REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

INCOME TAX APPEAL NO.3 OF 2018 AND NO.2 OF 2018

(CONSOLIDATED)

KENYA FLUOSPAR COMPANY LIMITED.....APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

AND

THE COMMISSIONER OF DOMESTIC TAXES.....APPELLANT

VERSUS

KENYA FLUOSPAR COMPANY LIMITED.....RESPONDENT

JUDGMENT

1. The two appeals herein were consolidated and heard together. They relate to the same judgment of the Nairobi Tax Appeals Tribunal delivered on 30th January 2018 in Appeal No.1 of 2016 and Appeal No. 37 of 2016 (Consolidated). I will refer to the parties as KFC and Commissioner respectively.

2. In Appeal No.2 of 2018 herein dated 15th March 2018 the Appellant is the Commissioner and the appeal is on the following grounds –

1. The learned Tribunal erred in law by ruling that a tax liability arises when an assessment of tax is communicated to the tax payer contrary to section 6(4) as read with section 13 of the VAT Act Cap.476 (now repealed) and section 5(3) as read with section 12 of the VAT Act 2013 which clearly provide the time as to when a tax liability arises.

2. In making its decision the Honourable learned Tribunal ignored the fact that the Kenyan taxation system is based on tax payers self declaration and that a tax liability arises and becomes due at the point at which a tax payer ought to have made a declaration and not when the Commissioner issues an assessment.

3. The failure by the Honourable learned Tribunal to appreciate the provisions of section 6(4) as read with section 13 of the VAT Act Cap.476 (repealed) as to when VAT liability arises led to the Honourable Tribunal reach an erroneous conclusion that section 68 (2) of the VAT Act, 2013 does not apply to the case at hand.

4. The learned Tribunal failed to appreciate that the VAT liability in dispute relates to the years 2007 to 2010 and therefore became due and payable long before the Value Added Tax Act Chapter 476 was repealed in 2013.

5. While holding that section 45(5) of the VAT Act 2013 is applicable in this matter the Honourable learned Tribunal erred in law and fact when it ignored and/or disregarded the Appellant's alternative argument that the respondent was willfully negligent and therefore section 45(6) of the VAT Act 2013 is applicable.

6. The Honourable Tribunal erred in law and fact when it failed to notice that the respondent was at all material times relevant aware that reverse VAT was applicable but deliberately and or negligently failed to declare the same in its return and thereafter remit payments and that the said acts amounted to gross willful negligence hence rendering the provisions of section 45(6) of the VAT Act, 2013 applicable.

7. The Honourable Tribunal erred in law and fact when it failed to find that section 45 (6) of the VAT Act 2013 is applicable even after the Appellant had discharged its burden of proof by extensively demonstrating that the respondent was reasonably expected to be aware of the VAT legislation subjecting payment of imported services to reverse VAT and omitting the same in its self assessment returns amounted to gross willful negligence.

8. The Tribunal erred in law and fact by failing to appreciate that the respondent entered into two distinct contracts one signed on 26th January 2009 which related to lease of equipments and the second one dated 29th January 2009 which related to provision of drilling services.

9. The learned Tribunal erred in law and fact by ignoring that the Reverse Circulation Drilling contract dated 29th between the respondent and Consolidated Building and Mining Trading (CBMT) Ltd Botswana was for the provision of both drilling equipments and the staff necessary to operate and maintain the drilling equipment and therefore making the same a contract for service and not a contract for lease of drilling equipment.

10. The learned Tribunal erred in law and fact by ignoring two versions of invoices submitted by the Respondent in evidence (the first version of invoices with a series number TDC XXX were in relation to the "equipment rentals" while invoices with a series number 100XX – 2009 were in relation to reverse circulation drilling contract") By ignoring the second set of invoices which clearly indicate that the payment made related to the provision of reverse circulation drilling service, the Tribunal arrived at an erroneous conclusion that all the payments made by the respondent related to lease for equipment and therefore subject to withholding tax at 15% instead of 20%.

11. The learned Tribunal erred in law and fact by failing to appreciate the fact that Titan Drilling Congo (SPRL (Titan) which entered into a lease agreement with the respondent on 26th January 2009 and Consolidated Building and Mining Trading Ltd (CBMT) which entered into a Reserve Circulation Drilling Contract on 29th January 2009 belong to the same group of companies and that Titan would raise and invoice to the Respondent while payments would be made directly to CBMT account in Jersy Island (the holding company).

12. The learned Tribunal erred in law and fact by failing to notice while the invoice were raised by Titan the relates (sic) used therein were the ones stipulated in the Reverse Circulation Drilling contract between the respondent and CBMT meaning that the payments related to the Reverse Circulation Drilling Services.

13. The learned Tribunal erred in law by allowing alleged management services fees paid by the Respondent to a related company (KCMC) as deductable expenses for purposes of determining the Respondent's taxable income contrary to the provisions of section 15(1) as read together with section 18(3) of the Income Tax Act.

14. The Tribunal erred in law and fact in failing to recognize that based on a contract between the respondent and KCMC, management services were to be offered to the respondent only upon request and that there was no evidence that the respondent ever requested for any services from KMC.

15. The Tribunal erred in law and fact by ruling that the alleged management fee paid by the Respondent to KCMC is an allowable expense in the absence of any evidence to the effect that the said management services were offered by KCMC.

16. The learned Tribunal erred in law and fact by failing to recognize that the evidence adduced by the Respondent to support receipt of the alleged management services was in the nature of shareholder and/or duplicated services which are not allowable under section 16 of the Income Tax Act.

17. The learned Tribunal erred in law by allowing management services fees paid by the Appellant (should be respondent) to a related company (KCMC) as deductable expenses for purposes of determining the appellant's (respondent's) taxable income contrary to the provisions of section 18(3) of Income Tax Act the Income Tax Act (Transfer Pricing) Rules 2006 and the OECD Transfer Pricing guidelines which require that the tax payer does prove that services alleged were actually offered and that the recipient of the services derived some commercial or economic value from the services.

18. The learned Tribunal erred in law by allowing the alleged management services fees paid by the Respondent to a related company (KCMC) as deductible expenses for purposes of determining the Respondent taxable income contrary to the provisions of section 5(1) as read with section 18(3) of the Income Tax Act and Chapter 7 of the OECD Transfer Pricing guidelines which expressly provide that duplicated services and shareholder activities do not qualify as an intra-group services (sic).

19. The learned Tribunal erred in law and fact by failing to recognize that the method applied by the respondent in sharing profits with KFC EPZ does not adequately remunerate the Respondent for the factions (functions) carried out assets utilized and the risk assumed in the mining of fluorspar.

20. The Tribunal failed to recognize that the Respondent's methodology of sharing profits treated dividends received from KFC EPZ as a trading profit hence reducing the profit share attributed to the Respondent.

21. The learned Tribunal erred in law and fact by allowing the Respondent method of sharing profit which method fails to recognize that the missing licence owned by the Respondent is the key intangible asset in the mining of fluorspar.

22. The learned Tribunal erred in law and fact by allowing the Respondent method of sharing profit which method disregarded risk taken by the Respondent in the exploration of mineral reserves.

23. The Tribunal erred in law and in fact when it allowed the method used by the Respondent in sharing profit which method treated the routine processing activity by KFC EPZ as a unique function.

24. The Honourable learned Tribunal erred in law and fact by failing to recognize that using a proper functional analysis KFC EPZ is the least complex party as it performed routine functions hence should be entitled to routine returns.

25. The Honourable learned Tribunal erred in law and fact by failing to recognize that using proper functional analysis the respondent has key valuable intangibles undertakes all the key risks and thus should be entitled to the residual profits after remunerating KFC EPZ for its routine functions.

3. Based on the above grounds Commissioner seeks from this court that its appeal be allowed and that the judgment of the Tax Appeals Tribunal be set aside; that the objection decision issued by the Commissioner the first relating to the issue of VAT and the second one relating on the issue of Corporation Tax and Withholding Tax be upheld; and lastly that the appeal costs be granted to the commissioner against the KFC.

4. Appeal No.3 of 2018 by KFC arises from the same decision of the Tax Appeals Tribunal. The appeal (No.3 of 2018) is on the following grounds -

i. The Tribunal erred in failing to find or hold that the respondent's purported Assessment was invalid as the respondent had failed to cite the provision under the Income Tax Act upon which it has been made. In particular, the Tribunal erred in;

a. failing to address and uphold the appellant's contention that the said Assessment was invalid as the respondent had failed to respond to the appellant's objection against its failure to cite the provision under which the Assessment was based.

b. failing to reject the respondent's reliance on section 3(2) (a) (i) of the Income Tax Act as that was not the basis of the impugned Assessment but rather relied upon (and improperly so) in the objection decision.

c. misconstruing section 3(2) (a) (i) of the Income Tax Act and therefore the basis upon which charging of tax whether on self assessment, additional assessment or any other assessment that would lead to determination of tax liability is based. As a charging section, section 3(2) (a) (i) could, and did not authorize the raising of an Assessment.

ii. The Tribunal erred in law in finding and holding that an Export Processing Zone (EPZ) company is a non-resident company for income tax purposes;

a. The Tribunal ignored the express, substantive provisions of the Income Tax Act defining resident and non-resident person i.e section 2 of the Income Tax Act and the paragraph 2 (f) Head B of the Third Schedule to the Income Tax Act which classifies an EPZ as resident for income tax for purposes of the Act.

b. The Tribunal's reliance on paragraph 3 (a) of the Eleventh Schedule (4B) to the Income Tax Act was mistaken as it specifically and only relates to rate of withholding tax applicable to an EPZ during the period when it is exempt from corporate tax i.e the non-resident rate of withholding tax

iii. The Tribunal fundamentally erred in fact in concluding the capping of operating profit to 100% of the costs by the Appellant's operating profit in one year was unjustifiable and unreasonable because it was based (on) internally prepared accounting documents. The Tribunal fundamentally misconstrued the true nature of the Appellant's business and the operating costs occasioned to it as the figures before it were actually based on the audited financial statements.

5. From the foregoing grounds of appeal, KFC has asked this court to set aside part of the judgment of the Tribunal delivered on 30/01/2018upholding the Appellant's tax assessment and holding that profit split method should be applied, but without capping of the appellant's operating profit at 100% of the production cost; to order that KFC is not liable to pay taxes in terms of the provisions of the Income Tax Act; to stop the Commissioner from demanding the tax, interest and penalties in respect of the years in contention; and lastly, to permanently restrain the Commissioner from taking any enforcement mechanisms with respect to the demand for tax for the years in contention.

6. By consent of counsel for the parties, the appeal proceeded by way filing of written submissions, which were also highlighted orally in court through Appeal No. 3 0f 2018.

7. Kenya Fluorspar Company (KFC) filed their written submission on 7th May 2019 while the Commissioner of Domestic Taxes (the Commissioner) filed written submissions on 24th August 2019. Thereafter KFC filed supplementary written submissions on 5th September 2019.

8. On the hearing date Mr. Amoko for KFC relied on the written submissions and the supplementary submissions filed, and orally submitted that the genesis of the contest herein was the assessment by the Commissioner dated 3rd September 2015 relating to corporation tax based on the income of KFC as opposed to its subsidiary KFC EPZ.

9. Counsel contended that the entire assessment of all taxes done on 3rd September 2015 was bad in law as the Commissioner failed to state the legal basis on which the taxes were raised under any of the heads of taxes. The only thing that the Commissioner did was to identify the notification he sent to KFC to appeal or contest the assessment, and also argue at the Tribunal that it did not matter that the legal basis was

not stated, and erroneously relying on the case of **Pilly Management Consultants – vs – Commissioner of Income Tax- HC Misc. Application No. 525 of 2006,** in which Korir J. observed that failure to identify the legal basis was immaterial. Counsel contended that in that particular case the legal basis for raising the taxes was actually identified, and that the question in that case was whether the decision was capricious.

10. Counsel contended that the relevant decisions herein were the case of **Geothermal Development Co. Ltd – vs – Attorney General and 30 others (2013)eKLR** a decision by Majanja J, and the case of **Republic – vs – Kenya Revenue Authority** – Ex parte **Funan Construction Ltd [2016]eKLR** a decision by Odunga, J. in which the court stated that the notice must state the legal basis on which the tax notice was issued, and contended that due to the failure of the Commissioner to state the legal basis of the assessment, this court should dismiss Appeal No. 2 of 2018 herein and allow Appeal No. 3 of 2018.

11. Counsel stated further that there were two additional issues on the corporation tax. First, that previously KFC had been a loss making statutory body which was privatized with new owners who came in to restructure it and make it viable, and thus formed Kenya Fluospar Company Ltd (present KFC). One of the important items in the restructured private company was to take into account the issue of taxes, and consequently the activities of KFC were separated from those of a subsidiary it formed – KFC EPZ. While KFC mined the mineral, it sold it to the subsidiary KFC EPZ which processed, exported and sold the product; thus the subsidiary took the risk of processing and selling the products. Thus tax authorities had to be concerned with determining the income of each of the two related companies.

12. In the present case, the Commissioner initially used the profit split method, which was a ratio formular and the KFC had no problem with the formular. However, the problem arose in the application of the methodology to the tax assessment, as there were errors of methodology resulting in erroneous taxes of over Kshs.5,000,000/= which mistakes KFC objected to and expected application of the correct methodology by the Commissioner.

13. However, instead of the Commissioner making the necessary corrections, it switched to another method of Transaction Assessment which was objected to by KFC as it was wrong, as it was not open to the Commissioner to change the tax assessment method is an objection case - and relied on the case of **Fidelity Shield Insurance Co. Ltd – vs – The Commissioner of Domestic Taxes – VAT Appeals Tribunal No.26 of 2012** in which the Tribunal stated that shifting of goal posts was unfair and illegal.

14. With regard to merits, counsel submitted that since the Tribunal agreed with KFC that the profit split method was the appropriate method, it followed that Appeal No. 2 of 2018 herein and submissions of the Commissioner disclosed no manifest error in the conclusion reached by the Tribunal, thus Appeal No.2 of 2018 herein should be dismissed with costs.

15. Counsel finally submitted that KFC was contesting the single item in which it did not succeed at the Tribunal, and on which they filed this appeal to challenge the decision of the Tribunal therein. This was the decision of the Tribunal on capping. Counsel contended that it was important that the relative roles of the two organizations be reflected, and that KFC should have been capped at 100% of its costs, which the Tribunal did not do.

16. Counsel argued that the Tribunal erred in principle on this issue of capping and the Tribunal's decision should thus be interfered with. The first reason for the error was that the decision of the Tribunal was not consistent with its own findings on the roles of the two companies. Secondly, the Tribunal did not give any reasons for the rejection of the 100% capping. Counsel urged this court to peruse and consider the written submissions and supplementary submission of KFC and dismiss Appeal No.2 of 2018, and allow Appeal No.3 of 2018 with costs.

17. Mr. Lemiso for the Commissioner in his oral submissions stated that this being a first court of appeal they had provided to this court with all the materials used before the Tribunal as this court had powers to reconsider them, and stated that there were six issues to be considered.

18. With regard to whether the assessment by the Commissioner was valid, counsel submitted that there was no dispute that the Commissioner had power to assess taxes, but KFC had now raised a dispute that the Commissioner had not cited the section of the law for doing such assessment herein. Counsel submitted that under section 77 of the Income Tax Act the Commissioner had power to make additional assessments, and in addition section 78 gave the particular ingredients of such assessments, Counsel stated further that the impugned assessment had all the required ingredients, and faulted counsel for the KFC for saying that it was necessary for the Commissioner to state the section of the law, while the case authorities cited did not state that it was mandatory to do so. In any event, counsel argued an assessment was not appealable to the Tribunal, but only the objection decision of the Commissioner was appealable.

19. Counsel stated further that before the Tribunal there were two objection decision appeals, one for VAT issued on 27/11/2015, and another on Corporation Tax, both of which assessments contained all ingredients required by law, even though the VAT Act had been repealed. Counsel thus urged this court to dismiss the ground of appeal challenging the assessments.

20. With regard to corporation tax, counsel appreciated that his colleague had clearly explained the operations of KFC and KFC EPZ, with KFC doing the mining and KFC EPZ doing the processing and export, and sales and submitted that though KFC EPZ was not a party in this appeal, the Schedule to the Income Tax Act deemed it as non-resident enterprise and thus not liable to payment of corporation taxes. Thus because it was attractive for a tax payer to allocate big profits to the EPZ to reduce taxes, that was what KFC did in the present case.

21. Counsel submitted that though the Transfer Pricing Rules 2006 under Rule 4 gave the tax payer, in a case of intertwined companies the choice of the method to apply in determining taxes payable, Rule 8 (2) stated that the person shall apply the method most appropriate. In addition, under Rule 9 the Commissioner had power to request for information and books of accounts, and that what the Commissioner did in this case. However, when the Commissioner asked for an assessment method and made the assessment, the tax payer objected, and the Commissioner then realized that the method of assessment used was not the most appropriate, and thus used the Transactional Nett Margin method.

22. Counsel submitted that the reasons for using the Transactional Nett Margin method were given in the Commissioner's statement of facts,

which were mainly two factors which had not been previously considered in the profit split method. First, the intangible mining licence. For the EPZ to operate KFC should do the mining, and KFC was thus to have a mining licence as an intangible asset of KFC. The second factor not considered was the exploration research to find the site for mining – also an intangible asset of KFC. Considering these two factors therefore, counsel argued that the profit split method of assessing tax was not appropriate, and the Commissioner thus used the Transactional Nett Margin method.

23. Additionally, on corporation tax, counsel argued that KFC had two related companies the EPZ and another Kestrel Capital Management Co. Ltd (KCMC) owned by same person, and KCMC was to provide management services. In this scenario the Commissioner was uncomfortable and thus disallowed a deduction of taxes, for the reason that the expenditure was not incurred wholly in production, as the e-mail communication from KFC received by the commissioner did not bring out any service or professional advice rendered by KCMC to KFC. Counsel emphasized that the OECD Guidelines were applicable to all parties involved herein.

24. With regard to VAT, counsel stated that the period in question was 2007 to 2013 and when the VAT assessment was done, no objection was received, thus it was payable. Counsel pointed out that infact KFC even paid VAT for 2011 to 2013 showing that such tax was payable and added that the contention that the Commissioner was barred from issuing VAT assessments 5 years after the event was not true under section 45(5) of the VAT Act 2013, since section 68 saved taxes outstanding under repealed Act.

25. Counsel argued that VAT became due at the time of supply – under section 5(1)(3) of the VAT Act, 2015, which was expounded under section 12 which had provisions similar to section 6 of the repealed Act. Thus counsel concluded that VAT became due herein when services were rendered, and emphasized that the repealed Act (Cap.476) did not have any time limitation, and that since the VAT was due under that repealed Act, then there could be no time limitation.

26. Counsel submitted also that alternatively, if this court finds that the law applicable was the new Act, then though section 45(5) provided for limitation of time, section 45(6) provides for exceptions to such limitation, and in the present case counsel argued, the tax payer engaged in gross neglect when they paid VAT for 2011 – 2013 without saying that reverse assessment was not valid, which means that they were liable to pay VAT assessed. In Kenya also counsel pointed out, the tax regime was self assessment and that tax became due at the time of self assessment.

27. Lastly, counsel submitted that the method applied by the Tribunal on capping was wrong, and asked this court to consider their detailed written submissions, and urged that the decision of the Tax Appeals Tribunal be set aside, Appeal No.2 of 2018 herein be allowed, and Appeal No.3 of 2018 herein be dismissed with costs.

28. In response, Mr. Amoko submitted that the Commissioner did not invoke section 77 of the Act, and that at the Appeals Tribunal, the Commissioner relied on section 33 of the Act. Further that section 77 of the Act, was being raised for the first time on appeal and that if the Commissioner had relied on same at the Tribunal, then KFC would have responded. Counsel emphasized that the Constitution of Kenya required that there must be a legal basis for executive action against a person, and such that was lacking in the present case.

29. With regard to merits of the matter, counsel submitted that the Commissioner now seemed to be asking for something like a retrial, while no substantive error of the Tribunal had been raised or submitted on by counsel.

30. With regard to corporation tax, counsel submitted that Parliament was the institution mandated to advance public good, and that the exploitation of an existing favourable tax regime was a right which KFC was entitled to according to the law, as it was the tax – payer who had the right to select the appropriate tax method, and in this case the Commissioner had not shown any act of tax evasion that would affect that right.

31. Counsel added that in the initial decision of 3/9/2015 the Commissioner had infact relied on the mining licence and research as a basis for recalculation of tax under the profit split system, and therefore he could not later change by issuing a fresh assessment as he did. Further, the Tribunal explained why the profit split method was appropriate and the only mistake the Tribunal made was with respect to capping of profit basing it on the contribution of parties to profit since the Tribunal did not give reasons which was an error, and had accepted the split profit method which was based on capping and could not thus refuse the capping for KFC.

32. With regard to management services, counsel stated that the Commissioner did not show that they were not excluded services, thus the reasoned decision of the Tribunal stands correct.

33. With regard to 5 years limitation period, counsel submitted that the exceptions of willful neglect or fraud of the tax payer were considered by the Tribunal and it found none. Thus it was not open to this court to consider the issue of time limit.

34. Finally, counsel submitted that the Interpretation and General Provisions Act (Cap. 2) required that action be taken within a reasonable time, and since KFC had been given a final tax assessment, the Commissioner could not go back to it, since it was now not possible to go back to section 68 of the Act.

35. I have considered the two appeals which were consolidated. I have considered both oral and written submissions of the parties and have also perused the proceedings and judgment of the Tax Appeals Tribunal and relevant documents.

36. The appeals herein relate to liability to pay taxes and the method of assessing or determining the same.

37. This being a first appeal from a decision of the Tribunal where documentary evidence was tendered by both sides this court has an obligation to reconsider all the relevant evidence that was tendered before the Tribunal and come to its own independent conclusions and interferences – see **Selle and Another – vs – Associated Motor Boat Company Ltd and Others [1968]EA123**. In doing so, I have to appreciate that the appeal is with regard to a specialized area, that is the application of the tax regime and tax laws. I will deal with issues

that I have identified, one after the other.

A. What is the effective date of reverse VAT assessment and whether in the circumstances the Commissioner could VAT assessment beyond 5 years.

38. Arguments have been put before me on both sides. The Commissioner states that assessment is effective when tax was to be self assessed. With regard to 5 years limitation the Commissioner maintains that it can do assessment after 5 years. KFC on the other hand says that such is not allowed by law. I note that the Tax Appeals Tribunal determined that the assessment of VAT herein was that at 27th November 2015. It also determined that the law applicable at assessment was the VAT Act 2013 which became operational on 2nd September 2013. The Commissioner maintains that under section 68(2) of the said Act, the Tax liability arose prior to the coming into operation of the VAT Act 2013, and that the repealed Act had no limitation period. In the alternative, the Commissioner relies on section 45(6) of the VAT Act 20B, alleging that the taxpayer herein committed acts of willful neglect, thus entitling the Commissioner to do assessment even after 5 years.

39. In deciding on the issue,Tribunal in particular concluded as follows –

> "The tribunal notes that tax becomes payable once assessment is served upon the appellant and that such tax would have been outstanding prior to the operationalisation of the VAT Act, 2013 on 2nd September 2013. As mentioned elsewhere in this judgment, the VAT Assessment which was is the subject of this appeal was confirmed on 27th November 2015 and as such became payable at that point. As to whether the Respondent can raise assessments beyond the five – year time limit as prescribed under section 45(6) of the said Act, the tribunal determines that the respondent has not provided cogent and persuasive arguments in support of their position."

40. Having considered the facts and circumstances of this matter, I agree with the Tribunal that reverse VAT tax herein was assessed and confirmed by the Commissioner on 27th November 2015 and could only became payable then, as there is no suggestion from the Commissioner that a reverse VAT assessment had been done before that date.

41. With regard to the 5 years limitation period, The Commissioner says that the repealed Act had no limitation period and relies on the transitional clause under section 68(2) of the VAT Act 2013 which provides as follows –

> "Notwithstanding the repeal of the Value Added Tax Act, the provisions of that Act shall remain in full force and effect for the purpose of assessment and collection of any tax and recovery of any penalty, payable under the Act and outstanding at the date upon which such repeal becomes effective.

42. In my view, section 68(2) of the VAT Act 2013 above, applies only to VAT already assessed and payable under the repealed Act, not VAT assessments done later on as happened in this case on 27/11/2015.

43. I also note that under the VAT Act 2013, Section 45(6), there are situations where the VAT assessment can be done beyond the five years limitation period. The Commissioner in the alternative relied on this section. The subject section provides as follows –

> "The time limit under subsection (5) shall not apply in the case of gross willful neglect, evasion or fraud."

44. In my view, for this section to apply, the Commissioner is required to demonstrate an act or acts of gross willful neglect, or tax evasion or fraud on the part of the tax payer. Short of that the section will not apply.

45. The Commissioner in the present case has not demonstrated any act of willful neglect, evasion or fraud committed by the KFC that would justify invocation of section 45(6) of the VAT Act 2013. Thus in my view the 5 years limitation period is applicable herein, and the decision of the Tribunal on the limitation period cannot thus be doubted, and will stand.

B. Whether the Commissioner was right in the using Transactional Nett Margin Method (TNMM) instead of Split Profit Method (SPM) in determining how to share the income tax between KFC EPZ.

46. Having considered all the arguments and documents used by the contesting parties herein, it is not in dispute that KFC opted to use the Split Profit Method in assessing the tax liability. The Commissioner also initially applied this method in his tax assessment. When a dispute was filed by the KFC however on the methodology used by the Commissioner in applying this profit split method, the Commissioner changed the method of assessment to Transaction Net Margin Method, citing existence of intangible assets of KFC, that is a mining licence and an exploration licence, and stating that KFC EPZ did not have such intangible licences.

47. I note that under the law, both tax assessment methods can be used under existing Kenya law, depending on the particular operations and relations of related enterprises. There are also other methods of assessing taxes. It is agreed that the choice has to be made governed by the Transfer Pricing Rules 2006, (LN67), under which Rule 4 provides as follows –

> 4. The taxpayer may choose a method to employ in determining the arm's length from among the method set out in rule 7.

48. Rule 7 thus gives the various methods of choice, one of them being the profit split method. In this regard also, Rule 8(2) provides as follows –

8(2). A person shall apply the method most appropriate for his enterprise, having regard to the nature of the transaction, or class of related persons or function performed by such persons in relation to the transaction.

49. In my view, it follows from the above provisions that the choice of the most favourable tax assessment method is that of the tax payer and not the Commissioners. In this regard, I agree with the reasoning in the case of **Unilever Kenya Ltd – vs – The Commissioner of Income Tax [2005]eKLR** wherein it was held that the tax payer is entitled to choose the most favourable method to their advantage as far liability to tax is concerned.

50. I however, agree that the Commissioner can intervene where there is evidence of fraud or evasion of taxes. The Commissioner can also intervene and re-asses income tax of a taxpayer and raise additional assessments – see **Pilli Management Consultants Ltd – vs – Commissioner of Income Tax – Mombasa HC Misc. Application No.525 of 2016**.

51. The main issue that has arisen herein is that instead of addressing the objection raised using the selected profit margin method, the Commissioner changed to the Transactional Nett Margin Method without indicating the law that confers on the Commissioner the power to change the method.

52. Even in this appeal the Commissioner has not pointed the section of the law that gives it the right to change the choice method elected by the taxpayer. The Commissioner maintains that it has general power to change the method because they found new intangible assets of KFC.

53. First of all, there is no evidence that the mining and prospecting licences were new assets not known in the profit split method. Secondly, even if they were new intangible assets, the Commissioner would have to back his change of method with the law, which they have not. I thus find that the Commissioner had no legal power to change to a new method of Transaction Nett Margin method. The Commissioner could only use the Profit Split method chosen by the tax payer. The Commissioner was thus right in using the Transactional Nett Margin Method.

C. Whether the alleged non benchmarked management services offered to KFC by a related non – resident company (KCMC) do in fact exist, and if so what value could be attributed to the same.

54. It is not in dispute that KFC entered into a management consultancy agreement with Kestrel Capital Management Limited (KCMC), such services to be provided upon requests. The Commissioner contends that no such management consultancy services were provided as no requests were made by KFC to KCMC for such services. KFC on the other hand maintains that they were provided with such management consultancy services by KCMC through meetings and other interactions on financial, investment and human resources matters, and relied on minutes of meetings held which were not disputed by the Commissioner.

55. In my view though indeed there is no evidence that any formal written requests for such management consultancy services was produced by KFC, there was evidence of interactions and meetings held. Such interactions and meetings between KFC and KCMC in my view were adequate proof of consultancy services provided. An adviser is an adviser and the final decision will still have to be made by the principal. If an adviser and a principal hold meetings and discuss items on the operations and management of the business affairs of the principal, in my view, that is adequate to satisfy the provision of consultancy services by the consultant. The fact that members of one corporate institution are the same in another corporate institution does not make a difference in law. As for the value to be attributed to the professional services provided, that will go according to the respective contract, and this court is not suited to determine the same with the facts placed before it.

D. Whether service on Hire of Equipment and Contractual fee for Drilling services should be subjected to the same rate of Withholding Tax

56. The rates applicable to charges for withholding tax are to be determined according to statute, and the Commissioner is bound to point at the applicable section of the law that provides for the rate they are applying in determining the rates of taxes payable. Indeed, KFC and Titan Drilling Congo SPRL (Titan) entered into a lease agreement signed on 26th January 2009; and another on 29th January 2009 KFC which is a "Reverse Circulation Drilling Contract" – with Consolidated Building and Mining Trading (CBMT) Ltd. Botwana, to provide drilling equipment and staff.

57. The Commissioner acknowledged that withholding tax of 15% was applied by KFC, but stated that, as there were records in the accounts of that withholding tax was charged but not paid. They demand payment at 20% presently. On the other hand KFC maintains that the reflection in its books was just to acknowledge the debt, and since no payment had been made yet, no withholding tax was due to the Commissioner as yet.

58. I note that this issue was dealt with by the Tribunal which made a finding that the acknowledgement of KFC of that liability in its accounts as a debt did not amount to payment. In my view, since withholding tax is made from payments made, the Commissioner's claim for payment was not valid, as withholding tax becomes due at payment. The rate of the tax is determined by statute and at the time of payment the commissioner can apply the applicable rates. I find no fault in the decision of the Tribunal.

E. Whether KFC EPZ is a resident company in Kenya for purposes of payment of tax.

59. The Commissioner has argued that the EPZ enterprise is not a resident company for tax purposes, while KFC has argued that it is resident, because it is incorporated in Kenya. In my view, under the provisions of the Export Processing Act 1990, the EPZ enterprise though incorporated and physically operating in Kenya was a non resident enterprise under the Act.

60. This is grounded on section 29 of the Act which confers on the EPZ enterprise preferential tax treatment. Section 3 (a) and (b) of the Eleventh schedule to the Act is also clear on the residence of the EPZ enterprise and the tax liability position. It provides as follows –

3(a). The enterprise shall be deemed to be non-resident subject to non-resident rate of withholding tax on payments made to such an enterprise and, where such payments are made by a person who is not an export processing zone enterprise, the tax shall be final.

(b) payment by an export processing zone enterprise to any person other than a resident shall be deemed to be exempted from tax.

61. It cannot thus be said as alleged by KFC that because the EPZ enterprise was incorporated in Kenya and operated in Kenya, then it was a resident enterprise for the purposes of taxation. The EPZ enterprise herein is thus a non resident enterprise. I agree with the finding of the Tribunal.

F. Whether the Capping of profit of KFC determined by the Tribunal was wrong.

62. KFC has contested the capping arrived at by the Tax Appeals Tribunal. The reasons for the capping were given by the Tribunal and were based on the respective activities of the two related enterprises that is the KFC and the EPZ enterprise. KFC was mining the minerals while the EPZ enterprise did the processing and export and activities. Those specific activities relied upon by the Tribunal have not been disputed by the KFC. The EPZ enterprise did more technical activities than KFC. In my view, with the evidence on record, the Tribunal cannot be faulted in reaching the decision, with regard to the capping of profits based on the activities of the two related enterprises. The fact that the Tribunal agreed with the Profit Split Method, did not mean that it should have agreed with the 100% capping proposed by KFC, as profits have to be based on activities, and turnover resulting from those activities.

63. Consequently, and for the above reasons, I find that both appeals have no merits. I thus dismiss Appeal No. 2 of 2018 and No.3 of 2018 herein. Each of the parties will bear their respective costs of appeal.

Dated and delivered at Nairobi this 6th February 2020.

GEORGE DULU

JUDGE

In the presence of -

Court Assistant ……

For KFC……..…….…….

For the Commissioner……..