



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA**

**AT NAIROBI**

**MILIMANI COMMERCIAL & TAX DIVISION**

**INCOME TAX APPEAL CASE NO. 36B OF 2017**

**SHERIA SACCO SOCIETY LIMITED.....APPELLANT**

**-VERSUS-**

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

(An Appeal from the judgment of Tax Appeal Tribunal at Nairobi dated the 2<sup>nd</sup> day of August 2017 in the Tax Appeal Tribunal Appeal No. 63 of 2016)

**J U D G M E N T**

1. This is an appeal from the Tax Appeal Tribunal which appeal is between **SHERIA SACCO SOCIETY LIMITED**, (herein after referred to as the SACCO), as the Appellant and **THE COMMISSIONER OF DOMESTIC TAXES**, (herein after referred to as The Commissioner) as the Respondent.

**BACK GROUND**

2. The SACCO is deposit taking entity and is regulated by SACCO Societies Regulatory Authority (SASRA). At the material time to this matter the SACCO had a total of 9,963 members. All of those members belonged to the Back Office Services Activities (BOSA) business. 7,501 of those members subscribe to Front Office Services Activities (FOSA) .

3. The Commissioner is established under the Kenya Revenue Authority Act, Cap 469, and is charged with the mandate of collecting revenue and administer tax regime on behalf of the Kenyan Government.

4. The Commissioner conducted an audit of the SACCO's income statements and PAYE records for the years 2011 to 2015. The Commissioner by a letter dated 7<sup>th</sup> July 2015 detailed its finding on various heads. The only issue, of that audit, that was before the Tax Tribunal and is before me is the Commissioner's finding that the SACCO had not brought to tax charge other non-interest income from its FOSA business. The SACCO responded, in writing, to that audit by indicating that:

**“Interest income is income received from offering loan products to its members. Thus, as provided under section 19A (4) (a), of the Income Tax Act, the Appellant (read the SACCO) reiterated that such income is exempt from tax”.**

5. The Commissioner proceeded to issue final audit findings. The Commissioner issued a confirming notice by letter dated 21<sup>st</sup> April 2016 and reiterated that the SACCO had some taxes to pay, one of those taxes which is before this Court was the corporation tax of Ksh.8,158,718. In that confirming notice the Commissioner relied on the provisions of Section 19A (4) (d) of the Income Tax Act Cap 470. The SACCO appealed, before the Tax Appeal Tribunal against that confirmation notice.

6. The SACCO presented the following grounds, as set out in the Tax Appeal Tribunal judgment:

i. The Respondent confirmed the Notice without due regard to the provisions of the Income Tax Act, the facts and circumstances of the case; the Respondent is of the view that the SACCO did not comply with the provisions under Section 19A(4) of the Income Tax Act.

ii. That the Respondent misapprehended the law in holding that interest income from Front Office Services Activity (FOSA) services was not mutual income exempt from taxation as per Section 19A (4) (a) of the income Tax Act.

iii. That the Respondent in its understanding gave the term “interest from members” a very restricted meaning and not the meaning as contemplated under Section 19A (4) (a) of the Income Tax Act. It is our considered view that this Section should be read in tandem with Section 2 of the Income Tax Act. The Section gives a precise definition of what constitutes interest as:

“interest (other than interest charged to tax) means interest payable in any manner in respect of a loan, deposit, debt, claim or other right or obligation, and includes a premium or discount by way of interest and a commitment or service fee paid in respect of any loan or credit.”

iv. That the SACCO consists of a total of 9,963 members. As required under Section 31 of the SACCO Societies Act, the SACCO only engages in business as authorized by the SACCO Societies Regulatory Authority (SASRA). In particular, that the SACCO does not engage in any sort of business with non-members as the same is prohibited by SASRA.

v. That the tax demand of Kshs.8,158,718 inclusive of penalties and interest on income from FOSA is erroneous. The Appellant contends that this income constitute interest from members and thus exempt from tax as provided under Section 19A (4) (a) of the Income Tax Act.

vi. Without prejudice to the foregoing, the SACCO has not been proscribed from applying the provisions under Section 19A (4) (a) and (b) by neither the Commissioner of Co-operatives nor the Commissioner of Domestic Taxes.

7. The Commissioner responded to those grounds. The Commissioner’s response, set out in the Tax Appeal Tribunal judgment are as follows:

i. The Respondent contends that interest income from FOSA is deemed to be other income that needs to be charged to tax on non-mutuality basis as FOSA activities and business is ordinarily open to both members of the SACCO as provided by the Appellant and non-members.

ii. That FOSA business includes provision of financial services that are ordinarily provided by commercial banks and which services like loan advances require collateral that markedly differ from the normal guaranteeing of loans in mutual business backed by members share contributions as collateral.

iii. That the fact that the Appellant has not only registered with the Commissioner of Co-operatives but has equally registered with the Central Bank of Kenya to provide FOSA services confirms that FOSA services constitute a separate business as spelt out in Section 19A (4) (d) of Income Tax Act, CAP 470 of the Laws of Kenya.

8. Before that Tax Appeal Tribunal the SACCO submitted that the Commissioner gave a restricted meaning to the term interest in Section 19A (4) (a) of Cap 470 and argued that the Commissioner mis-apprehended the Judgment of the High Court in **MURAMATI DISTRICT TEA GROWERS SACCO SOCIETY LTD (Unitas) –V- KENYA REVENUE AUTHORITY [2015] eKLR**. The SACCO argued that that decision made a finding that interest from members was excluded from taxation under Section 19A (4) (a) of Cap 470 because it was deemed to be for mutual benefit of the members of a SACCO.

9. The Commissioner submitted that FOSA services were not SACCO business and in the circumstances was service charge or fee charge in conducting SACCO business. That FOSA was to that extent removed out of realm of SACCO business. That since the SACCO’s FOSA traded with non members it was liable to tax on the profit of such trading.

10. That FOSA services were not services of a SACCO, as contemplated under the Co-operative Societies Act Cap 490, and accordingly interest accruing from FOSA services can only be defined as “any other income” which is taxable under Section 19A (4) (d) of Cap 470.

11. The Commissioner further argued before the Tax Appeals Tribunal that SACCO’s website under [www.sheriasacco.coop](http://www.sheriasacco.coop) indicated that the SACCO dealt with non members on the FOSA services.

12. The Tax Appeal Tribunal in its considered judgment of 2<sup>nd</sup> August 2017 had this to say:

i. Though the Appellant insisted on the fact that all its BOSA and FOSA loans were strictly and exclusively advanced to its members there was no attempt on its part to identify and provide a clear distinction as between the BOSA and FOSA loans ordinarily advanced by the Appellant and the parameters or factors informing the difference in the nature of the two separate loan categories advanced to the Appellant’s members or otherwise.

ii. The Appellant argues and which argument is to a larger extent logical and reasonable that Section 19A (4) (a) of the Income Tax Act does not make specific distinction as to which of the loans between BOSA and FOSA loans are exempt from taxation but the hallmark and purport of the said statutory provision is that interest from members of a designated cooperative society is exempt from taxation. This found favour with the decision of J. Kamau in **MURAMATI DISTRICT TEA GROWERS SACCO SOCIETY LTD (UNITAS SACCO) –VS- KENYA REVENUE AUTHORITY (2015) eKLR** when she stated thus:-

“bearing in mind the definition of SACCO business against the backdrop of the provisions of Section 19A (4) of the Income Tax Act, the Court found itself in agreement with the Respondent that it was not all income that was generated by a Co-operative Society could be deemed to be for mutual benefit of its members. However, interest from a member would be excluded as seen in Section 19A (4) (a) of the Income Tax Act and would be deemed to be for mutual benefit of the members.”

iii. The Tribunal guided by the foregoing decision that is binding on it is of the considered view that FOSA loans strictly and exclusively advanced to the members of the Appellant can be properly deemed to be for the mutual benefit of the Appellant's membership and interest income from such loan advances enjoys the full benefit of the provisions of Section 19A (4) of the Income Tax Act.

iv. The Critical issue for due determination by this Tribunal in the circumstances is whether the FOSA loans advanced by the Appellant during the accounting years in issue were strictly and exclusively advanced to the Appellant's members and to that extent whether interest income arising from such FOSA loan advances was exempt from taxation under the provisions of Section 19A (4) of the Income Tax Act.

v. The Respondent has consistently maintained a fact that has not been appropriately addressed and/or controverted on the part of the Appellant that from the information available from the Appellant's website and upon consideration of the loan application forms and the conditions from the grant of FOSA loans it is highly possible that FOSA loans have and/or are capable of being advanced to parties who are not at all members of the Appellant. The Respondent for instance made specific reference to the group loans that could be advanced to any group provided one member of such a group is a member of the Appellant.

vi. The Appellant was under an obligation to demonstrate to this Tribunal that all the FOSA loans advanced on its part during the accounting years of 2011 and 2012 and in respect of which the Appellant generated the interest income in issue were strictly and exclusively advanced to its specific members. It was not enough for the Appellant to allege without specific data and evidence as to whom the specific loans were advanced to so as to dissuade the Tribunal from in any manner holding that there was a possibility of the FOSA loans having been advanced to parties who were not member of the Appellant.

vii. The Tribunal agrees with the Appellant to the extent that the decisions in the **Muramati District Growers Sacco Society Limited case** and the **Nyeri Teachers Sacco** dealt substantively with the commercial services under FOSA activities of Co-operative Societies in general and did not specifically concern itself with interest income from FOSA loans strictly and exclusively advanced to members of the SACCOs.

viii. The Tribunal has upon due consideration of the entire set of the pleadings and documents filed before it and the submissions of the parties on record found that the Appellant has failed to discharge its burden of proof under Section 30(b) of the Tax Appeals Tribunal Act No. 40 of 2013 in proving that the tax decision on the Corporation Tax arising from interest income on FOSA loans in respect of the years 2011 and 2012 ought not to have been made by failing to demonstrate that the interest income in issue arose from FOSA loans strictly and exclusively advanced to the members of the Appellant and not otherwise howsoever as strongly suggested by the Respondent.

#### **FINDINGS ON FINAL DETERMINATION**

ix. In the circumstances the Tribunal finds that the Appeal as relates to the assessment and confirmation of the additional Corporation Tax in the sum of Kshs.8,158,718, inclusive of penalties and interest, lacks merit and accordingly orders as follows:-

- a. The Appeal is hereby dismissed;
- b. The assessment of the additional Corporation Tax forming the basis of the Appeal is hereby upheld;
- c. The Appellant to pay the additional Corporation Tax in issue and any further accrued penalties and interest; and
- d. Each party to bear its own costs.

13. It is against that determination that the SACCO has filed this appeal.

#### **THIS APPEAL**

14. The SACCO has filed 13 grounds of appeal. Those grounds however can be clustered into four grounds. Ground 1 to 4 faults the Tax Appeals Tribunal's determination that the SACCO lends to non members, through the FOSA services. Under ground 5 the SACCO faults the Tribunal for its reliance on the information on its website. Grounds 6 and 8 raises the issue of who bore the burden to prove before the Tribunal. Under Grounds 7, 9 to 13 the SACCO faulted the Tribunal for mis-directing itself on fact and law and thereby arriving at erroneous decision.

#### **ANALYSIS AND DETERMINATION**

15. This Court is guided, in determining this appeal, by the provisions of Section 56(1) of the Tax Procedure Act Cap 29. That section provides:

**“An appeal to the High Court or to the Court of Appeal shall be on a question of law only.”**

16. In respect to the first cluster of the grounds of appeal before me the SACCO submitted that it is its register which constitutes prima facie evidence of its membership. In that regard the SACCO referred to Section 40 of the Co-operative Society Act Cap 490. Further the SACCO submitted that it is restricted under Section 43 of the Co-operative Societies Act to only give loans to its members.

17. In response to this ground the commissioner, in my view, erred to have submitted contrary to the finding by the Tax Appeal Tribunal. I say the commissioner erred because it did not file a cross appeal objecting to the judgment of that Tribunal. It cannot therefore be permitted to argue contrary to the Tribunal's finding.

18. The Tribunal, it will be recalled from the reproduced judgment above, made a finding, which finding is in consonance with the High Court decision **MURAMATI CASE (Supra)**, that FOSA loans when strictly advanced to members of the SACCO, interest from such loans advanced fully benefit from the provisions of Section 19A (4) of Cap 470.

19. That being the finding of the Tribunal I reject the Commissioner's attempt to argue as follows:

**“FOSA services as defined by the Appellant (read SACCO) are not contemplated as SACCO Societies Act. A service fee is charged for FOSA. This thus takes FOSA from the realm of SACCO business to that of gains or profit from; (i) business or (ii) services rendered as defined under Section 3(2) (a) (i) and (ii) of the Income Tax Act.**

20. It will be seen that those submissions by the Commissioner are contrary to the Tribunal's finding and as stated before those submissions are for rejection.

21. On the issue of membership as argued by the SACCO I would start by saying that the SACCO got the wrong end of the stick. I say this because the issue before the Tribunal was not how membership is determined but rather whether FOSA services were offered to non members of the SACCO. The Tribunal by its considered judgment found that the SACCO failed to prove that its FOSA services were not offered to non members.

22. On the second cluster of the grounds of appeal the SACCO faulted the Tribunal for relying on the evidence on its website to determine that FOSA services were extended to non members. The SACCO referred to Sections 78A and 160B of the Evidence Act Cap 80 to argue that that electronic evidence of the website was inadmissible for failing to meet the standards of those Sections.

23. Before proceedings to interrogate that argument of the SACCO I need to state that electronic and digital evidence is admissible under Section 78A of Cap 80. When however a party wishes to rely on a statement electronically or digitally produced such a party is required to meet the parameters of Section 160B of Cap 80; that is by describing in which manner such a statement was produced; by giving particulars of the device involved in its production, amongst others.

24. The SACCO however needs to appreciate that what the Tribunal was dealing with was an appeal against the Commissioners' confirming notice that the SACCO had taxes to pay. When one appreciates that then the submissions of the Commissioner, under this head, are correct that the burden of proof lay on the SACCO. This is what is provided under Section 30(b) of the Tax Appeal Tribunal Act cap 40. That section provides:

In a proceeding before the Tribunal, the Appellant has the burden of proving-

- a. Where an appeal relates to an assessment, that the assessment is excessive; or
- b. In any other case, that the tax decision should not have been made or should have been made differently.

25. The SACCO did not meet that burden of proof.

26. Moreover the Tribunal had not only the confirming notice of the Commissioner before it but it also had the website, to refer to, and more importantly it had the Sheria Sacco Society Credit Policy and Procedure Manual. The National Chairperson of the SACCO, through her forward in that Policy and Procedure Manual in part stated thus:

**“This manual shall be carefully studied, as it constitute an integral part of the expectations of Sheria Sacco Society Limited's Credit Department and set out the details of the various procedures that should be followed. In this respect therefore, the purpose of this Credit Department's Procedure Manual is to provide guidance in decision-making and taking actions within the society for various operations and activities. The manual is intended to:**

- a. Establish and implement the objectives of the Society as interpreted by the Board of Directors; and**
- b. Govern the operations of the society. This is on the promise that it is an operational document that is meant to assist members of the Board and the staff in running the society smoothly.”**

27. When one considers those words of the SACCO's National Chairperson one would be left with no doubt that Policy and Procedure Manual was issued by the SACCO for its day to day running.

28. That being so then what that manual provides under the heading 'FOSA' is precisely what the Commissioner argued before the Tribunal. That manual provides under the subheading FOSA that group accounts can be open on the terms that “at least one member of the group” is a member of the SACCO. Under that same sub-heading the manual shows that FOSA services are extended to a group of between 10 to 20, who are registered with the Ministry of Culture and Social Services.

29. That in my view was the damning evidence which the SACCO needed to rebut. The SACCO failed to produce before the Tribunal evidence that no FOSA services were extended to non members, as provided in the Policy and Procedure Manual. All the SACCO needed

to do was to produce evidence of those who had accessed FOSA's services and thereby prove that those who accessed those services were members of the SACCO. The SACCO failed to do so.

30. Since that is the finding of this Court the other cluster of grounds of appeal alluding to be alleged error of the Tribunal, faulting its decision on Law and facts, must and are rejected.

**31. In view of what is stated above this appeal is without merit. It is dismissed with costs to the Respondent, The Commissioner of Domestic Taxes.**

**DATED, SIGNED and DELIVERED at NAIROBI this 15<sup>TH</sup> day of MAY, 2019.**

**MARY KASANGO**

**JUDGE**

**Judgment Read and Delivered in Open Court in the presence of:**

Sophie..... COURT ASSISTANT

..... FOR THE APPELLANT

.....FOR THE RESPONDENT