Commissioner of Domestic Taxes v Societe De Maintenance Petroliere (SMP) Kenya Branch (Tax Appeal E137 of 2020) [2023] KEHC 2427 (KLR) (Commercial and Tax) (22 March 2023) (Judgment)

Neutral citation: [2023] KEHC 2427 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

TAX APPEAL E137 OF 2020

DAS MAJANJA, J

MARCH 22, 2023

BETWEEN

COMMISSIONER OF DOMESTIC TAXES ..... APPELLANT

AND

SOCIETE DE MAINTENANCE PETROLIERE (SMP) KENYA BRANCH ..... RESPONDENT

(Being an appeals against the Judgment of the Tax Appeals Tribunal at Nairobi dated 25th September 2020 in Tax Appeal No. 2 of 2017)

JUDGMENT

Introduction

1. The Respondent("SMP") is the Kenyan branch of a French foreign company, whose business is the provision of drilling services to petroleum exploration licensees on exploratory wells located within the Republic of Kenya. In 2013, SMP won a tender and was subcontracted by Tullow Kenya BV ("Tullow") to provide it with drilling services. Tullow had been awarded an exploratory concession by the Government through the Ministry of Mining.

2. This decision is in respect of appeals by SMP and the Appellant (''the Commissioner'') from a decision of the Tax Appeals Tribunal (' the Tribunal''). Since the parties' positions and arguments emerge from the process leading to the appeal, I will set out the history of the matter in detail.

The Assessment

3. Sometime in early 2016, the Commissioner conducted an audit of SMP's tax affairs for the period between January 2013 and February 2016. It communicated its findings through its letter of 26th August 2016 where it issued various additional assessments in respect of Corporation Tax, Pay As You Earn (PAYE), Value Added Tax (VAT) and Withholding Tax (WHT).

4. On Corporation Tax, the Commissioner observed that in 2014, SMP, as a subcontractor, computed its taxable income without reference to section 4(f) and the Ninth Schedule of the Income Tax Act (Chapter 470 of the Laws of Kenya) ("the ITA") which applied to it as a petroleum company. The Commissioner held that as provided therein, SMP did not have any tax liability as the contractor had withheld tax in accordance with that part and as such, SMP was not supposed to carry over tax losses or claim a refund on the withheld tax as it did in its filing. As a result, the Commissioner disallowed the losses claimed in the audited accounts for the year 2014.

5. The Commissioner identified the following areas of non-compliance in respect of PAYE. First, it noted that SMP paid rent for its expatriate staff in Nairobi for which PAYE was not charged. The Commissioner brought this benefit to charge. Second, that SMP had saloon vehicles used in the Nairobi Office and on site which were for official and personal use. On this issue it agreed with SMP that one of the vehicles, a Toyota Rav 4, was to be taken as a personal vehicle and PAYE according charged on this benefit. Third, that an analysis of the General ledger revealed that SMP was paying personal expenses including security, electricity and water for some named expatriates which the Commissioner treated as employment benefits and charged PAYE accordingly. Fourth, on SMP accommodating and providing meals to its field staff and those of the contractor and other subcontractors at drilling sites, the Commissioner rejected SMP's explanation that this was a necessary expense and held that it was a taxable benefit under section 5 of the ITA.

6. On VAT, the Commissioner stated that the audit revealed that upon importation of machinery (Rig 5 and Rig 106), SMP did not pay VAT at the port of entry and that SMP explained that VAT was not paid on the strength of the remission certificate awarded to the contractor. The Commissioner noted that this was an anomaly since the remission certificate was specifically addressed to the contractor and that there was no provision of passing the benefit to subcontractors hence VAT was charged on the machinery.

7. On WHT, the Commissioner noted that SMP engaged the services of local and foreign professionals hence WHT ought to have been deducted on some local service providers. That as regards the foreign service providers, the Commissioner observed that in most cases, payments were done from SMP's head office then surcharged to the local entity. In the circumstances, it held that WHT was still payable and when computing the tax payable, it made reference to section 35 of the ITA as well as the Kenya-France Double Taxation Agreement ("the DTA"). It also noted that SMP did not deduct WHT for interest paid to a foreign financier.

The Objection

8. SMP objected to the assessment through its letter dated 28th September 2016. It based its case on section 15(4) of the ITA which provides that a deficit incurred by a person in a year of income shall be allowable as a deduction in ascertaining the total income of that person for that year of income and the next 9 years of income and that apart from forfeiture of accumulated tax losses deferred for periods exceeding 10 years, the ITA does not envisage a scenario in which a tax payer is required to forfeit accumulated tax losses. It argued that the ITA does not expressly or implicitly require a tax payer that has suffered

WHT as a final tax to forfeit accumulated tax deficits incurred in any year of income and under any circumstances save as outlined under section 15(4). Further, that the ITA, 2013 at paragraph 8 of the Ninth Schedule, provides that payment of tax by a petroleum service sub-contractor in accordance with the Ninth Schedule, “shall release the sub-contractor from liability for tax arising on that part of his income.....which derive from those services." SMP contended that this section, interpreted literally, is intended to reaffirm the supremacy of the Ninth Schedule over other sections of the ITA in so far as the taxation of petroleum sub-contractors is concerned. That indeed, the context of paragraph 8 and the wording of the section is amenable to no other interpretation other than the creation of a supremacy clause. In any case, SMP stated that the legislature recognized the possibility of multiple interpretation of paragraph 8 of the Ninth Schedule of the ITA and moved to lend clarity to the paragraph in the Finance Act, 2014.

9. SMP contended that paragraph 15(8) of the Ninth schedule of the ITA,2014 provides that WHT suffered by a petroleum sub-contractor shall only be final where the WHT was suffered by a "non-resident sub-contractor" and that a non-resident sub-contractor is defined as "a sub-contractor that is not resident and includes .... foreign government or foreign government body..... " SMP stated that it is a resident in Kenya by virtue of possessing a Certificate of Registration from the Registrar of Companies and effectively conducting its management from within Kenya and should not be subjected to tax as if it were a non-resident sub-contractor. That in any case, paragraph 15(3) of the Ninth Schedule of the ITA, 2014 provides that paragraph 15(1) and consequently paragraph 15(8), which outlines the instances in which source tax is the final tax, shall not apply if the sub-contractor "provides the services.....through a permanent establishment in Kenya”. SMP concluded that it was not liable to pay WHT as a final tax as it provides services in Kenya through the SMP Kenya branch which is a registered permanent establishment of SMP France.

10. On taxation of the housing benefit, SMP stated that the Commissioner had included housing costs incurred to accommodate employees that had been temporarily accommodated during their relocation and that relocation costs are bona fide business expenses. That it is not reasonable to expect an expatriate who is a first time visitor in the country to source his own accommodation.

11. On taxation of the car benefit, SMP stated that it owns a single Toyota Rav 4 that was used exclusively by its employee but that the tax computed on the motor vehicle benefit in the tax assessment was for 2 motor vehicles. That the Toyota Rav 4 was acquired by SMP in April 2014 but that the benefit for the year 2014 had been computed for the entire year and that the Commissioner had also computed tax on the car benefit for the entire year in 2015 whereas the said named employee using the car in that year was away from the country from August to December 2015. SMP further stated that the Commissioner had computed motor vehicle benefits for the entire year in 2015 whereas the taxes for September 2016 to December 2016 were not yet due. Thus, SMP stated that it had included the correct car benefit. SMP further stated that it had settled the principal tax connected with the provision of housing, motor vehicle, security and utilities benefits and paid the same.

12. On taxation of food and accommodation on the rig site, SMP stated it had provided a schedule of the costs it incurred in providing accommodation and meals to third party contractors. It faulted the Commissioner for including the following costs as benefits to the employee; mobilization costs relating to the transportation of the rig camp, costs relating to sanitization, fumigation and general pest control, salary contributions to third party vendors and purchase of assets for use in the rig site including washing machines and ovens which remain property of SMP. SMP urged that these should be deducted outright from the cost of food and accommodation and that it had provided evidence of the costs not qualifying as food or housing benefits. SMP argued that the provision of food and accommodation on the rig site is not for the benefit of the employees but is a necessary and indispensable pre-requisite to

the operation of the rig site. It contended that the internationally accepted convention in the oil and gas industry is that food and accommodation provided to employees on a detached and isolated installation is considered a legitimate cost of developing a rig site to make it amenable to human habitation as it is a condition precedent to the creation of employment premises. SMP submitted that this interpretation has been accepted by leading oil and gas jurisdictions including the United Kingdom, the United States of America, France, Australia, New Zealand and Germany.

13. On WHT on payments made to third party contractors, SMP faulted the Commissioner for bringing to charge government fees and immigration levies paid on behalf of SMP by its immigration agents contrary to section 35 (3) of the ITA. It further faulted the Commissioner for bringing to charge lease rentals for residential property paid to named landlords who are resident persons as section 35 of the ITA and paragraph 3 of the Third Schedule of the ITA allows for deduction of WHT only on payments made to non-resident landlords. It also faulted the Commissioner for bringing to charge payroll reimbursement payments made to Oilfield Movers Limited (OML), Royal Oilfield Logistics and Supplies (ROLS), Remote Site Solutions (RSS) and Allterrain Services Kenya Limited (ATS) contrary to section 35 of the ITA as SMP had deducted and remitted WHT on the management fees paid to both vendors.

14. SMP further faulted the Commissioner for bringing to charge payments made by SMP head offices for services provided in France and by suppliers resident in France in contravention of the DTA. That Article 7 of DTA provides that profits of a company can only be taxed in a contracting state if the company carries on business through a permanent establishment situated in the state. That none of the French service providers whose payments had been brought to charge had any permanent establishments situated in Kenya. That even if the transactions between the SMP head office and the French service providers had been provided directly to SMP, they would not be subject to WHT because the DTA allows deduction of WHT at source only in respect of profits from shipping and air transport and payments for dividends and royalties. SMP stated that it did not make payment in respect of any of the aforementioned services and was thus not liable to pay any WHT.

15. SMP faulted the Commissioner for demanding WHT on intercompany charges between the SMP head office and SMP contrary to section 35 of the ITA as recharges between a head office and its branch are not subject to WHT under the Kenyan ITA. SMP further faulted the Commissioner for assessing WHT on import duty, VAT and IDF fees paid on behalf of SMP by Freight Forwarders Kenya Limited and for assessing WHT on material and non-service items in contravention of section 35 of the ITA. It faulted the Commissioner for taxing logistics and transportation charges paid to non-resident companies including Global Star International, Havas Voyages, International Oilfield Services, Gailwinds logistics, SONEMA, Air France and COFACE when Freight and transportation charges are not subject to WHT whether paid to a resident or a non-resident person. That the Commissioner had also wrongly brought to charge payments made by the SMP head offices for services provided in the United States of America and Malta by American and Maltese suppliers respectively in contravention of DTA which excludes the application of WHT on transactions in jurisdictions other than those on which the economic activity was conducted or those where a permanent establishment is located, and that it was also in contravention of the sound tax principles laid down in the case of Motaku Shipping Agencies Ltd v Commissioner of Income Tax NRB HCCC No. 60 of 2013 [2014] eKLR which set the precedent regarding the application of WHT in instances where business is conducted through an agent. SMP contended that its head office was not and has never been its agent and thus its head office could not be assumed to have made any payments on behalf of SMP.

16. On VAT charged for the importation of rigs, SMP stated that it holds a valid and legally binding tax exemption letters issued under section 68(4) of the VAT Act and the Fifth Schedule (part B, item 30)

of the East African Community Customs Management Act, 2004 allowing the rigs to be imported into the country without payment of VAT. It adds that the letters were still valid as they had not been revoked at the time of the objection. That Rig 5 was re-exported back to France and even if import VAT was payable, which SMP still contested, then the tax payer would have been entitled to a refund of the VAT paid upon re-exportation. Thus, SMP viewed the demand for import VAT on Rig 5 as having been overtaken by time. SMP further stated that the Commissioner of Customs was at all times and still was aware of the whereabouts and purpose of rig which is a highly specialized piece of machinery that could not be diverted for unauthorized local use.

17. For the above reasons, SMP urged the Commissioner to set aside the initial assessments and issue an amended assessment taking into the account the arguments adduced above.

The Objection Decision

18. After reviewing the objection, the Commissioner rendered its objection decision on 24th November 2016 ("the Objection Decision"). The Commissioner upheld its decision on Corporation Tax, PAYE and VAT. On WHT, the commissioner reiterated that WHT on hire of personnel should be on the whole amount and not on the management fee element as withheld by SMP. Thus, the Commissioner treated the entire charge by SMP's service providers as management fees and credit was been given for the WHT paid. On WHT on services procured outside France the Commissioner upheld its decision that WHT on service providers outside France is payable irrespective of who pays for the expense with the interpretation being that SMP was a conduit for the payment but the services were provided to SMP. The Commissioner also upheld its decision on charging WHT on technical and training costs and that the decision was reached on the basis that the service had not been included in the definition of professional services in the DTA.

19. For the above reasons, the Commissioner amended and revised the assessments and demanded the sum of Kshs. 1,188,243,248.00. In its letter to the Commissioner dated 22nd December 2016, SMP notified the Commissioner that it intended to appeal against the assessments to the Tax Appeals Tribunal ("the Tribunal"). SMP conceded the portion of the assessment that related to PAYE on housing and motor vehicle benefit and made payment of the principal tax demanded.

The Tribunal Decision

20. The Tribunal heard SMP's appeal and delivered its judgment on 25th September 2020. The Tribunal framed the following 5 issues for determination:

    a. Whether the Commissioner erred in disregarding section 15(4) of the ITA in the treatment of SMP's accumulated tax losses and utilized advance tax credit?

    b. Whether the Commissioner erred in seeking to charge PAYE for food and accommodation of all persons at the rig site

    c. Whether the Commissioner erred in charging VAT on the importation of oil drilling rigs?

    d. Whether the Commissioner erred in charging WHT on technical and training fees

    e. Whether the Commissioner erred in subjecting WHT on services procured and performed in the USA.

21. On the the treatment of SMP's accumulated tax losses and utilized advance tax credit, the Tribunal was of the view that for the 2014 year of income, the applicable law was the provisions of the Ninth Schedule to the ITA prior to the amendments effected by the Finance Act, 2014. The Tribunal agreed

with the Commissioner and SMP's concession that the Ninth Schedule applies in computing gains or profits of a petroleum sub-contractor. However, the Tribunal noted that the pre-2014 Ninth Schedule to the ITA did not have a provision on how to deal with a situation where a petroleum sub-contractor, such as SMP, incurred and declared losses. That the law therefore had a lacuna which SMP sought to evade by relying on section 15(4) of the ITA as far as the principle of carrying forward losses is concerned.

22. The Tribunal observed that like any other company, a petroleum company has the same predisposition to incur losses hence the Commissioner's argument that the law as it stood 2014 was based on the expectation that a petroleum company would always be profitable lacked in merit. The Tribunal accepted the position taken by SMP that in 2014, it could rely on section 15(4) of the ITA in order to carry forward its tax losses. It held that even without expressly relying on section 15(4) of the ITA, a petroleum sub-contractor should be allowed to carry forward losses incurred because the concept of carrying forward losses is a basic accounting principle which SMP and by extension any other petroleum sub-contractor, should be allowed to benefit from.

23. The Tribunal fortified its position in light of the fact that the Finance Act 2014, included the principle of carrying forward losses at Paragraph 8 (2) of the Ninth Schedule to the ITA which only goes to demonstrate that petroleum sub-contractors are not exempt from the benefits of having their tax losses treated as an allowable expense. The Tribunal also relied on the well-established principle of taxation that any ambiguities or lacuna in the law should be interpreted in favor of the tax payer as opposed to the revenue authority. The Tribunal also dismissed the Commissioner's reliance on Paragraph 9 of the Ninth Schedule and stated that SMP is a resident company registered in Republic of Kenya under the laws of Kenya and that the provisions do not apply to its affairs.

24. On PAYE charged to SMP for food and accommodation provided to all persons at the rig site, the Tribunal held that the Commissioner should have charged PAYE to SMP for only the employees under its employ. The Tribunal further found that the Commissioner erred in taking into account extra costs such as mobilization charges, lease charges and fumigation fees among other costs as benefits to the employees as they are in their general nature not benefits to employees for PAYE to accrue. On the contention that SMP ought to have deducted PAYE for third party contractors, the Tribunal held that no evidence was produced to support the Commissioner's contention that these third party employees were seconded to SMP.

25. On the VAT charged on the importation of the oil drilling rigs, the Tribunal found that the exemption letter dated 26th August 2016 granted to Tullow provided that the equipment or material that qualify for remission under the letter must either be imported or purchased by Tullow for the VAT exemption to apply and it did not say the equipment should be "imported and purchased" by Tullow. The Tribunal held that this was intended to leave room for situations, such as those in this case, where the equipment belongs to the subcontractor but nonetheless is used for exploration purposes. That the equipment, though belonging to SMP, was imported by Tullow as evidenced by both the import entries as well as the export entries and to this extent therefore, the Tribunal accepted SMP's argument that it was not liable to pay VAT for the equipment in question and that Tullow being the importer was liable.

26. The Tribunal further determined the Commissioner's contention that if at all SMP was a beneficiary of the exemption letter, then it failed to meet the requirements of Legal Notices Nos. 13 and 14 of 2005 (''the Legal Notices''). The Tribunal concluded that the Legal Notices grant remission to specific companies namely; Woodside Energy (K) Ltd, Dana Petroleum Limited and Global Petroleum Limited and that in effect SMP was not among the companies listed therein hence it would be erroneous to hold that SMP failed to meet the requirements thereunder. The Tribunal held that the

only time an issue of the Legal Notices would arise would be if one of the sub-contractors of Tullow was listed. That the Legal Notices required Tullow to notify the National Treasury of the identity of any sub-contractor to whom Legal Notices would apply and that the notification required was to be undertaken by Tullow and not SMP. The Tribunal therefore concluded that SMP did not have any VAT liabilities in respect of the oil rigs and the Commissioner erred in holding otherwise.

27. On the WHT on the technical and training fees, the Tribunal noted the discrepancy between SMP's written pleadings and oral submissions as to whether the said technical and training services were wholly provided in France or part of it was done in Kenya. The Tribunal stated that it would be guided by SMP's written pleadings where it stated that "The services were provided mainly in France with Part of the training being done on the rig site in Kenya". The Tribunal observed that the DTA provides that where an enterprise carries on business in both states, then the enterprise will pay tax in each state in accordance with the level of activity carried out in each states. In its view, there was no evidence provided by SMP in support of the level of activity done in each country for it to make a determination in its favour. The Tribunal further rejected SMP's argument that the fees for the training services were paid by its head office in France by stating that the Head office eventually sought recharge of these fees from SMP. The Tribunal concluded that in the absence of evidence supporting SMP's contention, the Commissioner's treatment of the WHT was proper in law.

28. Regarding WHT on services procured in the USA, the Tribunal found held that SMP contracted the American company for the acquisition of Rig 106 and that the rig was acquired for the benefit of SMP but payment was effected by SMP's Head office in France. The Tribunal noted that the Head Office in France sought recharge of this fees from SMP and in the end, it is SMP which paid for the services it acquired from the American company. It thus concluded that SMP ought to pay WHT as charged by the Commissioner.

29. The Tribunal allowed SMP's appeal in part. It vacated the Commissioner's PAYE assessment amounting to Kshs. 242,509,440.00 and the Commissioner's VAT assessment of Kshs. 770,113,997.00. It however upheld the assessment of WHT for Kshs. 175,619,811.00 in respect of WHT. Each party was directed to pay its own costs.

30. Both parties are dissatisfied with various aspects of this decision. The Commissioner is aggrieved by the Tribunal's findings on the treatment of SMP's tax losses, PAYE in respect of the food benefit and VAT on the imported rigs. On its part, SMP is aggrieved with the decision on WHT on the technical and training services provided by the French and American entities.

31. Both parties have filed appeals which have been consolidated. The appeals were disposed by way of written submissions. As I stated earlier, the parties' arguments are clearly set out in the narration above.

Analysis and Determination

32. As I determine this appeal, I am cognizant of the fact that this court's jurisdiction is circumscribed under section 56(2) of the TPA which provides that "An appeal to the High Court or to the Court of Appeal shall be on a question of law only". The Court of Appeal in Bashir Haji Abdullahi v Adan Mohammed Nooru & 3 others NRB CA Civil Appeal No. 300 of 2013 [2014] eKLR accepted the passage of Denning J., in Bracegirdle v Oxley (2) [1947] 1 ALL ER 126, 130 where he stated as follows:

> The question whether a determination by a tribunal is a determination in point of fact or in point of law frequently occurs. On such a question there is one distinction that must always be kept in mind, namely, the distinction between primary facts and conclusions from those facts. Primary facts are facts which are observed by the witnesses and proved by testimony; conclusions from those facts are inferences deducted by a process of reasoning from them.

> The determination of primary facts is always a question of fact. It is essentially a matter for the tribunal who sees the witnesses to assess their credibility and to decide the primary facts which depend on them. The conclusions from those facts are sometimes conclusions of fact and sometimes conclusions of law. In a case under the Road Traffic Act, 1930, s. 11, the question whether a speed is dangerous is a question of degree and a conclusion on a question of degree is a conclusion of fact. The court will only interfere if the conclusion cannot reasonably be drawn from the primary facts... [Emphasis mine]

33. It is against the aforesaid background that I now turn to determine both appeals and propose to start with the Commissioner's which is anchored in its Memorandum of Appeal dated 20th November 2020 then proceed with SMP's which is grounded in the Memorandum of Appeal dated 23rd November 2020.

Treatment of SMP's accumulated tax losses and unutilized advanced tax credit

34. What the Tribunal and now this court is being called upon to determine is whether petroleum service subcontractors can carry forward tax losses and utilize tax credits. It is common ground that section 4(f) of the ITA is instructive that petroleum subcontractors such as SMP are taxed under the Ninth Schedule as it provides that "In computing the gains or profits of a "licensee" "contractor" or "subcontractor" as defined in the Ninth Schedule, the provisions of that Schedule shall apply."

35. It is also common ground that Paragraph 8 of the Ninth Schedule to the ITA prior to 2015 provided that

> Notwithstanding any other provision in this Act, profits or gains of a petroleum service subcontractor in respect of services provided in Kenya to a petroleum company shall be deemed to be income derived from Kenya and payment of tax by the petroleum company in accordance with this Part shall release the petroleum service subcontractor from liability for tax arising on that part of his income, profits or gains which derive from those service.

36. The Commissioner stated that since there is no liability on the part of the subcontractor once the contractor has withheld and paid taxes from the services provided by the subcontractor then the subcontractor cannot claim the same as a tax loss. I disagree. There is nothing in Paragraph 8 above that precludes a subcontractor from whom WHT has been deducted by the contractor from claiming it as a tax loss. The fact that the subcontractor is released from liability of payment of additional taxes does not mean that it has not suffered a tax loss from the taxes withheld.

37. I also agree with the Tribunal that prior to 2015 the Ninth Schedule did not provide how tax losses by petroleum contractors and subcontractors ought to be treated and that this was only cured with the introduction of the Finance Act, 2014 which introduced a new Ninth Schedule which now explicitly provides at Paragraph 8(2) as follows:

> 8 (2) If a contractor suffers a loss in respect of petroleum operations in a contract area for a year of income, the amount of the loss shall be carried forward and allowed as a deduction against the income of the contractor derived from petroleum operations in the contract area in the next following year of income of the contractor.

Therefore, there was no fault on SMP for relying on section 15(4) of the ITA in carrying forward the tax losses. The said provision provides that,

> 15 (4) Where the ascertainment of the total income of a person results in a deficit for a year of income, the amount of that deficit shall be an allowable deduction in ascertaining the total income of such person for that year and the next four succeeding years of income.

I therefore agree with the Tribunal that if there is any doubt as to whether taxes should be collected or not because of an ambiguity in the law, then the same ought to be effected and interpreted in favour of the taxpayer. This principle is one of the cornerstones of interpretation of tax statutes (see Stanbic Bank Kenya Limited v Kenya Revenue Authority CA Civil Appeal No. 77 of 2008 [2009] eKLR).

38. The Commissioner had also argued that prior to the amendments by the Finance Act, 2014, it was never contemplated that petroleum subcontractors would make a loss as evidenced by Paragraph 9(1) and (2) therein which provided as follows:

> 9. Assumed profit rate
>
> (1) Petroleum service subcontractors shall be deemed to have made a taxable profit equal to fifteen per cent, in this paragraph referred to as the "assumed profit rate", of the moneys referred to in subparagraph (2) which profits shall be taxed at the rate set out in the Third Schedule applicable to non-resident companies which have a permanent establishment in Kenya.
>
> (2) The assumed profit rate shall be applied to all moneys paid by a petroleum company to a petroleum service subcontractor, hereinafter referred to as the "taxable service fee", but excluding—
>
> (a) moneys actually paid by a petroleum company to reimburse the petroleum service subcontractor for the cost of mobilisation and, where applicable, demobilization; and
>
> (b) reimbursement of expenses.

39. My interpretation of the above provision is that what was deemed as profit and intended to be taxed at the rate of 15% was the said taxable service fee paid by the contractor to the subcontractor. It was never meant to provide that petroleum subcontractors will always be in a profitmaking position and thus taxed at an assumed rate for all their income all the time. If this was the case, then the preceding Paragraph 8 on subcontractors being absolved from further tax liability once it had been withheld by the contractor would have been rendered nugatory and of no consequence.

40. For the foregoing reasons, I find and hold that the Tribunal did not err when it held that SMP could carry forward its tax losses by relying on section 15(4) of the ITA as there was nothing in the Ninth Schedule that precluded it from doing so.

PAYE on food and accommodation benefit

41. The Commissioner submitted that SMP provides food to its employees at the rig site and that the food provided exceeds Kshs. 48,000.00 per year per employee. As a result, it treated the food, accommodation and the other social amenities provided by SMP to its employees as an employment benefit under section 5(3) and (4)(f) of the ITA.

42. Under the section 3(2)(a)(ii) and section 5(1) of the ITA, PAYE can only be charged on the income of individuals in gainful employment and that it is only the employer in an employer-employee relationship that has the statutory obligation to deduct and remit PAYE in accordance with the ITA (see China Road & Bridge Corporation v Commissioner of Domestic Taxes ML HC ITA No. E003 of 2020 [2021] eKLR). The Tribunal was correct to hold that the Commissioner could only charge PAYE for persons employed by SMP. Thus, in demanding PAYE, the Commissioner must be satisfied that the individuals it intends to charge PAYE are employees. SMP was adamant that the people it

provided the food and accommodation for were employees of third parties and not those of SMP. The Commissioner on the other hand accepted that in as much they were employees of third party contractors, they had been seconded to SMP. Since it is clear that the employment relationship is between the said employees and the third party contractors, then the obligation to deduct PAYE can only arise as to the said third party contractors and not SMP. In China Road & Bridge Corporation v Commissioner of Domestic Taxes (Supra), the court rejected a similar argument by the Commissioner when it attempted to charge PAYE on the appellant therein on allowances paid by it to police officers that had been seconded to it by the police officers' employer.

43. Since the Commissioner charged PAYE for persons who were not employees of SMP, it follows that the said assessment was erroneous. Thus, the question whether some of the listed costs were not employment benefits and thus not taxable was moot. In any case, the Commissioner admitted that the costs were not benefits and that they were lumped together by SMP in its audited accounts. Since SMP had explained and separated the said costs in its objection, nothing could have been easier than for the Commissioner to omit the same in the Objection Decision.

Import VAT of the Rigs

44. It was not in dispute that Tullow imported rigs on an exemption basis pursuant to an approval by the National Treasury through the letter dated 26th August 2014 which provided in part as follows:

> .....
>
> R.E: Exemption From Duties, VAT and IDF M/S Tullow Kenya B.V
>
> In accordance with the provisions of Regulation 38A (7) of the Customs and Excise Act, the Minister for Finance on 4th September, 2008, approved remission of IDF fees in respect of equipment and materials being imported/purchased by M/S Tullow Kenya B.V. for use in the oil exploration.
>
> 1. Duty exemption on equipment, spares and inputs is covered in the East African Community Customs Management Act, Fifth Schedule Part B item 30. However, the provision excludes motor vehicles.
> 2. Exemption from VAT is provided for under the provisions Section 68(4) of the VAT Act.
>
> Among the items approved by the Minister, the following import documents have been provided:
>
> .....
>
> The goods being purchased on duty/ VAT free basis by M/S Tullow Kenya
>
> B.V under the authority of this letter shall be subjected to the following conditions
>
> a) That the goods are to be used solely in connection with the petroleum operations carried out under the Production Sharing Contract;
>
> b) That M/S Tullow Kenya B.V, shall, as provided in the Production Sharing Contract, shall give preference to locally available goods necessary for carrying out petroleum operations;

c) That the goods purchased shall either be used during the petroleum operations, or transferred to the Government in accordance with the terms of the Product Sharing Contract, or exported or sold in accordance with paragraph (d)

d) That the goods purchased shall not be sold in Kenya edition, unless duty is paid;

e) That M/S Tullow Kenya B.V shall notify the National Treasury of the identity of any sub—contractor to whom Legal Notices Nos. 13 and 14 of 16th February, 2005 shall apply

f) "Petroleum Operations" means all or any of the operations related to the exploration for, development, extraction, production, separation and treatment, storage, transportation and sale or disposal of petroleum up to the point of export or the agreed delivery point of entry into a refinery, and included natural gas processing operations, but does not include refining operations.

In the event that the equipment and materials are not used solely for the project, appropriate taxes shall become due and payable.

.....

45. It is also common ground that the imported rigs were ultimately used by SMP. The Commissioner submits that SMP failed to comply with the Legal Notices as required by the letter and that the said rigs were only to be used by Tullow for its own use and not for use by third parties.

46. From the exemption letter of 26th August 2014, it is apparent, and I agree with the Tribunal, that it is Tullow and not SMP that was to notify the National Treasury of the identity of any subcontractor to whom Legal Notices applied. If Tullow had not notified the National Treasury, it follows that the Legal Notices would not apply to SMP. Further, there is nothing in the aforementioned conditions that stipulated that the imported rigs should be used only by Tullow and not by third parties. It was also not contended that the rigs were not used solely in connection with the petroleum operations carried out under the Production Sharing Contract or that Tullow did not give preference to locally available goods necessary for carrying out petroleum operations or that the rigs were neither used during the petroleum operations nor transferred to the Government in accordance with the terms of the Product Sharing Contract or that they exported or sold contrary to the conditions specified in the letter.

47. I therefore agree with the Tribunal that the Commissioner could not charge VAT on the rigs that had been imported free of VAT by Tullow pursuant to the remission granted to it by the Government. I also find and hold that neither Tullow nor SMP violated the conditions provided in the remission certificate or the Legal Notices.

WHT on the technical and training services

48. SMP is aggrieved by the Tribunal decision upholding WHT charged by the Commissioner on the technical and training services provided in France and in respect of management, technical and engineering services performed in the United States of America.

49. SMP argues that section 10(1)(ii) of the ITA which at the time of the assessment provided that WHT deductions shall not apply to a payment made, or purported to be made, by the permanent establishment in Kenya of a non-resident person to that non-resident person. That the said payments

subject to WHT were paid by its Head office to the non-resident entities thus WHT did not apply. While this is true, I note that SMP did not controvert the position that the Head office sought a recharge of the sums paid by it to these non-resident entities and essentially, this meant that it was SMP paying for these services. SMP also admitted at Paragraphs 66 and 67 of its Statement of Facts before the Tribunal that it was the one which contracted the French company and that the services were provided mainly in France and also part of the training was done on the rig site in Kenya. SMP did not also attribute the portion of the training that was done in France so as to be exempt from WHT as per the DTA between Kenya and France.

50. I find that the Tribunal rightly appreciated the facts and evidence before it on this issue and came to a reasonable conclusion that any other tribunal seating in its place would have arrived at. The Commissioner thus rightly charged WHT on those payments made by SMP in respect of the services provided by the French and American entities.

Conclusion and Disposition

51. For the reasons outlined above I dismiss both appeals. There shall be no order as to costs.

DATED AND DELIVERED AT **NAIROBI THIS DAY 22ND OF MARCH 2023.**

D. S. MAJANJA

JUDGE

Court Assistant: Mr M. Onyango.

Mr Lemiso, Advocate instructed by Kenya Revenue Authority for the Appellant.

Mr Nyaburi instructed by Iseme Kamau and Maema Advocates for the Respondent.