REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO.75 OF 2015

EVAMAR INVESTMENTS LIMITED.....APPELLANT

VS

THE COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGEMENT

BACKGROUND

1. The Appellant is a limited liability company incorporated in Kenya. Its sole business is development of real estate property with a view to earning rental income. The company developed some 16 units on an acquired piece of land in Upper-hill and sold 10 units in order to repay the loan from the financiers M/s Housing Finance, leaving six units to be held for rental income.
2. The Respondent is established by Section 3 of the Kenya Revenue Authority Act Cap. 469 of the Laws of Kenya and is mandated in Section 5 of the same Act to assess and collect taxes and to provide tax administrative services for Government of Kenya under various tax laws.
3. The Respondent issued an Amended Assessment of Kshs.12,109,466/= on 15th August 2014 after review of Appellant's objection to an initial assessment dated 17th June 2014 which was for Kshs.27,859,465/= inclusive of withholding tax.
4. The Appellant still being dissatisfied with the amended assessment filed an Appeal to the Local Committee of Income Tax - Nairobi by filing Memorandum of Appeal together with a Statement of Facts both

dated 26th September 2014, attaching various documents in support of the Appeal and to give background to the matter.

THE APPEAL

5. The Appeal relates to the years of income 2010, 2011 and 2012 and is against the Notice of Confirmation of additional tax assessment which Appeal was premised on the grounds set forth in the Memorandum of Appeal dated 26th September 2014 as under:-

   i) The Respondent's treatment of proceeds from sale of property as business income instead of treating it as capital gains tax which is suspended in Kenya.

   ii) Treating interest income as specific source of income under Section 15(7)(e) of the Income Tax Act.

   iii) The Appellant pleaded with the Local Committee to find that property sale income was a Capital transaction and therefore not subject to income tax and to find that interest income is not a separate source of income since Sec 15(7)(e) of Income Tax Act does not expressly say so.

6. From the date of the Assessment and until the filing of the Appeal with the Tax Appeals Tribunal several attempts were made between the Respondent and the Appellant to try and resolve the matter. Several meetings were held and correspondence exchanged. This included meetings with the Dispute Resolution Committee of the Kenya Revenue Authority but finally no agreement was reached.

7. The Appellant has advanced many arguments most of which are not premised on any legislation.

8. In the Statement of Facts the Appellant has demonstrated that it made tax returns in October 2013 covering 2010, 2011 and 2012 years of income, and that the tax returns showed tax losses while limited amounts of annual tax arising from interest income were paid to the Respondent and are confirmed by certificates of returns cited in the appendices.

9. The Appellant has further argued that it was due to being unable to raise long term finance which would be repaid in the long term from rental income from the 16 units, that it was compelled to sell 10 out of the 16 units to repay the short term loan and to leave the 6 units for purposes of earning rental income as retirement income.

10. The Appellant further explains that the rapid cost escalation which occurred during construction and which was over 27 million was rejected by the bank for additional financing and it became not only logical but also necessary to sell some units in order to bridge the project financing gap, otherwise the project would stagnate. The Appellant had to take this course of action reluctantly as it was undesirable. The Appellant attached appendix XI to highlight the financing gap as per schedule signed by the Quantity Surveyor, the Contractor and the Architect.

11. The Ten (10) units were sold for Kshs.173,000,000/=. Schedule VII attached to the Appellant's Statement of Facts confirms this by the list of houses sold.

12. All the funds received by way of deposits and the sales proceeds were deposited with the Bank offering construction finance (Housing Finance) in an "escrow account" and it was only used to defray

construction costs, incidental costs and Bank mortgage loan repayments as agreed with the bank and as part of the banks requirements in order to give the initial financing of Kshs.100,000,000/=. The Appellant attached "bank loan account" and the "escrow account" statements to in support thereof.

13. The Appellant further stated that it had no control over the escrow account and any movements in the account had to be authorized by the bank itself upon the Appellant's written requests and the Appellant attached a letter as an example of such a request to the bank in support of that statement.

14. The Appellant avers that although the Respondent has taxed interest income as a separate source under section 15(7)(e) of Income Tax Act, this section does not list interest as one of the income sources to be taxed separately. Thus The Respondent's treatment of this item puts the Appellant at unnecessary disadvantage since the interest cannot be offset against other business losses.

THE RESPONSE

15. In the amended assessment the Respondent recognized part of the cost of purchase of land as a revenue item amounting to Kshs.32,250,000/= Gain from sale of property was assessed at Kshs.54,785,396/= Tax on interest was assessed at Kshs.149,440/= and withholding tax on professional services amounted to Kshs.349,329/=

16. The Respondent averred that the Appellant sold the ten units with a profit making objective. On the contrary the Appellant argues that the

construction of the 16 units was solely for earning rental income which would be retirement income for the family at old age

17. The Respondent was however of an entirely different opinion and has advanced strong arguments refuting the Appellant's claims and basing its arguments on relevant statutes.

18. The Respondent lists points at issue as:

    i) Whether the Respondent issued assessments that were not correct.

    ii) Whether the reasons presented by the Respondent were valid to accept an objection after amended assessment.

19. The Respondent lists the relevant law as:

    i) Section 2(1) of the Income Tax Act

    ii) Section 3(2) of the Income Tax Act

    iii) Section 15(1) of the Income Tax Act

    iv) Section 56(1) of the Income Tax Act

    v) Section 73(2) of the income Tax Act

    vi) Section 84 of the income Tax Act

    vii)Section 86 of the Income Tax Act

    viii)The Income Tax (Local Committees) Rules.

20. The Respondent's interpretation of the law is that the gain on the sale of 10 units out of 16 units of the developed property amounting to Sh.42,915,251 was of business nature and therefore chargeable to tax and cites a number of indicators to confirm its interpretation.

    i) A letter dated may 10th, May 2004 from "Mazars" the Appellant's tax Agents stated that the initial projected cost was estimated at Kshs.104,000,000/=. The Owners were to inject Kshs.11,000,000/= and borrow Kshs.100,000,000/= from the

bank payable in 24months at 14.75% p.a. The Respondent therefore concluded that the intention was to sell part of the units in order to pay the bank and not to service the bank loan from rental income.

ii) That Units were sold at market value which implied a profit motive.

iii) That deposits from intending buyers started being received at the onset of the project in 2009 thereby confirming the project was a business venture.

iv) That the major part of the project was sold leaving a smaller part thus confirming the main object was profit motive.

v) That Sales agents were paid commissions to sell the units as is usual in real estate business.

vi) That there was advertising posted on notice boards which further confirmed commercial motive.

vi) That The Memorandum of Association of Evamar states that the Company was formed to trade and not as a part of retirement plan for Mr. and Mrs Mwaniki. The Respondent also observed that there are four other young person's being family members of Mr and Mrs. Mwaniki in the Company who are stakeholders in the same company meaning the company is not exclusively for Mr. and Mrs. Mwaniki's retirement plan.

vii)The Respondent also stated categorically that The Main Director of Evamar Investments Ltd was Mr Mwaniki, in the notes written and signed by himself for discussion in the meeting held between him and the Respondent on 13th, September 2012. In the opening

paragraph he stated that the Company was formed for purpose of building apartments on plot number 1/554 in Nairobi primarily for sale and attaches the notes purportedly signed by Mr. Mwanink as Appendix XIV on 12th September 2012.

viii) The Respondent in its final written submissions points out in paragraph 64 that the Appellant declared a gain of Kshs.42,915,251/= in the self assessment return for the year 2011 but did not pay tax on it since in the Appellants view this was a capital gain and insisted that this gain was income taxable at the rate of 30% under Sec 2(1), 3(2)(a)(i) of the income tax Cap.470 of the Laws of Kenya.

21. However, the Appellant in its final written submissions in the last paragraph stated that it is not pursuing the matter of taxing the interest income separately any further. In this case Tribunal treats Appellants prayer under taxation of interest income as having been brought to rest. The remaining arguments therefore relate only to the first item of determination which is to do with taxation of gain on sale of property as profit rather than Capital Gains Tax.

ISSUES FOR DETERMINATION:

i) Whether sale of developed real estate property falls under business income for income tax purposes under Sec. 3(2)(a).

ii) Whether interest income is a separate source of income for tax purposes.

TRIBUNAL ANALYSIS AND FINDINGS:

22. The Tribunal notes that Objects clause para. (2) of the Memorandum of Association of Evamar Investments Limited, states that the company is.....

> " *to acquire by purchase exchange or otherwise either for an estate in fee simple or for any limited interest, land, houses and premises of tenure, whether subject or not to any charges or encumbrances and to hold, sell, let, alienate, mortgage, charge or otherwise deal with all or any of such lands or premises".*

The Tribunal related this clause to the facts presented by both the Appellant and the Respondent and finds that this clause is akin to what has in actual fact taken place in the operations of Evamar Investments limited. Land has been acquired by the Company plot number 1/554, has been held, developed, and partly sold, partly let for rent.

23. The Tribunal is therefore required to determine whether the portion of the company's operations which has been sold amounts to business and therefore qualifies for taxation in the event of that business realizing a profit or gain in financial and economic terms.

24. In this regard there is need to narrow down to the definition of business and to establish beyond doubt what is business and what is not business so as to consider whether Evamar investments Limited was doing business or not.

25. Business is defined in Income Tax Act, Section 2 as *"business" "includes any trade, profession, vocation, every manufacture and concern in the nature of trade but does not include employment'.*

Webster Learners Dictionary defines business as "the *activity of making, buying, or selling, goods or providing services in exchange for money"*

The Tribunal has compared the Appellant's claims and the circumstances with these definitions and has formed the opinion that the construction and sale of the ten units by the Appellant falls squarely within both definitions of the word "business".

26. The Appellant preferred to have this gain treated under Capital gains Tax which at the time was suspended. Thus we need to define capital gains and see if the Appellant's case falls within the definition.

27. The simple and ordinary definition given by Accounting professionals says that: "capital gain" *"is the difference between the disposal price and the acquisition cost of certain capital assets"* It is implied here that nothing much has happened to the capital asset since acquisition, perhaps, only the normal repair and maintenance. There is nothing in this definition to suggest construction followed by immediate disposal by way of sale. This definition is therefore quite divorced from the Appellant's situation whereby major conversions of the acquired property have taken place thereby resulting in major shift of value bases to different economic levels. It therefore logically follows that this transaction cannot be treated or included under Capital gains Tax considerations.

28. The Tribunal finds the Respondent's assertions persuasive and to a large extent pointing to the direction of the real intentions of the subject development. It is also difficult to argue to the contrary when the main Director of the Appellant has signed a statement to the effect that the apartments were being developed *primarily for sale* as argued by the Respondent hereinbefore.

29. It is not in contention that the Appellant filed his tax returns for the years 2010, 2011 and 2012 and paid the taxes due under self assessment in the respective years. It is also not in contention that the tax not in dispute has been paid to the Respondent.

30. The main contention by the Appellant is that the income from disposal of the 10 units was not business income and should not therefore be taxed under the relevant sections of the Income Tax Act.

31. The Appellant supports this by stating that it was forced to sell the units due to the refusal by the banks to offer long term financing and later the refusal to offer additional loan to bridge the gap occasioned by the escalation of the project costs during construction and was therefore forced to rely on short term financing to complete the project. Thus in order to get out of the short term financing and since the rental incomes would not have been adequate to repay the short term loan installments then the only option was to sell some of the units in order to ensure successful completion of the project and to avoid stalling or stagnation of the project.

32. The Tribunal observed that it might as well be true that the initial aim by the owners was to develop 16 units and hold them for rent in the future. However the owners (Appellant) lacked resources to

accomplish this contemplated aim. The next best option was to borrow substantially in order accomplish the project and repay the loan as quickly as possible to avoid escalating costs and bank repayments including interest.

33. The Tribunal finds that this is a normal "business" situation which is likely to face anyone intending to do similar business but without adequate resources. Once the ideal alternative becomes impossible to implement due to inadequacy of resources alternatives considered. If considered and pursued then the initial plans are overtaken and the objectives are likely to change. It now becomes a venture with different objectives from the initial one. It can now be said that the initial intentions and aspirations have been achieved or accomplished but only in part as far as the 6 units are concerned. However as far as the units sold are concerned a business venture has been undertaken and thus it should be treated as such viz. a business.

34. The Appellant in its final written submissions in the last paragraph has argued that there has been no recurrence of similar venture meaning no continuity as expected in business and even no intention for the same to be repeated. The Tribunal observes however that the "Real estate" type of business is normally undertaken on project by project basis. One cannot say whether it will be repeated or not. It will depend on the opportunities coming up or lack thereof. At the moment we can only address and deal with what has taken place and is on record.

35. In the case of the Appellant the decision to sell ten (10) units in order to retain six (6) units was the best decision any business person would make faced by similar circumstances. However, this comes with other attributes to it. The Selling of ten (10) units in the open market at competitive prices generated business income since this is a business decision. It thwarts the original objective of holding the 16 units and enjoying rental income.

36. Income tax Act Cap 470 of the Laws of Kenya, Section 2(1) states that *"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 nonresident which accrued or was derived from Kenya."*

37. Section 3(2)(a)(i) of the Income Tax Cap 470, of the Laws of Kenya stipulates:
Subject to this Act, income upon which tax is chargeable under this Act is the income in respect of: gains or profits from a business for whatever period of time carried on.

38. The Tribunal is guided by from the authority cited by the Respondent in the final written submissions in the case of **Cape Brandy Syndicate v Inland Revenue Commission, (1921), 1 KB 64,** where it was stated that: *"In a taxing statute one has to look 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 tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used."*

39. In the final written submissions the Respondent has protested the Appellant's introduction of four grounds during oral presentations which it alleges were not in the original Memorandum and has sought protection of Section 13(6) of the Tax Appeals Tribunal Act, arguing that it amounts to ambushing the Respondent and or denying the Respondent opportunity to respond. Tribunal however noted that of all the grounds listed were not new i.e.

i) *Original intention as state of mind,*
ii) *Absence of recurrence*
iii) *Appellant not ordinarily trading in real Estate*
iv) *Period of time the land possessed.*

The Tribunal observed that the Respondent had already addressed each of the four grounds directly or indirectly either by quoting the relevant statutes or by responding directly to the stated grounds. The Tribunal is satisfied that neither the Appellant nor the Respondent has been denied any opportunity to present their views in the best manner possible for consideration by the Tribunal.

DECISION

40. The upshot of the foregoing is that the Sale of the ten (10) units out of the sixteen (16) resulted in business income and was therefore taxable under the relevant statutes as highlighted above subject to there being a gain/profit after considering all the applicable underlying costs.

41. The Appeal therefore lacks merit and is hereby dismissed.

42. The Tribunal upholds the tax Assessment of Kshs.12,109,466/= as contained in the Notice of Amended Assessment for the year of Income 2009 to 2012 dated 15th August 2014.

43. The Tribunal directs that each party shall bear its cost.

DATED AND DELIVERED AT NAIROBI THIS..6th....day of .December..2016

In the presence of: - PETER MOMANYI .....for the Appellant

FIONA KERUBO KIYUKA ..for the Respondent

.....
GEOFFREY KATSOLEH
CHAIRPERSON

.....
LILIAN RENEE OMONDI
MEMBER

.....
GABRIEL KITENGA
MEMBER

.....
FRANCIS K. KIVULLI
MEMBER

.....
PONANGIPALLI V.R. RAO
MEMBER