REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

MILIMANI LAW COURTS

TAX APPEAL NO.1 OF 2015

ASSOCIATED BATTERY MANUFACTURERS LIMITED.....APPELLANT

VERSUS

COMMISSIONER OF CUSTOMS SERVICES.....RESPONDENT

JUDGMENT

(1) **ASSOCIATED BATTERY MANUFACTURERS LIMITED** (hereinafter referred to as **"the Appellants")** have filed this appeal challenging the Ruling and decision of the **Customs & Excise Appeals Tribunal** delivered on **11th March 2015**, which decision upheld the tax claim by **THE COMMISSIONER OF CUSTOMS SERVICES** (The Respondent herein) against the Appellant for the amount of **Kshs.38,436,585**.

(2) The Appellant filed the Memorandum of Appeal dated **9th April 2015,** seeking to have the said decision of the Customs and Excise Appeals Tribunal set aside on grounds **THAT**:-

1. The Tribunal erred in fact and law in failing to appreciate that separators are specifically referred to in HS Code 8507.90.00 and the PE Battery Separators were therefore correctly classified under HS Code 8507.90.00.

2. The Tribunal erred in holding that the Appellant had agreed that the PE Battery separators imported by the Appellant required further work.

3. The Tribunal erred in fact and law in holding that the PE Battery Separators needed further work to be useable.

4. The Tribunal erred in fact and law in failing to find that the PE Battery Separators were used principally in the manufacture of batteries and had no other commercial use.

5. The Tribunal erred in law in failing to appreciate that where an article is imported in one piece and nothing remains to be done except to cut it apart, it shall be treated for dutiable purposes as if already cut apart and assessed according to its individual character.

6. The Tribunal erred in fact and law in failing to hold that the PE Battery Separators were properly classified under HS Code HS Code 8507.90.00 as the individual character of the separators did not change by mere virtue of the automated process that enabled the roll to be passed through a machine which cut and automatically fitted the separators into individual batteries.

7. The Tribunal erred in fact and law in holding that the PE Battery Separators were classifiable under HS Code 3920.10.10.

8. The Tribunal erred in fact and law in failing to find that the PE Battery Separators could not be classified under HS Code 3920.10.10 as the code specifically excludes cellular products and the PE Battery Separators are cellular products.

9. The Tribunal erred in fact and law in disregarding the scientific evidence adduced by the Appellant to demonstrate that the PE Battery Separators could not be classified under HS Code 3920.10.10.

10. The Tribunal erred in law and fact in holding that the Respondent's letter dated 26th April 2012 was a request for more

time to undertake the review.

11. The Tribunal erred in law in failing to appreciate that S.229(5) of the East African Communities Customs Management Act ("the Act") does not make any provision for the extension of time to communicate a decision.

12. The Tribunal erred in law in failing to uphold the clear and strict wording of S.229(5) of the Act.

(3) The Respondents opposed the Appeal and in doing so relied upon their statement of facts dated **18th May 2015**.

BACKGROUND

(4) The Appellant is a limited liability company engaged in the business of manufacturing automotive and solar batteries which business the Applicant has been engaged in since the year 1963.

(5) The Respondent is a statutory body established under the **Kenya Revenue Authority Act, Cap 469, Laws** of **Kenya. Section 5** of said Act describes the Respondent as an agent of the Government of Kenya, for the collection and receipt of all revenue including those under the **Income Tax Act, Cap 470, Laws of Kenya.**

(6) In order to engage in its core business being the manufacture of automotive and solar batteries, the Appellant required and imported PE Battery Separators. The purpose of these battery separators is to separate the positive and negative plates of the battery. The PE Battery Separators need to be porous enough to allow for the flow of ions, be resistant enough to prevent any flow of liquid and have the right thickness to fit into the battery. As such the PE Separators meet very specific technical specifications with regard to porosity and dimensions. A certificate of Analysis annexed at by the Appellant at Page 1 of their bundle of documents filed on **7th July 2017,** indicated the porosity of the PE Battery Separators to be **57.8%.**

(7) The Appellants have all along imported these PE battery separators under **HS Code Number 8507.90.00** of the Harmonized Commodity Description and Coding System (hereinafter referred to as the **"HS Code"),** which is an International standardized system developed and maintained by the World Customs Organization.

(8) Prior to the year 1997 the Appellant had a manual system of operation whereby the PE battery separators were imported as individual pieces which were then manually filled into the batteries. However in the 1997, the Appellant upgraded its operations to an automated system and thereafter began to import the PE battery separators in the form of rolls. A machine would then cut the PE separator roll into the required sizes which would then be automatically fitted into the battery.

(9) The Appellant contends that it has always imported PE battery separators under **HS Code 8507.90.00** and even after automation of its systems continued to import the rolls under **HS Code 8507.90.00,** since according to the Appellant the character of the material remained the same. The Appellant further states that at no time did the Respondent raise any issue or question regarding the importation of the PE battery separators under **HS Code 8507.90.00**. Even after the Appellant automated its operations and in 1997 began to import the separators in the form of rolls the Respondent raised no issue with the classification.

(10) It was not until almost fifteen (15) years later that Respondent vide its letter dated **11th January 2012** wrote to inform the Appellant that the PE Battery Separator was to be classified under **H.S. Code 3920.10.10** of the Common External Tariff. The reasons given for the change in classification were that a sample of the Roll was found to be coated with inorganic compound of silicon and that the Separators were being imported in rolls as opposed to pieces. The Respondent then raised a tax demand vide their letter dated **29th March 2012** on the basis that imports under **HS Code 3920.10.10** attract Import duty and **VAT** at 10% and 16% respectively.

(11) The Appellant disagreed with this change in classification and filed an Application for Review dated **20th April 2012** pursuant to **Section 229** of the **East African Community Customs Management Act** (**EACCMA**). The Appellant contends that the Respondent failed to provide a response to the application for Review within 30 days and the Appellant therefore pursuant to **Section 229(4)** of the same Act, treated its request for review as having been successful. The Appellant therefore continued to import PE battery separators under **HS Code 8507.90.00.**

(12) Two years later on **19th February 2014**, the Respondent again wrote to the Appellant demanding import duty on the separators insisting that they ought to have been classified under **HS Code 3920.10.10**. The Appellant filed another Application for Review vide their letter dated **19th March 2014**. The Respondent replied by a letter dated **27th March 2014** insisting that the PE battery separators were classifiable under **HS Code 3920.10.10**. The Appellant then filed an appeal before the **Customs and Excise Appeals Tribunal** (hereinafter referred to as **"the Tribunal")** challenging the Respondents classification under the HS Code of PE Battery separators.

(13) On **11th March 2015** the Tribunal rendered its decision in which it disagreed with the Appellant and held that PE battery separators fell within the classification Code Number **3920.10.10**. The Tribunal also held that the Respondent had responded to the Appellant's Application for Review within the statutory time frame. Being aggrieved by the decision of the Tribunal the Appellant appealed to the High Court.

(14) The Respondents position is that they conducted a testing of a sample of the PE battery separator in order to determine the appropriate tariff classification. The laboratory tests revealed that the goods being imported by the Appellant were not in pieces cut to size and shape under **HS Code 8507.90.00** which were specific about the dimensions and porosity of the PE battery separators. Rather the goods in question were imported in form of rolls which fell within **HS Code 3920.10.10**. The Respondents maintain that there had been a misclassification of the PE Battery Separators and issued a demand for taxes due.

(15) The Respondents concede that the Appellants did in compliance with **S.229 (1) CCMA** seek a review of the decision of the Commissioner, by their latter dated **19th March 2014** However the Respondents contend that this application for review was declined by the letter dated **27th March 2014**, in which the Respondent clarified to the Appellant that they had responded to the Application for Review vide the letters dated **26th April 2012** and **26th July 2012**. The Respondents maintains that the Tribunal did not err in determining that PE battery separators should be classified under **HS Code 3920.10.10** and urge the court to dismiss this appeal in its entirety.

ANALYSIS AND DETERMINATION

(16) The Appeal was canvassed by way of written submissions. The Appellants filed their written submissions on **7th November 2018** whilst the Respondents filed their submissions on **11th February 2019**. The Appellant filed Further written submissions on **10th April 2018**. On **15th April 2019** counsel appeared in court to highlight the written submissions **Ms NAZIMA MALIK** acted for the Appellants whilst **Mr. NYAGA** appeared for the Respondents.

(17) I have carefully considered the submissions filed by each party and I find that the following issues arise for determination:-

(i) Did the Customs and Excise Tax Appeals Tribunal err in upholding the Respondents decision to classify PE Battery Separators under HS Code 3920.10.10

(ii) Did the Respondents reply to the Appellant's Application for Review within the statutory time limit?

CLASSIFICATION OF PE BATTERY SEPARATORS UNDER THE HS CODE

(18) The Appellants have stated that they previously imported the PE Battery Separators as cut pieces under H**S Code 8507.90.00**. In 1997 upon automation of their operations the Appellant began to import the separators in the form of a Roll. That the Respondent raised no query with the classification until the year **2012** almost 15 years later when the Respondent informed the Appellant that the classification was erroneous.

(19) In disagreeing with the Respondent the Appellant countered that notwithstanding the change of their operations from a manual to an automated system, the material that constituted the PE Battery separators remained the same. They argue that the mere fact that the material was being imported as rolls instead of as ready cut to size pieces, did not warrant a change in classification. The first question that arises is why the Respondent took so long to query the Appellants classification of the PE Battery Separators? Why allow the Appellant to import the separators in the form of a roll for years only to abruptly question the same after 15 years. This behavior on the part of the Respondent is curious to say the least. It raises the question of whether the Respondent reclassification of the separators under a different **HS Code** was in actual fact bona fide. Be that as it may, I will proceed with my analysis of the submissions made in this appeal.

(20) In determining whether or not the Tribunal erred in upholding the Respondents classification, this court must of necessity answer this critical question – what is the correct and proper classification of PE Battery separators under the H.S code? This indeed is the main point of contention between the Appellant and the Respondent. The question is whether the PE Battery separators ought to be classified under **HS Code 8507.90.00** as contended by the Appellant or under **HS Code 3920.10.10** which is the Respondents position. The answer to the above question requires an analysis of the codes in question by examining their cover as per the **East Africa Community Common External Tariff**.

(21) The **Harmonized Tariff Schedule** is a systematic classification or enumeration of all goods found in international trade along with international rules and interpretation. Since Kenya is a signatory to the **World Custom Organization**, parties are required to rely on the Harmonized Community Description and Coding System. In the case of **Republic Vs. Commissioner General & Another Ex-parte Awal Ltd [2008] eKLR** the court stated as follows:-

> **"In the end I must conclude that looking at the material placed before me and the submissions tendered by learned counsels…the Respondents had the statutory duty to impose duty according to the tariff classification provided by law under the Customs and Excise Act and under the Harmonized Community Description and Coding System provided by the World Custom Organization explanatory notes in which Kenya is a signatory."**

(22) The **HS Code 8507.90.00** covers electric accumulators including separators, whether or not rectangular (including square). In the explanatory notes the Harmonized Community Description and Coding System gives the following explanations to the **HS Code 8507.90.00**.

> **"Subject to the general provisions regarding the classification of parts (see general Explanatory note to Section XVI) the heading also covers parts of accumulators e.g containers and covers; leads plates and grids whether or not coated with paste; separators or any material (except of unhardened vulcanized rubber or textile material) including those in the form of flat plates merely cut into rectangles (including squares), meeting very precise technical specifications (porosity, dimensions, etc) and hence ready to use."**

(23) **HS Code 3920.10.10** covers other plates, sheets, film foil and strip of plastics, non cellular and not reinforced, laminated, supported or similarly combined with other materials. The explanatory note to the Harmonized Commodity Description and Coding System (2002) gives the following explanations as to **HS Code 3920.10.10** under heading 10.

> **"10. In headings 39.20 and 39.21 the expression plates sheets, film foil and strip applies only to plates, sheets, film, foil and strip (other than those of chapter 54) and to blocks of regular geometric shape whether or not printed or otherwise surface worked, uncut or cut into rectangles (including squares) but not further worked (even if when so cut they become ready for**

use)"

(24) As submitted by the Appellants they had all along imported the PE battery Separators under **HS Code 8507.90.00** with no protest being raised by the Respondent. Even after automation of their operations in the year 1997 the Appellant continuing importing the battery separators under the same code. The only difference was that whereas the separators were initially imported as square pieces which were cut to size following automation, they were imported in rolls or sheets which were later automatically cut to fit the required use.

(25) In their decision of **11th March 2015**, the Tribunal found and held as follows:-

> **"(1) that imported PE Battery Separators are made of plastic materials, in rolls from measuring 1300mm, unprinted and need further work to make them ready to use and therefore fit into the description provided under tariff No.3920.10.10"**

(26) The Respondent submitted that the Appellant had admitted before the Tribunal that further work was required on the imported rolls to make them usable. The Tribunal at Para 2 of its Ruling dated **11th March 2015** stated as follows:-

> **"Both parties agreed that PE Battery Separators are made of plastic materials and imported in rolls measuring 1300 mm and that they still require further work to make them usable."**

(27) The Appellant categorically denies having made any such admission and/or concession. I have carefully perused the record of the proceedings before the Tribunal. Nowhere is such an admission indicated as having been made by the Appellant. Vide Para 30 in their written submissions the Respondent concurs that the Appellant never expressly admitted that battery separators imported in rolls requires further work to make them usable. Without a direct and unequivocal admission by the Appellant in this regard the Tribunal misdirected itself in concluding that such an admission had been made by the Appellant.

(28) The key finding of the Tribunal was that since the battery separators **"required further work to make them ready to use"** they could not be classified under **HS Code 8507.90.00** which only applies to items which are **"ready for use."**

(29) There was no dispute that the PE battery separators were being imported in the forms of a Roll and were through an automated process being cut into the sizes required for use. The question is whether this process of cutting the separator into the required size changes and/or alters its classification in any way. The Respondent contends that the form in which the product is imported (i.e in rolls) cannot be said to have the essential character of the finished product.

(30) It is pertinent to note that the PE battery separators were initially imported under **HS Code 8507.90.00**. The separators needed to meet very specific technical specifications with regard to porosity and dimensions classified by the manufactures certificate of Analysis as 57.8%. Did the change to importation of the separators in the form of a roll so radically alter the technical specifications of the product so as to warrant a change in classification or in other words was any further work or process being carried out after importation so as to render the separators **"ready for use?"**

(31) The Respondent contends that the process of cutting the rolls into the required size for use changed the nature and character of the goods in question. They submit that prior to **1997** the Appellant was importing PE Battery Separators in pieces as a finished product. Subsequently they began to import the product in Rolls which required cutting into size, therefore an unfinished product. The Respondent concludes that the plastics in rolls of 1300m imported by the Appellant cannot be said, by any stretch of imagination, to have the essential character of the finished product. The Respondent submits that **HS Code 3920.10** best describes the goods imported by the Appellant.

(32) On their part the Appellant insists that importing the separators in a form which requires cutting into the required size for use as opposed to pieces does not change the essential character or identity of the material used.

(33) It must be appreciated that there is a clear distinction between the term **"further work"** and "**automation**". Automation is merely a means to speed up a process and make it more efficient. On the other hand if a product is said to require further work, it means it requires further processing to render the same ready for use. Automation cannot be said to be the equivalent of further processing. Take for example a situation where a cow is milked manually as opposed to milking by machine. One cannot say that the milk obtained through manual milking has been subjected to further processing merely due to the fact of automation i.e milking by machine. Other examples of automation abound in Society. Indeed automation is the only way forward for any business to remain relevant and competitive in the world market today. However automation does not in my view alter and/or change the essential character of a product. All it does is to make a process more convenient and time effective.

(34) In the Indian case of **EXIDE INDUSTRIES –VS- COMMISSIONER OF CUSTOMS [2007] (116) ECC 413**, a case which is on all fours with the present case it was held:-

> **"As PER HSN notes under heading 85.07, battery separators of any material (except of unhardened vulcanized rubber or of textile material) including those in the form of plastic plates merely cut into rectangles (including squares) meeting very precise technical specifications (porosity), dimensions, etc) and hence "ready for use.. were battery separators of that heading. The above notes do not exclude battery separators in roll form from chapter Heading 8507. <u>As the imported goods in roll form were ready for use as battery separators, they were classifiable as battery separators and entitled to the assessment at concessional rate as claimed by the Appellants</u>**."[own emphasis]

(35) Similarly in the case of **COLLECTOR OF CENTRAL EXCISES –VS – BAKELITE HYLAM on Indian case** it was held that:-

"Mere cutting or punching holes does not amount to manufacture. Since hose sheets have insulating property and are used as electrical insulators, they cannot be taken out of the category of electrical insulators only because the sheets will have to be cut into requisite shape."

(36) Similarly I am of the view that merely cutting the imported rolls into the shape and size required for use cannot be said to amount to further processing of the PE Battery Separators. It is clear that to merely cut a roll into required size for use does not amount to manufacture. The essential character and or quality and specifications of the PE battery separators is not altered by merely cutting the roll into the required size for use.

(37) In the case of **COLLECTOR OF EXCISE –VS- BEICO ELECTRICAL INSULATORS (1998) 104 ELT**, it was held that:-

"Sheets having insulated properties and used as electrical insulators cannot be taken out of the category of electrical insulators only because the sheets will have to be cut into requisite shape."[own emphasis]

(38) I do find that hold that the individual character and specifications of the PE Battery Separators as imported by the Appellant was not altered merely by virtue of the automated process that enabled the roll to be passed through a machine which cut and automatically fitted the separators into each individual battery. The composition and material of the separators remains the same after the cutting process. I therefore find that the tribunal erred in finding that the PE battery separators imported by the Appellant required further work and were not ready for use.

(39) The next question is whether the PE Battery separators consisted of material which was cellular or non-cellular in nature. The appellant submitted that heading **3920** under the **HS Code** does not apply to material that is laminated and by the Respondent's own description the material they examined was coated with inorganic compounds of silicon. It is pertinent to note that **HS Code 3920.10.10** lists the items which fall under this classification as **"other plates, sheets, film, foil and strip of plastics, non-cellular and not reinforced, laminated, supported or similarly combined with other materials."** Therefore **HS Code 3920.10.10** applies only to non-cellular or non-porous material. It appears that this is a factor which the Tribunal did not take into consideration.

(40) The concise Oxford Dictionary defines the word **"cellular"** to mean and include the following:-

"1. Of or having small compartments or cavities; and

2. of open texture"

The PE Battery Separators need to be porous enough to allow for the flow of ions. The Manufacturers Certificate of Analysis gave the porosity of the PE Separators as 57.8%. There can be no doubt that the said separators are in fact porous and therefore cellular in nature. As such they could not be classified under **HS Code 3920.10.10** which only refers to non-cellular material.

(41) In the case of **SANWA FOODS INC –VS- UNITED STATES (United States Court of International Trade SLIP OP 93-169)**the Court held as follows:-

"…the HTSUS distinguishes between cellular and non-cellular plastics. Thus the plain language of heading 3920 expressly limits the coverage of that tariff provision to non-cellular plastic articles. Articles of cellular plastics are covered by the explicit terms of heading 3921 moreover upon closer examination, the court finds that non-cellular and cellular plastics are in fact different materials. According to Van Nostrands Scientific Encyclopedia 546 (7th Edition [..9] 1989) cellular plastics are "unique among the plastics in that the basic materials used in their manufacture are not synthetic polymers. Rather, they are derivative of a natural polymer cellulose. Consequently the court determines that the term "other materials" for the purpose of heading 3920 refers broadly to all materials other than non-cellular plastics."[own emphasis]

(42) This decision applies **"mutatis mutandis"** to the present appeal. There exists a clear distinction between cellular and non-cellular plastics. The Respondents do not dispute the fact that PE battery separators are cellular in nature. Cellular means porous and **HS Code 3920.10.10** only applies to material that is non porous whereas the PE Battery Separators are actually porous. Therefore **HS Code 3920.10.10** which applies to non-cellular materials cannot be taken to apply to the separators imported by the Appellants.

(43) The Harmonized commodity description is an international standard classification created by the World Customs Organization and the countries who are parties to it are guided by the General Interpretation rules with an aim of ensuring fair international trade. The Respondent who is mandated to receive taxes on behalf of the government is required to ensure fairness and should avoid charging corporate tax that would affect innovations by firms or companies. The Appellant ought not to be penalized for automating its operations thereby making the work done more efficient, convenient and time saving.

(44) For the above reasons I find that the Tribunal erred in its decision and finding that the mere fact of importation of the battery separators in the form of a roll warranted a change in their classification to **HS Code 3920.10.10** I find that the correct code for classifying the PE battery separators imported by the Appellant remains **HS Code 8507.90.00**

APPLICATION FOR REVIEW

(45) Under this heading the Tribunal in their decision dated **11th March 2015** found as follows:-

"(2) That the delay by the Commissioner of Customs services to respond was not in breach of Section 229 (4) and (5)

Upon receiving by way of the letter dated **29th March 2012**, a tax demand from the Respondents on the basis that there had been a misclassification of the PE battery separators the Appellants filed an application for review dated **20th April 2012**. The appellants contend that since the Respondents failed to respond to this application for review within the 30 day period provided by the **EACCMA** they (the Appellants) were entitled to on account of this delay conclude that their application for review had been allowed and hence were at liberty to continue to import the battery separators under **Code HS 8507.90**.

(46) **Section 229(1) and (2)** of the **EACCMA** provide as follows:-

> **"229(1) A person directly affected by the decision or omission of the Commissioner or any other officer on matters relating to customs shall within thirty days of the date of the decision or omission lodge an application for review of that decision or omission.**
>
> **(2)The application referred to under sub section (1) shall be lodged with the commissioner in writing stating the grounds upon which it is lodged."**

(47) The Appellant were therefore well within their rights to file an application for review and complied fully with **Section 229(2)** in doing so. **Section 229(4)** of the same Act provides:-

> **"The commissioner shall, within a period not exceeding thirty days upon the receipt of application under sub-section 2 and any further information the Commission or may require from the person lodging the application, communicate his or her decision within in writing to the person lodging the application stating the reason for the decision."**

(48) The Respondents maintain that a response to the application for review was tendered within the 30 day period, by way of a letter dated **26th April 2012** in which the Respondents indicated that they needed to submit samples of the goods imported by the Appellant to its laboratory for analysis before making a determination regarding the review application. Thereafter by letter dated **26th July 2012**, the Respondent communicated to the Appellant its final decision over the matter. The Respondent claims that by virtue of **Section 229(4)** they were entitled to call for further information, which they claim they did by way of the laboratory analysis, before rendering a final decision on the matter.

(49) It must be noted that **Section 229** is couched in mandatory terms. It clearly provides that the **Commissioner** "**shall" within a period not exceeding thirty days** communicate his reply to an application for review. The letter of **26th April 2012 did not** amount to a decision or determination. It simply indicated that laboratory tests were to be conducted on a sample of the product.

(50) The final decision was not communicated in writing until the letter of **26th July 2012** which was a full four (4) months after the 30 day period had expired. **Section 229(5)** of the **EACCMA** provides as follows:-

> **"(5) Where the Commissioner has not communicated his or her decision to the person lodging the application for review within the time specified in subsection (4) <u>the Commissioner shall be deemed to have made a decision to allow the application</u>."**[own emphasis]

Once again this provision is couched in mandatory terms. It is clear and requires no further explanation. The Respondent does not have any mandate under the Act to extend time. In **R –Vs. COMMISSIONER OF DOMESTIC TAXES ex Parte UNILEVER (2005) eKLR** the court held that even in a case where a party consents to a delay in the Commissioner rendering his decision, it would not make a tax demand in respect of a delayed decision valid. I therefore find that the request for more time to undertake the review did violate **Sections 229(4)** and **(5)** of the Act. The Tribunal therefore erred in its finding that the delay did not violate those provisions of law.

<u>CONCLUSION</u>

Based therefore upon the foregoing this Court finds merit in the present appeal. The same is allowed in its entirety with costs to the Appellant.

Dated in Nairobi this 5th day of November, 2019.

.....

Justice Maureen A. Odero