgment is that the Appellant's Appeal that was lodged on 15th April 2005 and filed on 18th April 2005 was not merited. Notably, the Appellant did not present to the court any submissions or proof that the Local Committee erred in law and in fact not examining all the material and evidence that was presented before it. For the foregoing reasons, all the grounds of Appellant's Memorandum of Appeal were not successful. Accordingly, the Appellant's Appeal is hereby dismissed with costs to the Respondent.

46. It is so ordered.

DATED and DELIVERED at NAIROBI this 11TH day of DECEMBER, 2014

J. KAMAU

JUDGE