



Commissioner of Domestic Taxes v Dynasoft Business Solutions Limited (Income Tax Appeal E083 of 2023) [2024] KEHC 13980 (KLR) (Commercial and Tax) (11 November 2024) (Judgment)

Neutral citation: [2024] KEHC 13980 (KLR)

**REPUBLIC OF KENYA
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)
COMMERCIAL AND TAX
INCOME TAX APPEAL E083 OF 2023
JWW MONG'ARE, J
NOVEMBER 11, 2024**

BETWEEN

COMMISSIONER OF DOMESTIC TAXES APPELLANT

AND

DYNASOFT BUSINESS SOLUTIONS LIMITED RESPONDENT

(Being an Appeal against the Tax Appeals Tribunal's judgement delivered on 20/4/2023 in TAT NO.785 of 2021)

JUDGMENT

1. The Respondent, a company whose main activity is to provide information communication technology service and business solution services within Kenya, was flagged for audit by the Appellant as there were discrepancies as per the undeclared withholding tax and declarations of income in the VAT returns.
2. The Appellant claimed that the Respondent had failed to withhold and remit tax in respect to payments made for royalties to a non-resident person (Microsoft) as per section 35(1) of the *Income Tax Act*. The Appellant also discovered that some supplies were not declared for VAT despite withholding VAT being deducted.
3. The parties disagreed on the amount of VAT to be paid and the payment of Withholding Tax (WHT) on the software purchase from Microsoft Ireland by the Respondent.
4. Ultimately, the Appellant issued an objection decision on 22/10/2021 whereby it revised the VAT assessment to Kshs.6,931,498/= and confirmed WHT at Kshs.49,889,281/= inclusive of penalties and interest.



5. The Respondent Appealed against the objection decision in the Tax Appeals Tribunal (the Tribunal) which considered the Appeal. The Tribunal allowed the Appeal subject to the partial Consent of the parties dated 17/5/2022 and set aside the Appellant's objection decision in respect of the assessment on withholding tax.
6. The Appellant being aggrieved by the decision of the Tribunal Appealed against it vide its memorandum of appeal on the following grounds:-
 1. . THAT the Honourable Tribunal erred in failing to find that the Respondent's Appeal contravened the express provisions of Section 52(2) of the *Tax Procedures Act*.
 2. That the Tribunal erred in law in failing to recognize that any action of parties flowing from any illegality were null and void ab initio.
 3. That the Honourable Tribunal erred in law by misinterpreting the provisions of Sections 2, 10(1) (b) and 35 of the *Income Tax Act*."
7. Based on the foregoing, the Appellant prayed to have the Appeal allowed and the decision of the Appellant set aside. Further the Appellant prayed to have its decision demanding taxes from the Respondent upheld and for the costs of the Appeal.
8. In opposition to this Appeal, the Respondent filed a statement of facts dated 14/7/2023.
9. The Respondent contended that the Tribunal correctly found that its Appeal before it was properly on record and valid; that the second ground of appeal was an entirely new ground that was not canvassed before the Tribunal and contravenes the provisions of Section 56(3) of the TPA 2015 and that no particulars surrounding the alleged illegality have been provided by the Appellant.
10. In response to the third ground of Appeal, the Respondent stated that payment made by it to Microsoft do not qualify as a royalty under sections 2, 10 and 35 of the *Income Tax Act* ('ITA') since the Agreements governing the relationship between the Respondent and Microsoft with respect to the software distributed by the Respondent to Microsoft's customers do not grant to the Respondent the right to use the software; that the Respondent is a mere distributor of Microsoft's software and only facilitates the business between Microsoft and Microsoft's customers.
11. Further that the absence of conferment on the Respondent by Microsoft of non-exclusive rights to reproduce, distribute or modify the Microsoft software, the payments made by the Respondent to Microsoft under the governing agreements cannot be deemed a royalty and the Tribunal thus correctly applied the provisions of section 2, 10 and 35 of the ITA in finding that payments made by the Respondent to Microsoft did not amount to a royalty.
12. The Respondent asserted, without prejudice to its arguments, that the Appellant has no legal basis to demand WHT from it for the period between 1/6/2016 to 7/11/2019 following deletion of Section 35(6) of the ITA which gave the Appellant power to demand WHT from the Respondent as if it was tax due and payable from the Respondent.
13. Based on the foregoing, the Respondent prayed for an order to uphold the judgement of the Tribunal and to dismiss the Appeal with costs.

Analysis and Determination

14. The Appeal was canvassed through written submissions with the Appellant filing its written submissions dated 3/11/2023 while the Respondent's submissions were dated 1/3/2024.



15. The court has carefully considered the entire record of appeal, the pleadings filed in opposition and the submissions by both counsels for the parties. The court notes that in its submissions, the Appellant stated that it abandoned ground (1) and (2) of its grounds of appeal and proceeded on ground (3) only. This therefore leaves the court with only the third ground only to determine, that is, whether the Tribunal erred in law by misinterpreting the provisions of Sections 2, 10 (1) (b) and 35 of the *Income Tax Act*.
16. Section 2 of the *Income Tax Act* defines a royalty as:-
- “royalty” means a payment made as a consideration for the use of or the right to use–
- (a) any copyright of a literary, artistic or scientific work; or
 - (b) any cinematograph film, including film or tape for radio or television broadcasting; or
 - (c) any patent, trade mark, design or model, plan, formula or process; or
 - (d) any industrial, commercial or scientific equipment.”
17. Section 10 (1) (b) of the *Income Tax Act* states:-
- “(1) For the purposes of this Act, where a resident person or a person having a permanent establishment in Kenya makes a payment to any other person in respect of–
- (a) ...
 - (b) a royalty or natural resource income;
- ...the amount thereof shall be deemed to be income which accrued in or was derived from Kenya.”
18. Section 35 of the *Income Tax Act* provides that:-
- “every person shall, upon payment of any amount to any non-resident person not having a permanent establishment in Kenya, in respect of a royalty, which is chargeable to tax, deduct therefrom tax at the appropriate non-resident withholding tax rate.”
19. In this case, the Respondent entered into 3 agreements with Microsoft (a non-resident entity) which granted it the authority to resell and distribute Microsoft’s licensed software subject to the terms and conditions set out in the agreements. The agreements are the Microsoft Dynamics Solution Provider Agreement (SPA Purchase Terms), the Microsoft Dynamics Solution Provider Agreement (SPA License) and the Master Partner Localization and Translation License Agreement (MPLLA). The agreements are produced in the record of Appeal.
20. Section 1 of the SPA Purchase Terms (page 63 of the record of Appeal) states:-
- “SPA Purchase Terms give the Company (the Respondent) the non-exclusive right to distribute licensed software and provide services to customers.”



21. Section 1 of the SPA License (page 99 of the record of Appeal) states:-
- “SPA Purchase Terms give the Company (the Respondent) the non-exclusive right to distribute licensed software and provide services to customers. This SPA License is intended for companies that sell primarily to external customers, not primarily for sales to the same entity that executes this SPA licence and its affiliates.”
22. Under section 3 of the SPA License (page 101 of the record of Appeal) Microsoft granted the Respondent the non-exclusive, non-transferable limited licence to distribute the licensed software.
23. Section 4(c)(1) of the SPA License (page 103 of the record of Appeal) states:-
- “Company Parties’ rights are expressly limited to the rights described in this SPA licence. Microsoft does not transfer any of its intellectual property rights in or to the licensed software or MS materials to any company parties.”
24. Under the MPLLA, Microsoft granted the Respondent the right to conduct localization and/or translation on the software products supplied by the Respondent to third party customers of Microsoft. The rights granted to the Respondent under the MPLLA were non-exclusive, royalty-free, non-transferable, non-assignable and terminable. This is stated in section 2.1 thereto at page 137 of the record of appeal.
25. From the foregoing agreements, I am of the view that Microsoft granted the Respondent the non-exclusive right to distribute its licensed software and provide services to customers. Microsoft did not transfer its intellectual property in the software to the Respondent and the Respondent did not pay any royalties towards it. The Respondent was granted rights limited to those of a commercial intermediary without the right to exploit or alter the software or further reproduce it.
26. In arriving at this conclusion I am guided by paragraph 10.1 of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention (MTC) Commentary to Article 12 provides that:-
- “Payments that are solely made in consideration for obtaining the exclusive distribution rights of a product or service in a given territory do not constitute royalties as they are not made in consideration for the use of, or the right to use, an element of property included in the definition.”
27. Further to that, paragraph 14.4 of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention (MTC) commentary to Article 12 provides that:-
- “Arrangements between a software copyright holder and a distribution intermediary frequently will grant to the distribution intermediary the right to distribute copies of the program without the right to reproduce that program. In these transactions, the rights acquired in relation to the copyright are limited to those necessary for the commercial intermediary to distribute copies of the software program. In such transactions, distributors are paying only for the acquisition of the software copies and not to exploit any right in the software copyrights. Thus, in a transaction where a distributor makes payments to acquire and distribute software copies (without the right to reproduce the software), the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes.’



28. In the case of Seven Seas Technologies Limited v Commissioner of Domestic Taxes [2021] KEHC 358 (KLR), the court held:-

“ This court was referred to the case of Engineering Analysis Centre of Excellence Private Ltd vs Commissioner of Income Tax Supreme Court of India Civil Appeals No. 8733-8734 where it reads in part; ‘In all these cases, the licence that is granted vide EULA, is not a license in terms of section 30 of the *Copyright Act* , which transfers an interest in all or any rights but a licence that imposes restrictions or conditions for the use of computer software.....

What is licensed by the foreign, non-resident supplier to the distributor and resold to the end -user or directly supplied to the resident end -user is in fact the sale of a physical object which contains an embedded computer program and is therefore sale of goods.’

In the court’s final disposition the judge held:-

“It is therefore right to conclude that the Appellant was not subject to pay royalties and in turn not liable to pay Withholding tax to the Respondent with regard to the distribution of the computer software. For these reasons the Appeal is allowed and the decision of the Tribunal set aside.”

29. Having considered the authorities above and the entire record, I find that the payments made by the Respondent to Microsoft were to enable it to distribute Microsoft’s software to end users in Kenya and were not royalty payments as described under section 2 of the *Income Tax Act*. As such, the Respondent was not liable to pay withholding tax to the Appellant as no royalties were paid. I agree with the Tribunal’s judgement and find that it did not misinterpret the provisions of Sections 2, 10 (1) (b) and 35 of the *Income Tax Act*.

30. The upshot of the foregoing is that the Appeal fails and the decision of the Tribunal is upheld. Each Party is directed to meet their own costs of the Appeal.

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 11TH DAY OF NOVEMBER 2024

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J.W.W. MONG’ARE

JUDGE

In the Presence of:

- 1. Ms. Naeku for the Appellant.
- 2. Ms. Mugwe holding brief for Ms. Waithira for the Respondent.
- 3. Amos - Court Assistant

