REPUBLIC OF KENYA

High Court at Nairobi (Nairobi Law Courts)

Commercial Civil Case 1 of 2011

MJENGO LIMITED……..……..……....……. APPELLANT

VERSUS

COMMISSIONER OF INCOME TAX …….……..…..…RESPONDENT

(An appeal from the decision of the Local Committee for Nairobi Area made on 9th December 2010)

JUDGMENT

FACTS GIVING RISE TO THE APPEAL

1. This appeal arises from the decision of the Nairobi Income Tax Local Committee dated 25th November, 2010 but delivered on 9th December, 2010. The appellant is a limited liability company incorporated in Kenya. In its statement of facts, the appellant stated that it imports **"partly manufactured rice and then processes it by cleaning, sorting, sizing, chemical treatment (fumigation) for preservation, branding and packaging".**

2. The respondent is charged, under the **Kenya Revenue Authority Act**, with the responsibility of assessing and collecting taxes levied under the provisions of the **Income Tax Act**, hereinafter referred to as "**the Act**".

3. The respondent carried out an audit of the appellant's business and observed that the appellant imports and packages rice for sale. The appellant had claimed industrial building allowance which was disallowed by the respondent on the basis that the appellant was not carrying on the basis of a manufacturer.

4. Consequently, the respondent raised Tax Assessment No. 0305200600073 in respect of the year of income 2006.

5. In its memorandum of appeal, the appellant stated that it had erred in claiming industrial building allowance and the proper deduction ought to have been Investment Deduction and that the respondent had erred in not allowing the same.

6. The Local Committee was called upon to determine whether or not the appellant was a manufacturer within the meaning of the **Act** and therefore entitled to Investment Deduction which is granted to manufacturing firms only.

7. The appellant contended that it is a manufacturing firm as it is registered by the Kenya Bureau of Standards as a manufacturer and also pays the relevant levies as demanded of manufacturing firms.

8. Upon consideration of all the evidence and submissions made before it, the Local Committee held that the appellant was not a manufacturer as defined under the Act. The Committee further noted that cleaning and re-packaging of rice does not constitute manufacturing since the appellant started with rice and ended up with rice, albeit in smaller packages for the convenience of consumers.

9. The Committee further contended that the fact that the appellant is registered by the Kenya Bureau of Standards as a manufacturing firm does not make the company a manufacturing firm under the **Income Tax Act.**

THE APPEAL

10. The appellant was dissatisfied with the findings of the Local Committee and preferred an appeal to this court. The memorandum of appeal consisted of several grounds, the major ones being:

(a) That the Local Committee erred in law and in fact in holding that the appellant is not a manufacturer within the meaning of the Income Tax Act.

(b) That the Local Committee misdirected itself in arriving at its decision by proceeding on the erroneous premise that the appellant's process was not "manufacture" solely because "the appellant starts with rice and ends up with rice albeit in smaller packages for the convenience of consumers".

(c) The Local Committee failed to appreciate that the process of cleaning, sorting, sizing, chemical treatment (fumigation) for preservation, branding and packaging of the rice are all rightfully part of manufacture as defined under the Income Tax Act.

APPELLANT'S STATEMENT OF FACTS

11. Pursuant to the provisions of **Rule 5** of the **Income Tax, (Appeal to the High Court) Rules**, the appellant filed its statement of facts and reiterated the nature of its business. The resultant rice product is of a different form, quality and property, the appellant alleged.

12. The appellant further stated that it was registered as a manufacturer by the Kenya Bureau of Standards on 17th September, 2002 and since then has dutifully paid Standards Levy to the Kenya Revenue Authority.

13. In the year of income 2006 the appellant bought new machinery worth Kshs.1,513,752/= and a building to be used for rice processing worth Kshs.14,367,518/= and sought to deduct that expenditure from its gains and profits as Investment Deduction as provided under paragraph 24 of the **Second Schedule** to the **Income Tax Act**. The deduction was however disallowed by the respondent for the reason that **"there was no making of any goods or any activity that could be construed to be manufacturing".**

PARTIES' SUBMISSIONS

14. The parties filed their respective submissions and both **Mr. Kashindi** for the appellant and **Mr. Matuku** for the respondent highlighted the same.

15. The appellant submitted that under the **Income Tax Act** manufacture is defined thus:

"Manufacture means making (including packaging) of goods or materials from raw or partly manufactured materials or other goods, or the generation of electrical energy for supply to the

national grid or the transformation and distribution of electricity through the national grid but does not extend to any activities which are ancillary to manufacture, such as design, storage, transport or administration".

He stated that the word "**include**" and "**including**" are phrases of extension and not of restrictive definition and the same are not equivalent to using the phrase "**means**".

16. He cited the case of **DILWORTH vs. COMMISSIONER OF STAMPS [1899] AC 99 at pages 105 and 106,** where the court observed:

"The word "include" is very generally used in the interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so 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 merely employed for the purpose of adding to the natural significance of the words or expressions defined."

17. A similar holding as above was also pronounced by the court in **REYLODS vs. INCOME TAX COMMISSIONER FOR TRINIDAD AND TOBAGO [1966] 1 WLR 1**, where it was stated that the word "**including**" is generally used in statutes to enlarge the meaning of the preceding words.

18. Mr. Kashindi submitted that the proper way to interpret the word "**manufacture**" in this appeal would be to enlarge its meaning to include other processes and activities that would not ordinarily be regarded as "**manufacture**" within the meaning which the word ordinarily bears.

19. Further, counsel submitted, the definition of "**manufacture**" in the Act is open to several interpretations. The definition may be construed to mean:

(i) That packaging, where it occurs alone, amounts to manufacture.

(ii) That "manufacture" means making and includes packaging, processing, cleaning and grading of rice.

20. Counsel further submitted that in interpreting tax statutes there is no room for intendment and the rule of strict construction applies. It is also an established principle that where the meaning of statute is in doubt the ambiguity must be construed in favour of the tax payer, he added. Further, it is also an established principle that an exemption from tax or a benefit to a tax payer cannot be removed except by clear words to achieve that purpose.

21. On the other hand, the respondent submitted that the appellant's premises had been inspected and it was established that there was no manufacturing taking place at all. There was no making of any goods or any activity that could be construed to be manufacturing.

22. Mr. Matuku further submitted that packaging alone cannot amount to manufacture. In his view, packaging as used in the definition of "manufacture" under the **Income Tax Act** cannot be read in isolation from the work of "**making**". For packaging to qualify for Investment Deduction it must be part of the "making" process subsequent to which the goods will be packaged but not as a standalone activity. Counsel cited Justice G.P. Singh in **PRINCIPLES OF STATUTORY INTERPRETATION**, 7th Edition at page 142 and 143 where the author states as follows:

"The Legislature has power to define a word even artificially. So the definition of a word in the definition section may either be restrictive of its ordinary meaning or it may be extensive of the same. When a word is defined to mean "such and such", the definition is prima facie restrictive and exhaustive; whereas the word defined is declared to "include" such and such, the definition is prima facie extensive. ……A definition which defines a word to mean A and to include B and C

cannot in its application be construed to exclude A and to include only B and C."

23. Regarding the appellant's registration as a manufacturer by the **Kenya Bureau of Standards** under the **Standards Act**, Mr. Matuku submitted that such registration is only for the purposes of collection of the Standards Levy and cannot be a guiding point as to whether the appellant qualifies for Investment Deduction under the Income Tax Act. The two statutes were legislated for different purposes.

24. Counsel cited the case of **COMMISSIONER OF INCOME TAX VS. KENYA SEED COMPANY LIMITED**, **High Court Income Tax Appeal No. 284 of 1986 (unreported**), where the issue of what amounts to "manufacture" in the preparation of farm produce into seeds for planting was considered. The court held:

"From the above evidence, I find that the process through which the seed goes, a process which involves selection, drying the seed at a controlled temperature, shelling, grading the seed, sizing the same and chemically treating it are processes which change the state of the raw or ordinary seed to a marketable seed for planting, and this, in my considered opinion, fall within the definition of the manufacturing process."

In the instant case, Mr. Matuku stated, the machine that was acquired by the appellant only performs the work of sizing and sealing the packages. It does not perform the function of cleaning and sorting and further, there is no fumigation which takes place in the packaging process.

DERMINATION

25. Although counsel for the parties raised several issues for determination, I think the main issue that was before the Local Committee and which now falls for determination, was whether a machine used for weighing (sizing) and sealing packets of rice can qualify for Investment Deduction as provided for under paragraph 24 of **Part (V)** of the **Second Schedule** to the **Income Tax Act.**Under that paragraph Investment Deduction is claimable by tax payers who are engaged in manufacture and who use machine and buildings for which the Investment Deduction is claimed for manufacturing process. The paragraph states as hereunder:

"24. (1) Subject to this schedule, where capital expenditure is incurred-

(a) on the construction of a building and on the purchase and installation therein of new machinery, and the owner of that machinery, being also the owner or lessee of the building, uses that machinery in that building for the purposes of manufacture; or

(b) on the purchase and installation of new machinery in a part of a building other than a building or part thereof previously used for the purpose of manufacture, and

i) the owner of the new machinery subsequently uses that machinery in that building for the purposes of manufacture; and

ii) the machinery has not been installed substantially in replacement of machinery previously in use in an existing business carried on by the owner of that new machinery

c) …..
dd)….
e) ….

there shall be deducted, in computing gains or profits of the person incurring that expenditure for the year of income in which they were first used (hereinafter referred to as "the year of first use)" either both the building and machinery referred to in sub-paragraph (a) or both the machinery and, for the purpose of manufacture, the part of the building in which that machinery has been installed referred to in sub-paragraph (b), or the building referred to in sub-paragraph (c),

provided that, prior to its being used for manufacture after its completion, it has been used for no other purpose, or the machinery referred to in sub-paragraph (d) or (dd) or the building referred to in sub-paragraph (e), as the case may be, a deduction referred to as an investment deduction".

26. I have already stated the definition of the word "**manufacture**" under the **Income Tax Act**. Although in its statement of facts the appellant alleged that it is involved in the importation of **"partly manufactured rice",** it is not clear to the court what that means. Rice is not manufactured, it is grown. The respondent contended that he had inspected the appellant's premises and ascertained that there was no manufacturing that was taking place at all. I have no reason to doubt that. The machine in question was being used for sizing and packaging rice only and such packaging alone did not amount to "manufacture.

27. For purchase of new machinery to qualify for Investment Deduction under the **Act,** that machinery must be used for the purposes of manufacture as defined under the **Act**.

28. Even if packaging of rice were to be construed to include manufacture as contended by the appellant, I do not agree that the appellant was making or packaging anything from raw or partly manufactured materials. The appellant imports rice, which is neither raw nor partly manufactured material, then processes, cleans and packages the same. That cannot amount to "**manufacture**" under the **Act.**

29. The fact that the appellant is registered as a manufacturer under the Standards Act and thus pays Standards Levy does not qualify it to be a manufacturer under the Income Tax Act. The Standards Act defines a manufacture to include **"process, treat, install, test, operate and use".**

30. I agree with the appellant that the **Standards Act** and the **Income Tax Act** were enacted for totally different purposes and the word "**manufacture**" must be read in the context of each of the two Acts.

31. Having come to that conclusion, this appeal must be dismissed, which I hereby do. The finding by the Local Committee is upheld. The appellant shall bear the costs of the appeal.

WRITTEN AND SIGNED BY JUSTICE D. MUSINGA

DATED, DELIVERED AND COUNTERSIGNED ON THIS 25TH DAY OF JANUARY, 2013 BY THE HONOURABLE JUSTICE G.K. KIMONDO FOR AND ON BEHALF OF JUSTICE D. MUSINGA, PURSUANT TO THE PROVISIONS OF ORDER 21 RULE 3 (2) OF THE CIVIL PROCEDURE RULES.

SIGNED:

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