



**Stefanutti Stocks Kenya Limited v Commissioner of Domestic Taxes (Tax Appeal E128 of 2021)  
[2023] KEHC 22157 (KLR) (Commercial and Tax) (15 September 2023) (Judgment)**

Neutral citation: [2023] KEHC 22157 (KLR)

**REPUBLIC OF KENYA  
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)  
COMMERCIAL AND TAX  
TAX APPEAL E128 OF 2021  
DAS MAJANJA, J  
SEPTEMBER 15, 2023**

**BETWEEN**

**STEFANUTTI STOCKS KENYA LIMITED ..... APPELLANT**

**AND**

**COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT**

*(Being an appeal against the judgment of the Tax Appeals Tribunal  
at Nairobi dated 18th June 2021 in Tax Appeal No. 18 of 2020)*

**JUDGMENT**

**Introduction and Background**

1. The appellant is a subsidiary of Stefanutti Stocks International Holdings Limited, a company resident in the Republic of South Africa that carries on the business of providing engineering solutions and construction services for marine, civil and general works. The appellant commenced operations in Kenya in 2012. It was awarded contracts by Base Titanium; the first contract in 2013 and the second one in 2017.
2. The respondent (“the Commissioner”) carried out a review of the Appellant’s financial records for the year of income ending February 2013 and issued an additional assessment on September 6, 2019 for Kshs 158,44,585.00 in respect of corporation tax. In arriving at this decision, the Commissioner stated that the appellant, in reporting the income earned for the year 2013, omitted Kshs 193,474,920.00 terming it as contract over claim and only reported income of Kshs 323,244,106.00 for that period. That in the appellant’s letter dated September 5, 2019, it had stated that the over claim relates to work done but not yet certified by the client, hence similar to a deposit.



3. The commissioner reviewed the interim payment certificates for the subject period and determined that the total certificate value income was Kshs 516,718,765.00. That all the Interim payment certificates were signed off as evidence of work done for purposes of payment pursuant to clause 14 of the conditions of contract to the agreement with Base Titanium. That a total income of Kshs 516,718,765.01 was earned in the year 2013 but no evidence had been provided to demonstrate that work was not done, that the revenue over claim of Kshs 193,474,920 was classified as deferred income for reporting purposes in the appellant's audited financial accounts yet work was already done and certified by the client. According to the Commissioner, these amounts should not have been classified as such since it was not part of the advance payment and that in the event the value of work done as per the certificate was not approved by February 28, 2013, all the costs incurred in earning the amount in the certificate ought to have been accounted for as work in progress. That this was to conform with the matching principle and to be consistent with section 15(1) of the *Income Tax Act* (chapter 470 of the Laws of Kenya) ("the ITA") and that from the audited financial statements for year 2013, no work in progress had been accounted for.
4. The commissioner stated that the appellant ought to have reported the whole amount attributable to all Interim Payment Certificates (IPCs) in year 2013 as required under section 3(2)(a)(i) of the *ITA* and that the revenue overclaim of Kshs 193,474,920 was therefore brought to charge. The Commissioner also noted that the appellant had not provided details of an invoice no. "5" which the appellant had stated could not be found and if it was not provided, it would use the best judgment to determine its value in accordance with section 31 of the *TPA*.
5. On personnel costs expensed, the commissioner noted a variance between employment costs claimed in the audited financial accounts and gross salaries from the payrolls/PAYE returns provided by the appellant in respect of salary expenses. According to the Commissioner, the appellant did not support the variance of Kshs 46,391,512.00 as expenditure wholly and exclusively incurred in the production of income as required by section 15 of the *ITA* and therefore disallowed under section 16(1)(a) of the *ITA*. The Commissioner held that expatriate personnel costs claimed including rent, cable television subscription, installation and activation fees as well as other miscellaneous payments by the appellant for the benefit of expatriate personnel were personal expenses and are not allowable against business income in accordance with section 16(2)(a) of the ITA.
6. The Commissioner also considered related party transactions between the appellant and its related non-resident entity, Stefanutti Stocks Marine (Pty) Ltd. It determined that the appellant had expensed a sum of Kshs 305,877,874.00 for items such as a steel plant, transport, plant & equipment (internal), temporary work, internal plant, plant & equipment (external) small tools L, I&S, form work, safety, offices and services cement, travel overseas, professional services and subcontractor costs. The Commissioner relied on section 18(3) of the *ITA* read together with the *Income Tax (Transfer Pricing) Rules, 2006* of the ITA which provides that where a resident company deals with a related non-resident entity, the resident company must demonstrate that the transactions are priced at arm's length. The Commissioner requested for a Transfer Pricing (TP) Policy covering all the transactions with the related entity and all the purchases invoices from the related entity. As the appellant did not provide them, the Commissioner held that the TP policy provided by the appellant did not cover transactions between the parties and that in its letter dated September 5, 2019, the appellant stated that no formal agreement exists with regard to plant hire between the appellant and related parties.
7. The Commissioner took the position that the determination of whether or not payment for service is at arm's length price is a two-step approach as set out in chapter 7 of the *OECD Transfer Pricing Guidelines*. First, it must be determined whether the service has been rendered. Second, whether the charge for such service is at arm's length. That based on the information provided by the appellant, the



Commissioner concluded that it was difficult to determine whether goods and services were supplied to the appellant and whether the corresponding expenses were priced at arm's length in line with section 18(3) of the *ITA*. It disallowed the expenses in accordance with section 15(1) of the *ITA*.

8. The appellant objected to the assessment through its letter dated October 4, 2019 and urged the commissioner to set aside the initial assessment. On the contract over-claim, the appellant averred that the advance payment of Kshs 193,474,920.00 was reported deferred revenue and did not meet the International Financial Reporting Standards (IFRS) requirements for recognition of income. That this income is not required to be reported as revenue in the 2013 financial statements and that IAS 18 of the International Accounting Standards requires the following conditions to be fulfilled before recognition of income; the amount of revenue can be measured reliably, it is probable that economic benefits will flow to the seller, the stage of completion at the balance sheet date can be measured reliably, the costs incurred, or to be incurred, in respect of the transaction can be measured reliably and that where the criterion above is not met, revenue arising from rendering of services should be recognized only to the extent of the expenses that are recoverable.
9. The appellant contended that under the matching principle, where money is received from a client and the company has not yet fulfilled its contractual obligation to earn the money, then that income is reported as deferred revenue. The appellant states that payment of Kshs 193,474,920.00 was received in advance of delivery of services and was appropriately reported as deferred income. Since it did not perform its contractual obligations, it cannot recognize the funds as income and that the associated costs were incurred in the succeeding years of income hence there were no costs included in WIP (work in progress). It asserted that the certificate of works issued was agreed by the parties and in advance of work done to allow it to be cash positive and facilitate easier execution of the contract. It maintained that the client would not pay more than the actual agreed price, the only distinction being the timing of payment.
10. On the invoice sought by the commissioner, the appellant stated it was non-existent and was never issued and was a result of a system error which skipped number "5" when issuing the invoice. It contended that the appellant could not attribute a value to a document that was never issued or a transaction that did not take place. It attached the general ledger report showing, in a sequential manner, all the invoices it had raised.
11. The appellant further stated no corporate tax was due on the contract overclaim since it was reported in the income statement for the succeeding year and fully taxed on that income. It attached the financial statements for the 2014 year of income that indicated that the deferred revenue recognized in 2013 had been fully recognized as income in the 2014 year of income.
12. The appellant explained the variance personnel costs by attributing it to expatriate employees working on the projects located in Kenya and that the charge for the expatriate employees was then recharged from Stefanutti Stocks PTY Limited to the appellant through an intercompany invoice presented to the commissioner. On the expatriate costs incurred by the appellant to provide housing, cable television and subscription fees, the appellant stated that these costs were not personal but represented legitimate employee benefits which is an allowable business expense.
13. On the related party costs, the appellant explained that related party transactions between entities in the Stefanutti Stocks Group were conducted in accordance with the TP policy document prepared for Stefanutti Stocks (PTY) Limited prepared in February 2016 which it produced. That its TP document covers the following transactions; construction services, rental of plant and equipment and management support services and that it was listed in the transfer pricing study as one of the entities of the Stefanutti Stocks Group. The appellant contended that its dealings with its related entities;



Stefanutti Stocks Marine (SSM) a division of Stefanuti Stocks (Pty) Limited ("SSP) were done in accordance with the TP policy maintained by Stefanutti Stocks (PTY) Limited and that in light of the fact that Stefanutti Stocks Marine is a division of Stefanuti Stocks (Pty) Limited, and that Stefanuti Stocks (Pty) Limited forms part of the Stefanutti Stocks Group, the TP policy and the transfer pricing comparable benchmark prepared for Stefanutti Stocks Group would equally apply to the transactions conducted by Stefanutti Stocks Marine and the appellant.

14. The appellant maintained that all the services and commodities invoiced by Stefanutti Stocks Marine to it were delivered and rendered in accordance with the TP policy and that all equipment leased to it were physically present and used in Kenya at the relevant construction site which it operated. The appellant stated that it was responsible for all operations and maintenance of equipment as well as supervision and employment of all equipment (plant) operators and Stefanutti Stocks Marine merely provided the equipment for use. The appellant contended that not all invoices billed to it related to services rendered by Stefanutti Stocks Marine as the amount included invoices for cost recovery for expenses incurred on its behalf by Stefanutti Stocks Marine which seeks reimbursement of the cost as evidenced by the invoices it furnished to the Commissioner.
15. The Commissioner rendered its objection decision on December 6, 2019 ("the Objection Decision"). On the overclaim amount of Kshs 193,474,920, the Commissioner reviewed the objection in light of the IAS 18 conditions advanced by the appellant and concluded that certificates of work done are a unit of measure of the revenue due thus indicating that the revenue can therefore be measured reliably, the seller is the contractor and has thus built and been paid in the year thus economic benefits do flow to them, accumulation of the certificates can determine the stage of completion in the books, contractual agreement had been met and thus work had been done and could therefore be measured and hence determine the costs incurred. That since the aforementioned criteria had been met, the condition 5 of IAS 18 was irrelevant in this regard.
16. On the grounds that the costs related to deferred revenue were claimed in succeeding years, that is in 2014 and that the issuance of the certificate of works was done consensually and in advance of work done, the Commissioner stated that this was contrary to the total certification value tabulated and that the certification was the supporting documentation for work done through which the client measures the value of works done and proceeds to pay for the corresponding invoice. On the missing invoice no "5", the commissioner agreed that the same was neither issued nor claimed in the appellant's books and thus the issue was dropped.
17. The commissioner also agreed and found that the deferred income observed in 2013 was brought to charge in 2014 and duly accounted for. However, it was determined as communicated above that this income was duly earned in 2013 and as such could only be declared in the correct year; 2013. Further, that all the certificates and corresponding invoices had been fully reconciled and no dispute had been noted in regards to the value therein. That from the foregoing, it was clear that the appellant should have reported the whole amount attributable to all IPCs in year 2013 as required under section 3(2)(a) (i) of the ITA and the "revenue overclaim" of Kshs 193,474,920.00 had therefore been determined to be income chargeable in 2013 and thus ought to be subjected to tax accordingly as earlier communicated.
18. On the salary expenses, the Commissioner maintained that the variance between the employment costs claimed in the audited financial accounts and gross salaries from the payrolls/PAYE returns was not supported as expenditure wholly and exclusively incurred in the production of income as required by section 15 of the *ITA* and the amount was therefore disallowed in accordance with section 16(1) (a) of the *ITA*. On the other hand, the commissioner found that an examination of the supporting documents of the expatriate personal expenses was fully supported and indeed incurred in



the production of business revenue and thus, personnel costs consisting of the expatriate emoluments and non-cash benefits were allowed as a business expense.

19. After reviewing supporting documentation provided by the appellant on related third party transactions, the Commissioner concluded that they were insufficient to support the appellant's objection as the appellant was not listed as one of the Group entities but features on the organisational chart, the copies of Stefanutti Stocks Marine invoices to the appellant indicated that the item being charged was cost recovery, no lease agreements for plant & machinery were provided to demonstrate intention to render services/intention to seek services, the invoices attached may indicate cost recovery however; no documentation was availed to demonstrate that these transactions were at arm's length, no third party invoices where applicable were availed for examination to determine which benchmarking approach had been applied and whether it is in line with the TP Policy adduced. The Commissioner concluded that it was evident that determination of whether services were rendered and whether they were at arm's length could not be made and therefore the related party expenditures remained disallowed and thus the tax as demanded earlier was indeed due and payable.
20. Following an examination of the objection grounds and the supporting documents, the commissioner partially allowed the original 2013 corporation tax additional assessment in accordance with the adjustments outlined to Kshs 274,157,583.00 inclusive of penalties and interest.
21. The appellant lodged an appeal with the Tax Appeals Tribunal ("the Tribunal"). It urged the Tribunal to find that Corporate income tax is not payable on deferred revenue and income received in advance of performance of contractual responsibilities, that Staff costs are allowable costs pursuant to section 15 of the ITA and that costs paid to related parties and supported by a transfer pricing policy are allowable costs under sections 15 and 18 of the [ITA](#).
22. In its judgment rendered on June 18, 2021. the Tribunal framed four issues for determination as follows:
  - a. Whether the Commissioner erred in demanding tax on deferred revenue.
  - b. Whether the Commissioner erred in disallowing expenditure incurred by the appellant for the year 2013 in respect of differed income.
  - c. Whether the Commissioner erred in disallowing personal expenses.
  - d. Whether the Commissioner erred in disallowing related party expenses.
23. On the first issue, the Tribunal noted that since the deferred revenue had already been accounted for, it held that nothing in section 3(2)(i) of the [ITA](#) compelled the parties to account for revenue which had already been accounted for in 2014. Consequently, the Tribunal found that the Commissioner erred in bringing to charge the appellant's deferred revenue which had already been accounted for by the time it made its assessment. On the second issue, the Tribunal held that in view of the fact the impugned expenditure was not incurred for generation for income during the year 2013, then the Commissioner did not err in disallowing that expenditure as the expenditure incurred in the production of the deferred income could only be attributed to the year when the income was earned. On the third issue, the Tribunal noted that the expenditures were of a personal nature and as such were disallowed under section 16(2)(a) of the [ITA](#) and therefore the Commissioner did not err in disallowing the appellant's expenditure on staff costs. On the fourth and last issue, the tribunal stated that since the appellant had stated in its letter of September 5, 2019 that no formal agreement existed with regard to plant hire between the appellant and the related parties and in the absence of documents as evidence that services to the related party were actually rendered, or whether they were at arm's length coupled with omission



of transactions as between the appellant and Stefanutti Stocks Marine in the TP Policy, the tribunal found that the commissioner's decision to disallow the expenses related to the transactions was correct.

24. For the reasons set out, the tribunal made dispositive orders setting aside the assessment of tax on the deferred income, it upheld the Commissioner's decision to disallow the personal expenses and the Commissioner's decision to disallow the related party expenses.
25. The appellant appeals to this court against the Tribunal's judgment on the disallowed claims through the Memorandum of Appeal dated August 13, 2021. The Commissioner filed its Statement of Facts dated September 15, 2021. Both parties have supplemented their arguments through written submissions which are on record. Since the appeal and the parties' submissions mirror their positions as already highlighted above, I find that it is not necessary to summarize them again and will only make relevant references in my opinion below.

### **Analysis and Determination**

26. The court's jurisdiction in determining this appeal is circumscribed by 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". A court limited to resolving matters of law is not permitted to substitute the Tribunal's decision with its own conclusions based on its own analysis and appreciation of the facts unless the findings are so perverse that no reasonable tribunal would have arrived at them (see *John Munuve Mati v Returning Officer Mwingi North Constituency & 2 others* [2018] eKLR).
27. Although the appellant has raised four grounds in its Memorandum of Appeal, it has condensed the same to three issues for determination in its submissions as follows;
  - a. Whether the Tribunal erred in holding that the costs incurred by the appellant in generation of its deferred income were disallowable expenses.
  - b. Whether the staff costs incurred by the Appellant on its expatriate personnel are deductible or allowable expenses under section 15(1) of the *ITA*.
  - c. Whether the Tribunal erred in disallowing related party expenses.

### **Costs incurred in generation of deferred income**

28. The appellant submits that while the tribunal addressed the issue of expenditure incurred by the appellant in generation of its deferred revenue and held that the same are disallowable expenses, this issue was not among those in the appellant's grounds of appeal and that the issue was raised by the commissioner in its Statement of Facts filed before the Tribunal. That the tribunal in determining this issue, misdirected itself by mixing a claim for personnel expenses with that of expenses incurred in generation of deferred income.
29. Having gone through the appellant's objection, I agree that the appellant at para. 2 stated that, "...the costs relating to the deferred revenue were incurred in the succeeding years of income. It is for this reason that there are no costs included in WIP (work in progress)." It is clear therefore that the appellant never contended that it incurred costs that ought to have been deducted and allowed in the 2013 year of income. In the Objection Decision, the Commissioner also confirmed this position that the costs relating to the deferred income were claimed in 2014 but then stated that it could not allow the costs claimed in 2014 as this was contrary to the certification value tabulated and that the certification was the supporting documentation for work done through which the client measures the value of works done and proceeds to pay for the corresponding invoice.



30. I therefore agree with the appellant that the tribunal addressed the issue of expenses incurred in generation of the appellant's deferred income when the same was not raised by the appellant in its objection or appeal. The Tribunal's holding that the said expenses are disallowable cannot be allowed to stand as it was arrived at based on the wrong facts. In any event, since the tribunal held that the deferred revenue had already been accounted for and that the commissioner was wrong in subjecting it to income tax, in the same way, the costs relating to the deferred revenue were incurred and claimable in the Appellant's succeeding year of income and as such there was nothing due to the commissioner from the appellant on account of its deferred income. I therefore find that the appellant succeeds on this ground of appeal.

### **Staff costs incurred by the Appellant on its expatriate personnel**

31. According to the commissioner, the appellant did not support the variance between employment costs claimed in the audited financial accounts and gross salaries from the payrolls/payee returns as expenditure wholly and exclusively incurred in the production of Income as required by section 15 of the *ITA*. The commissioner held that costs relating to rent, cable television subscription, installation and activation fees as well as other miscellaneous payments were well supported and were indeed incurred in the production of the appellant's business revenue.
32. The tribunal held that the aforementioned expenses were personal expenses and not allowable against business income. I agree with the appellant that this conclusion was erroneous in light of the commissioner's findings that the appellant had supported the same as having been incurred in generating the business income.
33. However, the tribunal did not deal with the issue whether the Commissioner erred in disallowing the salary expense as this was an express ground of appeal and which the Appellant submitted on. Although the Appellant urges the court to make a finding on this issue, this is a factual issue reserved for determination by the Tribunal and this court, in considering only matters of law can only conclude that the Tribunal erred in failing to make the decision but cannot go ahead and determine the matter. In this respect, the proper remedy would be to order the Tribunal to hear and determine this issue (see *Guaca Stationers v Commissioner of Domestic Taxes* ML ITA No. 24 of 2017 [2020] eKLR and *Commissioner for Investigations and Enforcement v Menengai Oils Limited* ML HC ITA No. 40 of 2020 [2021] eKLR).

### **The related party dealings**

34. The tribunal agreed with the Commissioner that the appellant failed to adduce supporting documentation to the effect that the services between the appellant and its related entities were not rendered at arm's length. On its part, the appellant contends that the tribunal failed to consider the evidence presented by it to demonstrate that indeed services were rendered to it by Stefanutti Stocks Marine and that the same was in accordance with the Transfer Pricing Policy of the Stefanutti Stocks Group of Companies. Whereas the appellant provided the Group's TP Policy prepared in 2016, I note that under the Policy's "Scope of Analysis" it was prepared as "a basis for future transactions within the group" meaning that the said policy only applied to the related parties' transactions after February 2016. I therefore agree with the Commissioner that the Policy did not cover the transactions between the related parties during the subject period, that is 2013, and that the appellant had admitted in its earlier correspondence that there were no formal agreements governing the transactions between the appellant and the related entities.



35. I therefore find and hold that the tribunal was correct to conclude that the appellant did not provide supporting evidence to prove that the transactions between it and its related entities were at arm's length. This ground of appeal therefore fails.

### **Disposition**

36. In conclusion, I make the following dispositive orders in relation to the appeal:
- a. The appeal in respect of the related party transactions is dismissed.
  - b. The appeal in respect of costs incurred in generation of deferred income is allowed.
  - c. The Tribunal is directed to rehear the appeal and make a determination as to whether salary expenses are allowable costs pursuant to section 15 of the *Income Tax Act*.

**DATED AND DELIVERED AT NAIROBI THIS 15<sup>TH</sup> DAY OF SEPTEMBER 2023.**

**D. S. MAJANJA**

**JUDGE**

Court Assistant: Mr Michael Onyango.

Mr Wasonga instructed by Wasonga B. O and Associates Advocates for the Appellant.

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

