



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
COMMERCIAL & ADMIRALTY DIVISION
(MILIMANI LAW COURTS
INCOME TAX APPEAL No 6 OF 2013

B E T W E E N:

NYERI TEACHERS SACCO PLAINTIFF

VERSUS

THE COMMISSIONERS OF DOMESTICE TAXES.....RESPONDENT

J U D G M E N T

1. The Appeal before the Court is brought under **Section 37(7) of the Income Tax Act** and **Rule 4 of the Income Tax (Appeals to the High Court Rules)**. The Appeal is against the Decision of the Local Committee for Nyeri Area made on 8th May 2013. A copy of the decision being appealed against is annexed to the Memorandum of Appeal. It states “*the Income Tax Local Committee recorded the following decision in your case: -*

(a) The Appellant has the obligation to pay the WHT that was not paid. The appeal on this ground therefore fails.

(b) The FOSA income and the sundry incomes which squarely fall under Section 19A(4)(d) of the Income Tax Act and are therefore taxable after allowing the deductions allowable under the Income Tax Act

(c) The appeal issue on dividend income requires the parties to exchange further documentation within fourteen (14) days to bring this case to conclusion.

2. On 23rd May 2013 the Appellant gave Notice to the Commissioner of its intention the appeal the decision dated 14th May 2013 pursuant to Section 91 of the Income Tax Act. Under Section 86(2) the Memorandum of Appeal was to be presented within 30 days. That was done on 14th June 2013. The decision was in fact made on 8th May. It was contained in a letter dated 14th May which was received by the Appellant on 18th May. Therefore, the Memorandum was filed within the prescribed time.

3. The Memorandum of Appeal sets out a description of the Parties. It states that the Appellant is a Savings and Credit Co-operative Society registered under **section 4 of the Co-operative Societies Act (Cap 290)**, In fact it is **Cap 490, Laws of Kenya**. Also **Section 23 of the SACCO Societies Act No 14 of 2008**. The Respondent is the Commissioner of Domestic Taxes, which is a statutory office created under

the **Kenya Revenue Authority Act (Cap 470)** and has the powers and duties conferred by that Office.

4. The Appellant describes itself as a co-operative society which has as its sole objective the promotion of the welfare and economic interest of its members based on the following principles enshrined under **Section 4(b)** of the **Co-operatives Societies Act** as well as under **Section 2** of the **Sacco Societies Act No14 of 2008**. Under those sections it provides the following services:

(a) Receipt of withdraw-able deposits, domestic money transfer services, loans, advances and credit facilities; or

(b) Receipt of non-withdraw-able deposits from members and which deposits are not available for withdraw for the duration of the membership of a member in a Sacco society and may be used as collateral against borrowings and domestic money transfer services.

5. The Appellant asserts that all the business it conducts is through the principle of mutuality. The Memorandum describes that as; “where a person does not make profit for himself”. It may also be that it is the concept that profit is shared out between the members. The Factual Background in the Memorandum sets out that the Appellant carries out Back of Office Services as well as Front of Office Services (FOSA). It is said that profits are shared out between members for which, the Appellant pays a withholding tax of 5% which is paid to the Respondent. Paragraph 2.5 sets out that the Appellant is a member of Kenya Union of Savings and Credit Co-operative Limited. The Appellant saves with the KUSCCO and receives various financial services including dividends on its savings. The Respondent levied withholding tax on the dividends and interest earned. The Appellant takes issue with that.

6. The Appellant also carries out FOSA activities. The Respondent has levied tax on the income from those activities for the year 2008 and the year 2009. This income arises from:

- a) Commission on advances,
- b) Commissions on loan transfers
- c) Commission on salary transfers
- d) Commission on standing orders
- e) Commission on closed accounts
- f) Commission on cash withdrawals
- g) Commissions on cheques clearance
- h) Commission on sundry services and
- i) Sales of various stationery items

It is said that the commissions and sales serve the primary purpose of meeting the costs of the services and items and the running costs of rendering such service.

7. The Grounds of Appeal pleaded are:

1.0 The Local Committee for Nyeri Area erred in Law and in fact in holding that the Appellant was liable to pay With Holding tax on interest paid by the Kenya Union of Savings and Credit Co-operatives Limited (KUSCCO Ltd).

2.0 The Local Committee for Nyeri Area erred in Law and in fact in holding that the Income from the Appellant’s Front Office Savings Activities (FOSA) and sundry income fall squarely under

section 19A (4)(d) of the Income Tax Act and are therefore taxable after allowing the deductions allowable under the Income Tax Act.

8. The Issues for resolution can be distilled into two principle issues namely;

- (1) Whether the income from the front office activities is mutual in nature and therefore not liable for taxation, and
- (2) Whether the Respondent erroneously levied withholding tax at the corporation tax rate.

Although the issues set out appear to be relatively succinct they do necessitate careful consideration of the underlying issues. These include

- (a) The status and position of the Appellant as a SACCO and its functions as such;
- (b) The categorisation of those functions under the Income Tax Act and in particular the two areas subject to this appeal
- (c) Does the exemption for mutuality apply to KUSSCO?
- (d) Are the FOSA activities which have incurred an income tax liability fall within the recognised functions and services offered by the Appellant under the SACCO Societies Act and the SACCO Society Regulations.

9. The Parties, in particular the Appellant, have filed voluminous written submissions which the Court has considered and are dealt with below. The Appellant's Submissions were filed on 21st April 2016 and the Respondent's Submissions were filed on 9th June 2016 and the Parties Advocates highlighted their arguments on 13th June 2016. The Court has considered both Parties submissions. The Appellant was then also directed to file their audited accounts and tax returns for the years subject to the assessment. That was done on 14th September. Unfortunately, by 23 September 2016, the documents were not on the Court file and Counsel provided the Court with a second copy.

10. The Appellant is a Savings and Credit Co-operative Society registered under Section 4 of the Co-operatives Societies Act which provides:

4. Registration of co-operative societies

Subject to the provisions of this Act, a society which has as its objects—

(a) the promotion of the welfare and economic interests of its members;

and

(b) has incorporated in its by-laws the following co-operative principles—

(i) voluntary and open membership;

(ii) democratic member control;

(iii) economic participation by members;

(iv) autonomy and independence;

(v) education, training and information;

(vi) *co-operation among co-operatives; and*

(vii) *concern for community in general, may be registered by the Commissioner as a co-operative society under this Act with or without limited liability.*

Provided that a co-operative union or an apex society shall not be registered except with limited liability.

11. The Appellants submissions assert that SACCOs have as their main objective the promotion of the welfare and economic interests of their members and they a “not for profit” organisation. The Appellant has not exhibited its certificate of registration nor any document that sets out its aims and objectives. In addition, **Section 2 of the SACCO Societies Act** is relied upon. It provides; “**deposit-taking business**” means—

(a) *a Sacco business in which the person conducting the business holds himself out as accepting deposits on a day-to-day basis; and*

(b) *any other activity of the Sacco business which is financed, wholly or to a material extent, by lending or extending credit for the account and at the risk of the person accepting the deposit,*

including the provision of short-term loans to members;”

The Appellant also relies on extracts of the **Sacco Societies Act (Deposit Taking Sacco Business) Regulations 2010 (No 39 of 2010)** In particular Regulations 23 and 29 which require the setting of a savings policy together with the power to charge interest rate and fees.

12. The Respondent is opposing the Appeal. Its Written Submissions argue that the main issue before the Local Committee was the interpretation of Section **19A(4)(a)** which together with the preceding sections provides:

19A. Co-operative societies

(1) *This section shall apply to designated co-operative societies other than—*

(a) *a society which has been exempted from all the provisions of the Cooperative Societies Act (Cap. 490) under section 92 of that Act; or*

(b) *a society in respect of which the Commissioner is of the opinion, having regard to the number of members composing it, the nature of its business, the manner in which its business is conducted, the extent of its transactions with non-members or any other relevant factors, is a body corporate carrying on business for its own profit.*

(2) *In the case of every designated co-operative society, other than a designated primary society, the income on which tax shall be charged shall be its total income for the year of income deducting therefrom an amount equal to the aggregate of bonuses and dividends declared for that year and distributed by it to its members in money or an order to pay money; but the deduction shall in no case exceed the total income of the society for that year of income.*

(3) *In the case of every designated primary society, other than a designated primary society which is registered and carries on business as a credit and savings co-operative society to which the provisions of subsection (4) apply, the income on which tax shall be charged shall be its total income for the year of income deducting therefrom an amount equal to the aggregate of bonuses and dividends declared for that year and distributed by it to its members in money or an order to pay money.*

(4) In the case of a designated primary society which is registered and carries on business as a

credit and savings co-operative society its total income for any year of income shall, notwithstanding any other provisions of this Act, be deemed to be the aggregate of—

(a) fifty per centum of its gross income from interest (other than interest from its members);

(b) its gross income from any right granted for the use or occupation of any property, not being a royalty, ascertained in accordance with the provisions of this Act;

(c) gains chargeable to tax under section 3(2)(f);

(d) any other income (excluding royalties) chargeable to tax under this Act not falling within paragraph (a), (b) or (c) ascertained in accordance with the provisions of this Act.

The Local Committee heard the Appellant's appeal against assessment and disallowed it agreeing that the income in question falls within **Section 19A**

13. The Income in question is firstly, the income generated from holding deposits of what must be assumed to be deposits not being used by its members. As the very function of a SACCO is to use deposits to lend onto members, the fact that significant surplus funds are being deposited means that they are not being used for the recognised function of the SACCO which is onward lending. **Section 36** does not envisage that type of investment. Secondly, there is the issue of the organisation or entity where the deposits are held. The accounts recognise the surplus funds and also show that they are deposited with Co-operative Bank, which is a commercial entity. Funds are also deposited with KUSCCO and invested in KUSCCO shares. The Appellant's argument is to assert that because of its own mutual status the doctrine of mutuality extends to those organisations. There is no evidence before the Court that KUSCCO is a mutual society. In fact some of its own stated aims and objectives and functions fall outside **Section 4**. In the circumstances, any income earned from those deposits cannot benefit from the status of mutuality and therefore must fall within **Section 19A**.

14 As correctly stated, the various statutes and regulations permit the Appellant to carry out what it calls BOSA activities. Those include receiving deposits and onward lending. Those are strictly within its aims and objectives and therefore would benefit from the special tax position provided to mutual societies.

15 However, when it comes to the Front of Office Activities, those could be more akin to commercial banking. The Appellant admits these are "additional services" they offer to their members. One example is receiving and onward transfer of salary. The Act refers to receipt of deposits. Dealing with a salary could and does relate to funds that will not be invested in the Sacco and therefore are outside of its core function. Again, it is uncontested that those services are paid for. In highlighting it was suggested that the charge is simply a charge to offset the cost of production etc, however, it is clear there is an element of commission and an element of profit as is clearly demonstrated in the accounts. That profit has not been shared between the members (See **Section 42 et seq**).

16. In the circumstances, those activities are not within the aims and objectives of SACCOs as set out in the two Acts and regulations. They are not by their nature for the benefit of the members as a collective. They cannot be said to be not for profit and the profits are not shared between the members and therefore cannot benefit from the mutual label and the privileges that brings. The Appellant has also not provided evidence of the necessary permissions to conduct such activities. It cannot be right that whatever a mutual society does becomes subject to mutuality. In fact it is the other way around, the activities of a society define it as mutual or commercial. In this case the FOSA activities are undoubtedly commercial in nature and therefore the Appeal must fail. Appeal dismissed.

17. The Appeal sets out many details of the assessment, however, the issues for determination are not the quantum of the assessment but the fact that the income was deemed to be within **Section 19A(4)**. It is unnecessary therefore for the Court to adjudicate upon the quantum of the assessment.

Order accordingly,

FARAH S. M. AMIN

JUDGE

SIGNED AND DELIVERED AT NAIROBI THIS 7th Day of December 2016

In the Presence of:

Isaiah Otieno – Court Assistant

Miss Gitau Holding Brief for Mr Osando for the Appellant

Mr Lemiso Holding Brief for Mr Chaballa for the Respondent