REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA
AT NAIROBI (NAIROBI LAW COURTS)

Income Tax Appeal 626 of 2002

COMMISSIONER OF INCOME TAX ……..……...…… APPELLANT

VERSUS

WESTMONT POWER (K) LTD ……..…… RESPONDENT

(An Appeal from the decision of the Local Committee for Nairobi South dated 20th September, 2002. Additional assessment No. 09851998000084 Year of Income 1998)

JUDGMENT

These are two appeals brought under Rule 4 of the Income Tax (Appeals to the High Court) Rules. Although there is no formal order on record that the two appeals be consolidated, they both relate to similar facts and are both concerned with the same legal question. They also involve the same parties. The appeals have been conducted simultaneously and the contending parties have proceeded in a manner to suggest that the two had been consolidated. The pleadings, authorities and submissions in both were the same except for minor differences relating to matters of detail which are not important to the decision of the appeals. For those reasons and any other that may emerge later, I have decided to write one Judgment for both appeals and the decision herein will apply to both equally.

Before I embark on the issues raised in the appeals, here is a recapitulation of the facts.

As the name shows, the Appellant is the Commissioner of Income Tax. The Respondent on its part is a limited liability company engaged in the production of electric power in our Republic. To enable it do its business, the Respondent imported two barges for fuel storage and power generation. Now, this is where the problem arose. According to law, a tax payer was entitled in certain circumstances to claim what was referred to as "Investment Deduction Allowance" and to be granted what was referred to as "wear and tear deduction". This is considered later. So when the Respondent declared its tax liability in 1997 it claimed an Investment Deduction Allowance of Kshs.1,534,415,670/= and Wear and Tear Allowance – the same as Wear and Tear Deduction of Kshs.123,955,759/=. This resulted in a Declared Income loss of K£80,630,238/= which is equal to Kshs.1,612,606,560/= on the basis of the barges it had imported. The claims were rejected by the Appellant which upon reassessment revised the Respondent's income loss as K£1,539,566/= which is equal to Kshs.30,791,320/=. The reason given by the Appellant for the rejection was that during the years in issue, the purpose for the importation of the barges was not covered by the circumstances which would entitle the Respondent to make the claims. The Respondent was aggrieved by the decision of the Appellant and following interim procedures appealed to the relevant Local Committee involved in the matter pursuant to the provisions of Section 86 (1) (b) of the Income Tax Act (Cap 470). The basis of the appeals to the Committee were as follows:

"***1. The Respondent (The Appellant in this appeal) has erred by refusing to accept … (the) claim for investment deduction on construction of an industrial building, purchase and installation of plant and machinery used for purpose of manufacture as provided under paragraph 24 of the second schedule of the Income Tax Act.***

2. The Respondent has erred by refusing to grant … (the Respondent in this Appeal) wear and tear deduction on Plant and Machinery as provided under paragraph 7 (1) and 8 (I) (ii) of the second schedule of the Act.

3. The Respondent has erred by reducing … (the Respondent's – the one before me) adjusted loss for the year to K£1,539,566".

The Committee found in favour of the Respondent as follows:

"**1. Generation of power has always been a manufacturing process.**

2. Barges carry the function of premises and should be defined as such".

The Appellant was aggrieved by the decision of the Committee and lodged the present appeals. The Appeals are based on the same Grounds which were set out in the Memoranda of Appeals as follows:

"***1. The Local Committee for Nairobi South erred in Law and in fact in holding that generation of power has always been a manufacturing process even prior to the amendment contained in the Finance Act 2001.***

2. The Local Committee for Nairobi South erred in Law and in fact in failing to take into account that prior to 2001 generation of power was not a manufacturing process and the same became a manufacturing process after the amendment of Paragraph 24 of the Second Schedule to the Income Tax Act vide Finance Act 2001.

3. The Local Committee's ruling is bad in law in that it did not "confirm, reduce, increase or annul" the Appellant's assessment as is required under Section 87 (2) (c) of the Income Tax Act.

4. The Local Committee erred in Law by relying on dubious, unverified evidence, material and case Law from countries with different Legislations and experiences as relates to generation of power as presented by the Respondent.

Pursuant to Rule 5 of the Income Tax (Appeals to High Court) Rules, the Appellant attaches:

(a) A copy of the Notice of the Local Committee decision dated 20th September, 2002 marked "A".

(b) A copy of the Notice of Intention to Appeal to the High Court dated 2nd October, 2002 marked "B".

(c) Statement of Facts marked "C"."

The controversy in the above assessments affected the years 1997 and 1998. So one appeal relates to one year while the other to the next year. However, only one decision is necessary to resolve the disputes in both appeals.

The parties are in agreement as to the issues in dispute. There are two issues. The first one is whether power generation amounted to power manufacture and the second one is whether a barge carries the functions of premises. If the answer to both is yes, then the Respondent would be entitled to make the claims in issue and result in the appeals being refused.

The parties filed and relied upon written submissions. According to the Appellant, power generation did

not, until the year 2001, amount to manufacturing and that a barge did not carry the functions of premises to qualify for wear and tear deduction.

The relevant provisions of law which relate to the disputes in the appeals are set out in paragraphs 7 (1) Part II and 24 (1) (a) and (d) of Part V of the Second Schedule to Cap 470. I will reproduce those Provisions:

Paragraph 7 (1) of Part II of the Second Schedule provides as follows:

"***Subject to this part; where, during a year of income, machinery owned by a person is used by him for the purpose of his business, there shall be made in computing his gains or profits for that year of income a deduction (in this part referred to as "wear and tear deduction")".***

Paragraph 24 (1) (a) and (d) on its part provides as follows:

"***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 that building, uses that machinery in that building for the purposes of manufacture; or

(d) On or after 1st January, 1992 on the purchase and installation of machinery to be used for the purpose of manufacture; or otherwise setting up the machinery for use as may be appropriate for the type of machine …

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 … a deduction referred to as investment deduction".

First things first. Although the Appellant appeared to suggest in its appeal that there was also a dispute on the status of the barges, this is not borne out in the Memoranda of Appeals. In fact, in its written submissions, the Appellant only made a passing reference to that aspect of the case but did not tell the Court how it was aggrieved by it and in what manner it sought to fault the Committee's decision on it. It is not surprising, therefore, that the Respondent did not make any submission on that question: The reason is simply because it was not part of the appeals and was therefore a minor issue to begin with.

Another part which needs to be put out of the way immediately relates to what I consider to be a technical objection to the decision of the Committee and that is captured in Ground No. 3 of the Appeals. This objection is, in my view, spurious and a red herring. It is pedantic and not helpful to the resolution of the real contest between the parties. It is quite obvious that the Committee overturned the decision of the Appellant. The effect of that was that the Appellant's decision was annulled. In the written submissions filed on behalf of the Appellant, his Counsel did not refer me to any authority on the consequence of the Committee failing to specifically say that it had annulled the decision of the Appellant. This court like all other judicial tribunals deliberating on disputes before it is concerned with the substance and merits of a decision and not its technical points. I was not told nor is there any evidence that the Appellant has suffered substantial injustice as a result of the alleged default if indeed it is one. The objection based on that ground must and is hereby rejected.

If I may, let me now go to what I consider to be the main point for decision. It is simply this: did the generation of electricity during the period in question constitute or amount to "manufacturing" to entitle the Respondent the claims for Investment deductions?

The parties are not in dispute as to what amounts to manufacturing as concerns the matters in controversy. In fact, that is understandably so since the same is not without an independent definition. The word "manufacture" for the purposes of the matters raised in the appeals was defined as follows in paragraph 24 (3) (e) of the Second Schedule of Cap 470:

"***The making (including packaging) of goods or materials or other goods but does not extend to any activities which are ancillary to manufacture, such as design, storage, transport or administration".***

If I understood the contesting parties well, Counsel for the Appellant took the position that the provisions of that paragraph ought to be interpreted strictly so that since it did not specifically mention generation of electricity, the same should not be included in the definition of the word manufacture. The Respondent's Counsel on the other hand argued that the Court ought to give a purposeful interpretation to the Act saying that although there was no specific mention of the word power generation in the definition, the same was in fact to be so included.

The Appellant's Advocate did not cite any judicial authority to support his proposition. The Respondent's Advocate on his part gave a detailed illustration of the process of electric power generation to support the fact that the same amounted to manufacturing. In her submission, it was said that the fuel barge stores fuel which was the raw material for the generation of electrical power. During what was said to be normal operation of the Plant, fuel is transferred from the service tank in the fuel barge by a forwarding pump to the power barge through interconnecting hoses and pipes, into the main pump on the power barge. The process goes on, leading to combustion, leading to a "fuel to electricity conversion". Referring to ***Commissioner of General Income Tax vs Power Ltd (1970) E A 328*** which stipulated that "the verb manufacture may within certain limits, have different meanings according to the context in which it is used, but in almost every sense it must mean to produce something", she urged the Court to find that power generation was a manufacturing process. Counsel also referred to certain commonwealth decisions which suggested that electricity was something that could be "made". (***In the Matter of an Application for a Patent by Henry Barnato Rartzen Patents Appeal Tribunal, United Kingdom***) and that it was "goods" (***State Electricity Commission of Victoria vs Commissioner of Taxation (1999) FCA***; and ***Quebec Hydro-Electric Commission vs Deputy Minister of National Revenue***) she argued the definition given to the word manufacture in the Act should be interpreted without more restriction other than that specified in it. If, she argued, there was any ambiguity, that should be interpreted in favour of the tax payer. For this proposition, she referred to the case of ***Commissioner of Inland Revenue vs Scottish Central Electricity Power Company (1931) 15 TC 761*** where the Court said as follows at page 790.

"**But in a taxing Act, I venture to think that it would be contrary to all principle to seek for an implication against a tax payer".**

For good measure, the Respondent's Counsel argued that when Parliament amended the law under consideration to include generation of electricity as manufacture, it was moving to clarify what was envisaged even before.

I have considered all the positions presented by the contending parties and I am persuaded to agree with the submissions proffered by the Respondent's Counsel.

Even though taxation is acceptable and even essential in democratic societies, taxation laws that have the effect of depriving citizens of their property by imposing pecuniary burdens resulting also in penal consequences must be interpreted with great caution. In this respect, it is paramount that their provisions must be express and clear so as to leave no room for ambiguity. Following the ***Inland Revenue vs Scottish Central Electricity Company case***, any ambiguity in such a law must be resolved in favour of the taxpayer and not the Public Revenue Authorities which are responsible for their implementation. That aside, it is quite evident from the explanation advanced that electric power generation is a process that amounts to what is defined in the Act as a manufacturing process since it involves the conversion of one thing into another which is desired for consumption. I agree that in this regard a purposeful interpretation must be adopted if one is to appreciate the purpose of the exemption contemplated in these matters. This position must have been the reason why it was subsequently found necessary to amend the law to include generation of electric power in the definition of the word "manufacture".

The Appellant's Counsel did not assail the foreign decisions cited on behalf by the Respondent's Counsel on substance save to make a general statement without elaboration that the position here was different.

Whether that is so or not, I am convinced that the foreign authorities alluded to are persuasive and I will be guided by the same.

In the result, I am left with no option but to dismiss the two appeals which I hereby do with costs to the Respondent.

Dated and delivered at Nairobi this 30 day of January 2006.

ALNASHIR VISRAM

JUDGE