



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
COMMERCIAL AND ADMIRALTY DIVISION
CIVIL SUIT NO. 507 OF 2014

VIVO ENERGY KENYA LIMITED.....PLAINTIFF

- VERSUS -

KENYA REVENUE AUTHORITY.....DEFENDANT

JUDGEMENT

1. This is an appeal from the decision of the Local Committee dated 19th September 2013.
2. The appellant believes that the decision was wrong as it declared that the sale of a non-exclusive and non-transmissible authorization to use the Trade Marks, manifestations and the word “**SHELL?**” as a part of its corporate name without payment of royalty was a sale of a property giving rise to royalty within the meaning of Section 2 of the Income Tax Act and hence chargeable to tax.
3. As far as the appellant was concerned, the proceeds of sale of the Trademarks and manifestations, which were paid to the appellant was not Income as spelt out in the Income Tax Act.
4. The Local Committee is said to have arrived at the wrong conclusion because it had fundamentally misapprehended the proper construction of the provisions of Section 2 as applied to or as read together with Sections 3 (2) (a) (iii) and 6 of the Income Tax Act.
5. The Commissioner of Domestic Taxes was faulted for concluding that Section 2 (1) of the Income Tax Act defined **ROYALTY** as including gains derived from the sale or exchange of any right or property, giving rise to royalty.
6. In this case, the appellant contended that it had only been granted non-exclusive and non-transmissible rights to use the trademarks, the manifestations and the right to include the word “**SHELL?**” in its name in Kenya, without payment of royalty.
7. If the Local Committee had taken into account the fact that the user had been granted to the appellant without any payment, and also because the user was not transmissible, the appellant believes that the decision of the Local Committee would have been different.
8. The money which the appellant paid was described by it as being a contribution for Research and Development.
9. However, the appellant was also of the view that even if the money was utilized for the acquisition of intangible assets, the said payment could not have amounted a Royalty, as defined in the Income Tax Act.

10. It may have been money paid for the disposition of rights which had been granted under the Licence Agreement, but not Revenue Income under the provisions of the Income Tax.

11. The appellant's contention was that royalties are payments for the use of patents, trademarks, designs, modes, plans or processes. Therefore, money which was paid out for Research and Development could not be royalties.

12. Another factor which the appellant drew attention to was the fact that it was only given non-exclusive and non-transmissible rights to use the Trade mark, manifestations and the name "**SHELL?**" in Kenya. Therefore, the owner had retained ownership. That is why the appellant was obliged to seek the consent or the concurrence of the owner, if the appellant wished to either transfer or to transmit any of the rights conferred upon it under the agreement.

13. The appellant noted that the Commissioner of Domestic Taxes had charged a global Tax on the amount of Kshs. 427,964,870/- without specifying the specific value or scope of the rights that were the subject of the Cost Contribution Agreement. In the opinion of the appellant, that was an error.

14. But the Respondent was of the view that the sum of Kshs. 430,675,000/- which was realized from the sale of economic rights was taxable.

15. As far as the respondent was concerned, that sum was not realized from the sale of legal rights.

16. Therefore, if the proceeds were from the sale of economic rights, the respondent submitted that such funds were taxable pursuant to section 2 (1) as read with section 3 (2) (a) and section 6 (1) of the Income Tax Act.

17. Citing section 2 (1) of the Act, the respondent pointed out that the word "*Royalty?*" was defined as;

"a payment made as a consideration for the use of or the rights to use –

....

....

(c) a patent, trade mark, design or model, plan, formula or process?

18. Why would such payments be required attract tax?

19. As far as the respondent was concerned, the answer was spelt out in section 3 (2) (a) (iii) of the Income Tax Act which reads as follows;

"Subject to this Act, income upon which tax is chargeable under this Act is income in respect of

–

i.

ii.

iii. ***a right granted to another person for use or occupation of property?.***

20. I understand the respondent to be saying that the appellant was given the right to use the trade mark.

21. The respondent then went on to point out that section 6 (i) of the Income Tax Act says that;

"for the purposes of section 3 (2) (a) (iii), gains and profits' include a royalty, rent, premium on similar consideration received for the use or occupation of the property?.

22. If the respondent was correct, it would mean that the person being given the right to use the trade

mark had not acquired the said trade mark exclusively.

23. They had only acquired the right to use the trade mark.
24. The respondent sees the transaction as a clear transfer of rights and royalty payable at zero rate.
25. Did the appellant acquire the ownership of the trade mark?
26. Paragraph 4 of the Agreement dated 1st January 1982 stipulated as follows;

“Users hereby acknowledge that proprietor are the sole and rightful owners of the Trade Marks and the Manifestations and agree that during the continuance of this Agreement they will not claim any rights in or to the Trade Mark and/or Manifestations save the permission to use them as specifically provided herein?.”

27. The “Users? are **KENYA SHELL LIMITED**, whilst the “proprietors? are **SHELL INTERNATIONAL PETROLEUM COMPANY LIMITED (SIPC)**.
28. In a nutshell, the appellant did not acquire the ownership of the trade mark.
29. Was royalty payable at zero rate as submitted by the respondent?
30. Paragraph 5 of the Agreement dated 1st January 1982 provided as follows;

“No royalty shall be payable by the Users to the Proprietors in respect to the authorization granted under this Agreement but the proprietors may at any time give notice to the Users to negotiate for agreement on payment of royalty in that respect and if, within six months of the giving of such notice the parties have not so agreed, proprietors may at any time thereafter terminate subject as provided in Clause 8 hereof this Agreement on further notice of one year to users to that effect?.”

31. That provision is clear; it says that “No royalty shall be payable?“. That is most definitely not the same thing as saying that “royalty will be payable at zero rate?“.
32. In my considered view, the respondent was wrong when it expressed the view that the parties had agreed to zero rate the royalty. The parties had expressly stated that no royalty would be payable.
33. The respondent appeared to appreciate that position in paragraph 6.1.3 of its submissions, where it said;

“Your honour, from the foregoing it is clear that the SIPC granted each company a non exclusive, non transmissible royalty free trade mark and manifestations Licence Agreement?.”

- The emphasis is mine.

34. Thereafter, the respondent said that;

“The agreement was for no royalty ‘free royalty’ and not ‘free of royalty’ as purported by the Appellant?.”

With utmost respect to the respondent, the parties had not agreed that there would be royalty which was free. Such reasoning is the same as talking about a zero rated royalty.

35. The agreement was that no royalty would be payable unless and until a 6 months’ Notice had been issued by the proprietors to the Users.

36. I fully appreciate that the fact that the right to use the trade mark and the manifestations was not exclusive, is not sufficient to determine whether or not a right had been transferred to the User. Even a non-exclusive right can be transferred.

37. I further find that the parties cannot determine what constitutes or what does not constitute royalty, by simply choosing whether or not to use the word royalty. Royalty is a word which has been defined as follows, in section 2 (1) of the Income Tax Act;

“Royalty means a payment made as a consideration for the use of or the right to use –

- a. *the copyright of a literary, artistic or scientific work; or*
- b. *a cinematograph film, including film or tape for radio or television broadcasting; or*
- c. *a patent, trade mark, design or model, plan, formula or process; or*
- d. *any industrial, commercial or specific equipment, or for information concerning industrial, commercial or scientific equipment or experience, and gains derived from the sale or exchange of any right or property giving rise to that royalty?.*

38. The significant part of that definition are the words *“a payment made as a consideration?.*

39. When parties agreed that no payment shall be made, then there is no consideration. That position is different from one in which the payment is zero. In the latter situation, the issue which arises is about the sufficiency of the consideration.

40. In this case money was paid. The question that must be answered is whether or not such payment was consideration for the purposes of the appellant being permitted to use the trade mark and the manifestations, as well as the name *“SHELL?,* which belonged to the Proprietors *SITC.*

41. The respondent acknowledged thus, in paragraph 6.1.2 of its submissions;

“... The contract provides as follows:

Whereas the user (Kenya Shell) have for many years past been using within their business such trademarks and manifestations with the agreement of the proprietors (Shell International Petroleum Company Limited); and whereas users wish to continue to use and display the said trademarks and manifestations, as hereinafter defined, and the proprietors are willing to permit such use and display subject regulation by formal agreement.... Now it is HEREBY AGREED BETWEEN THE PARTIES AS FOLLOWS....?

42. The agreement cited herein is dated 1st January 1982. Under that agreement, there was no payment.

43. The payment was made much later, under the **COST CONTRIBUTION AGREEMENT (CCA).**

44. The respondent acknowledged that **SHELL** was to make available specialist research and development and technical services. The respondent went further to state as follows at paragraph 7.1.3 of its submissions;

“By virtue of funding shell’s research and development, the Appellant and other cost shares became the economic owners of the resulting know how?.

45. That suggests that the appellant made a payment to fund the research and development of Shell’s activities.

46. Yet at paragraph 7.1.13, the respondent said;

“SBI and the Appellant in 2007 entered into a Sale and Purchase Agreement (SPA) in which the

SBI acquired the entire beneficial/economic and legal rights in the relevant trademarks and visual manifestations. SBI paid the Appellant U.S. \$ 8,331,000 for the rights acquired?.

47. Later, at paragraph 7.1.16 the respondent submitted thus;

“The Appellant got paid out and captured the same as revenue in its book of accounts as revenue?.

48. The appellant had never owned the trademarks. Why, therefore were they being paid for the trademarks, if, indeed, the payment was in that respect?

49. Both parties acknowledge that the appellant did not own the trademarks. Therefore, if the appellant was paid, it cannot have been for the trademarks.

50. The payment was specifically for Research and Development. This is my understanding, that the appellant, when putting to use the trademarks and manifestations, was expected to carry out research and development. However, as the said trademarks did not belong to the appellant, the benefit, in the long run, would go to SBI.

51. As the respondent pointed out at paragraph 20 (ii) of the Statement of Facts it filed on 5th December 2013;

“The Research and Development costs are allowable deductions as they were incurred wholly and exclusively in the production of income. This is because the know-how emanating from the economic ownership of the rights under the CCA was employed by the Appellant in generating income for which tax was accounted for?.

52. In that respect, the payment was of a capital nature. It was not money which the appellant was to use for trading.

53. The payment was a one-off, but in respect to which the task to be performed was of an enduring kind. I so find because the results of any research and development would be expected to be durable. Of course, it would be hoped that the results would have an impact on the profits of the person applying them, but whether or not such an impact was realized, the results would remain.

54. In conclusion, I find that the Local Committee erred by concluding that the payment was a gain derived from the sale of a property, giving rise to a royalty.

55. Accordingly, I set aside the decision of the Local Committee dated 19th September 2013, and hold that the payment was not a royalty, and it was not taxable. The payment was of a capital nature.

56. I therefore allow the appeal and order the Respondent to pay the costs of both this appeal and also of the proceedings before the Local

Committee.

DATED, SIGNED and DELIVERED at NAIROBI this 9th day of March 2016.

FRED A. OCHIENG

JUDGE

Judgement read in open court in the presence of:

Mrs. Onchwari for Oraro for the Plaintiff

Miss Bururu for Miss Odando for the Defendant

Collins Odhiambo – Court clerk.