

THE RESPONSE

9. The Respondent avers that the Objection Decision was served by the Respondent to the Appellant vide an email dated 16th October 2017 which date was before the expiry of the sixty days stipulated under Section 51(11) of the TPA, 2015.
10. The Respondent avers that having established that the alleged grant was actually management fees paid by the Appellant to Nailab Accelerator Limited, the related company, and for management services, the Appellant had an obligation pursuant to Section 35(3)(f) of the ITA to deduct withholding tax in respect of the fees. The Appellant's failure to do so led to the imposition of late penalties and interest under Sections 35(6) and 94 of the ITA respectively.

ISSUES FOR DETERMINATION

11. Having carefully studied the pleadings, submissions and documentation of both parties, the Tribunal is of the respectful view that the issues for its determination are as hereunder;
 - a) Whether the Objection Decision dated 13th October 2017 issued by the Respondent to the Appellant is unlawful for contravening Section 51(11) of the Tax Procedures Act (TPA).
 - b) Whether the Respondent's withholding tax assessment of Kshs.6,386,658/= being principal tax, penalties and interest is defective and should be vacated.
12. The Tribunal after hearing both parties' submissions, the law pertaining thereto and the authorities cited, makes its analysis on each of the issues for determination separately as follows:-
 - a. **Whether the Objection Decision dated 13th October 2017 issued by the Respondent to the Appellant is valid.**
13. The Respondent issued the Objection Decision dated 13th October, 2017 through email dated 16th October 2017. The service by email was in accordance with section 74(1)(c) of the TPA (2015). The transmission was in electronic form, via an email which was confirmed to be the correct address by the Appellant.
14. The Respondent avers that the Appellant promised to acknowledge receipt and thereafter send someone to pick the hard copy. Following failure by the Appellant to pick the same, the Respondent subsequently sent the hard copy to the Appellant on 1st November, 2017. The date, 1st November, 2017, was 61 days from the date the Appellant issued the respective Notice of Objection.

15. The time limitation within which the Respondent was supposed to make an Objection Decision is set out in Section 51(11) of the TPA 2015 which states that:-

“Where the Commissioner has not made an Objection Decision within sixty (60) days from the date that the taxpayer lodged a Notice of Objection, the objection shall be allowed.”

16. The Appellant lodged a Notice of Objection to the Respondent on 1st September, 2017. The Respondent issued an Objection Decision to the Appellant through a letter dated 13th October, 2017. However, the letter was not served on the Appellant on the same date. It was served later via an email dated 16th October, 2017. The email used by the Respondent was ernest@ernestandmartin.com. The Respondent maintains that the Objection Decision was served by the Respondent to the Appellant vide the email dated 16th October, 2017.

17. The Tribunal as pertains to service of documents and in particular services of notices is guided by Section 74 of the TPA 2015, which provides that the same may be made as follows:-

- “(a) delivering it to the person or the person’s representative.*
- (b) leaving it at , or sending it by post to, the person’s usual or last known place of business or residence; or*
- (c) Transmitting it in electronic form.”*

18. According to the Respondent it served the Notice of Objection Decision in electronic form. The Appellant maintains that the Objection Decision served electronically was not received by it. The Appellant however confirmed to have received subsequent communication from the Respondent through the same email address referred to above.

19. The Appellant in its submissions relied on various authorities. The Tribunal will refer to them to distinguish them as follows;

- a) In the Tax Appeals Tribunal, Tax Appeal Number 55 of 2016; **ABDALLA MOHAMMED VS. COMMISSIONER OF DOMESTIC TAXES**, an authority cited by the Appellant, one of the issues for determination was whether an Objection Decision issued after sixty (60) days from the date the respective Objection was lodged was unlawful and/or tainted with illegality for contravening Section 51(11) of the TPA, 2015. It is worth noting that the mode of service of the Objection Decision was not in contestation.
- b) Similarly, in the Tax Appeals Tribunal, Tax Appeal Number 56 of 2016; **MINAZINI ENTERPRISES VS. COMMISSIONER OF DOMESTIC TAXES** an authority cited by the Appellant, one of the issues raised was to determine whether an Objection by the Respondent was unlawful and/or tainted with illegality for

contravening section 51(11) of the TPA. In this instant case the date of service of the respective Objection Notice is also not contested.

- c) **THE COURT OF APPEAL CASE NUMBER 224 OF 2015 AT NAIROBI, BOSS FREIGHT TERMINAL vs THE COMMISSIONER OF DOMESTIC TAXES**, an authority cited by the Appellant, involved an appeal which was filed out of time. The judges in this matter were dealing with and reiterated the principle that an Appeal filed out of time and without leave of the Court was not a mere technicality that could be saved by Article 15 of the Kenya Constitution or an overriding objective.
- d) **THE HIGH COURT AT NAIROBI (NAIROBI LAW COURTS) MISCELLANEOUS CIVIL APPLICATION 221 OF 2010, TETRA PAK V. COMMISSIONER OF CUSTOMS SERVICE (2012) eKLR**, involved limitation of time within which to lodge an application.

- 20. The Appellant’s case deals with the transmission mode of the subject Objection Decision. Therefore, the four cases cited as authorities to support the Appellant’s Appeal have been distinguished and found not relevant.
- 21. The Tribunal finds that the email address in issue belonged to the Appellant’s Tax Agent, the same was used prior to the said Objection Decision and its correctness was not contested by the Appellant, save for the allegation that the email was not received and it was the legal mode of service of documents.
- 22. The Respondent issued the objection Decision dated 13th October, 2017 through email dated 16th October 2017. The service by email was in accordance with Section 74(1)(c) of the TPA, 2015. The transmission was in electronic form, via an email which was confirmed to be the correct address by the Appellant.
- 23. The Respondent avers that the Appellant promised to acknowledge receipt and thereafter send someone to pick the hard copy. Following failure by the Appellant to pick the same, the Respondent subsequently sent the hard copy to the Appellant on 1st November, 2017. The date, 1st November, 2017, was Sixty One (61) days from the date the Appellant issued the respective Notice of Objection.
- 24. The Tribunal finds the Objection Decision was lodged by the Respondent through electronic transmission on 16th October 2017 and that it was in line with Section 74(1) (c) of the TPA 2015. The service date of 16th October 2017 was within sixty days from the date the Appellant lodged the respective notice of objection which was 1st September 2017.
- 25. Consequently, the Tribunal finds and holds that the Respondent’s Objection Decision dated 13th October 2017 issued by the Respondent to the Appellant is valid.

b) Whether the Respondent's withholding tax assessment of Kshs.6,386,658/= being principal tax, penalties and interest is defective and should be vacated.

26. The Appellant claimed the management expenses of Kshs.72,137,363/= as deductible expenditure in the 2014 Self-Assessment under Section 15(1) of the Income Tax Act.

27. The Appellant contends that the arrangement between the company and NAL was informed by KICTB's requirement of a bidder of the consultancy contract being able to propose a workable specified governance structure to facilitate funding arrangements. The governance structure was to be established in a manner that recognized full sponsorship from KICTB while facilitating private sector development.

28. As a condition precedent, the Appellant set up NAL, a company limited by guarantee, to execute the consultancy contract with KICTB. NAL is said to be exempt from Corporation Tax.

29. In pursuit of fulfilling its contractual obligation to KICTB, the Appellant entered into a grant agreement with NAL. In the agreement the Appellant agreed to give NAL a grant of Kshs.120,000,000/= to enable the latter provide formative support to create and manage the pilot technology IT business incubator.

30. The Appellant to buttress its case referred to various authorities, which the Tribunal will distinguish as follows:

a) **MISCELLANEOUS APPLICATION NO.743 OF 2006; KEROCHÉ INDUSTRIES LIMITED VS. KENYA REVENUE AUTHORITY & 5 OTHERS [2007] eKLR 240.** The same involved a judicial review Application as to whether the Respondent acted outside the law. The grounds for judicial review were illegality, irrationality and impropriety of procedure.

b) **MISCELLANEOUS APPLICATION NO.1223 OF 2007; vs THE COMMISSIONER OF DOMESTIC TAXES EX-PARTE BARCLAYS BANK LTD,** was in respect of payment of withholding tax on payments made to Card Companies, Visa International Service Association, MasterCard Inc. and American Express Limited as well as payments made as Interchange Fee to other banks, referred to as Issuers. The Card Companies administer a world-wide consumer payment system for their numbers to provide their customers with the means of making payments using credit cards. The consumer payment is administered by the credit card companies through a network that links all their members throughout the world. The banks pay various fees to the Card Companies in order to access the networks. The appeal concerned the payment of withholding taxes

on fees paid to international card companies and the court framed the two issues for determination as;

- i) Whether the Respondent was entitled to claim tax on payments made to international credit card companies as royalties under the provisions of section 35(1)(b) of the Income Tax Act; and
- ii) Whether the Respondent was entitled to claim tax on payments referred to as “interchange fees” made by a bank to other banks referred to as “issuers” on the basis that such payments were “management and professional fees” and subject to withholding tax pursuant to section 35(1)(a) of the Income Tax Act.

31. The Appellant’s case is in respect of **management or professional fees** labelled as **grant fees**. The two cases cited to support the Appeal are therefore not relevant under the circumstances.

ANALYSIS AND FINDINGS.

32. The Tribunal notes that management fees paid to a resident person or having a permanent establishment in Kenya is subject to Withholding Tax under Section 35(3)(f) of the ITA.

33. It is worth noting that Nailab Limited, the Appellant, paid a sum of Kshs.72,137,363/= to Nailab Accelerator Limited (NAL) a related company, in 2014. The amount paid is shown as grant income in NAL’s financial statements for the year ended 31st December 2014. However, the same amount Kshs.72,137,363/= is shown as management expenses in the Appellant’s financial statements for the year ended 31st December 2014.

34. Furthermore, the Tribunal noted that the Appellant appended the Financial Statements of NAL for 2013 and 2014 leaving out the Appellant’s Financial Statements for the respective years.

35. NAL is a company limited by guarantee. It was set up to provide formative support to create and manage a pilot technology IT business incubator. The Appellant and NAL have a common director.

36. The Appellant was contracted by the Kenya ICT Board (KICTB) to provide Consultancy services, which it sub-contracted to NAL. The contract sum was Kshs.144,430,737/= The income received from KICTB in 2014 is included under grant income in the Appellant’s Financial Statements for the year ended 31 December 2014.

37. We have noted that NAL’s Self-Assessment Return for 2014 was filed on a nil basis on the grounds that the company was exempted from corporation tax. However, the Respondent has pointed out that NAL applied for tax exemption from corporation tax under paragraph 10 to the First Schedule of the Income Tax Act, the application of which was rejected. The rejection is a

subject of appeal at the Tax Appeals Tribunal. However, the Appellant did not raise the matter during the hearing and the Tribunal will not delve into it but will limit itself to the issues at hand as pleaded by the Appellant.

38. Having studied the documentation provided, the Tribunal notes that Contract No. KICT6/KTCIP/RFP/11/2011-2012 dated December 2012 was between the Kenya ICT Board and Nailab Limited and was for consultancy services. The execution of the consultancy services was carried out by Nailab Accelerator Limited, a related company, sub-contracted for that purpose. In this respect a grant contract between Nailab Limited and Nailab Accelerator was drawn.
39. The fees for the consultancy services rendered to the KICTB by Nailab Limited was included as revenue in the company's Financial Statements for the year ended 31st December 2014. The respective revenue was included in the company's self-assessment for the year.
40. In 2014, NAL was paid Kshs.72,137,363/= for management services to Nailab Limited. The amount is included under operating cost captioned "management expenses" in the 2014 Financial Statements of Nailab Limited. The expenditure is claimed as a Tax Deduction in the 2014 Self-Assessment of Nailab Limited.
41. The Appellant submits that whereas the financial statements referred to the funds as management expenses, this was a misstatement error as there were no other management services provided and the same ought to have read "Grant Fees: However a perusal of NAL's financial statements for the year ended 31 December 2014 shows that the management fee received from Nailab Limited is shown as "Nailab Ltd/KICTB grant income".
42. It is not in doubt that NAL provided consultancy or management services for which it received compensation. The compensation was however paid by Nailab Limited not by KICTB.
43. Management fees is defined under section (2)(1) of the Income Tax Act. As per the Act, "management or professional fee" means a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy service however calculated. The Tribunal regrets to note that the grant fees introduced by the Appellant, is not defined in the Income Tax Act.
44. The Tribunal finds that the amount paid by the Appellant to NAL was for management or professional fees as defined under the Income Tax Act. Management or professional fees payable to a business enterprise is chargeable to tax under Section (3)(2)(a)(i) of the Income Tax Act. However, such income "shall not apply unless the payment is incurred in the

production of income accrued in or derived from Kenya or in connection with a business carried on or to be carried on, in whole or in part, in Kenya”

45. The Appellant incurred management expenses in 2014 in respect of business carried on in Kenya. The respective expenses were deducted in arriving at the taxable income of the Appellant in the 2014 year of income.
46. Management or professional fee is subject to withholding tax under Section 35(3)(f) of the Income Tax Act. However, such a payment is subject to withholding tax only when the management or professional fee is chargeable to tax. NAL was not exempted from corporation tax in 2014. Consequently, the receipt of management or professional fee was chargeable to tax. The payment of management or professional fee by the Appellant in 2014 should have been subjected to withholding tax in accordance with Section 35(3)(f) of ITA. As the withholding tax was not paid by the due date, the same attracted late payment penalty and interest in accordance with Section 35(6) and Section 94 of ITA respectively.

DECISION

47. From the foregoing analysis and findings, the Tribunal makes the following Orders:-
- a) The Respondent's Objection Decision dated 13th October 2017 is valid.
 - b) The Respondent's Tax Assessment dated 18th August 2017 is hereby upheld.
 - c) Each party shall bear its cost.
48. Orders accordingly.

DATED and DELIVERED at NAIROBI this 18th day of *December* 2019.

In the presence of

Yvonne Wanjiru.....for the Appellant

Fridah Mwangera.....for the Respondent

Josephine K. Maangi
.....
JOSEPHINE K. MAANGI
CHAIRPERSON

Richard Rotich
.....
RICHARD ROTICH
MEMBER

Tanvir Ali
.....
TANVIR ALI
MEMBER

Geoffrey Karuu
.....
GEOFFREY KARUU
MEMBER

Delilah Kadzo Ngala
.....
DELILAH KADZO NGALA
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