REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

COMMERCIAL & ADMIRALTY DIVISION

INCOME TAX APPEAL NO. 13 OF 2017

OCEANFREIGHT (E.A) LIMITED...APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES ....RESPONDENT

(Being an Appeal from the Judgment of the Tax Appeals Tribunal at Nairobi

delivered on the 8th day of December 2016 in the Tax Appeal

Tribunal Tax Appeal No. TAT/101 OF 2015)

BETWEEN

OCEANFREIGHT (E.A) LIMITED...APPELLANT

VERSUS

THE COMMISSIONER OF DOMESTIC TAXES..........................RESPONDENT

JUDGMENT

1. This Court is asked by the parties to render one judgment in respect to seven (7) Appeals. The request is not unreasonable because there is commonality of issues in the Appeals and one decision could help save judicial time.

2. The Appeals are:-

i. High Court Income Tax Appeal Number 3 of 2017 Gulf Badr Group (Kenya) limited *verses* The Commissioner of Domestic Taxes.

ii. High Court Income Tax Appeal Number 13 of 2017 Oceanfreight (E.A) Limited *versus* The Commissioner of Domestic Taxes.

iii. High Court Income Tax Appeal Number 9 of 2017 Inchcape Shipping Services (k) Limited *versus* The Commissioner of Domestic Taxes.

iv. High Court Income Tax Appeal Number 29 of 2017 WEC Lines (k) Limited *versus* The Commissioner of Domestic Taxes.

v. High Court Income Tax Appeal Number 14 of 2017 CMA CGM (K) Limited *versus* The Commissioner of Domestic Taxes.

vi. High Court Income Tax Appeal Number 33 of 2017 Sturrock Shipping (k) Limited *versus* The Commissioner of Domestic Taxes.

vii. High Court Income Tax Appeal Number 8 of 2017 Seven Seas Technologies Limited *versus* The Commissioner of Domestic Taxes.

This Appeal acts as the lead file.

3. A Common character of the Appellants is that they are all shipping Agents registered in accordance with Section 8 of The Merchant Shipping Agent and are for purposes of tax, resident in Kenya. Common as well is that all Appellants are in the shipping industry and act as agents for International Shipping lines.

4. The Appeal raises four broad issues and this Court is asked to give clarity on them. The first is whether charges collected on demurrage for containers are chargeable to income tax. The second is whether VAT is chargeable to post landing charges on processing documents prepared by the Appellants.

5. A third issue is whether withholding tax is chargeable on amounts received on account of carriage of transhipment cargo originating from partner states of the East African Community.

6. The last is the issue of deemed dividends. This is an issue which relates to the application of Section 24 of The Income Tax Act which empowers KRA to deem dividends on a taxpayer if it is satisfied that the only reason for non-issuance of dividends is to evade taxation.

7. Before discussing these issues, the Court restates two legal principles which may well be obvious but which the Court must constantly bear in mind in determining the appeals. The first is that the purpose of an Appeal is to evaluate a matter on the basis of the case presented and argued by the parties before the tribunal from which the Appeal arises, in this case the Tax Appeals Tribunal. To allow a party to traverse outside its original case would be to allow it to argue a case that is different from that argued at the tribunal and that would amount , not arguing an appeal, but to presenting a different case.

8. The interpretation of Tax statutes calls for a strict interpretation of the language used by the legislature and in this regard the statement of Rowlatt J in Cape Brandy Syndicate –vs- I.R.C 1 KB 64, 71 is often cited. The Judge stated:-

> "In a taxing statute one has to look at merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used".

Of the question of demurrage charges

9. The point of contention is how to treat demurrage charges on containers. Is it part of freight or should it be treated as rent for detained containers? Treating it as one and not the other has an implication as to whether it is to be brought to charge under the Income Tax Act as existing at the material time.

10. The Appellants urge this Court to find that demurrage is paid as and constitutes part of the amount received on account of the carriage and is therefore part of the cost of carriage. The Respondent on the other hand is unequivocal that demurrage charges do not form part of the freight levied by the shipping line as the same can only be accrued after the goods have been cleared through customs and have entered the country.

11. It has to be remembered that the case of Commissioner before the Tribunal was that the demurrage charges that were the subject of the impugned tax demanded was demurrage on containers. For that reason, it would be imperative to understand the true nature of demurrage on containers. In this regard one could possibly start with the legal definition of demurrage. Bearing in mind that the word may have different meanings depending on the circumstances it is to be applied, a specific meaning of the word in respect to ocean containers is desirable. In Black Law Dictionary (10th Edition) this type of Demurrage is referred as"

> "a charge due for the late return of ocean containers or equipment".

If the Court accepts that definition, as it does, then it diminishes the force of the Appellants' argument that guidelines on similar tax matters from Australia, India, Canada and America supports their proposition that Demurrage on containers is considered to be part of freight. Let me turn to those decisions.

12. In Taxation Ruling No. 2006/1 from Australia, Demurrage is defined as follows:-

> "Demurrage is ordinarily an amount of money paid as liquidated damages to the ship-owner by the Charterer or shipper for failing to complete loading and discharging within the time allowed under a voyage or charter party".

13. In Paragraph 43 of the ruling is the following opinion:-

> [43] The words 'in respect of such carriage' appearing in section 129 embrace any activity relating to carriage by sea of the items listed in the section. In relation to the carriage of goods, for example, the activities would include the loading of the goods at the port of shipment and unloading at the port of discharge. In the light of the context in which carriage by sea is undertaken, as explained in paragraph 62, the following payments made by a 'shipper' or 'shipper charterer' in respect of the carriage of its goods embarked in Australia are for the purposes of section 129 to be treated as follows:
>
> > (a) Amounts paid or payable by way of 'demurrage' on the loading and unloading of the goods are to be included in determining the taxable income under the section (see paragraphs 107 to 111).

(b) Amounts paid or payable by way of 'deadfreight' to the extent that such payments constitute payments for not providing a full cargo as required under a bill of lading or voyage charter party fall outside the scope of the section (see paragraphs 112 to 115).

(c) Payments for cleaning charges by a 'shipper' to a ship-owner by way of contribution or to reimburse the ship-owner for such expenditure are to be excluded in determining the taxable income under the section (see paragraphs 120 to 124).

14. One notices that the demurrage referred to therein is on the loading and unloading (discharging) of goods but not demurrage on the containers.

15. In respect to the meaning assigned to demurrage in Section 44B of the Indian Income Tax Act, it is unclear whether it extends to demurrage on containers. The provision reads;

[S.44B]Special provision for computing profits and gains of shipping business in the case of non-residents.

44B. (1) Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to seven and a half per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) The amounts referred to in sub-section (1) shall be the following, namely :—

(i) the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

Explanation.—For the purposes of this sub-section, the amount referred to in clause (i) or clause (ii) shall include the amount paid or payable or received or deemed to be received, as the case may be, by way of demurrage charges or handling charges or any other amount of similar nature.

16. In Canada, the Canada Revenue Agency issued information for Freight Carriers and includes demurrage payments and penalties as freight services. The demurrage payments and penalties are said to be:-

"Demurrage payments and penalties-

Amounts that a shipper pays a carrier for the detention of a ship, freight car, or other cargo conveyance during loading or unloading beyond the scheduled time of departure".

17. In a communication of 19th August 1998, The Director of the International Trade Compliance Division (USA) was required to provide advice on whether the dispatched demurrage amounts are to be taken into account when determining the appropriate non-dutiable international freight to be deducted from the rate actually paid or payable in determining transaction value. He advised:-

"Similarly, we find that the despatch and demurrage amounts at issue here are associated with the cost of actual freight involved in moving such cargo to the United States and that they constitute part of the actual freight costs. The amounts in question directly relate to the rate of loading the steel onto the vessel and this rate affects the total amount POSCO must pay to Hyundai. Therefore, we find that these amounts are to be taken into account in determining the actual international freight costs. The fact that despatch/demurrage are the subject of a separate account between Hyundai and POSCO has no bearing on whether they are part of international freight".

18. It seems to this Court that the above decisions and advise are in connection with demurrage directly associated with the freight and therefore payment made in respect thereof cannot be treated as additional freight.

19. How is this to be contrasted with demurrage on containers? This Court is asked by the Commissioner to follow the decision in Steamship Company of Svendborg and Steamship Company of 1912 –vs- The Commissioner of Internal Revenue CTA Case No. 6567 where it was held that:-

"It is undeniable that petitioners are rendering service to its client in providing containers for their use. For the extended use of the containers, petitioners are charging demurrage fees. *Although, petitioners call it a penalty, they are in effect imposing a form of rental or lease fee for the continued use of the containers. The cash or its equivalent that they receive is a flow of wealth*."

The demurrage fees are income derived from sources within the Philippines. The subject demurrage fees were generated within the Philippines, hence, "the containers as well as the payments exchanged hands here. Thus, the flow of wealth proceeded from, and occurred within Philippine territory, enjoying the protection accorded by the Philippine government. In consideration of such protection, the flow of wealth should share the burden of supporting the government".

20. It would seem probable that the demurrage incurred for the period of preloading or for failure to unload the vessel before the lapse of the contract period is clearly demurrage associated with the freight. The freight comes to an end at the port of landing and any demurrage imposed on the container for late return after port is a post importation charge. There is therefore merit in distinguishing or segregating this charge from costs on freight.

21. Whether that charge for the late return of the container is called a penalty or rent, it is an income to the owner of the container, which is the shipping line. By way of analogy, when Banks charge penalty interest on late repayment of a facility that charge is income just as the regular interest charge on punctual repayment. As the charge on demurrage would have been derived from or accrued in Kenya, it is subject to income tax legislation in Kenya. That is the effect of Section 3(1) and 3(2) of the Income Tax Act which reads:-

3. Charge of tax

(1) Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.

(2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of—

(a) gains or profits from—

(i) any business, for whatever period of time carried on;

(ii) any employment or services rendered;

(iii) any right granted to any other person for use or occupation of property;

(b) dividends or interest;

(c) (i) a pension, charge or annuity; and

(ii) any withdrawals from, or payments out of, a registered pension fund or a registered provident fund or a registered individual retirement fund; and

(iii) any withdrawals from a registered home ownership savings plan;

(d) *deleted by Act No. 14 of 1982, s. 17*;

(e) an amount deemed to be the income of any person under this Act or by rules made under this Act;

(f) gains accruing in the circumstances prescribed in, and computed in accordance with, the Eighth Schedule;

(g) subject to section 15(5A), the net gain derived on the disposal of an interest in a person, if the interest derives twenty per cent or more of its value, directly or indirectly, from immovable property in Kenya; and

(h) a natural resource income.

22. The effect of the provisions of Section 10(1) would be to deem the income from demurrage charges on containers to be income which accrued in or is derived from Kenya. It reads:-

[S. 10(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)a management or professional fee or training fee;

(b)a royalty or natural resource income;

(c)interest and deemed interest;

(d)the use of property;

(e)an appearance at, or performance in, any place (whether public or private) for the purpose of entertaining, instructing, taking part in any sporting event or otherwise diverting an audience; or

(f)an activity by way of supporting, assisting or arranging an appearance or performance referred to in paragraph (e) of this section;

(g)winnings;

(h)deleted by Act No. 16 of 2014, s. 6(b), the amount thereof shall be deemed to be income which accrued in or was derived from Kenya: Provided that—

(i) this subsection shall not apply unless the payment is incurred in the production of income accrued in or derived from Kenya or in connexion with a business carried on or to be carried on, in whole or in part, in Kenya;

(ii) this subsection shall not apply to any such payment made, or purported to be made, by the permanent establishment in Kenya of anon-resident person to that non-resident person;

(iii) for the avoidance of doubt, the expression "non-resident person" shall include both head office and other offices of the non-resident person.

23. It is true that following amendment to the Act made in 2018, specific provisions of the law were made in respect to demurrage. Under Section 2 demurrage was defined to mean:-

"Demurrage charges" means the penalty paid for exceeding the period allowed for taking delivery of goods, or returning of any equipment used for transportation of goods".

24. In Section 10, an amended was made to specifically include demurrage charges in the category of income which accrued in or is derived from Kenya.

25. Section 35 was amended to expressly provide for withholding tax on demurrage and paragraph 3 of the third schedule was amended to provide the withholding tax rate on demurrage to be at 20%.

26. The Appellants urge that the budget statement made by the Minister responsible for Finance in support of the proposals made to the aforesaid amendments is telling and should impact on this decision. This is the Minister's statement;

"Mr. Speaker, the Port of Mombasa is the gateway to East and Central Africa, and is one of the busiest Ports along the East African coastline. The Port provides direct connectivity to over eighty (80) Ports worldwide attracting various service providers, particularly the shipping lines. Under the current legislative framework, payments for such services which represent income from Kenya are not subjected to tax. This creates an unfair playing field for residents of Kenya whose income from similar sources are subject to tax. I therefore, propose to amend the Income Tax Act to subject payments for demurrage charges made to non-resident persons to withholding tax at a rate of twenty percent".

27. The Appellants assert that there is an express admission by the Government that, prior to the amendments, there was no legal framework to charge demurrage as income.

28. The Respondent take a different view and ask this Court to find that the amendments merely fortified an existing framework and could very well be over-legislation. That in any event the Minister's word cannot bind them.

29. I observe that the Minister made the statement during the pendency of the Appeals before Court. A plain reading of his statement is that there was no legislative framework subjecting demurrage to tax. Should this therefore be the end of the matter? The Respondent herein is the Commissioner of Domestic Taxes, a commissioner appointed by dent of Section 13 of The Kenya Revenue Authority Act. Under the provision of Section 5(l) of the said act "the authority shall, under one general supervision of the minister, be an agency of the Government for the collection and receipts of all revenue".

30. In the matter before Court it is the Commissioner of Domestic Taxes and not the Minister who is a party. While, in principle, the Minister can exercise general supervision over the KRA and its commissioners, the Commissioner of Domestic Taxes takes a different view of the matter from that of the Minister. Simply, the party that is before Court has not made any admissions and this Court cannot take the Budget statement as a concession by the Respondent. Although the statement may be taken as indicative of the Government position in the matter, the Court is not absolved from carrying out its own evaluation and passing judgement on the matter based on the position taken by the parties and the law and facts before it.

31. On my own assessment and for reasons I have given, I have come to the conclusion that demurrage charges on containers was chargeable to income tax even under the statutory regime that existed at the material time. Any amendments that come later may have served to reinforce legislation that was already clear and without ambiguity.

32. The Court turns to consider whether there was a duty on the part of the Appellants to deduct withholding tax from the demurrage charges on containers which it had collected on behalf of the its principles, the Shipping Lines. I found this to be the more vexing question and invited further submissions from the parties. I take those submissions into account.

33. The statutory regime on withholding tax is found in Section 35 of the Act. Subsection 1 of the provision sets out the instances when tax must be withheld upon payment to a non-resident person not having a permanent establishment in Kenya while subsection 3 is on payment to a person resident or having a permanent establishment in Kenya.

34. On whom the obligation to withhold the tax falls, section 4(1) of the Income Tax (withholding tax) Rules 2001 reads:

(1) A person who makes a payment of, or on account of, any income which is subject to withholding tax shall deduct tax therefrom

in the amount specified—

(a) under paragraphs 3 and 5 of Head B of the Third Schedule; and

(b) where the Government of Kenya has double taxation agreement with the Government of another country, in the terms of that agreement:

Provided that the rates of tax under this subrule shall not exceed the rates specified under paragraph (a).

35. Taking the judgment in Appeal No. 101 of 2015 ocean freight (E.A) Limited –vs- The Commissioner of Domestic Taxes as an example, this is how the Tribunal dealt with the issue:

"35. It is important now to note that the Income Tax (Withholding Tax) Rules,2001 mandates a person who makes payment of, or on account of, any income, which is subject to Withholding tax to deduct tax from the payment at the provided rate. The said Rules do not create a distinction between instances where the payer is an agent and where the payer is the principal himself. It is the

Tribunal's view that even an agent is under obligation to retain a portion of any payment made to any person on behalf of the principal and to remit the same to the Respondent because of withholding tax, if the payment is chargeable to income tax. It is worth the emphasis that the obligation is only created where the payment is chargeable to Income Tax Civil Suit 60 of 2013 (Income Tax Appeal) Motaku Shipping Agencies limited The upshot therefore is that the Respondent's confirmed Additional Assessment relating to Withholding tax 'and relating to demurrage charges mounting to KES.142,308,538/= is hereby confirmed and this Appeal is accordingly dismissed".

36. If it is accepted, as this Court has held, that payment on post-port demurrage on containers is a charge to Income Tax then the withholding tax ought to have been dealt with Under Section 35(1) (c) of the Income Tax Act which reads:-

"A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of:-

a) …..

b) …..

c) A rent, premium or similar consideration for the use or occupation of property, except aircraft, aircraft engines, locomotives or rolling block;

Which is chargeable to tax, deduct therefrom tax at the appropriate non-resident rate."

37. When Section 35(1) and Rules (2) and 4(1) of the Income Tax (withholding tax) Rules 2007 are read together then it becomes clear that the person who bears the responsibility to withhold tax is the one who makes the payment of the income. This is apparent from the definition of who a payer and payee are under Rule (2) of the Withholding Tax Rules which reads:-

"'Payee' A person who receives income from a payer for the purpose of these rules".

"'Payer' A Person who deducts Withholding Tax for the purposes of these Rules".

38. There is now a divergence between the parties as to who the payer is in respect to the charges on demurrage on containers. The Appellants think that it is obviously the consignee while the Respondent argue that it is the Appellants who should do so before remitting the income to its principals.

39. One would have thought this to be rather straightforward because the entire case of the Respondent is that demurrage in containers is an income accrued or derived in Kenya by the shipping lines which are non-resident of the country. In these circumstances the person paying the charges would be the consignee or importer and the payee would by the shipping lines, although they would receive the money through the Appellants who were their local agents.

40. The Respondent does not think that the matter is that uncomplicated. It is argued that the consignee paid the demurrage based on local invoices raised by the Appellants and so Section 35(1) (c) would not apply to the consignee and the obligation to withhold tax would be on the Appellants before repatriating the money to the parent company.

41. The Court is not certain that the evidence on the invoices placed before the Tribunal is as stated by the Respondent. I flag out two examples. The invoice of 3rd June 2016 bespeaking African Cotton Industries Ltd to pay demurrage fees of USD 780.00 is in the name of W.E.C Lines (the Shipping Line) ,although the corresponding address on the invoice is of W.E.C Lines Kenya Limited (the Agent) (TAT 13/2016). The payment order of 31st December 2012 for demurrage of USD 182 to be paid by Super First Forwarding Ltd is raised by Gulf Badr Group (Kenya) Ltd (The Agent) but clearly states that it does so as agent for Evergreen Line (the shipping line). It is therefore evident that the monies though payable through the agents are monies to the shipping lines. This, in fact, is in tandem with the Respondent's own case that demurrage charges on the container are charges paid to the shipping line, non-residents of Kenya.

42. Even if the Court was to accept that the invoices for the Demurrage charges were raised solely in the name of the Agents, the position ought not to be any different. The law recognises the Appellants as shipping Agents under Section 8 of the Merchant Shipping Act and are licenced as such. Demurrage on containers is a charge payable to the principals and so the shipping Agents can only be an agent for these payments. That is the statutory arrangement. So the payment made by the consignee is a payment made to the shipping lines who are non-resident. The shipping lines is a non-resident payee receiving money through their agencies while the consignee is the payer. Ordinarily, under the provisions of Section 35(1) (c) the onus is on the consignee to withhold the tax. But that, in my view, is not the end of the matter!

43. Not the end because, as pointed out by the Respondent in its further submissions, the arrangement is that, although the payment is eventually to a non-resident shipping line, the payment is made to resident agents. The Respondent then calls in aid the provisions of Rule 4(1) of the Income Tax (withholding Tax)Rules 2001;

> 4(1) A person who makes a payment of, or on account of, any income which is subject to withholding tax shall deduct tax therefrom in the amount specified—
>
> > (a) under paragraphs 3 and 5 of Head B of the Third Schedule; and
> >
> > (b) where the Government of Kenya has double taxation agreement with the Government of another country, in the terms of that agreement:
>
> Provided that the rates of tax under this subrule shall not exceed the rates specified under paragraph (a).

44. It is argued that the words " <u>on account of</u>**"** are not idle as they bring to charge any remittances by a person on behalf of another provided the transaction falls within the ambit of section 35(1) (c).Mr Kiragu for the Appellants does not agree with that characterisation of the words and prefers that "on account of '' means " in respect of''.

45. In resolving these competing positions, it helps to bear in mind the purpose and object of withholding tax on a non-resident. I think it is to ensure that taxes are paid on income accrued in or derived from Kenya by the non-resident as a first, and perhaps, final tax. If that Tax is not withheld then it will by all likelihood be lost. If the penalties on post-port demurrage are an income that attract a charge on tax, then the agent who collects the income and then remits it to the non-resident has an obligation to ensure that the tax that ought to be withheld is indeed withheld before making the remittance to its non-resident principal. If there is no such obligation, then there would be a leak on tax. It is for the reason that I hold that in the circumstances obtaining here the Appellants are the persons paying for purposes of section 35(1) of the Income Tax and I am unable to fault the Tribunal's decision in that respect. That conclusion should not be illogical or oppressive to the shipping agents because even if the shipping agents were to so withhold the tax they would not be withholding part of their income but the income of their principals.

46. In reaching this outcome I am paying homage to a cannon of interpretation of the law advocated by the Court of Appeal in construing Tax law. In <u>Kenya Revenue Authority V Republic (expate Fintel ltd [2019] eKLR</u> the Court held;-

> "While the words "upon payment" in their colloquial and ordinary parlance suggest "payment" or "paid", that is, to be given money for something in exchange, it is our considered view that the relevant statute, the Income Tax Act must be the source of the meaning to be attached to it. The interpretation must be contextual.
>
> A statute ought to be looked at, in the context of its enactment and as a whole as opposed to picking and choosing words in isolation. "No part of a statute and no word of a statute can be construed in isolation. Statutes have to be construed so that every word has a place and everything is in its place." So said the learned Judges of the Supreme Court of India in Reserve Bank of India V. Peerless General Finance and Investment Co. Ltd., 1987 SCR (2) 1".

47. There is an ancillary matter in respect to the issue of withholding taxes raised in Civil Appeal No. 14 of 2017 <u>CMA CGM (E) -VS- THE COMMISSIONER OF DOMESTIC TAXES.</u> CMA CGM Limited is an agent of CMA SA which is a shipping line based in Marseille, France. Before the tribunal, the Appellant had argued that there exists a Kenya – France Double Taxation Treaty (DTT) in which Article 8(2) thereof provides for only 5% of the gross amount derived by Kenya by a shipping line registered in France to be taxed in Kenya. It would seem however that the Tribunal did not make any finding on this specific argument.

48. The Double Tax Agreement is a regime for avoidance of double taxation and the prevention of fiscal evasion with respect to taxes between the two countries. Article 8 on Shipping and Air Transport reads:-

> 1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.
>
> 2. The provisions of paragraph 1 shall also apply to profits from the participation in pool, a joint business or an international operating agency.

49. On the close reading of Article (2) (a), the agreement covers amounts received by the enterprise on account of carriage of passengers or freight. Having come to the finding that demurrage on late return of containers is a post-freight income and not part of freight then demurrage is excluded from the double-taxation framework. That would be a complete answer to the argument taken up by the Appellant.

VAT ON POST LANDING CHARGES

50. The Court moves away from taxation of demurrage to whether Valued Added Tax (VAT) is chargeable to post landing charges. As a

prelude to the discussing the arguments made in this respect, the Court makes some observations.

51. First, the applicable legislation in respect to the issues raised is the Value Added Tax (act no 35 of 2013) prior to its repeal (hereinafter the repealed Act). Second, VAT is a Tax charged on the supply of goods and services in Kenya (which are not excluded) and on importation of goods and services into Kenya (Section 5). In contrast, under subsection 5 thereof Tax on importation of goods into Kenya were charged as if it were a duty of customs and was payable by the person who imports the goods.

52. There is then the provision of Section 14 (2) of the relevant VAT Act which provides:-

> S.14 (2) Unless the context otherwise requires, a supply of services that is ancillary or incidental to the importation of goods shall be treated as part of the importation".

53. The arguments by the Appellants, unpacked, is basically that document processing fees are associated with freight costs and are part of the taxable value of imported goods. How did the tribunal deal with this submission? In Tax Appeal No. 13 of 2016 W.E.C LINGS (KENYA) LIMITED –VS- COMMISSIONER OF DOMESTIC TAXES, the Tribunal held that the document known as a delivery order is a local document and not a customs document and was not part of freight and did not constitute customs value of goods.

54. If I understand the position of the law correctly the costs of services treated as part of imported goods to Kenya are included in the taxable value of imported goods. By dint of Section 14(2), as a general rule, supply of services that is ancillary or incidental to the importation of goods is treated as part of the importation. The issue then becomes whether document processing fees is ancillary or incidental to importation.

55. The Appellants argue that Bill of Lading (BL) fees and Delivery Order fees are ancillary charges in connection with the international transportation of goods. For that reason, they do not merit to be legally or economically dissociated with other freight charges.

56. There is then this statement of fact made by one of the Appellants in VAT No. 143 of 2015 Inchcape Shipping Services (k) Limited –vs- The Commissioner of Domestic Taxes.

> "The Bill of Lading fees and the Delivery Order fees are usually charged to cover the costs of preparation and delivery of those documents. Although the fees are charged by the shipping line, the industry practice has been to allow the agents to keep the fees as their income because most of the associated costs would be incurred locally. These is done in lieu of the agents collecting the fees and remitting them to the principal and later on invoice the principal to recover the costs associated with the production and delivery of the documents. This arrangement does not necessarily alter the economic substance and legal nature of the supply made by the shipping line to the importer, neither does it transform the agent to become a supplier of services to the importer. Further, the act of the principal allowing the agent to retain BL and DO fees does not negate the importers legal responsibility to declare such fees as part of the freight costs in Form C36 and account for the duty and VAT thereof".

57. There is some consensus by the parties that so as to understand whether or not the document processing fees should be treated as part of freight costs reference needs to be made to the provisions of East African Community Customs Management Act (EACCMA). There is the legal requirement that VAT on imported goods is to be collected as if they were a duty of customs.

58. The 4th schedule to EACCMA is the legal framework for determination of the value of imported goods liable to ad Valorem Import Duty. Paragraph 9(2) of the schedule reads:-

> Paragraph[9(2)] In determining the value for duty purposes of any imported goods, there shall be added to the price actually paid or payable for the goods:-
>
> (a) the cost of transport of the imported goods to the port or place of importation into the Partner State; provided that in case of imports by air no freight costs shall be added to the price paid or payable;
>
> (b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the Partner State; and
>
> (c) the cost of insurance.

59. The parties herein have given competing interpretation to the provisions of Paragraph 2((6). The Appellants urge me to find that the documentary processing fees is part of freight costs and is part of the taxable value of imported goods. The Respondent on the other hand seek to persuade me that the reading of the provision excludes post landing expenses.

60. Let me interrogate these positions. So as to guide on customs valuation of imported goods in the East African Community, The Directorate of Customs and Trade of The East African Community issues manuals from time to time. Both sides refer to one such manual. The Appellants submits that the manual includes the cost of Bills of lading, delivery costs and associated costs as part of the value of imported goods by allowing adjustments for the following expenses:-

> (g) Loading, unloading and handling charges associated with the transport of the imported goods;
>
> ……

(j) Associated costs incidental to delivery such as:

- Warehouse/storage charge and other associated costs incurred in the country of export in connection with transportation of the imported goods from the supplier's premises and placing it on board at the port or place of export.

- Costs of bills of lading, airway bills, customs clearance, packing charges, delivery costs.

- Demurrages, dock dues, cartages in the dock areas

- Drayage

- Fumigation of gas charges (the cost incurred to gas or fumigate goods to protect against infestation by insects).

61. Further the Court is asked to pay attention to the definition of associated costs in the manual which reads:-

> Associated costs refers to the costs, charges, and expenses related to the physical transport from the port or place of shipment for export to the partner state, for example delivery costs, demurrage, e.t.c

The Court is then asked by the Appellants to interpret the manual as including the document processing fees as part of the value of imported goods. On the part of the Respondent it is urged that the formula for determining the customs value would assist resolve the matter. Two options are given. The first is by adding what is found in <u>column</u> of C.36 which includes net prices on invoices to B adjustments of the price paid or payable which includes costs of delivery to the community. The second contemplates where Post Landing Expenses (c) are included in A. Where this happens then C is to be deducted. In that tabulation customs value is:-

(A+B) or (A+B-C) if 'C' is included in 'A'.

62. Clearly then post landing expenses are not included in the cost of freight. Yet to understand the exact nature of the post landing expenses that are excluded one must return to the subsidiary legislation. It helps to recall the provisions of paragraph 9(2) which reads:-

> Paragraph[9(2)] In determining the value for duty purposes of any imported goods, there shall be added to the price actually paid or payable for the goods:-
>
> (a) the cost of transport of the imported goods to the port or place of importation into the Partner State; provided that in case of imports by air no freight costs shall be added to the price paid or payable;
>
> (b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the Partner State; and
>
> (c) the cost of insurance.

63. It seems to this Court that post landing expenses that are excluded are any expenses that are neither transport to the port or place of importation, loading, unloading and handling charges associated with such transport or costs of insurance.

64. Looking at the sample invoices provided to the Tribunal one sees the following as the charges levied.

<u>INCHCAPE</u>

Terminal Handling Charges

Temp added Risk surcharge

Container clearing charge

Lift on/lift off charge

Documentation fees

<u>W.E.C LINES</u>

Cleaning fee

Container deposit fee

Drop off fee

ISP-ISPs Mombasa

THD-THCD Mombasa 20ft.

65. Are these services associated with transport of the imported goods to the port or place of importation? Put another way, are they distinct with transportation to the port or place of importation. Loading and unloading associated with transport to port or place of importation would be getting the goods onto or off the vessel. Those are associated with freight. It is accepted by both sides that containers belong to the shipping lines, so the containers have to be returned by the consignees after removing their goods. Costs of returning the container and cleaning it would also be associated with freight.

66. It would seem that the invoiced services are intimately connected with the freight that is undertaken by the shipping lines and are not additional services which are needed after the goods have landed. In reaching this decision the Court is guided by the principles set out in the Card Protection Plan Ltd –vs- Commissioner of Customs and Excise Case 3-394/96 where the House of Lords held:-

> "In order to determine, for the purposes of value added tax, whether a supply of services which comprises several elements is to be regarded as a single supply or as two or more distinct supplies to be assessed separately, it must be taken into account, first, that it follows from Article 2(1) of Sixth Directive 77/388 that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the system of value added tax.
>
> There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied. In those circumstances, the fact that a single price is charged is not decisive".

67. These services can be contrasted with those referred to by Counsel Ochieng which are clearly post landing. These include the fees that the importer needs to pay to Kenya Bureau of Standard for inspection, port charges to Kenya Post Authority or the importers clearing agent who does the actual processing of the importation documents.

68. Again it may not be helpful to urge that because it is the shipping agent which receives these fees then it must be post landing charges. The Agency agreement between W.E.C lines B. V and W.E.C lines Kenya Ltd would offer an explanation as to whether such fee really belongs to the shipping Agent. It provides, partly;-

> "All local fees including e.g Documentation fees, bill of lading fees, and Administration fees e.t.c are to be retained by and for the credit of the Agent where the port custom and practice allows for such collection from the shipping, unless agreed otherwise".

I do not accept the argument by the Respondent that this is an acknowledgement by the parties to the agreement that the charges invoiced as document processing fees are distinct and separate from freight charges. It appears more sensible to read it as an arrangement where the agent retains what it has received and for that amount to be credited to what will eventually be paid as agency fees.

69. And once accepted that it is fees associated with loading, unloading and handling charges it does not escape taxation because by dint of the paragraph 9(2) of the 4th schedule of EMCA it has to be declared and included as part of the cost of freight.

70. As I reach a decision that departs from the Tribunal, I must emphasise that the Court is not setting a rule that all services for which shipping lines charge are to be treated as associated or incidental to importation of goods and are to be treated as part of importation. The character of each service must be interrogated so to discover its true nature.

TAX ON TRANSHIPMENT

CARGO ORIGINATING FROM OUTSIDE KENYA

71. One of the Appellants, W.E.C Lines (Kenya) Limited ,framed his grievance under this head as follows:

> "The demand for withholding tax in respect of carriage of goods in transit through Kenya from the neighbouring countries is wrong and not in accordance with the requirement of Section 9 of the Income Tax Act. It is the Appellants' contention that the Respondent does not have jurisdiction to tax such income Under Section 9 of the Income Tax Act".

72. It is common ground that the Tax in question is from cargo originating from Uganda, Rwanda, Burundi and Tanzania. All are East Africa Community Partner States.

73. The Tribunal took the view that Partner States have integrated into one customs territory and that by virtue of Section 253 of EACCMA, the community statute takes precedence over Partner State Laws with respect to which its provisions relate. In that event it held that the Appellant should withhold tax on amounts received on carriage of transhipment for cargo originating or destined for Partner States

74. The determination of this issue rests, in my estimation, on the interpretation to be given to Section 9(1) of the Income Tax Act and whether the definition of terms from EACCMA should be inferred into those provisions.

75. Section 9(1) of the Income Tax Act provides:-

> 9. (1). Where a non-resident person carries on the business of ship-owner, charterer or air transport operator and a ship or aircraft owned or chartered by him calls at any port or airport in Kenya, the gains or profits from that business from the carriage of passengers who embark, or cargo or mail which is embarked, in Kenya shall be that percentage of the full amount received on account of the carriage which the Commissioner may determine to be just and reasonable; and those gains or profits shall be deemed to be income derived from Kenya; but this subsection shall not apply to gains or profits from the carriage of passengers who embark, or cargo or mail which is embarked, in Kenya solely as a result of transshipment.

76. The word transhipment is not defined under the Income Tax Act. In Blacks Laws Dictionary (10th Edition) it means:-

> "The act of taking cargo out of the ship and loading it on another. Transhipment may also involve transfer of cargo to another mode of transportation, such as rail or truck."

77. In EACCMA it is defined as:-

> "….the transfer, either directly or indirectly, of any goods from an aircraft, vehicle or vessel arriving in a partner state from a foreign place, to an aircraft, vehicle or vessel, department to a foreign destination".

78. This Court would agree with the characterisation of Section 9(1) given by the Respondent as applying specifically to outbound cargo except where the cargo is handled as a result of transhipment through Kenya. There is, however, a chasm in outcome if one was to interpret the provision by applying the definition in EACCMA as opposed to that of the legal parlance found in Blacks Laws Dictionary.

79. If one applies the latter meaning, then gains or profits of non-resident ship-owner from carriage of cargo which is embarked on Kenya solely for purposes of transfer to the ship shall not be deemed to be income derived from Kenya. The origin of the cargo would not matter.

80. If ,however, the term "partner state", "foreign place'' and "foreign destination'' from EACCMA are inferred to Section 9(1) then it takes a different shade. Under EACCMA foreign is defined as:-

> "So foreign place is a place outside a partner state and a foreign destination is a destination outside the partner state. The interpretation of Section 9(1) would then be that reached by the Tribunal that gains or profits on carriage on transhipment for cargo origination, destines for a partner state would be deemed to be income be derived from Kenya".

81. In an attempt to answer this question, I posed the following question to the parties; Is the question of transhipment a customs issue and if so how? This question of course is posed in the context of the dispute before Court.

82. This Court has considered the answer given to this question by Counsel for the parties. It seems that Transhipment can be an issue of both the customs regime and of income tax law. As a customs issue it, as proposed by the Appellants, relates to movement of goods into any partner state from a foreign place (that is a place outside a partner state). But I would agree with the Appellants that if the intention of legislation was that the word "transhipment" in the Income Tax Act would be that in EACCMA then nothing would have been easier than the statute saying so expressly. Like for instance, where the VAT Act,2013, in section14(1)(a) ,applies the provisions of EACCMA to Vat matters. This is because of the gravity of such construction. It could amount to EACCMA presuming that the East Africa Community has jurisdiction on certain aspects of income tax of partner states. Shipping tax is levied under the ITA and so in construing the word "Transhipment" under Section 9(1), reference should be to its ordinary meaning. The result is that income from carriage of goods which embarks in Kenya solely for outward carriage is not brought to charge.

83. Having held as much, what are the facts around which ITA No. 31 of 2017 involves? From the statement of facts before the Tribunal, the Appellant states that the Respondent erred in law and fact by demanding withholding tax on gross amounts received on account of carriage of goods on transit from Uganda, Rwanda, Burudi and Tanzania. The amount demanded was Kshs.43,755,592.00. In response the Respondent does not dispute that the demand is on account of carriage of goods on transit from Uganda, Rwanda, Burundi and Tanzania. For the reason that it is income on transhipment ,then it should have not be brought to charge.

Deemed Dividends

84. Arising in Appeal No. 13 of 2018 W.E.C Line (k) Ltd –vs- Commissioner of Domestic Taxes is the question of deemed dividends. Following a Tax audit exercise, the Respondent directed that Kshs.35,000,000.00 be declared as dividend for the Appellant's year of income 2014 and dividend tax of Kshs.5,500,000.00 be paid immediately. The Appellant challenged this.

85. Holding in favour of the Respondent, the Tribunal stated:-

> [80] The Tribunal, having analyzed the submissions of both parties is in agreement with the Respondent that Section 24 of ITA empowers the Respondent to deem dividends where the Respondent is satisfied that the only reason for non-issuance of dividends is to evade taxation. Furthermore, the burden rests on the Appellant to prove that it did not have the ability to pay dividends, which burden the Appellant has failed to discharge to the satisfaction of the Tribunal.
>
> [81] Consequently, the Tribunal is of the respectful view that it has not found any reasonable ground by the Appellant to explain its failure to issue dividends. The ground advanced by the Appellant on unpredictability of VAT refunds is not a convincing reason for not paying dividends because refunds cannot stop a company from issuing dividends".

86. It is common ground that the Respondent employed the power available to him under Section 24 of the ITA to direct the deeming of dividends;-

> S.24 (1) Where the Commissioner is of the opinion that a private company has not distributed to its shareholders as dividends within a reasonable period, not exceeding twelve months, after the end of its accounting period such part of its income for that period which could be so distributed without prejudice to the requirements of the company's business, he may direct that that part of the income of the company shall be treated for the purposes of this Act as having been distributed as a dividend to the shareholders in accordance with their respective interests and shall be deemed to have been paid on a date twelve months after the end of that accounting period.
>
> (2) The Commissioner may direct that a charge be made upon a company in respect of adjustments to the liability of a shareholder as a result of a direction under subsection (1):
>
> > Provided that—
> >
> > (i)if such a charge is made, such company shall be entitled to recover from the shareholder the amount of tax attributable to the adjustment made in respect of such shareholder; and
> >
> > (ii)where an adjustment is made under this section relating to the distributable profits of a company and such profits are subsequently distributed, the proportionate share therein of a shareholder shall be excluded in computing the total income of that shareholder.
>
> (3) Deleted by Act No. 8 of 1978, s. 9(i)(ii).
>
> (4) A private company may at any time before making a distribution of a dividend to its shareholders inquire of the Commissioner whether the distribution would be regarded by him as sufficient for the purpose of subsection (1) of this section, and the Commissioner, after calling on the company for such information that he may reasonably require, shall advise the company whether or not he proposes to take action under this section.
>
> (5) Where under this section part of the income of a company is treated as having been distributed and divided to its shareholders and in consequence thereof, another company is treated as having received a dividend, then for the purpose of applying the provisions of subsection (1) of this section to the other company, the dividend which it is treated as having received shall be deemed to be part of such income of the other company available for distribution by such other company to its shareholders as dividends.

87. The object of those provisions is to check on a Tax payer whose only reason for not distributing dividends is to reduce its tax liability.

88. When Section 24(1) of ITA is broken down, it emerges that dividends cannot be deemed if it will prejudice or negatively affect the requirements of the Tax payer's business. An immediate question arises as to whom between the Tax payer and the Tax collector bears the onus of proving whether the deeming of tax will be to the detriment of the Tax payers business. The Appellant and Respondent take different positions.

89. The Appellant submits that the provision is a penalty section because deeming of dividends imposes a greater tax burden on the tax payer. It is then argued that the onus of proving that funds can be distributed "without prejudice" to the business of the tax payer is on the Commissioner. The Appellant cited the decision of the House of Lords in Thomas Fattorini (Lancashire), Ltd. -vs- Inland Revenue [1942] which was said to interpret a provision similar to Section 24(1) of ITA.

90. There the House of Lords held in Thomas Fattorini (Lancashire), Ltd. -vs- Commissioner of Inland Revenue:-

> "It seems clear that the discussion must proceed *ab initio* on the footing that the action of the directors must be judged by considering what their conduct would reasonably be if no question of Sur-tax influenced their decision. Withholding of distribution for the purpose of 'avoidance of the payment of "super-tax' by shareholders would, if found, obviously negative the reasonableness of any part so withheld. The other general point to be observed is that, as it seems to me, what has to be found is that the Company acted unreasonably in withholding some part of its income from distribution. It is not enough to show that a part could reasonably be distributed, if at the same time it could be said, as it well might, that it was equally reasonable to withhold distribution. The Section is highly penal, and I feel no doubt that the onus is originally, and remains, on the Revenue to show that the Company acted unreasonably in withholding part of its income from distribution".

91. On the other hand, the Respondent asks the Court to give regard to the manner in which prejudice is proved, perhaps established, so as to get the answer to the question. It is submitted that the Commissioner, after receiving the returns and audited accounts of a company, assesses whether a taxpayer who has not declared dividends ought to declare the same. A Taxpayer who thinks it ought not to be charged deemed dividends will then provide further information and documentation that demonstrates that it ought not to be so charged as it will jeopardise its business. It is asserted by the Respondent that the onus then rests on the Taxpayer.

92. I have familiarized myself with the provisions under discussion in Thomas Fattorini (Lancashire) Ltd. It is Section 21 of the Finance Act 1922 which reads:-

> S.21. With a view to preventing the avoidance of the payment of super-tax through the withholding from distribution of income of a company which would otherwise be distributed, it is hereby enacted as follows:
>
> (1) Where it appears to the Special Commissioners that any company to which this section applies has not, within a reasonable time

after the end of any year or other period ending on any date subsequent to the fifth day of April, nineteen hundred and twenty-two, for which accounts have been made up, distributed to its members in such manner as to render the amount distributed liable to be included in the statements to be made by the members of the company of their total income for the purposes of super-tax, a reasonable part of its actual income from all sources for the said year or other period, the Commissioners may, by notice in writing to the company, direct that for purposes of assessment to super-tax, the said income of the company shall, for the year or other period specified in the notice, be deemed to be the income of the members, and the amount thereof shall he apportioned among the members:

Provided that, in determining whether any company has or has not distributed a reasonable part of its income as aforesaid, the Commissioners shall have regard not only to the. CLU-rent requirements of the company's business but also to such other requirements as may be necessary or advisable for the maintenance and development of that business.

(2) Any super-tax chargeable under this section in respect of the amount of the income of the company apportioned to any member of the company, shall he assessed upon that member in the name of the company, and, subject as hereinafter provided, shall be payable by the company, and all the provisions of the Income Tax Acts and any regulations made thereunder relating to super-tax assessments and the collection and recovery of super-tax shall, with any necessary modification, apply to super-tax assessments and to the collection and recovery of super-tax charged under this section.

(3) A notice of charge to super-tax under this section shall in the first instance be served on the member of the company on whom the tax is assessed, and if that member does not within twenty-eight days from the date of the notice elect to pay the tax a notice of charge shall be served on the company and the tax shall thereupon become payable by the company:

Provided that nothing in this subsection shall prejudice the right to recover from the company the super-tax charged in respect of any member who has elected as aforesaid but who fails to pay the tax by the first day of January in the year of assessment or within twenty-eight days of the date on which he so elected, whichever is later.

(4) Any undistributed income which has been assessed and charged to super-tax under this section shall, when subsequently distributed, he deemed not to form part of the total income from all sources for the purposes of super-tax of any individual entitled thereto.

Where a member of a company has been assessed to and has paid super-tax otherwise than under this section in respect of any income which has also been assessed and upon which super-tax has been paid under this section, he shall, on proof to the satisfaction of the Special Commissioners of the double assessment, be entitled to repayment of so much of the super-tax so paid by him as was attributable to the inclusion in his total income from all sources of the first-mentioned income.

(5) Where super-tax is charged under this section in respect of the income of a company for any year or other period, the Commissioners of Inland Revenue shall, on a certificate from the Special Commissioners that (he super-tax has been accounted for, repay to the company the amount of any corporation profits tax paid by the company in respect of the corresponding accounting period or part thereof.

(6) This section shall apply to any company—

(a) which has, since the fifth day of April, nineteen hundred and fourteen, been registered under the Companies Acts, 1908 to 1917; and

(b) in which the number of shareholders computed as hereinafter provided is not more than fifty; and

(c) which has not issued any of its shares as a result of a public invitation to subscribe for shares; and

(d) which is under the control of not more than five persons.

For the purposes of this subsection—

In computing the number of shareholders of a company there shall be excluded any shareholder who is a trustee or nominee for some person otherwise owning or beneficially interested in shares in the company, or who is an employee of the company, or is the wife or the unmarried infant child of a beneficial owner of shares in the company;

A company shall be deemed to be under the control of any persons where the majority of the voting power or shares is in the hands of those persons or relatives or nominees of those persons, or where the control is by any other means whatever-in the hands of those persons;

The expression “relative” means a husband or wife, ancestor, or lineal descendant, brother, or sister;

The expression “nominee” means a person who may be required to exercise his voting power on the directions of, or holds shares directly or indirectly on behalf of, another person;

Persons in partnership and persons interested in the estate of a deceased person or in property held on a trust shall, respectively, he deemed to be a single person.

(7) In this section the expression "member" shall include any person having a share or interest in the capital or profits or income of a company, and the expression " employee" shall not include any governing director, managing director, or director.

(8) The provisions contained in the First Schedule to this Act shall have effect as to the computation of the actual income from all sources of the company, the apportionment thereof amongst members of the company, and otherwise for the purpose of carrying into effect, and in connection with, this section.

(9) The provisions of this section shall apply for the purposes of assessment to super-tax for the year 1923–24 and any succeeding year of assessment.

93. The overarching objective of Section 24 of ITA is to check that non-distribution of dividends that would in ordinary circumstances be distributable is not employed as a devise for avoidance of Tax liability. Unlike the English position, the provisions of the subsection 4 is a mechanism for a company, before making a decision on distribution of dividend, to inquire with the Commissioner whether he deems the distribution as a scheme of tax avoidance. The Commissioner, after calling for any information from the company which he may reasonably require, advises the company on whether or not he proposes to take action under Section 24. Subsection (4) reads;

S. 24 (4) A private company may at any time before making a distribution of a dividend to its shareholders inquire of the Commissioner whether the distribution would be regarded by him as sufficient for the purpose of subsection (1) of this section, and the Commissioner, after calling on the company for such information that he may reasonably require, shall advise the company whether or not he proposes to take action under this section.

94. Two things need to be observed in respect to Subsection (4). The first is that it is optional. The Tax payer may or not make the inquiry of the Commissioner. Secondly, there is nothing to suggest that the company is obliged to take the advice of the Commissioner and therefore to make distribution of the dividend on the basis of the advice.

95. Whether or not a tax payer opts to take the route of Subsection (4) should perhaps have an implication on who bears the onus of proving that the declaration of a dividend will or will not jeopardise the business of the company. If the Tax payer takes the voluntary option of Subsection (4) in which he furnishes the commissioner with any information that the Commissioner may reasonably require so as to form his opinion and the Commissioner persists on deeming dividends, then the onus must squarely lie on him to prove that his action will not prejudice the requirements of the business of the Company.

96. If however, like here, the company does not seek the advice of the Commissioner under Subsection (4), then the Tax payer should bear the burden of proving that the Commissioner's action is detrimental to its business. This is because non-distribution of dividends has the potential of abuse and a tax payer should be happy and willing to prove that, in not distributing dividends, it is not engaging in tax avoidance.

97. Having come to that conclusion, I uphold the Tribunal's decision that on this occasion the burden of prove lay with the Tax payer to demonstrate that did it not have the ability of paying dividend without hurting its business. So did the Appellant discharge this onus?

98. In its case before the Tribunal, the Appellant argued that out of its trade receivables of Kshs.53,450,169.00, Kshs. 24,000,000.00 was in respect of VAT refunds which were yet to be paid by the Respondent and it was therefore unreasonable to expect the Appellant to declare dividends of Kshs.55,000,000.00. Further, that the Appellant operated in an industry that had over the last years preceding the Appeal experienced global volatility and that this was heightened by domestic uncertainty as the country was getting into a general election. Further, that the Appellant had since declared a dividend of Kshs.14,000,000.00 and paid out withholding tax of Kshs.1,400,000.00.

99. The Tribunal did not think much of the arguments and on the VAT refunds held that it was not a convincing reason because refunds cannot stop a company from issuing dividends. On the volatility of the industry, the Tribunal took the view that volatility of the industry does not preclude the respondent from applying the law and that the Appellant had not disclosed what had materially changed to enable it issue dividends in the past.

100. At the Appeal before this Court the Appellant submitted that it is impossible to pay a dividend without actual cash to do so and that in 2014 the Appellant only had cash amounting to Kshs.600,251.00. Further, that even putting the cash and trade receivables together , the total of Kshs.54,050,420.00 would fall short of the deemed dividend of Kshs.55,000,000.00

101. For the Respondent it was argued that as at 31st December 2014, the Appellant had a net worth of Kshs.64,361,866.00 and was capable of declaring a 55 Million dividend in the financial year 2014.

102. In the arguments made before the Tribunal, the Commissioner does not seem to dispute that, at the material time, the tax payer had outstanding trade receivables of Kshs.24,000,000.00 in respect of VAT refunds. Further it did not seem dispute that it was difficult to predict when VAT refund would be repaid. This were therefore common ground. While it may be true that the income tax Regime and that of VAT may be different, delayed refund of VAT may have a negative impact of the tax payer's cash flow. In that respect there was some merit in the Appellant's arguments that because of severe constraints in cash flow, a declaration of a dividend could adversely affect its business. However, the Appellant was obliged to provide further proof that it could not make out such payment through any other means, for instance borrowing, without hurting the Company. By not going that extra mile the Appellant failed to make out it's case.

103. This Court comes to the conclusion that the Appellant had not discharged its onus of proving that distribution of dividends would imperil the business of the company.

Outcome:

104. On demurrage the decision of the Court in respect to Appeal No. 29 of 2017, 31 of 2018, 14 of 2017, 13 of 2017 and 3 of 2017 is as follows:-

104.1 The Court upholds the decision of the Tribunal that demurrage relating to the delay of containers post-port is not part of freight.

104.2 The Court upholds the decision of the Tribunal that demurrage referred to in 104.1 above should be treated as income derived from Kenya and that the shipping agents were liable to withhold tax.

105. In respect to Appeal No. 14 of 2007, the argument that the decision of the Tribunal in respect to demurrage charges infringes on the provisions of the *Avoidance of Double Taxation and Prevention of Fiscal Evasion With Respect to Taxes on Income Agreement* between the Republic of France and the Republic of Kenya is without merit and is dismissed.

106. As regards Appeals No. 29 of 2017, 31 of 2018, 33 of 2017 and 9 of 2017, the Court sets aside the decision of the Tribunal that delivery order fees is not part of freight and allows the Appeals in this respect.

107. For Tax Appeal No. 31 of 2018 the Court allows its Appeal on the question of assessment of freight Tax on the transhipment cargo originating from Uganda, Rwanda, Burundi and Tanzania.

108. Again on Tax Appeal No. 31 of 2018 the Court dismisses the Appeal on the question of deemed dividends.

109. As the Appeals have partly succeeded but also partly failed, each party to each Appeal shall bear their own costs.

Dated, Signed and Delivered in Court at Nairobi this 7th Day of February 2020

F. TUIYOTT

JUDGE

PRESENT:

Tugee for Appellant

Machasio for Bahati Appellant in 14/2017

Nyagah for Ochieng for Respondent in 13/2017

Nyagah for Respondent in 14/2017

Court Assistant: Nixon